EUROPEAN ECONOMY

OCCASIONAL PAPERS

Number 33 - June 2007

Main results of the 2007 fiscal notifications presented by the candidate countries

by Directorate-General for Economic and Financial Affairs

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Contents

MAIN RESULTS OF THE 2007 FISCAL NOTIFICATIONS PRESENTED BY THE CANDIDATE COUNTRIES

INTRODUCTION

In this Occasional Paper the Directorate General for Economic and Financial Affairs publishes its overview and assessments of the 2007 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 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. Background

All candidate countries were invited to submit fiscal notifications to the Commission services by 1 April 2007, in accordance with the commitments made under the pre-accession fiscal surveillance procedure. This notification is the seventh such annual exercise, though only the third for Croatia, a candidate country since June 2004, and the second 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 then 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.

2. Reported general government balances and debt levels

Table 1 shows the general government net borrowing/net lending figures reported in April 2007 and the corresponding figures reported in the previous notification of April 2006.

Table 1: General government net lending (+) / borrowing(-) (% of GDP)

	Notifi-cation	2003	2004	2005	2006	2007(1)	average 2003-06
Croatia	2007	-5.5	-4.1	-3.8	-2.2	-1.8	-3.9
	2006	*-4.5*	*-5.0*	*-3.9*	*-2.3*		*-3.9*
The former Yugoslav Rep. of Macedonia	2007	-1.1	0.0	0.2	-0.6	-1.0	-0.4
	2006	*-1.1*	*0.0*	*0.3*	*-0.6*		*n.a.*
Turkey	2007	-11.3	-5.8	-0.3	0.4	-0.8	-4.2
	2006	*-11.3*	*-5.7*	*-1.2*	*-1.1*		*-4.8*

(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 slight surplus, extending its significant budgetary improvement since 2001.

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 average deficits of around 4% of GDP annually, but both with a declining trend.

The plans for the current year, as signalled in the April 2007 notifications, foresee a further reduction of the deficit in Croatia and a slight increase of the deficit in the former Yugoslav Republic of Macedonia. Turkey foresees a switch from a slight surplus of 0.4%% of GDP in 2006, helped by special one-off factors, to a slight deficit of 0.8% of GDP in the current year.

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

Gross debt of the candidate countries stood at the end of 2006 at 39% and 41 % of GDP for the former Yugoslav Republic of Macedonia and Croatia, respectively and at close to 61% 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.

Table 2: General government gross debt (% of GDP)

	Notification	2003	2004	2005	2006	2007(1)	change 2003-06
Croatia	2007	41.0	43.2	43.7	40.8	38.7	-0.3
	2006	*40.9*	*43.7*	*44.2*	*42.1*		*1.2*
The former Yugoslav Rep. of Macedonia	2007	42.9	40.0	46.9	39.4	32.1	-3.6
	2006	*39.0*	*36.6*	*40.9*	*35.6*		*n.a.*
Turkey	2007	85.1	76.9	69.6	60.7	56.8	-24.5
	2006	*85.1*	*76.9*	*69.6*	*59.5*		*-25.6*

(1) planned

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.

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 in these countries. Table 3 gives some key indicators of economic development in the countries. In particular, growth rates continued to be relatively high in 2006, ranging from 6% in Turkey to 3.1% in the former Yugoslav Republic of Macedonia.

Inflation reaccelerated somewhat in the former Yugoslav Republic of Macedonia and Turkey, whereas interest rates fell in the countries, except in Turkey. 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 3: Main economic trends

annual averages	2002	2003	2004	2005	2006
Growth (GDP in real terms, change in %)					
Croatia	5.6	5.3	4.3	4.3	4.8
The former Yugoslav Rep. of Macedonia	0.9	2.8	4.1	3.8	3.1
Turkey	7.9	5.8	9.0	7.4	6.1
Inflation (CPI, change in %)					
Croatia	1.7	1.8	2.0	3.3	3.2
The former Yugoslav Rep. of Macedonia	2.3	1.1	-0.4	0.5	3.2
Turkey	45.0	21.6	8.6	8.2	9.6
Interest rate (3-months, % per annum)					
Croatia	4.63	5.42	7.31	6.21	4.46
The former Yugoslav Rep. of Macedonia	n.a.	n.a.	8.49	9.94	6.40
Turkey	50.49	37.68	24.26	20.40	21.65
Exchange rate (bilateral EUR exchange rate)					
Croatia	7.42	7.58	7.50	7.40	7.32
The former Yugoslav Rep. of Macedonia	60.98	61.26	61.32	61.30	61.19
Turkey	1.43	1.69	1.77	1.67	1.80

4. Quality and reliability of notified deficit and debt figures

The 2007 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 (next page) summarizes the specific findings for each country in this respect.

Table 4: Main findings as regards the data methodology

Croatia	Turkey
- Taxes are recorded on a pure cash basis. - Deficiencies seem to exist in the recording of guarantees called, the implementation of the accrual principle and the recording of government expenditure in the context of repayments of pensioner's debt. - It is still too early to make a proper assessment of the introduction of the ESA 95 methodology, even if the government finance statistics methodology of the IMF (GFS 2001) should provide some assurance to the quality of the data. **The former Yugoslav Republic of Macedonia** - Establish reporting based on ESA 95 (The data quality of the notification by the country was not assessed, as it was not yet based on ESA 95 and the degree of information provided was limited.)	- Some methodological issues should be further clarified, especially the delimitation of general government, the accruals recording notably for taxes and other revenue items, the recording of guarantees and military expenditure. - Statistical discrepancies have been reduced; however a further improvement is expected. - The National Statistical Office should be more involved in preparing notification, especially for ESA95 methodological aspects, incl. delimitation of general government and sub-sectors. - A 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 non-financial and financial accounts for general government and its sub-sectors. The lack of ESA table 2 (government revenue and expenditure) and either ESA table 6 (annual financial accounts) or, alternatively, ESA table 27 (quarterly financial accounts for general government), does not allow for consistency tests that are essential for assessing quality of fiscal data.

FISCAL NOTIFICATION OF CROATIA

1. Key fiscal indicators reported

On 1 April 2007, the Croatian authorities submitted the 2007 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.

