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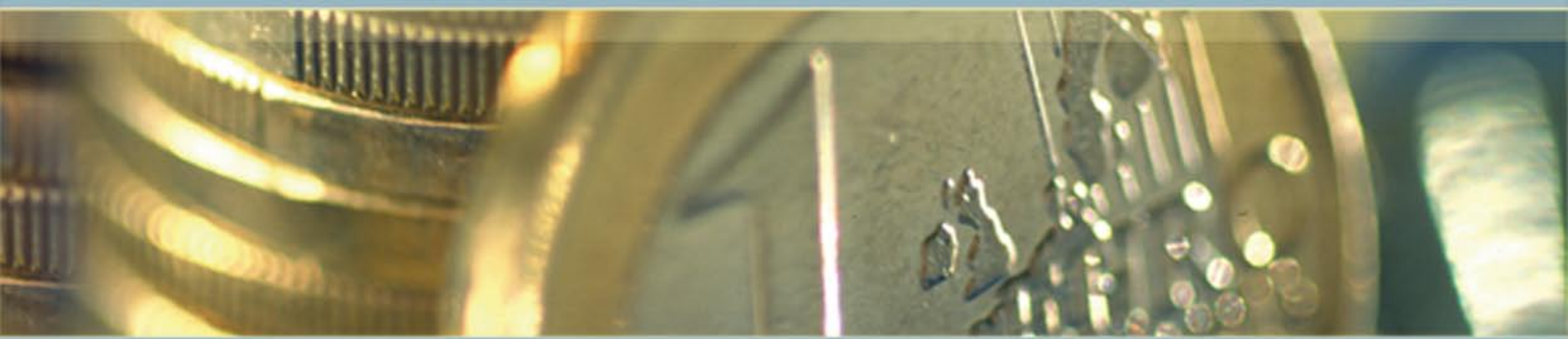

2008 Fiscal notifications of candidate countries: overview and assessment

Directorate-General for Economic and Financial Affairs

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INTRODUCTION

In this Occasional Paper the Directorate General for Economic and Financial Affairs publishes its overview and assessments of the 2008 Pre-accession fiscal notifications of the candidate countries (Croatia, the former Yugoslav Republic of Macedonia and Turkey).

One of the economic priorities of the 1999 and 2000 Accession Partnerships was the establishment of an annual fiscal surveillance for the candidate countries. This gave birth to the so-called Pre-Accession Fiscal Surveillance Procedure, which aims at preparing countries for the participation in the multilateral surveillance and economic policy co-ordination procedures currently in place in the EU as part of the Economic and Monetary Union. The annual Pre-Accession Fiscal Notifications are part of this procedure. Candidate countries are under this procedure invited to provide regular budgetary data in methodological compliance with the EU Accounting Standards (ESA 95). Their purpose is to ensure that government data of candidate countries are of a sufficient standard during the pre-accession period to allow fiscal policy and analysis and to ensure that their reporting of fiscal positions becomes increasingly comparable to Member States. Thereby, the pre-accession fiscal notifications serve as preparation for the surveillance procedures in the Economic and Monetary Union of the EU.

OVERVIEW

1.1. BACKGROUND

All candidate countries were invited to submit fiscal notifications to the Commission services by 1 April 2008, in accordance with the commitments made under the pre-accession fiscal surveillance procedure. This notification is the eight such annual exercise, though only the fourth for Croatia, a candidate country since June 2004, and the third for the former Yugoslav Republic of Macedonia, a candidate country since December 2005. Countries generally met the reporting deadline by submitting an initial notification, but most sent rectifications of different kinds after this date.

The framework of the fiscal notifications is now well known. Countries are more or less familiar with the EU legal and methodological principles for the calculation of general government deficits and debt levels. The presentation of the notification tables and in particular the reconciliation between the national budget balance and the balance used in EU fiscal surveillance is generally in line with the requirements. Significant efforts have been made to provide figures that comply as much as possible with the methodology and coverage required by the fiscal notifications.

The prospect of accession is a catalyst for reforms in the scope and the management of the national budgets. Budget presentations are being modernised, and national budgets' coverage of government operations is being made more exhaustive. In particular, there has been a spectacular reduction in the number of off-budget and special funds accounts and operations. Also, the reference to central and general government in EU fiscal surveillance often leads to more systematic monitoring, supervision and controllability of the operations of local authorities and of social security.

1.2. REPORTED GENERAL GOVERNMENT BALANCES AND DEBT LEVELS

Table 1 shows the general government net borrowing/net lending figures reported in April 2008 and the corresponding figures reported in the previous notification of April 2007.

Table o.2.1:

General government net lending (+) / borrowing(-) (% of GDP)

	Notifi-cation	2004	2005	2006	2007	2008(1)	average 2004-07
Croatia	2008	-4.3	-4.0	-2.5	-1.6	-1.6	-3.1
	2007	*-4.1*	*-3.8*	*-2.2*	*-1.8*		*-3.0*
The former Yugoslav Rep. of Macedonia	2008	0.0	0.2	-0.5	0.6	-1.5	0.1
	2007	*0.0*	*0.3*	*-0.6*	*-1.0*		*-0.3*
Turkey	2008	-4.5	-0.6	-0.1	-1.2	-1.0	-1.6
	2007	*-5.8*	*-0.3*	*0.4*	*-0.8*		*-1.6*

(1) planned

This year's notifications show that during last year the general government deficit shrank further in Croatia, switched to a small deficit in the former Yugoslav Republic of Macedonia after a slight surplus in 2005, and that Turkey posted a deficit, reversing the trend budgetary improvement since 2001. This change in 2007 could be driven by increased financial turbulence and weaker political stability.

Looking at trends over a longer 4-year period, the general government budget of the former Yugoslav Republic of Macedonia was nearly balanced, whereas Croatia and Turkey posted on deficits declining from over 4% of GDP annually to rates between 1-1 ½% today.

The plans for the current year, as signalled in the April 2008 notifications, foresee a similar deficit in Croatia as last year, and an increase by about 1% in the deficit in the former Yugoslav Republic of

Macedonia. Turkey foresees a slight decrease from a deficit of 1.2% of GDP in 2007, to a deficit of 1.0% of GDP in the current year.

Table o.2 displays the notified general government gross debt ratios and the corresponding figures notified in April of last year.

Table o.2.2:

General government gross debt (% of GDP)

	Notifi-cation	2004	2005	2006	2007	2008(1)	change 2004-07
Croatia	2008	43.2	43.7	40.8	37.7	35.8	-5.4
	2007	*43.2*	*43.7*	*40.8*	*38.7*		*-4.5*
The former Yugoslav Rep. of Macedonia	2008	36.6	39.6	31.6	24.5	23.8	-12.1
	2007	*40.0*	*46.9*	*39.4*	*32.1*		*-7.9*
Turkey	2008	59.2	52.3	46.1	38.8	36.4	-20.5
	2007	*76.9*	*69.6*	*60.7*	*56.8*		*-20.1*

(1) planned

Gross debt of the candidate countries stood at the end of 2007 at 24.5% and 38 % of GDP for the former Yugoslav Republic of Macedonia and Croatia, respectively and at close to 39% in the case of Turkey. However, there has been a continued trend of falling general government debt ratios for all three countries, however to different degrees: very lightly only in the case of Croatia, modestly in the case of the former Yugoslav Republic of Macedonia and very strongly in Turkey. Strong nominal GDP growth has contributed to reduce or contain the debt ratio, supported by primary surpluses in the former Yugoslav Republic of Macedonia and particularly in Turkey. The fast decrease of debt in Turkey is due to (i) tight fiscal policy, (ii) a lower interest burden due to falling interest rates, (iii) very strong nominal growth and (iv) a strengthening of the TRY vis-à-vis the other currencies of denomination in the Turkish public debt.

1.3. ECONOMIC BACKGROUND

The overall improvement of reported deficit and debt figures in the candidate countries occurred against the background of generally favourable macroeconomic conditions. Table 3 gives some key indicators of economic developments in the countries. In particular, growth rates continued to be relatively high in 2007, ranging from 5.6% in Croatia to 4.5% in Turkey.

Inflation decelerated somewhat in all countries, whereas interest rates rose, except the former Yugoslav Republic of Macedonia. Exchange rates remained de-facto pegged to the euro in Croatia and the former Yugoslav Republic of Macedonia and showed a depreciating trend in Turkey.