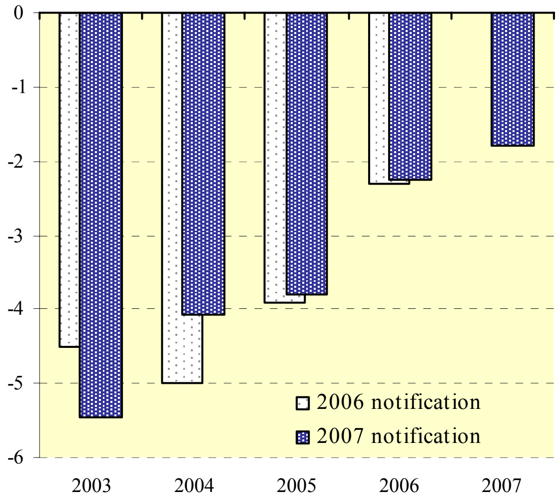
Table 1 - Croatia: General government indicators and nominal GDP

% of GDP	Notification	**2002**	**2003**	**2004**	**2005**	**2006**	**2007(1)**
Net lending (+) / borrowing(-)	2007		**-5.5**	**-4.1**	**-3.8**	**-2.2**	**-1.8**
	2006	*-4.1*	*-4.5*	*-5.0*	*-3.9*	*-2.3*	
Primary net lending (+) / borrowing (-)	2007		**-3.4**	**-2.0**	**-1.6**	**-0.1**	**0.3**
	2006	*-2.0*	*-2.5*	*-2.9*	*-1.6*	*-0.1*	
Gross debt	2007		**41.0**	**43.2**	**43.7**	**40.8**	**38.7**
	2006	*40.0*	*40.9*	*43.7*	*44.2*	*42.1*	
Gross fixed capital formation	2007		**5.3**	**4.4**	**3.9**	**3.5**	**3.6**
	2006	*3.9*	*5.3*	*4.5*	*3.9*	*3.8*	
Nominal GDP growth rate (%)	2007			**8.3**	**7.6**	**8.3**	**8.2**
	2006		*9.5*	*7.3*	*7.6*	*7.6*	

(1) planned

According to the figures reported, the general government deficit gradually narrowed from 5.5% of GDP in 2003 to 2.2% in 2006. For the year 2007, a further reduction to 1.8% of GDP is projected (table 1). As for the year 2006, the original budget framework adopted in November 2005 foresaw a deficit target for the consolidated general government sector of 3.2% of GDP on a modified accrual principle based on GFS 1986, equivalent to 2.3% in ESA 95 terms, and significantly lower than the 2005 deficit of 3.8% of GDP. The deficit reduction was expected to be driven by a marked reduction of current spending in percent of GDP, in particular on wages, subsidies and social transfers. However, the first half of 2006 was marked by better than expected revenue collection resulting from stronger growth and cautious budgeting. This, together with some spending overruns, led to the adoption of a supplementary budget in July with higher revenues and expenditures relative to GDP. Excess revenues were partly used to finance higher current spending. The marginal reduction of the revised budget deficit (to 2.2% in ESA 95 terms) resulted mainly from lower than initially planned capital spending. The estimate for the general government net lending/borrowing position in 2006 confirms that the revised deficit target in 2006 has been

Chart 1 **Croatia: General government net borrowing (-) (% of GDP)**



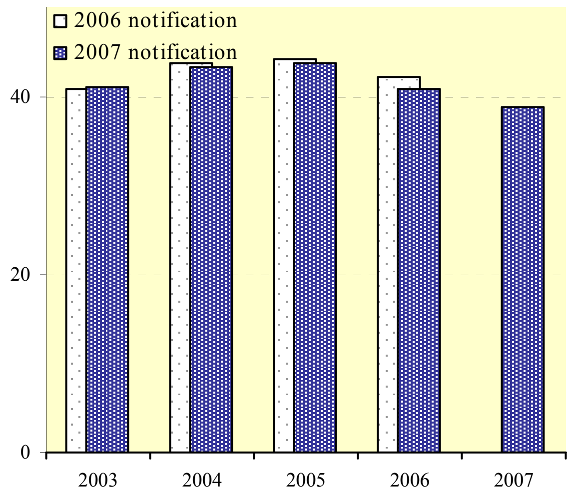
met. The notification also shows, that an increase in outstanding arrears as well as payments on guarantees together added some 0.5 percentage points of GDP to the general government deficit in 2006 as reported under ESA 95 standards.

The submission projects the general government deficit to further narrow to 1.8% of GDP in 2007, which is in line with the policy target set in Croatia's third Pre-Accession Economic Programme (PEP) submitted in December 2006. Notwithstanding a favourable performance of budget revenues during the first quarter of 2007, further fiscal consolidation is likely to require support from the spending side, too. At the same time, a stronger fiscal restraint appears challenging against the background of current pressures to increase spending and in view of the general elections scheduled later in 2007. According to the joint Ministerial conclusions of May on the Croatian 2006 PEP, significant fiscal risks of overspending in the area of pensions, wages and subsidies remain and add uncertainties as to the overall fiscal stance in 2007.

Interest payments have been broadly stable relative to GDP and have only slightly increased from 2% of GDP in 2003 to 2.2% in 2006, reflecting good access to international financing at relatively favourable and stable borrowing conditions. However, the shift to domestic borrowing may lead to somewhat higher debt servicing costs.

The stock of general government gross debt in national currency terms increased markedly in 2004 and 2005 by 14% and 9%, respectively, followed by a slight increase of 0.9% in 2006. The general government gross debt-to-GDP ratio rose from 41% in 2003 to 43.7% in 2005, but fell slightly below the 2003 level in 2006. For 2007, the fiscal notification projects an increase in the stock of debt by 2.7%, but a further reduction in the debt-to-GDP ratio by around 2 percentage points to 38.8% of GDP (Chart 2).

Chart 2 **Croatia: General government gross debt (% of GDP)**



The different contributions to the change in debt, expressed in percentage points of GDP, are indicated in the upper part of Table 2. In 2005 and 2006, the growth of nominal GDP had a significant impact on the debt-to-GDP ratio. The marked reduction of the primary deficit to close to balance in 2006 helped reducing the debt ratio considerably. Moreover, other factors contributed to the change in gross debt in 2006, including significant revenues from privatisation. Reported planned figures for 2007 suggest that continued fiscal consolidation, namely a switch to primary surplus will contribute to a further lowering of the debt ratio. However, as outlined above, uncertainties remain with respect to budget implementation and the overall fiscal stance in 2007. Furthermore, significant revenues from privatisation are scheduled to finance off-budget instalments in the context of a pensioners' debt repayment scheme and can therefore not be used for deficit financing purposes.