Table o.3.1:

Main economic trends

Growth (GDP in real terms, change in %)

(annual averages)	2003	2004	2005	2006	2007
Croatia	5.3	4.3	4.3	4.8	5.6
The former Yugoslav Rep. of Macedonia	2.9	4.1	4.1	3.9	5.1
Turkey	5.3	9.4	8.4	6.9	4.5

Interest rate (3-months, % per annum)

2003	2004	2005	2006	2007	*(annual averages)*
5.42	7.32	6.21	4.46	5.66	**Croatia**
n.a.	8.49	9.94	6.40	5.60	**The former Yugoslav Rep. of Macedonia**
37.68	24.26	20.40	21.65	22.56	**Turkey**

Inflation (CPI, change in %)

(annual averages)	2003	2004	2005	2006	2007
Croatia	1.8	2.0	3.3	3.2	2.9
The former Yugoslav Rep. of Macedonia	1.1	-0.4	0.5	3.2	2.3
Turkey	21.6	8.6	8.2	9.6	8.8

Exchange rate (bilateral EUR exchange rate)

2003	2004	2005	2006	2007	*(annual averages)*
7.57	7.50	7.39	7.30	7.33	**Croatia**
61.26	61.32	61.30	61.19	61.18	**The former Yugoslav Rep. of Macedonia**
1.69	1.77	1.67	1.80	1.78	**Turkey**

1.4. QUALITY AND RELIABILITY OF NOTIFIED DEFICIT AND DEBT FIGURES

The 2008 notifications of Croatia and Turkey have, as regards methodological aspects, been assessed in detail in the country evaluations (see below). The purpose of the country evaluations is to review the figures and to analyze the reconciliation between the national budget figures and the notified figures. Eurostat also provided for each country section a summary assessment of how far the notified figures complied with the ESA 95 methodology. The country evaluations mention the various areas where progress has been made and where further improvement is required.

From a methodological point of view, there has been progress in the statistical quality of reported data in the countries compared to last year's notification. Yet further efforts are needed in all three countries assessed in order to ensure that the deficit and debt data compiled are fully compatible with ESA 95 standards. In particular, a more complete submission of tables and the implementation of the accrual principle are identified in the country assessments as further challenges for more than one country. Table 4 (below) summarizes the specific findings for each country in this respect.

Box o.4.1:

Main findings as regards quality of notified data

Croatia

Further institutional co-operation is necessary in order to improve data quality and reliability.

Some difficulties remain in particular in Croatia's classification outside government. Further efforts to improve financial accounts for the government sector would be beneficial to allow for a better assessment of some transactions, which are currently regarded as financial with no impact on the deficit. The authorities have not yet implemented the decision by Eurostat on the time of recording of the payment of the pensioners' debt.

The former Yugoslav Republic of Macedonia

Data quality was not assessed, as this second notification did not provide data based on ESA 95.

Turkey

There have been some major revisions of figures since the previous notification, mainly due to a revision of GDP, which aligned National Accounts with ESA95.

Some methodological issues should be further clarified, especially delimitation of general government, accruals recording notably for interest, taxes and other revenue items, capital injections and military expenditure.

Statistical discrepancies have been reduced, but further improvement is expected.

The National Statistical Office should be more involved in preparing the notification, especially for ESA95 methodological aspects, incl. delimitation of general government sector and sub-sectors.

Full assessment of data remains difficult. The quality of deficit and debt figures should be further improved, incl. by compiling full set of ESA 95 accounts (non-financial and financial) for general government sector and its sub-sectors. Lack of ESA Table 2 (government revenue and expenditure) and ESA Table 6 (annual financial accounts) or alternatively ESA Table 27 (quarterly financial accounts for general government) prevents applying consistency tests that are essential for assessing the quality of fiscal data.

Part I

Fiscal notification of Croatia

1. FISCAL NOTIFICATION OF CROATIA

1.1. KEY FISCAL INDICATORS REPORTED

On 1 April 2008, the Croatian authorities submitted the 2008 fiscal notification to the European Commission. Reported fiscal indicators are presented in Table 1 and Charts 1 and 2 which also provide a comparison with the figures submitted a year ago.

Table I.1.1:

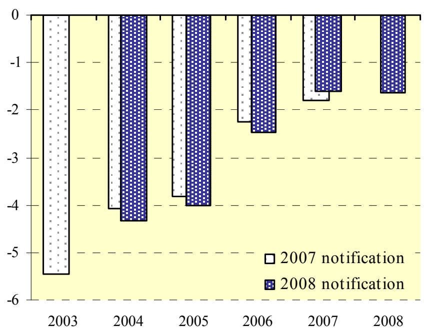
Croatia: General government indicators and nominal GDP

% of GDP	Notifi-cation	2003	2004	2005	2006	2007	2008(1)
Net lending (+) / borrowing(-)	2008		**-4.3**	**-4.0**	**-2.5**	**-1.6**	**-1.6**
	2007	***-5.5***	***-4.1***	***-3.8***	***-2.2***	***-1.8***	
Primary net lending (+) / borrowing (-)	2007		**-2.2**	**-1.8**	**-0.3**	**0.4**	**0.4**
	2007	***-3.4***	***-2.0***	***-1.6***	***-0.1***	***0.3***	
Gross debt	2008		**43.2**	**43.7**	**40.8**	**37.7**	**35.8**
	2007	***41.0***	***43.2***	***43.7***	***40.8***	***38.7***	
Gross fixed capital formation	2008		**4.4**	**3.9**	**3.5**	**4.2**	**3.6**
	2007	***5.3***	***4.4***	***3.9***	***3.5***	***3.6***	
Nominal GDP growth rate (%)	2008		**8.3**	**7.6**	**8.3**	**9.8**	**10.2**
	2007	***9.5***	***8.3***	***7.6***	***8.3***	***8.2***	

(1) planned

According to the figures reported, the general government deficit continued to narrow from 4.3% of GDP in 2004 to 1.6% in 2007. For the year 2008, the deficit is projected to remain unchanged as a percentage of GDP (table 1). With respect to the size of the deficits, it should be noted that the reported figures do not include debt repayments to pensioners, which – according to a Eurostat decision of March 2008 (see below under "deficit and debt methodology") – should be recorded as cash expenditures in the year of payment. The proper implementation of the Eurostat decision would increase the general government deficit by around 1 percentage point of GDP per year over the period 2004- 2007.

Graph I.1.1: **Croatia: General government net borrowing (-) (% of GDP)**



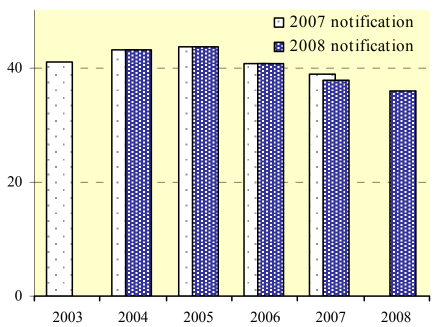
As for the year 2007, the original budget framework adopted in late 2006 foresaw a deficit target for the consolidated general government sector of 2.8% of GDP in terms of the modified accrual principle based on GFS 1986, which – according to the Croatian authorities – is equivalent to 1.8% in ESA 95 terms and compares with a deficit of 2.5% of GDP a year before. The significant reduction of the deficit-to-GDP ratio was expected to be almost exclusively driven by a reduction of current spending relative to GDP, in particular on subsidies and social transfers. In mid-2007, the government proposed and the parliament adopted a revision of the 2007 budget. The revision was partly motivated by better than expected revenue performance, resulting from strong economic activity in the first half of the year. Total revenues were revised upwards by 1.4% of GDP. However, the budget revision was also motivated by the government's intention to change the amount and structure of spending. Additional spending, which amounted to 1.2 percentage points of GDP, included one-off payments resulting from court decisions and the repayment of health sector arrears. Moreover, the revised budget provided for an increase in spending on investment (notably road construction), social spending (maternity benefits), education, wages, pension and health. The net effect of the budget revision led to a slightly lower deficit target of 1.6% of GDP, compared to 1.8% foreseen in the original budget. Preliminary data on cash budget execution of the consolidated general government in 2007 suggest that budget implementation has been broadly in line with the revised plan. The notification also shows, that an increase in outstanding arrears as well as payments on guarantees together added some 0.1-0.2 percentage points of GDP to the general government deficit as reported under ESA 95 standards.

The submission projects the general government deficit to remain at 1.6% of GDP in 2008, which is broadly in line with the policy target set in Croatia's fourth Pre-Accession Economic Programme (PEP) submitted in December 2007. Although this target does not seem to be overly ambitious, the actual fiscal outcome may be less comfortable than programmed for a number of reasons. First, economic growth is likely to be weaker than expected at the time when the fiscal projections were prepared, which may imply lower than projected revenues. Secondly, recent budget amendments suggest increases in net spending, notably resulting from some fiscal measures to alleviate the impact of higher food and energy prices, and there are continued pressures to increase public sector wages, transfers and subsidies. Sticking to the fiscal target would therefore require to implement compensatory cost saving measures and to withstand those pressures.

Interest payments have been broadly stable relative to GDP, hovering at around 2.1% of GDP on average. This may reflect continued good access to international financing at relatively favourable terms and improved borrowing conditions on domestic markets. Although the recent international financial market turmoil has had limited effects on borrowing conditions so far, it cannot be excluded that financing conditions will become tighter, which will eventually increase debt servicing costs.

The stock of general government gross debt in national currency terms increased only slightly in 2006 and 2007 by 1% and 1.5%, respectively, compared to a growth rate of 9% in 2004 followed by a slight increase of 0.9% in 2005. The general government gross debt-to-GDP ratio declined markedly from 43.2% in 2004 to 37.7% of GDP in 2007. For 2008, the fiscal notification projects a further nominal increase in the stock of debt by around 5%, but a further reduction in the debt-to-GDP ratio by around 2 percentage points to 35.8% of GDP *(Chart I.1.2)*.