Table 2 - Croatia:

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

	2005		2006		2007(1)	
	*GDP % pts**		*GDP % pts**		*GDP % pts**	
Change in gross debt ratio	+0.6		-3.0		-2.0	
to which contribution of ...						
• Primary balance	1.6		0.1		-0.3	
• Interest	2.2		2.2		2.1	
• nominal GDP growth	-3.1		-3.4		-3.1	
• Other	-0.2		-1.9		-0.8	
	mio. HRK	*% of GDP*	*mio. HRK*	*% of GDP*	*mio. HRK*	*% of GDP*
General government net borrowing	8,823	3.8	5,625	2.2	4,848	1.8
+ Other contributions (2)	-481	-0.2	-4,683	-1.9	-2,055	-0.8
= Change in general government gross debt	8,342	3.6	942	0.4	2,793	1.0
General government gross debt	101,180	43.7	102,122	40.8	104,915	38.7

* 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

2. The macroeconomic context

As indicated in table 3, the Croatian economy has experienced relatively strong real GDP growth during the reference period. In 2006, growth accelerated to 4.8%, from 4.3% a year before.

Table 3 - Croatia: Main economic trends

	annual averages	2002	2003	2004	2005	2006
Growth	GDP in real terms, change in %	5.6	5.3	4.3	4.3	4.8
Inflation	CPI, change in %	1.7	1.8	2.0	3.3	3.2
Unemployment	official, % of labour force	14.8	14.3	13.8	12.7	11.2
Current account	balance, % of GDP	-8.7	-7.3	-5.1	-6.4	-7.7
Interest rate	Interbank 3 months, % p. a.	4.63	5.42	7.31	6.21	4.46
Exchange rate	HRK/EUR	7.42	7.58	7.50	7.40	7.32

Source: Reuters/Ecowin

Economic activity remained largely driven by domestic demand. Notably, investment spending accelerated markedly to 11%, up from 5% a year before. Imports of goods and services grew slightly stronger (7.3%) than exports (6.9%), leading to a negative contribution of net exports to growth. High-frequency indicators suggest a continuation of relatively strong growth in the first quarter of 2007. The situation on the labour market continued to improve. The officially registered unemployment rate fell to 15.9% in April 2007, compared to 17.2% in the same month a year ago. The recent labour force survey recorded a decline in the unemployment rate from 12.7% in 2005 to 11.2% in 2006. The growth of average gross wages accelerated in 2006 and led to a slight increase in real unit labour cost. Average annual consumer price inflation slightly declined to 3.2% by end-2006 (2005: 3.3%), and further to 2.6% in April 2007, as the impact of the energy price hike started to ease.

The current account deficit widened to around 7.7% of GDP in 2006, up from 6.4% in 2005. The trade deficit rose from 24% of GDP in 2005 to 24.4% in 2006 and the surplus in services slightly declined to 16.6% (from 16.9% in 2005). The deficit of the income balance remained at 3.1% of GDP, but a lower surplus in transfers of 3.2% (against 3.8% in 2005) contributed to the widening of the current account deficit. The net inflow of FDI increased to around 7.8% of GDP in 2006, thus fully financing the current account deficit.

The exchange rate of the kuna vis-à-vis the euro remained broadly stable with a small appreciation of around 1% on average during 2006. Foreign debt continued to accumulate to EUR 29 billion at end-2006, or around 85% of GDP. The growth of foreign debt was mainly driven by an acceleration of external borrowing by the corporate sector to 30% year-on-year, while the growth of external borrowing by the banking sector slowed to 13.2% and the stock of foreign debt owed by the government declined by 5.5%. Official reserves of the Croatian National Bank continued to rise by around 17% to a fairly comfortable level of EUR 8.7 billion, reflecting around 5.3 months of 2006 imports of goods and services.

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 2007 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. The budget balance reported for 2005 amounts to HRK 3,758 million, equivalent to or 1.6% 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 2005 and 2006, representing 2.2% and 1.3% 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. For each of the years 2005 and 2006 an increase in arrears equivalent to around 0.2% of GDP is reported. *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 2005 and 2006, adding 1.2 percentage points and 0.9 percentage points, respectively, to the consolidated central government deficit. *Third*, an adjustment is made for the amount of state guarantees that have been called by public companies with an impact of 0.3% of GDP in both 2005 and 2006. A *fourth* adjustment is made for the assumption of a loan by the Croatian Health Insurance Institute, equivalent to 0.3% of GDP in the year 2005. *Fifth*, an adjustment is made for accrued concession revenues equivalent to 0.1% of GDP in 2005, offsetting an entry of the same size in 2004. For the year 2007, the fiscal notification projects an adjustment of the working cash balance of the central government equivalent to 0.8% of GDP, exclusively driven by the net borrowing position of extra-budgetary funds. Thus, a further accumulation of arrears and payments against state guarantees is apparently not projected.

Table 4 - Croatia:

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

	2005		**2006**		**2007(1)**	
	mio. HRK	*% of GDP*	*mio. HRK*	*% of GDP*	*mio. HRK*	*% of GDP*
Most prominent national budget balance (2)	-3,758	-1.6	-2,268	-0.9	-3,336	-1.2
+ adjustment to central government net lending	-5,047	-2.2	-3,357	-1.3	-1,336	-0.5
= Central government net lending (S.1311) (3)	-8,805	-3.8	-5,625	-2.2	-4,673	-1.7
+ Local government net lending (S.1313)	-91	0.0	-72	0.0	-175	-0.1
+ Social security net lending (S.1314)	73	0.0	72	0.0	0	0.0
= General government net lending (S.13)	-8,823	-3.8	-5,625	-2.2	-4,848	-1.8

(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 2005 and 2006, largely offset by small surpluses in the accounts of the social security sub-sectors. Therefore, the net lending/borrowing position of the general government does virtually not differ from the consolidated central government balance.

Stability of data[1]

As this is only the third notification of government deficit and debt submitted by Croatia, there is still limited possibility to analyse revisions to the data over time.

Between the April 2006 and April 2007 EDP notifications, data for the years 2003-2005 have been slightly revised for the debt of local government (long-term loans) due to the use of different data sources in the April 2007 notification compared to previous years. Deficit data have been revised in 2003 and 2004 due to the reclassification of expenditure between 2003 and 2004, to be in line with the accrual principle.

Data for all years (2003 onwards) are considered as half-finalized.

Deficit and debt methodology

In compiling the notification, ESA 95 has been used for the second time. It has however not been possible to make all adjustments needed to comply with ESA 95, such as full accrual recording, recording of guarantees according to ESA 95 and classification of units according to ESA 95. A project on government finance statistics was initiated with Croatia in the beginning of 2006 and is expected to be finalised at the beginning of 2008. Therefore, revisions of data and larger implementation of ESA 95 rules are expected for the

[1] The remainder of this section has been provided by Eurostat.

April 2008 notification. In the meantime, the EDP reporting is still partly based on the IMF methodology (GFS 2001).

The working balance in table 2A is based on ESA 95 and therefore includes no financial transactions. 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. Taxes are recorded on a pure cash basis, indicating partial non-compliance with Regulation 2516/2000 on the recording of taxes and social contributions.

In tables 3, no transactions were reported for "securities other than shares" except for local government in the year 2006. No sub-sectors hold any central government debt. The statistical discrepancy in table 3 has decreased in 2005 and 2006 compared to previous years, and according to the Croatian authorities this downwards trend will continue as data quality is expected to improve further.

Eurostat has identified one contentious issue, which relates to the so called "pensioners' debt repayment", originating from 1993-1998. The Croatian authorities have reported to Eurostat that an amount of 10.1 bn HRK (corresponding to 4% of GDP in 2006) should be allocated as government expenditure in 1998. Nevertheless, Eurostat believes that according to ESA 95 these amounts should be allocated to more recent years. Eurostat is currently investigating the issue in co-operation with the Croatian authorities.

Questionnaire related to the notification tables

Croatia has completed part of the requested tables. 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 has asked the Croatian authorities to change the way of recording of guarantees called, paid cash by government and of cash repayments to government. These amounts are today recorded as financial transactions, which is not in line with ESA 95. The implementation of the ESA 95 rule will marginally increase the deficit for 2003-2006. 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 does presently not comply with the Eurostat rules on the recording of Military expenditure. The table on *Public-Private-Partnerships, securitisation operations, and sale and leaseback transactions (table VII)* has not been filled.

Gross domestic product

Croatia has implemented the basic requirements of ESA 95 as to the methodology and definitions used. But there is still some way to go before reaching a satisfactory level of compliance.

4. Conclusions

Croatia's third fiscal notification shows a gradual reduction of the general government deficit between 2003 and 2006, driven by adjustments in the primary balance. The general government debt-to-GDP ratio has temporarily risen from around 41% in 2003 to 43.7% in 2005, but fell back to around 40% in 2006, due to a significantly lower primary balance and as a result of sizeable privatisation receipts. The further reduction of the deficit projected for 2007 seems rather ambitious and will require the implementation of fiscal consolidation measures, which may be difficult during an election year. The projected reduction in the debt-to-GDP ratio in 2007 may be hampered by the partial use of privatisation receipts to finance one-off payments to pensioners in the context of a debt redemption scheme.

With respect to the quality of the data submitted, a number of problems have arisen from the Eurostat assessment of the Croatian notification. However, as this is only the third time that Eurostat has analysed the Croatian figures, and as Eurostat has not yet provided any technical assistance on public finance statistics to Croatia, it is not possible to provide a full quality evaluation. It is also too early to make a proper assessment of the introduction of the ESA 95 methodology, even if the government finance statistics methodology of the IMF (GFS 2001) should provide a degree of assurance to the quality of the data. Due to the current problems identified in the assessment, notably concerning the recording of guarantees called, the implementation of the accrual principle and the recording of government expenditure in the context of the repayment of the "pensioners' debt", Eurostat will continue its bilateral contacts with the Croatian authorities in order to finally agree on these issues.

FISCAL NOTIFICATION OF THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

1. Key fiscal indicators reported

In their April 2007 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.

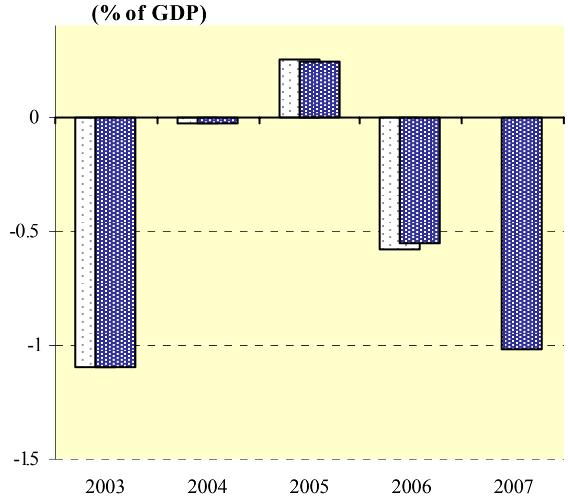
Table 1 - The former Yugoslav Republic of Macedonia: General government indicators and nominal GDP

% of GDP	Notifi-cation	2002	2003	2004	2005	2006	2007(1)
Net lending (+) / borrowing(-)	2007		**-1.1**	**0.0**	**0.2**	**-0.6**	**-1.0**
	2006	***-5.6***	***-1.1***	***0.0***	***0.3***	***-0.6***	
Primary net lending (+) / borrowing (-)	2007		**0.0**	**1.0**	**1.1**	**0.5**	**-0.1**
	2006		***0.0***	***0.8***	***1.2***	***0.5***	
Gross debt	2007		**42.9**	**40.0**	**46.9**	**39.4**	**32.1**
	2006	***43.0***	***39.0***	***36.6***	***40.9***	***35.6***	
Gross fixed capital formation	2007	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
	2006	***n.a.***	***n.a.***	***n.a.***	***n.a.***	***n.a.***	
Nominal GDP growth rate (%)	2007			**5.5**	**7.2**	**7.3**	**9.2**
	2006		***3.1***	***5.5***	***4.5***	***5.9***	

(1) planned

According to the notified data, the general government fiscal position improved in 2004 and 2005 close to balance after a deficit of 1.1% of GDP in 2003. In 2006, the deficit increased again, reaching 0.6% of GDP, while for 2007 a further increase in the deficit to 1.0% of GDP is planned. The main factors for the favourable fiscal performance in 2004 and 2005 were higher than expected tax revenues, while expenditures remained under control. In some areas, such as public investment, expenditures even remained below targets. As a result, the realised fiscal outcome was significantly better than planned. In 2006, the fiscal revenue remained largely favourable, despite lower than expected non-tax revenues, resulting from an expected but actually unpaid telecom dividend. Programmed expenditures remained below targets as well. However, in November 2006, the new parliament approved a supplementary budget envisaging additional spending of about 2% of GDP. Despite this additional spending, the overall deficit remained within