Graph I.1.2 : **Croatia: General government gross debt (% of GDP)**



The different contributions to the change in debt, as expressed in percentage points of GDP, are indicated in the upper part of Table 2. In 2006 and 2007, the growth of nominal GDP had a significant impact on the change, i.e. reduction of the debt-to-GDP ratio. Also, the swing from a primary deficit of 0.3% of GDP in 2006 to a primary surplus of 0.4% of GDP helped reducing the debt ratio. Moreover, other factors contributed to the change in gross debt in 2006 and 2007, including significant revenues from privatisation averaging at around 1.1% of GDP per year. Reported planned figures for 2008 suggest a further reduction of the debt-to-GDP ratio by 1.9 percentage points. However, as outlined above, uncertainties remain with respect to budget implementation and the overall fiscal stance in 2008.

Table I.1.2:

Croatia:

Contribution to changes in general government gross debt and gross debt ratio

		2005		2006		2007		2008(1)	
		*GDP % pts**		*GDP % pts**		*GDP % pts**		*GDP % pts**	
Change in gross debt ratio		+01		-2.9		-3.1		-1.9	
to which contribution of ...									
	• Primary balance	1.8		0.3		-0.4		-0.4	
	• Interest	2.2		2.2		2.0		2.0	
	• nominal GDP growth	-3.1		-3.4		-3.6		-3.5	
	• Other	-0.4		-2.0		-1.0		0.0	
		mio. HRK	*% of GDP*	*mio. HRK*	*% of GDP*	*mio. HRK*	*% of GDP*	*mio. HRK*	*% of GDP*
General government net borrowing		9,269	4.0	6,158	2.5	4,389	1.6	4,959	1.6
+	Other contributions (2)	-879	-0.4	-5,133	-2.0	-2,832	-1.0	-37	0.0
=	Change in general government gross debt	8,390	3.6	1,024	0.4	1,557	0.6	4,921	1.6
General government gross debt		101,185	43.7	102,210	40.8	103,767	37.7	108,688	35.8

* differences of ratios to GDP in year t to ratios to GDP in year t-1

(1) *planned*

(2) *Net acquisition of financial assets, appreciation/depreciation of foreign currency debt and remaining statistical adjustments*

1.2. THE MACROECONOMIC CONTEXT

As indicated in table 3, the Croatian economy has experienced relatively strong real GDP growth over the past few years.

Table I.1.3:

Croatia: Main economic trends

	annual averages	2002	2003	2004	2005	2006	2007
Growth	GDP in real terms, change in %	5.6	5.3	4.3	4.3	4.8	5.6
Inflation	CPI, change in %	1.7	1.8	2.0	3.3	3.2	2.9
Unemployment	official, % of labour force	14.8	14.3	13.8	12.7	11.2	11.0f
Current account	balance, % of GDP	-8.7	-7.4	-5.2	-6.4	-7.9	-8.6
Interest rate	Interbank 3 months, % p. a.	4.63	5.42	7.32	6.21	4.46	5.66
Exchange rate	HRK/EUR	7.42	7.57	7.50	7.39	7.30	7.33

Source: Reuters/Ecowin

In 2007, GDP growth accelerated markedly to 5.6%, up from 4.3% in 2005, despite some moderation in the second half of the year. The economic expansion remained largely driven by domestic demand, and in particular strong private and public consumption. At the same time, the growth of investment decelerated somewhat to a still robust 6.5% year-on-year, down from close to 11% in 2006. This moderation was partly due to the gradual completion of motorway construction and lower private investment growth. The contribution of net exports to GDP growth remained negative (-0.8 percentage points) in 2007. High frequency indicators suggest a continuation of a relatively robust economic performance in the first quarter of 2008. The officially registered unemployment rate continued to decline, from 16.7% in 2006 (end of period) to 14.4% in 2007. According to official data from the Employment office, employment increased markedly by 3.3% in 2007, following a similarly strong increase in the year before. According to most recent data from the labour force survey, the unemployment rate (ILO) declined to 8.2% in the third quarter of 2007, down from 9.1% in the second quarter. This reduction is however largely due to seasonal factors (e.g. tourism).

Average annual inflation decreased slightly in 2007 to 2.9%, down from 3.2% a year before. While inflation remained low throughout the first half of the year, it significantly accelerated in the second half and reached 5.8% year-on-year in December and above 6% in early 2008, compared to 2.1% in December 2006. This acceleration was mainly due to supply shocks which led to considerable price increases of agricultural and food products. Moreover, hikes in administered utility prices, most of which are controlled by local governments, also added to higher inflation. In the first quarter of 2008, year-on-year inflation stabilised at 5.8%.

The current account deficit widened significantly to 8.6% of GDP in 2007, up from 7.8% a year before, notably resulting from higher world energy and other commodity prices and continued strong domestic demand and imports. The composition of the current account has not changed compared to previous years. A high trade deficit (25.2% of GDP, up from 24.4% in 2006) was again not fully compensated for a by the surplus in services (16.8% of GDP, up from 16.6% in 2004), mostly attributable to tourism revenues. Net FDI inflows grew by around 33% in 2007 to 9.2% of GDP, from 7.6% in 2006, more than offsetting the current account deficit. FDI flows were largely driven by the recapitalisation of banks, while Greenfield investments remained relatively low.

Despite a continued surge in capital inflows, the nominal exchange rate of the Kuna vis-à-vis the euro has been kept stable. In 2007, the average monthly rate fluctuated within a very small range between 7.29 and 7.40 kuna and appreciated by 0.2% year-on year in 2007. This trend continued in early 2008, when the kuna appreciated by 0.5% in January to April. The level of official foreign exchange reserves reached a comfortable level of EUR 9.3 billion at end-2007, equivalent to around 5 months of imports of goods and services.

1.3. METHODOLOGICAL ISSUES

Main challenges

The main challenge will be to further improve deficit and debt reporting on ESA 95 standards.

Transposition of national budget balances into ESA 95

Table 4 quantifies the transposition of cash budget balances into the ESA 95 net lending/net borrowing position. The first line shows the actual (and for 2008 planned) figures for the most prominent budget balance, which in the case of Croatia is the central government budget balance after net acquisition of non-financial assets. In other words, the net acquisition of non-financial assets is treated as expenditure above the line. This balance includes, contrary to previous years' notifications, the net borrowing position of extra-budgetary users, namely the social security funds (pension, health, employment services). The budget balance reported for 2006 amounts to HRK - 2,270 million, equivalent to -0.9% of GDP.

Line 2 of table 4 adjusts for the difference between the central government cash balance and the ESA 95 net lending/net borrowing position of the central government. The size of adjustment is quite significant in both 2006 and 2007, representing 1.5% and 0.8% of GDP, respectively. The adjustments for the central government comprise a number of distinct issues. First, since ESA 95 net lending/borrowing is an accrual concept, an adjustment is made for the change in arrears that are not accounted for in the central government cash balance. In 2006, arrears increased by 0.2% of GDP, while in 2007 the stock of arrears was reduced by 0.2% of GDP, mostly due to repayments of outstanding obligations of the public health sector. Second, the adjustment includes the net lending/borrowing positions of extra-budgetary funds that are not included in the central government budget accounts. They are quite significant in both 2006 and 2007, adding 0.9 percentage points and 0.7 percentage points, respectively, to the (consolidated) central government deficit. Third, adjustments are made for the amount of state guarantees that have been called by public companies with an impact as high as 0.5% and 0.2% of GDP in 2006 and 2007, respectively. For the year 2008, the fiscal notification projects a working cash balance of the central government equivalent to -0.8% of GDP. The net borrowing position of the central government is forecast at 1.5% of GDP. The difference is exclusively explained by net borrowing of extra-budgetary funds. Thus, a further accumulation of arrears and payments against state guarantees are apparently not foreseen.

Table I.1.4:

Croatia: Transposition of national budget balances into ESA 95 net lending (+)/borrowing (-)

		2005		2006		2007		2008(1)	
		mio. HRK	*% of GDP*	*mio. HRK*	*% of GDP*	*mio. HRK*	*% of GDP*	*mio. HRK*	*% of GDP*
	Most prominent national budget balance (2)	-3,758	-1.6	-2,270	-0.9	-2,272	-0.8	-2,530	-0.8
+	adjustment to central government net lending	-5,402	-2.3	-3,795	-1.5	-2,265	-0.8	-2,130	-0.7
=	Central government net lending (S.1311) (3)	-9,160	-4.0	-6,065	-2.4	-4,537	-1.6	-4,660	-1.5
+	Local government net lending (S.1313)	-109	0.0	-92	0.0	148	0.1	-299	-0.1
+	Social security net lending (S.1314)	0	0.0	0	0.0	0	0.0	0	0.0
=	General government net lending (S.13)	-9,269	-4.0	-6,158	-2.5	-4,389	-1.6	-4,959	-1.6

(1) planned
(2) central budget
(3) Consolidated central budget (the consolidated central budget includes the central budget as well as extra- budgetary funds - Croatian Waters, Environment Protection Fund, Croatian Motorways, Croatian Roads, State Agency for Deposit Insurance and Bank Rehabiliation, Croatian Privatisation Fund)

Regarding the other sectors of the general government, local governments recorded very small deficits in 2006 and 2007. Therefore, the net lending/borrowing position of the general government does virtually not differ from the consolidated central government balance.

Stability of data

Due to the relatively short time-series available, there is limited possibility to analyse revisions to the data over time.