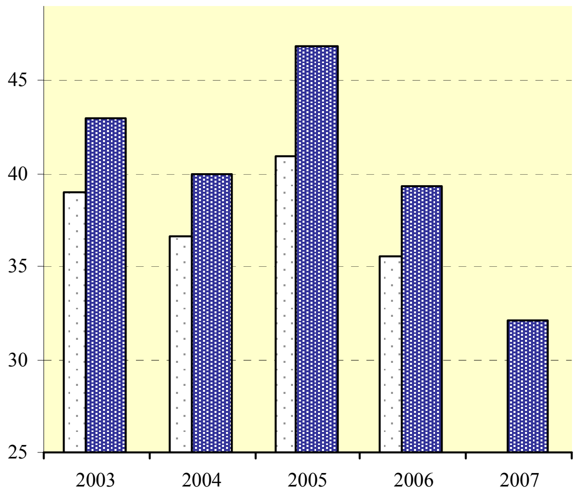
Chart 1: **The former Yugoslav Republic of Macedonia: General government net borrowing (-) (% of GDP)**



the 0.6% of GDP deficit target agreed with the IMF. The deficit target for 2007 is largely in line with the country's commitments towards IMF (see table 1).

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 2.2% - 2.6% during the reporting period. To some extent, the low interest rate level also reflects the high share of concessional financing through IFIs and bi-lateral donors. 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, an increase in the financing costs of the debt is likely. However, this increase in the financing costs is partly compensated by the decline in the absolute level of the debt stock. 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 is planned to be close to zero. The role of the primary balance for reducing the debt is shrinking accordingly.

Chart 2: **The former Yugoslav Republic of Macedonia: General government gross debt (% of GDP)**



The stock of general government gross debt declined during the reporting period from 42.9% of GDP in 2003 to 39.4% in 2006. In 2007, the debt ratio is planned to decline further to 32.1% of GDP. I n 2005, the debt ratio rose by nearly 7 percentage points of GDP. The main factor behind this increase has been the issue of € 150 Eurobonds at the end of 2005 in order to finance an early repayment of London Club debt scheduled for early 2006. As a result, the debt ratio dropped again by 7.5 percentage points of GDP in 2006. In 2007, the debt ratio is planned to decline by another 7.3 percentage points of GDP. To a certain extent, this reflects further early repayments of debt to foreign creditors. Compared to the 2006 notification, the debt profile of the 2007 notification is more than 3 percentage points of GDP higher than notified in 2006. The main reason for this upward revision is that in 2007, debt in foreign currency and deposits has been taken into account. As a result, the current reporting thus is more complete and accurate than the 2006 notification (chart 2).

Unfortunately – like in 2006 – the fiscal notification does not contain data on General government gross fixed capital formation.

Nominal GDP growth is reported to have accelerated markedly, increasing from 5.5% in 2004 to 7 ¼ in 2005 and 2006. In 2007, a further acceleration of nominal growth to 9.2% is planned. However, a significant share of this acceleration is due to higher increases in prices, while (registered) real GDP growth has even decelerated in 2005 and 2006.

The decomposition of the development of the debt ratio (table 2), indicates a significant increase in the debt ratio (by 6.9% of GDP) in 2005 and strong decline by more than 7 percentage points in 2006 and 2007.

The main contribution to this increase comes from the residual factor "other", mainly reflecting the Eurobond emission in late 2005. The primary surplus had a debt ratio reducing impact of 1.1 percentage points, while the "snow ball effect" (the net impact of interest payments and nominal GDP growth) had a debt reducing effect of 2.3% in 2005. Overall, the debt reducing effect of the primary balance and the snowball effect was slightly smaller than in 2005 (2.7 percentage points in 2006, compared to 3.0 percentage points in 2005). In 2007, the contribution of those factors will be slightly smaller (2.5 percentage points of GDP). However, like in 2006, the decline in the debt ratio will be mainly driven by "other" factors, such as the early repayment of outstanding debt (to foreign creditors). The contribution of the primary balance to the reduction in the debt ratio appears to decline from 1 percentage point of GDP in 2005 to close to zero in 2007, while the impact of stronger nominal growth on the debt reduction will increase, from some 2.7 percentage points of GDP to 3.3 percentage points in 2007.

Table 2 - The former Yugoslav Republic of Macedonia:
Contribution to changes in general government gross debt and gross debt ratio

	2005		2006		2007(1)	
	*GDP % pts**		*GDP % pts**		*GDP % pts**	
Change in gross debt ratio	+6.9		-7.5		-7.3	
to which contribution of ...						
• Primary balance	-1.1		-0.5		-0.1	
• Interest	0.8		1.0		0.9	
• nominal GDP growth	-2.7		-3.2		-3.3	
• Other	9.8		-4.9		-4.8	
	mio MKD	*% of GDP*	*mio MKD*	*% of GDP*	*mio MKD*	*% of GDP*
General government net borrowing	-697	-0.2	1,700	0.6	3,394	1.0
+ Other contributions (2)	27,942	9.8	-14,843	-4.9	-16,742	-5.0
= Change in general government gross debt	27,245	9.6	-13,143	-4.3	-13,348	-4.0
General government gross debt	133,317	46.9	120,174	39.4	106,826	32.1

* 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 2006 notification, the latest revision points to a stronger contribution of nominal growth in 2005 and 2006 to reducing the debt ratio. However, the increase in debt ration due to a more complete data set was also stronger than expected. As a result, the debt ratio in 2005 and 2006 appears to have been higher than reported last year.

Overall, the debt dynamics is driven by early repayments and nominal growth, while the contribution of the primary balance to lowering the debt ratio is on a declining trend. However, in view of the relatively high nominal growth, low implicit interest rates and the small size of interest payments of around 1% of GDP, the downward path of the debt ratio appears not to be at risk.

2. The macroeconomic context

During the last two years, the officially registered economic growth decelerated, declining from 4.1% in 2004 to 3.8% in 2005 and 3.1% in 2006. However, the reliability of this data is plagued by a significant share of unregistered economic activity. Alternative indicators point to a more favourable economic performance during the recent years. Weaknesses in the statistic system still impede the analysis of the development of aggregate demand components. During the last years, the main driving forces of the economy appear to have been exports and investment, while private and public consumption seem to have been subdued. With respect to economic sectors, the biggest contribution to registered growth came from manufacturing and trade.

Industrial production has increased by 7% in 2005, reached only to 2.5% in 2006 and accelerated again to a growth rate of 10% during the first 4 months of 2007. 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.