Between the April 2008 and April 2007 EDP notifications, central government deficit data for the years 2004-2006 have been revised due to the reclassification of called guarantees from financial to non-financial transactions in line with Eurostat advice. In addition, the entries in table 2D relating to social security funds have been excluded and moved to Budgetary Central Government (table 2A) in line with the outcome of the CARDS 2003 project. There have also been some revisions of data in the working balance of central government due to updated data sources. Finally, debt data have been marginally revised in 2004-2006 due to updated data sources.

Data for all years (2004 onwards) are considered as half-finalized. As an outcome of the recent CARDS 2003 project, which was finalised in the beginning of 2008, the fiscal reporting is expected to be revised in the close future and data are therefore to be treated as provisional at this stage.

Deficit and debt methodology

In compiling the notification, ESA95 methodology has been used for the third time. It has however still not been possible to make the adjustments needed to fully comply with basic features of ESA95, such as accrual recording and classification of units according to ESA95. Initially, results on these two areas were expected already in the April 2008 notification. However, the implementation has been delayed and is now expected to start from the second half of 2008. Therefore, as in previous notifications, the EDP reporting is still partly based on IMF methodology (GFS 2001).

General government consists of the central and local government sub-sectors. The current general government coverage has been explained by the Croatian authorities in the explanatory notes sent with the notification.

Concerning the classification of certain units, there has already been some work done in the context of CARDS 2003. There have also been exchanges between Eurostat and the Croatian authorities in the context of the fiscal reporting, and the discussion on the sectorisation for a number of units is expected to continue in the coming months. The current exchanges mainly relate to some infrastructure companies and the Croatian Bank for reconstruction and development (HBOR), but a more comprehensive analysis of sector delimitation in general is expected in the future.

The working balance in table 2A is based on ESA95 and consists of the overall deficit/surplus of the Budgetary Central Government according to the National Charts of Accounts. Data are recorded on a cash basis except for two extra-budgetary funds of central government (Croatian Roads and Croatian Motorways), which report data on an accrual basis. There are some adjustments in the tables 2A and 2C for accruals on expenditure. The 2008 April notification also includes, for the first time, the adjustment for the called guarantees which were previously recorded as financial transactions.

It is claimed by the Croatian authorities that there are no financial transactions included in the working balance, although this will be further analysed by Eurostat in the forthcoming weeks.

Taxes are recorded on a pure cash basis, indicating non-compliance with Regulation 2516/2000 on the recording of taxes and social contributions.

In tables 3, no transactions are reported for "securities other than shares" except for a very small amount for local government in the year 2006. No sub-sector holds any central government debt. In line with the inclusion of social security funds in Budgetary Central Government as explained above, the corresponding changes have been introduced in table 3A and 3D.

The statistical discrepancy in table 3 has been revised slightly upwards compared to the April 2007 notification, and amounts to almost 2% of GDP in 2004. Nevertheless, it shows a downwards trend over the years.

Concerning the time of recording of the so called pensioner's debt, which was initially raised during the April 2007 notification, and which has been subject of discussion between Eurostat and the Croatian authorities during the autumn/winter 2007/2008, Eurostat took its formal decision on 28 March 2008. The decision was officially communicated to the Croatian authorities. The decision, which implies a cash recording of the government expenditure relating to the pension debt, has not been implemented yet in the fiscal notification by the Croatian authorities. The decision implies an increase in the government deficit of Croatia by 1.8 bn HRK (0.8% of GDP) in 2004 and 2005, 2.4 bn HRK (1% of GDP) in 2006 and 3.3 bn HRK (1.2% of GDP) in 2007.

Questionnaire related to the notification tables

Croatia has completed part of the mandatory tables in the Questionnaire. Concerning Other receivables/payables relating to taxes and social contributions (table I), the table has not been compiled due to non-availability of accrual data in the Croatian accounts. EU transactions (table II) is not yet relevant for Croatia. For Government guarantees (tables IIIa, IIIb, IIIc) Eurostat asked in the April 2007 notification the Croatian authorities to change the way of recording of guarantees called and paid cash by government, and of cash repayments to government. This change was implemented in the April 2008 notification and the recording is now in line with ESA95. Croatia does not provide any data on Debt cancellations (table IV), but confirms that there have been no such cancellations. Concerning Capital injections (tables Va and Vb), only a few items are provided in table Va (table Vb is empty). Regarding Military equipment expenditure (table VI), Eurostat has taken note that Croatia still does not comply with the Eurostat rules on the recording of Military expenditure. The table on Public-Private-Partnerships (PPP), securitisation operations, and sale and leaseback transactions (table VII) has not been filled. Concerning Public-Private-Partnerships, there has been one recent project in Croatia (Zagreb Arena), with a signed contract. The Croatian authorities have been asked to analyse the project in order to decide on the correct recording. For the moment, the infrastructure being built, does not seems to appear in the balance sheet of government.

Gross Domestic Product

Croatia has made good and evident progress in national accounts data compilation, and has also improved regularity and consistency of data transmission. Most of the basic requirements of ESA95 have been implemented, but significant issues of non-compliance with ESA remain. Addressing these is foreseen within the coming year and is expected to necessitate upward revisions to GDP. GDP data is currently available back to 1995.

The Croatian national accounts have not yet implemented Council Regulations (EC) No 448/98 of 16 February 1998 and No 1889/2002 of 23 October 2002 (on the allocation of Financial Intermediation Services Indirectly Measured – FISIM). Croatian GDP is hence biased downwards. Commission Decision 98/715 of 30 November 1998 (concerning the principles for measuring prices and volumes) is currently in the process of implementation.

1.4. CONCLUSIONS

The April 2008 fiscal notification of Croatia confirms a gradual reduction of the general government deficit during the reporting period to 1.6% of GDP in 2007, or by 2.7 percentage points. This process of continued fiscal consolidation was driven by gradual improvements in the primary balance. The general government debt-to-GDP ratio has fallen by 5.5 percentage points to 37.7% of GDP, with a significant contribution from the government balance, notably the switch from a primary deficit in 2006 to a primary surplus in 2007. The decline in the debt ratio resulted also from sizable privatisation revenues, which are likely to diminish in the forthcoming years.

With respect to the quality and reliability of the data submitted, a number of problems and shortcomings have arisen from the Eurostat assessment. However, as this is only the fourth time that Eurostat has analysed the Croatian figures and as no technical assistance on public finance statistics has yet been provided to Croatia by Eurostat, it is not possible to provide a full quality evaluation.

It is also not possible at this stage to make a proper assessment of the introduction of the ESA95 methodology as some important areas like accrual recording and ESA95 sectorisation still need to be implemented. The fact that Croatia is using the government finance statistics methodology of the IMF (GFS 2001), should however provide some assurances with respect to the quality of data.

Due to the current issues identified in the assessment, notably the implementation of the accrual principle, the classification of certain units and the requested analysis of the public-private-partnership, Eurostat will continue its bilateral contacts with the Croatian authorities in order to conclude on these issues.

Concerning the classification of HBOR, Eurostat is currently questioning its classification outside government and will work closely with the Croatian authorities in the coming months in order to clarify the issue. Based on present evidence, Eurostat believes that HBOR could be reclassified inside the general government and the debt of HBOR reclassified as government debt. As regards the PPP project, analysis of the project and the contract is needed in order to decide on the classification. Eurostat will also need to analyse more the nature of some transactions, currently regarded as financial with no impact on the deficit, as there is very little or no reporting in questionnaire Va relating to capital injections, superdividends and privatisations.

Finally, the Croatian authorities have not yet implemented in their notification the Eurostat decision on the time of recording of the payment of the pensioner's debt (see above).

Part II

Fiscal Notification of the former Yugoslav Republic of Macedonia

2. FISCAL NOTIFICATION OF THE FORMER YUGOSAV REPUBLIC OF MACEDONIA

2.1. KEY FISCAL INDICATORS REPORTED

In their April 2008 fiscal notification, the authorities of the former Yugoslav Republic of Macedonia reported the following key fiscal indicators to the European Commission. The reported figures are shown in table 1 and charts 1 and 2.

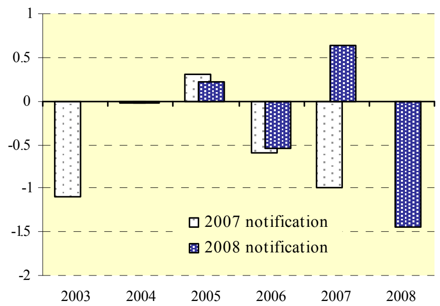
Table II.2.1:
the Former Yugoslav Republic of Macedonia: General government indicators and nominal debt

% of GDP	Notifi-cation	2002	2003	2004	2005	2006	2007	2008(1)
Net lending (+) / borrowing(-)	2008			**0.0**	**0.2**	**-0.54**	**0.6**	**-1.5**
	2007	***-5.6***	***-1.1***	***0.0***	***0.3***	***-0.60***	***-1.0***	
Primary net lending (+) / borrowing (-)	2008			**1.0**	**1.1**	**0.5**	**1.5**	**-0.8**
	2007		***0.0***	***1.0***	***1.1***	***0.5***	***-0.1***	
Gross debt	2008			**36.6**	**39.6**	**31.6**	**24.5**	**23.8**
	2007	***43.0***	***42.9***	***40.0***	***46.9***	***39.4***	***32.1***	
Gross fixed capital formation	2008			**n.a.**	**3.6**	**3.0**	**4.1**	**5.6**
	2007	***n.a.***	***n.a.***	***n.a.***	***n.a.***	***n.a.***	***n.a.***	
Nominal GDP growth rate (%)	2008			**5.5**	**8.1**	**8.0**	**9.6**	**12.4**
	2007		***3.1***	***5.5***	***7.2***	***7.3***	***9.2***	

(1) planned

According to the notified data, the general government fiscal position showed a minor deficit of about ½% of GDP in 2005, while in 2006 the general government realised a surplus of about ½% of GDP, instead a planned deficit of -1.0% of GDP. For 2008, the authorities plan a deficit of -1.5% of GDP (see table 1). Like in previous years, the main reason for the better than expected fiscal performance in 2007 was related to a better than expected revenue performance, benefitting from strong GDP growth and improvements in tax collection. However, in contrast to previous years, implementation of public spending was more in line with budgetary targets. The deficit target for 2008 is in line with the country's commitments towards IMF.

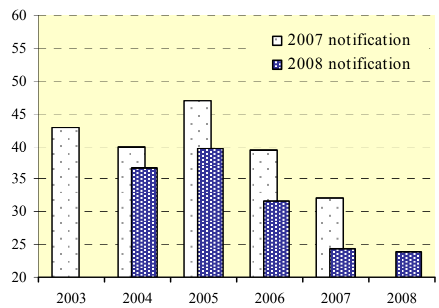
Graph II.2.1 : **The former Yugoslav Republic of Macedonia: General government net borrowing (-) (% of GDP)**



Interest payments have remained broadly stable as a share of GDP, amounting to around 1% throughout the reference period. This reflects the country's relatively low level of indebtedness and favourable financing conditions, with an implicit interest rate between 2.6% - 2.9% during the reporting period. However, in view of the increasing trend in international interest rates and the current shift in the country's debt portfolio from multilateral creditors towards domestic financing, the financing costs have increased, from 2.6% in 2003 to 2.9% in 2007. For 2008, the authorities envisage a slight decline in financing costs to 2.8%. The primary balance registered a surplus of about 1% of GDP in 2004 and 2005. In 2006 this surplus shrank to 0.5% of GDP, while in 2007, the primary balance rose to 1.5% of GDP. For 2008, the increase in the deficit will result in a primary deficit of about ¾% of GDP.. As a result, the negative primary balance will increase the debt ratio accordingly.

The stock of general government gross debt declined during the reporting period from 36.6% of GDP in 2004 to 24.5% in 2007. In 2005, the debt ratio rose by some 3 percentage points of GDP, mainly due to an Eurobond issue in order to finance an early repayment of London Club debt scheduled for early 2006. As a result, the debt ratio dropped again by 8 percentage points of GDP in 2006. In 2007, the early debt repayment significantly contributed to a further decline in the debt ratio to 24.5% of GDP. For 2008, the authorities envisage a further reduction in the debt ratio to 23.8% of GDP. Compared to the 2007 notification, the debt profile of the 2007 notification is significantly lower, which might be related to a closer alignment with ESA 95. *(chart II.2.2)*.

Graph II.2.2 : **The former Yugoslav Republic of Macedonia: General government gross debt (% of GDP)**



In contrast to last year, the notification presents data on fixed capital formation, indicating a rise in gross fixed capital formation, from 3.6% of GDP in 2005 to 4.1% in 2007. For 2008, a further significant increase to 5.6% of GDP is planned.

Nominal GDP growth accelerated markedly, increasing from 5.5% in 2004 to about 8% in 2005 and 2006 and 9.6% in 2007. For 2008, a further strong increase is expected, reaching 12.4% nominal growth. However, a significant part of this acceleration is probably due to increases in the price level.

The decomposition of the development of the debt ratio (table 2), indicates a marked increase in the debt ratio (by 3% of GDP) in 2005 and strong decline by 8 percentage points in 2006 and 7 percentage points in 2007.

This profile mainly reflects discretionary measures, such as the Eurobond issue end of 2005 and the use of those funds in early 2006 to pay back external debt, which contributed 6 percentage points to the rise and fall in the debt ratio in those 6 years. In 2007, further early debt repayments reduced the debt ratio by 6.7 percentage points of GDP. The primary balance had an increasing impact on the debt ratio increasing of 1.1 percentage points and 0.5 percentage points in 2005 and 2006. In 2007, the primary surplus reduced the debt ratio by 1.5 percentage points of GDP. In 2008, the primary balance is seen to increase the debt ratio by 0.8 percentage points of GDP. Overall, the "snow ball effect" (the net impact of interest payments and nominal GDP growth) had a debt reducing effect of close to 2 percentage points of GDP in 2005-2007. For 2008, a similar debt reducing impact of a similar size is expected. In 2006 and 2007, the decline in the debt ratio was mainly driven by "other" factors, such as the early repayment of outstanding debt (to foreign creditors). However, in 2008, the main factor for the further decline in the debt ratio will be nominal GDP growth, reducing the debt ratio by 2.7 percentage points of GDP. The costs of servicing the debt will increase the debt ratio by 0.6 percentage points, while in contrast to the past, due to the markedly higher deficit in 2008, the primary balance will also have debt increasing effect, contributing 0.8 percentage points to the debt ratio. Furthermore, the provided data indicates some further debt increasing measures, with debt ratio increasing effect of 0.6 percentage points.

Table II.2.2:

The former Yugoslav Republic of Macedonia:
Contribution to changes in general government gross debt and gross debt ratio

		2005		**2006**		**2007**		**2008(1)**	
		*GDP % pts**		*GDP % pts**		*GDP % pts**		*GDP % pts**	
Change in gross debt ratio		+03		-8.0		-7.1		-0.6	
to which contribution of ...									
	• Primary balance	-1.1		-0.5		-1.5		0.8	
	• Interest	0.9		1.0		0.8		0.6	
	• nominal GDP growth	-2.7		-2.9		-2.8		-2.7	
	• Other	5.9		-5.6		-3.7		0.6	
		mio MKD	*% of GDP*	*mio MKD*	*% of GDP*	*mio MKD*	*% of GDP*	*mio MKD*	*% of GDP*
General government net borrowing		-647	-0.2	1,672	0.5	-2,184	-0.6	5,541	1.5
+	Other contributions (2)	16,963	5.9	-17,314	-5.6	-12,593	-3.7	2,397	0.6
=	Change in general government gross debt	16,316	5.7	-15,642	-5.1	-14,777	-4.4	7,938	2.1
General government gross debt		113,368	39.6	97,726	31.6	82,949	24.5	90,887	23.8

* *differences of ratios to GDP in year t to ratios to GDP in year t-1*
(1) planned
(2) Net acquisition of financial assets, appreciation/depreciation of foreign currency debt and remaining statistical adjustments

Compared to the 2007 notification, the overall debt level is significantly lower while the profile is largely in line with the previous notification. This feature would have deserved a more detailed explanation in the fiscal notification.

Assessment: Debt dynamic is driven by early repayments and nominal growth, while the contribution of the primary balance to lowering the debt ratio is expected to reverse in 2008. However, in view of the relatively low implicit interest rate and the small size of interest payments of less than 1% of GDP, the downward path of the debt ratio appears not to be at risk.

2.2. THE MACROECONOMIC CONTEXT

Annual economic growth accelerated to 5% in 2007, compared to annual growth rates of about 4% in the three years before. However, the reliability of this data is still plagued by a significant share of unregistered economic activity. Weaknesses in the statistic system still impede the analysis of the development of aggregate demand components. Available data points to private consumption and investment as main demand factors, while due to the high import content of investment and exports, the net contribution of trade tended to be negative. With respect to economic sectors, the most dynamic sector appears to have been trade and transport, while growth in the manufacturing sector as a whole tended to be in line with overall GDP growth. Industrial production rose by 4% in 2007, compared to only 2.3% in 2006. The year before, industrial output had increased by 7% in 2005. This high volatility reflects a rather high degree of specialisation in the country's product portfolio, with a high concentration on only a few sectors, such as steel production and textile manufacturing, and the dominance of a few, large companies, where output fluctuations in those enterprises immediately have a bearing on aggregate production figures.

Inflation has been low during most of 2007, but accelerated markedly during the last months of the year, reflecting higher energy prices, but also higher food prices, resulting from unfavourable weather conditions during summer. Thus, while inflation rates had been around 1% during the first three quarters in 2007, the sharply increased price rises in the last quarter brought annual inflation to 2.3%, compared to 3.2% the year before.

Unemployment rates have continued to decline in 2007, but the overall unemployment level is still high, at some 35% on average in 2007. However, the existence of a substantial informal sector probably distorts official unemployment figures. More realistic estimates point to a level of unemployment of about 25%, which is still very high.