Inflation has been particularly low in 2004 and 2005, reflecting the impact of the country's accession to WTO, which resulted in a significant increase in trade liberalisation and a drop in agricultural prices. In 2006, higher energy prices and the need to align excise duties to EU levels brought inflation to 3.2%. However, during the first 4 months of 2007, consumer price inflation has dropped again to around 1%.

However, indications of low capacity utilisation rates in many sectors and particularly high unemployment rates of above 35% of the labour force point to unrealised growth potential of the economy. To some extent those statistics are inflated by persons, who work in the informal sector but register as unemployed in order to benefit from the social security linked to the status as unemployed. More realistic estimates point to a level of unemployment of about 25%, which is still very high.

Table 3 - The former Yugoslav Republic of Macedonia: Main economic trends

	annual averages	**2002**	**2003**	**2004**	**2005**	**2006**
Growth	GDP in real terms, change in %	0.9	2.8	4.1	3.8	3.1
Inflation	CPI, change in %	2.3	1.1	-0.4	0.5	3.2
Unemployment	official, % of labour force	31.9	36.7	37.2	37.3	36.0
Current account	balance, % of GDP	-9.5	-3.4	-7.7	-1.3	-0.4
Interest rate	Deposit 3 months, % p. a.	n.a.	n.a.	8.49	9.94	6.40
Exchange rate	MKD/EUR	60.98	61.26	61.32	61.30	61.19

Source: Reuters/Ecowin

External balances improved markedly in 2005, with a strong narrowing of the current account deficit from -7.7% of GDP in 2004 to -0.4% 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. 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.

At the end of 2006, the authorities of the former Yugoslav Republic of Macedonia emitted a 3-year government bond with a yield of 9.6% and started with the early redemption of the 5-year continuous bond. The exchange rate remained stable towards the euro, which helped to keep consumer price inflation low.

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. The first line shows the actual (and for 2007 planned) figures for the most prominent budget balance, which in the case of the former Yugoslav Republic of Macedonia is the central government budget balance.

Table 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)	697	0.2	-1700	-0.6	-3,394	-1.0

(1) planned

Line 2 of table 4 adjusts for the difference between the central government cash balance and the GFS 1986 net lending/net borrowing position of the central government. The size of adjustment is relatively low. Table 2A of the fiscal notification provides some information on granted and repaid loans, reflecting the financing transaction end of 2004 in order to repay external public debt. Unfortunately no further data has been reported on the transposition between the most prominent national budget concept and central government balance according to ESA 95

Regarding the other sectors of the general government, local governments were only established in June 2005, with the implementation of a fiscal decentralisation package. In the past, those entities were part of the central government. So far, no data on the fiscal activities of these local entities appears to be available. The social security notified minor deficits of 0.1% - 0.2% of GDP. However, a significant share of this sector's revenues and expenditures still seems to be recorded as being part of the central government.

4. Conclusions

The April 2007 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 about 1% of GDP. However, the 2007 notification points to a declining primary surplus and thus a diminishing contribution from the government balance to the debt reduction. However, 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 the alignment of the country's notification, which is based on GFS 1986 with the ESA 95 accounting standard. 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 he contribution of the deficit/surplus and other factors on the debt level (tables 2-4 of the fiscal notification).

FISCAL NOTIFICATION OF TURKEY

1. Key fiscal indicators reported

The main figures reported by the Turkish authorities to the European Commission in May 2007 (compared to the figures reported in March 2006) are shown in Table 1 and Charts 1 and 2.

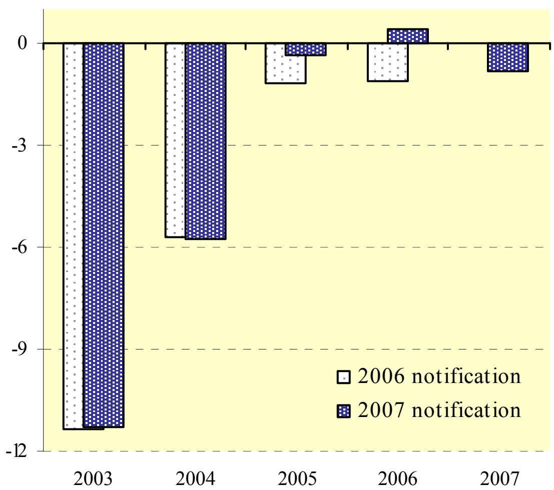
Table 1 - Turkey: General government indicators and nominal GDP

% of GDP	Notifi-cation	2001	2002	2003	2004	2005	2006	2007(1)
Net lending (+) / borrowing(-)	2007		**-12.9**	**-11.3**	**-5.8**	**-0.3**	**0.4**	**-0.8**
	2006	***-29.8***	***-12.9***	***-11.3***	***-5.7***	***-1.2***	***-1.1***	
Primary net lending (+) / borrowing (-)	2007		**7.1**	**5.9**	**5.9**	**8.8**	**8.0**	**7.0**
	2006	***-2.7***	***7.1***	***5.9***	***5.9***	***8.0***	***6.7***	
Gross debt	2007		**93.0**	**85.1**	**76.9**	**69.6**	**60.7**	**56.8**
	2006	***105.2***	***93.0***	***85.1***	***76.9***	***69.6***	***59.5***	
Gross fixed capital formation	2007		**5.1**	**4.1**	**3.6**	**4.3**	**4.2**	**4.4**
	2006	***5.3***	***5.1***	***4.1***	***3.6***	***4.3***	***4.2***	
Nominal GDP growth rate (%)	2007			**29.6**	**19.7**	**13.2**	**18.3**	**8.0**
	2006		***55.6***	***29.6***	***19.7***	***13.2***	***11.2***	

(1) planned

The 2007 notification illustrates robust fiscal consolidation until 2006 - which had started after the 2001 financial crisis – followed by mere stabilization in 2007 which could be driven by some financial turbulence in 2006 and 2007. The general government budget balance improved rapidly from a deficit of almost 30% of GDP in 2001 to a surplus of 0.4% of GDP in 2006. In order to improve the sustainability of public finances, the Turkish authorities have been targeting substantial primary surpluses, which were around or above 6% of GDP during most of the reporting period. Only in 2001, the very year of a major financial crisis, substantial expenditures to cover the losses of state banks led to a primary deficit of 2.7% of GDP. The fiscal consolidation experienced in 2006 stems chiefly from better than anticipated working balances in the central government, in part linked to the fall in real domestic interest rates. An important feature of Turkey's public finances is the high burden of interest payments. Since 2001, real domestic interest rates have been high, reflecting relatively high economic uncertainty and a tight domestic capital market. In addition, interest rates are closely related to exchange rate fluctuations and changes in market sentiment. The start of EU membership negotiations and the anchor provided by the