Table II.2.3:

The former Yugoslav Republic of Macedonia: Main economic trends

	annual averages	2002	2003	2004	2005	2006	2007
Growth	GDP in real terms, change in %	0.8	2.9	4.1	4.1	3.9	5.1
Inflation	CPI, change in %	2.3	1.1	-0.4	0.5	3.2	2.3
Unemployment	official, % of labour force	31.9	36.7	37.2	37.3	36.0	34.9
Current account	balance, % of GDP	-9.5	-4.1	-8.4	-2.6	-0.9	-3.1
Interest rate	Deposit 3 months, % p. a.	n.a.	n.a.	8.49	9.94	6.40	5.60
Exchange rate	MKD/EUR	60.98	61.26	61.32	61.30	61.19	61.18

Source: Reuters/Ecowin

External balances improved markedly in 2005 and 2006, with a strong narrowing of the current account deficit from -8.4% of GDP in 2004 to -0.9% in 2006. The main driving factors behind this favourable development were private transfers, in particular workers remittances and cash changeovers at the exchange offices. In 2005 and 2006, these inflows amounted to 17.5% and 18.6% of GDP, covering some 90% of the trade deficit. The trade deficit itself remained relatively stable, at some 18-20 of GDP. Capital inflows related to foreign direct investment (FDI) rose sharply in 2006, reaching nearly 6% during the whole year. In the past, FDI inflows usually amounted to some 1-2% of GDP. The main reason for this sharp increase was the privatisation of the electricity distribution company to foreign investor. This favourable picture started to change only in the last quarter of 2007, when decelerating exports and private transfers led to an end-year current account deficit of 3.1% of GDP. The strong inflow of foreign funds resulted in a marked increase of foreign exchange reserves to more than 5 months of imports of goods and services. This stronger external position has allowed the authorities to use some part of the foreign exchange reserves of early repayment of external debt.

The exchange rate remained stable towards the euro, which through stable import prices helped to contain inflationary pressures emanating from higher prices for energy and food.

2.3. METHODOLOGICAL ISSUES

Main challenges

Data in the fiscal notification are reported on the basis of GFS 1986. The main challenge still is the introduction of ESA 95 accounting standards for deficit and debt reporting.

Transposition of national budget balances into ESA 95

Table 4 quantifies the transposition of cash budget balances into the GFS 1986 net lending/net borrowing position. Unfortunately the notified data set did not provide on the most prominent national budget balance. Thus it is not possible to assess the size of the adjustments made to transpose the national budget balance to one in line with ESA 95.

Concerning the other sectors of general government: Local governments were only established in June 2005, with the implementation of the law on fiscal decentralisation. In the past, those entities were part of the central government. So far, most of the financial flows are still included in the central government accounts and by law, the end-year accounts of the local governments are balanced by Central government transfers. The social security sector notified minor deficits of 0.1% - 0.2% of GDP in 2005 and 2006, but a surplus of 0.6% of GDP in 2007. Like in the case of the local governments, a significant share of this sector's revenues and expenditures still seems to be recorded as being part of the central government.

Table II.2.4:

The former Yugoslav Republic of Macedonia:
Transposition of national budget balances into ESA 95 net lending (+)/borrowing (-)

	2005		2006		2007(1)	
	mio MKD	*% of GDP*	*mio MKD*	*% of GDP*	*mio MKD*	*% of GDP*
Most prominent national budget balance	708	0.2	-1704	-0.6	-3,393	-1.0
+ adjustment to central government net lending	248	0.1	605	0.2	-1	0.0
= Central government net lending (S.1311)	956	0.3	-1099	-0.4	-3,394	-1.0
+ Local government net lending (S.1313)	0	0.0	0	0.0	0	0.0
+ Social security net lending (S.1314)	-259	-0.1	-601	-0.2	0	0.0
= General government net lending (S.13)	647	0.2	-1672	-0.5	2,184	0.6

(1) planned

2.4. CONCLUSIONS

The April 2008 fiscal notification of the former Yugoslav Republic of Macedonia confirms the overall favourable fiscal position, with relatively low general government net borrowing requirement, a relatively low debt ratio and sustainable financing costs of the public sector debt, amounting to slightly less than 1% of GDP. However, the notified data points to a declining primary surplus and thus a diminishing contribution from the government balance to the debt reduction. The decline in the debt ratio is increasingly driven by strong nominal growth and other factors, such as early debt repayments.

Concerning methodological issues, the main challenge still is to upgrade the country's public sector accounting standards from the currently used GFS standard to ESA 95. Furthermore, for assessing the country's fiscal situation, it would be necessary to provide more details on the various levels of general government, the transposition from the national working balances to ESA 95 concept and on the contribution of the deficit/surplus and other factors on the debt level (tables 2-4 of the fiscal notification).

Part III

Fiscal Notification of Turkey

3.1. KEY FISCAL INDICATORS REPORTED

The main features of the fiscal notification reported by the Turkish authorities to the European Commission are shown in Table 1 and in Charts 1 and 2. A comparison with the figures submitted a year ago is included.

Table III.3.1:

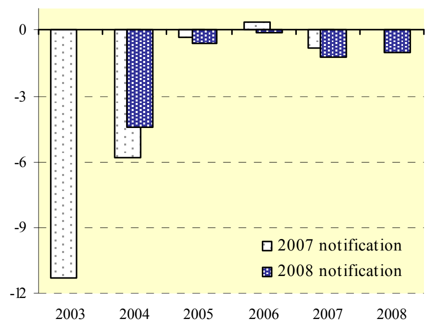
Turkey: General government indicators and nominal GDP

% of GDP	Notifi-cation	2001	2002	2003	2004	2005	2006	2007	2008(1)
Net lending (+) / borrowing(-)	2008				**-4.5**	**-0.6**	**-0.1**	**-1.2**	**-1.0**
	2007	***-29.8***	***-12.9***	***-11.3***	***-5.8***	***-0.3***	***0.4***	***-0.8***	
Primary net lending (+) / borrowing (-)	2008				**4.5**	**6.0**	**5.5**	**4.0**	**4.3**
	2007	***-2.7***	***7.1***	***5.9***	***5.9***	***8.8***	***8.0***	***7.0***	
Gross debt	2008				**59.2**	**52.3**	**46.1**	**38.8**	**36.4**
	2007	***105.2***	***93.0***	***85.1***	***76.9***	***69.6***	***60.7***	***56.8***	
Gross fixed capital formation	2008				**2.8**	**3.2**	**3.5**	**3.4**	**3.1**
	2007	***5.3***	***5.1***	***4.1***	***3.6***	***4.3***	***4.2***	***4.4***	
Nominal GDP growth rate (%)	2008				**55.4**	**16.1**	**16.9**	**12.9**	**10.2**
	2007		***55.6***	***29.6***	***19.7***	***13.2***	***18.3***	***8.0***	

(1) planned

The 2008 notification illustrates robust fiscal consolidation until 2006 - which has started after the 2001 financial crisis – followed by an increase in the deficit in 2007, which is expected to remain around 1% of GDP in 2008. The general government budget balance improved rapidly from a deficit of 4.5% of GDP in 2004 to an almost balanced budget in 2006. In 2007, a deficit of 1.2% of GDP was recorded. In order to improve the sustainability of public finances, the Turkish authorities have been targeting substantial primary surpluses, which were around, or above, 4% of GDP during the reporting period. An important feature of Turkey's public finances is the high burden of interest payments. Until 2006, real domestic interest rates have been falling rapidly, reflecting an increase in confidence and a deepening domestic capital market. In recent months, interest rates have picked up, in tandem with rising inflationary pressures, more exchange rate fluctuations and changes in market sentiment. The anchor provided by the IMF programme has enhanced macroeconomic stability until recently, but since its end in May 2008 the lack of strong and binding fiscal rules may weaken the credibility of the fiscal strategy. As a result, financing costs, which are highly pro-cyclical and are difficult to predict, may increase faster than anticipated in 2008. The primary surplus is expected to rise by 0.3 percentage point in 2008. This appears not consistent with the target of 3.5% of GDP in the Medium-Term Fiscal Framework (using ESA95 methodology).

Graph III.3.1 : **Turkey: General government net borrowing (-) (% of GDP)**



After the sharp increase of the government debt level in the 90s to 75% in 2001, the debt-to-GDP ratio has been declining rapidly, reaching 46.1% in 2006 and 38.8% in 2007. For 2008, a further reduction in the debt ratio by 2.4 percentage points is planned, to 36.4% of GDP (Chart 2).

Graph III.3.2 : **Turkey: General government gross debt (% of GDP)**

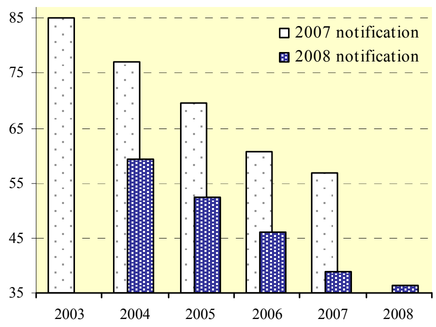


Table 2 below takes a closer look at the factors behind the debt dynamics. The upper part of the table analyses the annual change in the debt-to-GDP ratio and decomposes these changes into several underlying factors: the impact of the primary surplus, the effects of interest rates and nominal GDP growth, as well as other factors. During 2006-2007, the debt-to-GDP ratio declined substantially, by over 6 percentage points annually. In 2008 a further - albeit much smaller - reduction by 2.4 percentage points is expected. The most noteworthy aspect in this context is the changing role of nominal GDP growth and interest payments for the dynamics of debt ratio. As can be seen in Table 2, interest and GDP growth increased the debt ratio marginally by a combined 0.1 percentage points in 2007. In 2008, however, these tow factors are expected to have a strong increasing impact on the debt ratio of about 1.7 percentage points. The main underlying reasons for this development are the fall in nominal GDP growth rates and increasing inflationary pressures. As a result, the net effect of nominal GDP growth and interest rate has changed from a debt- decreasing factor in 2006 to a debt- increasing factor in 2007. In a context of subdued growth, projections for 2008 point again at a lower contribution of nominal growth and a roughly stable contribution of interest rates to the debt reduction. The primary surplus is the most important factor for the reduction in the debt ratio, as it reduces the debt-to-GDP ratio by over 4% throughout the reported period.