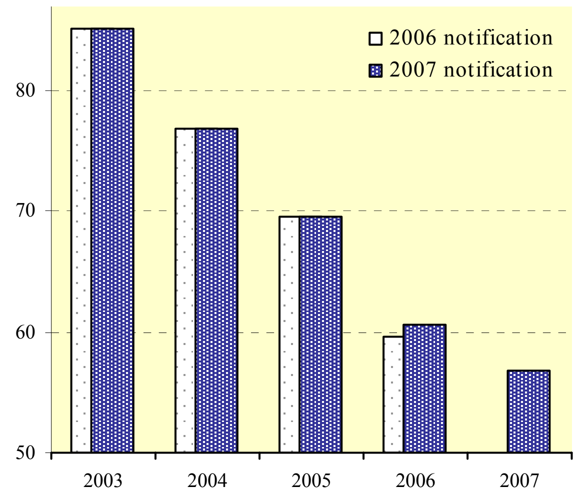
Chart 1 **Turkey: General government net borrowing (-) (% of GDP)**



IMF programme have enhanced macroeconomic stability. As a result, financing costs came down faster than anticipated in 2006. During the reporting period, the financing costs fell from 27.1% in 2001 to 7.6% in 2006. In 2006, the interest rate burden declined by 1.6% of GDP. For 2007, a very modest increase of just 0.3% to 7.9% of GDP is foreseen. Government gross fixed capital formation fell from 5.3% of GDP in 2001 to 3.6% of GDP in 2004. As from 2005, however, GFCF has been hovering around 4⅓% of GDP. Due to decreasing inflation, nominal GDP growth decelerated from 55.6% in 2002 to 13.2% in 2005. In 2006, in tandem with an acceleration in inflation, nominal growth increased by 5.1 percentage points to 18.3%. The disinflation expected in the second half of 2007 should reduce nominal GDP growth to 8%. In sum, recent volatility in nominal GDP growth mainly reflects changes in inflationary pressures, while real output growth remains strong.

A better alignment of the treatment of accrued interest with ESA 95 standards in the 2007 fiscal notification led to a improvement of the primary balance by respectively 0.8 percentage points in 2005 and 1.3 percentage points in 2006. Conversely, the primary surplus is expected to fall by 1 percentage point in 2007. This appears slightly at odds, given that the government continues to adhere to the 6.5 % of GNP primary surplus target agreed upon with the IMF (using GFS methodology), but can partly be explained by a different treatment of privatization proceeds in these methodologies.

Chart 2 **Turkey: General government gross debt (% of GDP)**



After the sharp increase of government debt in the 90s to 105.2% in 2001, the debt-to-GDP ratio has been declining to 69.6% in 2005 and 60.7% in 2006. For 2007, a further reduction in the debt ratio by 10.1 percentage points is planned, to 56.8% of GDP (Chart 2).

Table 2 takes a closer look at the factors behind the debts 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 and all other factors. During 2005-2006, the debt-to-GDP ratio declined substantially, by over 7 percentage points annually. In 2007 a further - albeit a much smaller - reduction by 3.9 percentage points is expected. The most noteworthy aspect in this context is the declining 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 cumulative 0.3 percentage point in 2004. In 2006, however, this category is expected to have a strong decreasing impact on the debt ratio of about 3 percentage points. The main underlying reason for this development is the sharp rise in nominal GDP growth due to increasing inflationary pressures. As a result, the net effect of nominal GDP growth and interest rate will change from a debt-increasing factor in 2005 to a debt-decreasing factor in 2006. In a context of renewed disinflation, projections for 2007 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 7% throughout the reported period.

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 2005 the most significant items in this group have been equities 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 raised debt by 18.2 percentage points of GDP in 2001 and by 6.2 percentage points in 2002. In 2003-2005, the appreciation of the currency decreased the debt by roughly 1.5% points per annum. Preliminary indicators for 2006 point at a debt increase by 1.5% of GDP as a result of the depreciation of the TRL. Issuances below par increased debt by around 3% of GDP in 2005-2006. Besides the general government net borrowing, this was the most important single factor for the change in the general government debt. Finally, statistical discrepancies increased the debt by around ½% of GDP in 2006, which represents a significant improvement compared with the 2.5% in 2005.

Table 2 - Turkey:
Contribution to changes in general government gross debt and gross debt ratio

	2005		**2006**		**2007(1)**	
	*GDP % pts**		*GDP % pts**		*GDP % pts**	
Change in gross debt ratio	-7.3		-8.9		-3.9	
to which contribution of ...						
• Primary balance	-8.8		-8.0		-7.0	
• Interest	9.2		7.6		7.9	
• nominal GDP growth	-8.9		-10.8		-4.5	
• Other	1.3		2.2		-0.2	
	mio. TRY	*% of GDP*	*mio. TRY*	*% of GDP*	*mio. TRY*	*% of GDP*
General government net borrowing	1,638	0.3	-2,400	-0.4	5,086	0.8
+ Other contributions (2)	6,340	1.3	12,887	2.2	-1,287	-0.2
= Change in general government gross debt	7,978	1.9	10,487	2.2	3,799	0.7
General government gross debt	339,069	69.6	349,556	60.7	353,355	56.8

* 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

In 2005, the general government deficit amounted to 0.3% of GDP, while other adjustments accounted for 1.3% of GDP. In 2006, the impact of other adjustments on the debt level rose to 2.2% of GDP, while the general government sector recorded a surplus of 0.4% of GDP. In 2007, the Turkish authorities expect a deficit of 0.8% of GDP, while other adjustments affecting the debt level are expected to contribute slightly negatively to the change in the debt stock, namely by 0.2% of GDP. The notification would have benefited from an explanation of the underlying factors. Overall, however, the notified data indicate a continuous decline of all debt relevant factors, with the notable exception of the 2006-2007 developments in the other contributions.

2. The macroeconomic context

The 2001 financial crisis dramatically affected Turkey's public finances. As observed in Table 3, output growth rebounded strongly and constantly in the subsequent years. Inflationary pressures declined significantly up to 2005. Since early 2006 inflation has stabilized at levels of around 10%. The sharp output contraction in 2001 led to a marked increase in unemployment, rising from 6.6% of the labour force in 2000 to over 10% in 2002-2006. So far, the robust 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 is still relatively small. The current account balance moved from a surplus of 2.4% of GDP in 2001 gradually to a deficit of 7.9% of GDP in 2006. Although foreign direct investment inflows have picked up considerably since 2005, the current account deficit has been largely financed by short-term capital inflows, attracted by relatively high interest rate differentials.