Table III.3.2:

Turkey:
Contribution to changes in general government gross debt and gross debt ratio

	2005		**2006**		**2007**		**2008(1)**	
	*GDP % pts**		*GDP % pts**		*GDP % pts**		*GDP % pts**	
Change in gross debt ratio	-6.9		-6.2		-7.3		-2.4	
to which contribution of ...								
• Primary balance	-6.0		-5.5		-4.0		-4.3	
• Interest	6.7		5.6		5.2		5.3	
• nominal GDP growth	-8.2		-7.5		-5.3		-3.6	
• Other	0.7		1.2		-3.3		0.2	
	mio. TRY	*% of GDP*	*mio. TRY*	*% of GDP*	*mio. TRY*	*% of GDP*	*mio. TRY*	*% of GDP*
General government net borrowing	3,940	0.6	1,072	0.1	10,653	1.2	9,586	1.0
+ Other contributions (2)	4,296	0.7	8,982	1.2	-28,069	-3.3	2,046	0.2
= Change in general government gross debt	8,236	1.5	10,054	1.5	-17,416	-2.3	11,632	1.2
General government gross debt	339,427	52.3	349,481	46.1	332,065	38.8	343,697	36.4

* *differences of ratios to GDP in year t to ratios to GDP in year t-1*

(1) planned

(2) Net acquisition of financial assets, appreciation/depreciation of foreign currency debt and remaining statistical adjustments

The lower part of table 2 shows the absolute changes in the debt level and differentiates between the impact of general government net borrowing and other contributions.

This latter category comprises three different variables which affect the debt level, besides the general government net borrowing. The first item contains adjustments for net acquisitions of financial assets in the form of currency and deposits, securities, loans as well as shares and other equity. Since 2006 the most significant items in this group have been equity sales. This reflects rapidly increasing privatization revenues. The second group summarises changes in the value of existing assets and loans, or foreign exchange assets and liabilities. In this group, the most significant impact came from exchange rate fluctuations, which decreased debt by roughly 1 percentage point of GDP in 2005, and due to a weaker TRY, debt increased by 1.5 percentage points in 2006. Preliminary indicators for 2007 point at a debt decrease by almost 2% of GDP as a result of the appreciation of the TRY. Issuances below par increased debt by between around 3% of GDP in 2005-2007. Besides the general government net borrowing, this was the single most important factor for the change in the general government debt. Finally, statistical discrepancies altered the debt by around ½-1% of GDP during the reporting period, slightly higher than in the 2007 notification.

In 2005, the general government deficit amounted to 0.6% of GDP, while other adjustments accounted for 0.7% of GDP. In 2006, the impact of other adjustments on the debt level rose to 1.2% of GDP, while the general government sector recorded a surplus of 0.1% of GDP. In 2007, the Turkish authorities recorded a surplus of 1.2% of GDP, while other adjustments affecting the debt level contributed quite negatively to the change in the debt stock, namely by 3.3% of GDP. These other contributions are expected to have only a minor, and even positive, impact on the debt ratio in 2008. The notification would have benefited from an explanation of the underlying factors.

3.2. THE MACROECONOMIC CONTEXT

The 2001 financial crisis has dramatically affected Turkey's public finances. As observed in Table 3, output growth rebounded strongly and constantly in the subsequent years. Overall, economic growth has been above potential until 2007. However, one has to bear in mind the dramatic contraction during previous crises in 1994 and 1999. Indeed, by 2003, Turkey had just reached its output levels of the early and mid-90s. Inflationary pressures have declined significantly in the period up to 2005. Since early 2006, inflation hovered at levels of around 9-10%. Annual consumer price inflation has declined from 55% in 1999 to 8% in 2005 and rose to an average of 9.6% in 2006, before falling to 8.8% on average in 2007. The sharp output contraction in 2001 led to a marked increase in unemployment, rising from 6.6% of the labour force in 2000 to about 10% in 2002-2007. So far, the robust real GDP growth observed since 2002 has not yielded very significant job creation. However, the fiscal impact of these labour market developments have been limited, mainly due to the fact that the unemployment system has been introduced relatively recently and the number of entitled persons still is still relatively small. The current account deficit increased significantly. From a deficit of 0.3% of GDP in 2002, it moved gradually to a deficit of 6.1% of GDP in 2006, before falling slightly to 5.7% of GDP in 2007 Although foreign direct investment inflows have picked up considerably since 2005, the current account deficit has –at least until 2007 – been financed by sizeable short-term capital inflows, attracted by relatively high interest rate differentials.

Table III.3.3:
Turkey: Main economic trends

	annual averages	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Growth	GDP in real terms, change in %	6.2	5.3	9.4	8.4	6.9	4.5
Inflation	CPI, change in %	45.0	21.6	8.6	8.2	9.6	8.8
Unemployment	official, % of labour force	10.4	10.5	10.3	10.2	9.9	9.9
Current account	balance, % of GDP	-0.3	-2.4	-3.6	-4.6	-6.1	-5.7
Interest rate	Deposits weighted average, 3 months, % p. a.	50.49	37.68	24.26	20.40	21.65	22.56
Exchange rate	TRY/EUR	1.43	1.69	1.77	1.67	1.80	1.78

Source: Reuters/Ecowin

Despite relatively weak growth in disposable income and relatively high unemployment, the Turkish authorities managed to achieve substantial primary surpluses. Therefore, they have increased tax revenues by raising tax rates and reducing public expenditure, primarily by only moderate increases of public sector wages and linear expenditure cuts. However, education and health have been largely exempted. Since 2005, however, real public sector wages have been rising and in early 2006, income taxes have been lowered. Although it appears premature to comment on the impact of the recent rise of inflation on wages, a comprehensive monitoring seems advisable.

3.3. METHODOLOGICAL ISSUES

Main challenges

The main challenge will be to further improve deficit and debt reporting using ESA 95 standards.

Transposition of national budget balances into ESA 95

Table 4 sets out the transposition of the national budget balance into the ESA 95 general government net borrowing/net lending definition. The first line shows the actual - and for 2008 planned - figures of the most prominent budget balance which is in Turkey the central government budget deficit (the official budget announced by the Ministry of Finance). The transposition from the national budget concept into ESA 95 requires a series of adjustments: First, the treatment of financial transactions - such as loan or equity sales and purchases - has to be adjusted to ESA 95 standards. In the case of Turkey, the main change is related to appropriations for guarantee payments and expected privatisation revenues. The size of those corrections is relatively small, as it alters the deficit by less than 0.5% throughout the reporting period. Second, the accounting of accrued receivables and payables such as revenues and interest payments is aligned with ESA 95 standards. As last year, this alignment was rather neutral. Also for 2008, the Turkish authorities do not expect a significant correction. A third adjustment refers to the institutional setup, taking into account the net lending/borrowing of other central government bodies that are not included in the central government budget. In the case of Turkey, this relates mainly to the social security institutions. On average, these institutions register a budgetary surplus of about 1% of GDP. In sum, these adjustments result in an ESA 95 central government deficit, which was during the reporting period between 0.91 and 0.5 percentage points lower than the deficit based on the national definition. In 2008 the deficit reducing impact is expected to rise to 0.9% of GDP, up from 0.4% in 2007 and 0.5% in 2006.

Table III.3.4:

Turkey:

Transposition of national budget balances into ESA 95 net lending (+)/borrowing (-)

	2005		2006		2007		2008(1)	
	mio. TRY	*% of GDP*	*mio. TRY*	*% of GDP*	*mio. TRY*	*% of GDP*	*mio. TRY*	*% of GDP*
Most prominent national budget balance	-8,117	-1.3	-4,643	-0.6	-13,883	-1.6	-17,997	-1.9
+ adjustment to central government net lending	-846	-0.1	-1,321	-0.2	-3,228	-0.4	1,280	0.1
= Central government net lending (S.1311)	-8,963	-1.4	-5,964	-0.8	-17,111	-2.0	-16,717	-1.8
+ Local government net lending (S.1313)	448	0.1	-1,207	-0.2	-1,066	-0.1	-754	-0.1
+ Social security net lending (S.1314)	4,575	0.7	6,099	0.8	7,525	0.9	7,886	0.8
= General government net lending (S.13)	-3,940	-0.6	-1,072	-0.1	-10,653	-1.2	-9,586	-1.0

(1) planned

Stability of data

Data have been provided for the years 2004-2007 as well as planned figures for 2008. As compared with the April 2007 notification, there have been revisions of the data, especially to general government deficit (net borrowing) for 2005-2007, mostly due to revisions in the central government and on 2006 in the local government sector. The figures for social security funds have been revised to a lesser extent.

The general government deficit (net borrowing) was revised downwards by less than 0.1 % of GDP in 2004. The more significant revision was made to the deficit ratio for 2004 upwards by 1.3 % of GDP (from a deficit of -5.8 of GDP to a deficit of -4.5% of GDP). These revisions in deficit ratios are mostly due to revisions of the GDP. GDP has been revised significantly for all years due to methodological changes and incorporations of new data sources.

For 2007, the general government deficit was changed from a forecast of deficit of 0.8 % of GDP in April 2007, to a deficit of 1.2% of GDP reported in April 2008. The main factor was an deterioration for central government, resulting especially from a equity sales.

The absolute debt figures for years 2004-2006 have been revised to a very limited extent, but in relation to GDP figures have changed significantly because of the significant revisions of GDP. For 2004-2006 there are small changes in absolute figures as well, mainly in long-term securities other than shares and in long-term loans. However the forecasted figure for 2007 has been lowered by 2.49 % of GDP.

The Turkish data are labelled as "finalized" for years 2004-2006 and as "half finalized" for year 2007.

Due to the changes in data requested by Eurostat, the Turkish authorities submitted two EDP notifications.

Deficit and debt methodology

There are still some uncertainties over the quality of the calculation of the net borrowing (-) / net lending (+) for general government, mostly due to accrual recording, as well as to the classification of some government units and to data coverage for local government and social security funds.

Central Government

The central government sub-sector deficit is dominant within the general government total. Central government consists of:

- general budget institutions;
- special budget institutions;
- regulatory and supervisory agencies;
- revolving funds;
- and three extra-budgetary funds reporting surpluses except in 2006, (2007 surplus was 0.16% of GDP).

Sectorisation and the calculation of net borrowing (-)/net lending (+) of revolving funds needs to be further investigated. They are currently classified inside government because they don't have capacities to work independently and act only on behalf of general government.

Also the case of CSA (compulsory saving account) needs further clarification. CSA is a pension fund under the management of Treasury for the government employees. The main income of this account was the compulsory cuts from the salaries of the employees. The money that cumulated in this account was invested on the Treasury Securities. In 2007 with an administrative order the cumulative amount at the account was re-paid to the employees. After all the repayments, a certain amount of security is left at CSA and given back to the Treasury in 2007. It is not clear if CSA is a funded or unfunded, autonomous or non-autonomous, scheme and in consequence weather it should it be classified inside or outside of general government and how transactions relating to its activities should be recorded.

In the Turkish notification, the transition from public accounts deficit to the net borrowing of central government starts from the official central government budget balance (working balance).

Local government and social security funds

For the compilation of the local government sub-sector, an annual survey is conducted providing figures on a cash basis. For the deficit and debt notification, the results of the survey are compared and completed with figures provided by central institutions including the Ministry of Finance, the Undersecretariat of Treasury and social security institutions. The sectorisation of some of the units included in local government needs to be further clarified as it seems that the market / nonmarket character of those has not been tested.

Iller Bank has a capital that results from contributions made by municipalities and some other local government bodies. The purpose of the bank is to provide credits to local government units. Currently for EDP purposes Iller Bank is classified inside general government, however in some other statistics it is classified in the financial sector.

In the calculation of net lending of the social security funds, their financial balances are used, appropriately crosschecked with Treasury information. However the figures are available only on a cash basis for the moment. Information on financial transactions is not available, therefore EDP Table 2D cannot be considered complete.

Accrual recording

The figures for accounts receivable for central government cover only accrual recording of taxes, using a simple time adjusted cash method (one of the two methodologies foreseen by Regulation 2516/2000). It seems that the other revenue of central government are recorded on a cash basis.

The recording of expenditure in the working balance is partly on an accrual basis, and no further adjustment is carried out.

Taxes collected by local government are also recorded on a cash basis. Accrual recording is expected in following years.

Social contributions and social benefits are still recorded on a cash basis. Accruals are expected for the future, however not in a short run.

Other methodological issues

Capital injections are all recorded as capital transfers at the level of central government, whereas there might be some recorded as financial transactions at the local government level. Privatization receipts seem to be correctly recorded as financial transactions.

The recording of guarantees as well as military expenditure needs clarification with respect to compliance with ESA95 rules. Their impact on the deficit is an issue to be further investigated by Eurostat. For the moment Eurostat does not have enough background information.

Debt

Concerning the recording of consolidated debt, social security funds as well as local government holdings of government debt seem now appropriately consolidated, but social security holdings needs some further investigations. "Saving Deposit Insurance Fund (SDIF)" and its operations with Treasury are not completely clear at this point and how they affect net lending/borrowing (B9).

In years from 2004 to 2005 a noticeable negative foreign exchange impact (i.e. reducing the debt, corresponding to an appreciation of the currency) is reported, whereas in 2006 a positive impact was recorded (depreciation) and a very noticeable negative impact again in 2007. There are no swaps in Turkey.

Statistical discrepancies

Comparing with the April 2007 EDP notification, the statistical discrepancies have been reduced. Eurostat provided guidance for how to record issuance above/below par and redemptions of bonds and this led to some improvements but the issue seems to be a complex one and further guidance from Eurostat is probably needed. The April 2008 EDP reporting shows average discrepancy per year of 0.18% of GDP in 2004-2007. However, yearly discrepancies remain large. A very high positive discrepancy is reported in 2007 (0.73% of GDP).

Questionnaire related to the EDP notification tables

Only partial information was provided on other receivables/payables relating to taxes and actual social contributions (Table I) and guarantees (Tables IIIa-IIIc) and privatisations (Table Va). No information is available for other receivables/payables of general government S.13 relating to the EU (Table II), debt cancellations (Table IV), capital injections in public corporations and superdividends (Tables Va,Vb), military equipment expenditure (Table VI) and public-private partnership, securitisation operations undertaken by government and sale and leaseback operations undertaken by government (Table VII).

Gross Domestic Product

The publication of a major revision to the Turkish National Accounts System, aimed at adapting them to ESA95 standards, was postponed several times. First results of this revision, including GDP, have become available in March 2008. While no final assessment on compliance can be made, the new figures are apparently of improved quality, and some basic requirements of ESA95 as to the methodology and definitions have been implemented.

GDP and components of the revised vintage are currently available back to 1998, the new base year. The length of time series as well as the coverage of variables could still be improved. Relative stability of figures is expected for future transmissions.

The Turkish national accounts have not yet implemented Council Regulations (EC) No 448/98 of 16 February 1998 and No 1889/2002 of 23 October 2002 (on the allocation of Financial Intermediation Services Indirectly Measured – FISIM) and Commission Decision 98/715 of 30 November 1998 (concerning the principles for measuring prices and volumes). This means that neither the allocation of FISIM nor chain-linking of previous year's prices in the construction of volume series have been achieved yet. The Turkish GDP is hence still biased downwards.

3.4. CONCLUSIONS

The 2008 fiscal notification illustrates, like in previous years, the successful efforts made in Turkey since 2001 in correcting fiscal imbalances and improving the quality of the fiscal monitoring. Until 2006 in particular, the rapid decline in real domestic interest rates - in combination with favourable real effective exchange rate developments - led to a very significant decrease of the fiscal burden caused by the 2001 financial crisis. The Turkish authorities achieved substantial primary surpluses after 2001. Those surpluses not only helped reduce the debt ratio, but also helped to bring down interest rates by strengthening market confidence. An in-depth assessment of Turkey's debt dynamics demonstrates the importance to adhere to an appropriate level of primary surpluses in order to reach the targeted reduction in the debt ratio. The introduction of a strong fiscal rule would further help this process by raising the credibility of the fiscal strategy.

There have been some revisions of figures since the previous notification, mainly due to the availability of more definitive data and to changes in some adjustment items. There are still methodological issues that should be clarified with Eurostat, especially regarding the delimitation of general government, the accruals recording notably for taxes and other revenue items, the recording of guarantees and military expenditure. The statistical discrepancies have been reduced, however further improvement is expected.

Eurostat recommends that the National Statistical Office should be more involved in the preparation of the notification figures, especially for the ESA 95 methodological aspects, including those referring to delimitation of general government sector and sub-sectors.

A full assessment of the data remains difficult. Therefore, it is recommended that the authorities give high priority to further improving the quality of the deficit and debt figures. One of the means to achieve this is that the statistical authorities compile of a full set of ESA 95 accounts (non-financial and financial) for the general government sector and its sub-sectors. The lack of ESA Table 2 (government revenue and expenditure) and ESA Table Table 6 (annual financial accounts) or alternatively of ESA Table 27 (quarterly financial accounts for general government) prevents applying consistency tests that are essential for the assessment of the quality of the fiscal data.

In this respect, it should be noted that the compilation of fiscal tables on an ESA 95 basis is broadly compatible with the fiscal reporting according to the IMF requirements (GFSM2001). A convergence projects between the ESA 95 GFS reporting and the IMF GFS reporting is ongoing. In this context, EU27 Member States have been given the option to service their reporting obligations to the IMF by way of using the Eurostat database and the recognized bridge table between the two systems. The Turkish authorities should be aware of this project and should consider adopting this approach.