Table 3 - Turkey: Main economic trends

	annual averages	**2002**	**2003**	**2004**	**2005**	**2006**
Growth	GDP in real terms, change in %	7.9	5.8	9.0	7.4	6.1
Inflation	CPI, change in %	45.0	21.6	8.6	8.2	9.6
Unemployment	official, % of labour force	10.4	10.5	10.3	10.2	9.9
Current account	balance, % of GDP	-0.8	-3.3	-5.2	-6.3	-7.9
Interest rate	Deposits weighted average 3 months, % p. a.	50.49	37.68	24.26	20.40	21.65
Exchange rate	TRY/EUR	1.43	1.69	1.77	1.67	1.80

Source: Reuters/Ecowin

Despite relatively weak growth in disposable income and relatively high unemployment, the Turkish authorities managed to achieve substantial primary surpluses. They have increased revenues by raising tax rates and reduced 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 overall impact of these measures, a comprehensive monitoring seems advisable, in particular since elections are due in 2007.

3. Methodological issues

Main challenges

The incorporation in the April 2007 EDP notification of information on acquisition of central government securities by both local government and social security funds has improved the EDP tables 3D and 3E, and reduced the discrepancy in particular in social security funds. However, the calculation of the stock/flow adjustment for these two sub-sectors remains incomplete due to lack of data.

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 2007 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 1% 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 2007, 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 1.1 and 1.9 percentage points lower than the deficit based on the national definition. In 2007 the deficit reducing impact is expected to rise to 1.9% of GDP, up from 1.1% in 2006 and 1.4% in 2005.

Table 4 - Turkey:

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

	2005		**2006**		**2007(1)**	
	mio. TRY	*% of GDP*	*mio. TRY*	*% of GDP*	*mio. TRY*	*% of GDP*
Most prominent national budget balance	-8,117	-1.7	-3,995	-0.7	-16,827	-2.7
+ adjustment to central government net lending	1,507	0.3	-655	-0.1	4,705	0.8
= Central government net lending (S.1311)	-6,610	-1.4	-4,650	-0.8	-12,122	-1.9
+ Local government net lending (S.1313)	397	0.1	445	0.1	426	0.1
+ Social security net lending (S.1314)	4,575	0.9	6,606	1.1	6,609	1.1
= General government net lending (S.13)	-1,638	-0.3	2,400	0.4	-5,086	-0.8

(1) planned

As regards other sectors of the general government, the main impact on the overall balance comes from the social security institutions, reducing the general government net lending by roughly 1% of GDP during 2005-2007. Local governments have only a very limited impact on the ESA95 general government deficit.

Stability of data[2]

Data have been provided for the years 2003-2006 as well as planned figures for 2007. As compared with the April 2006 notification, there have been revisions of the data, especially to general government deficit (net borrowing) for 2005-2006, mostly due to revisions in the

[2] The remainder of this section has been provided by Eurostat.

central government sub-sector. The figures for local government and social security funds have been revised to a very limited extent.

The general government deficit (net borrowing) was revised upwards by less than 0.1% of GDP in 2003 and downwards by less than 0.1% of GDP in 2004. The most significant revision was made to the deficit for 2005, upwards by 0.8 % of GDP (from 1.2% to 0.3%[3]). These revisions are mostly due to revisions of the working balance and of other accounts receivable in central government. For 2006, the general government balance was changed from a forecast of deficit of 1.1% of GDP in April 2006 to a surplus of 0.4% of GDP reported in April 2007. The main factor was an improvement for central government, resulting from a better than expected public accounts (working balances).

The debt figures for years 2003-2004 have not been revised at all; the figure for 2005 has been revised to a very limited extent (0.01% of GDP). However the forecasted figure for 2006 has been changed by 4.67 % of GDP. Compared to the previously notified data, the GDP figure for 2006 has been noticeably changed vis-à-vis the forecast submitted in April 2006.

The Turkish data are labelled as "finalized" for years 2003-2005 and as "half finalized" for year 2006. Due to the changes in data requested by Eurostat, the Turkish authorities submitted three fiscal 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 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 four extra-budgetary funds reporting significant surpluses of 0.3% of GDP each year on average.

Sectorization and the calculation of net borrowing (-) / net lending (+) of the regulatory and supervisory agencies as well as revolving funds need to be further investigated, as Eurostat has not received complete information.

In the Turkish notification, the transition from the 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.

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[3] 0.1% of GDP accounts for rounding.

The sectorization of some of the units included in local government needs to be further clarified as it seems that the market / non-market character of those has not been tested.

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.

The incorporation in the April 2007 EDP notification of information on acquisition of central government securities by both local government and social security funds has improved the EDP tables 3D and 3E, and reduced the discrepancy in particular in social security funds. However, the calculation of the stock/flow adjustment for these two sub-sectors remains incomplete due to lack of data.

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 is 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 for future 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 recorded as financial transactions. The recording of guarantees and of military expenditure with respect to compliance with ESA 95 rules need clarification and their impact on the deficit are issues to be further investigated. At present 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. For 2003 to 2005, a noticeable negative foreign exchange impact (i.e. reducing the debt, corresponding to an appreciation of the currency) was reported, whereas for 2006 a positive impact was recorded (depreciation). There are no swaps in Turkey.

Statistical discrepancies

Compared to the 2006 notification, the statistical discrepancies have been reduced. Eurostat provided guidance for correct recording of holding of government bonds by social security funds, and requested a new EDP notification, which led to improvement in the EDP reporting and reducing statistical discrepancy. The 2007 notification shows an average annual discrepancy of 0.15% of GDP for 2003-2006. However, yearly discrepancies remain large. The highest positive discrepancy is reported for 2005 (0.85% of GDP). Scope for further improvement lies in completing the information on stock/flow adjustment by subsector.

Questionnaire related to the 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). 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, superdividends and privatisations (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

Turkey has implemented the basic requirements of ESA 95 as to the methodology and definitions used. However, there is still scope for improvement to reach a satisfactory level of compliance.

4. Conclusions

The 2006 fiscal notification illustrates the successful efforts made in Turkey since 2001 in correcting fiscal imbalances and improving the quality of the fiscal monitoring. Until 2005 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 reduced 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 a growing importance of the adherence to significant primary surpluses and of a further reduction of financing costs.

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 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 project between the ESA 95 GFS reporting and the IMF GFS reporting is ongoing. In this context, Member States have 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.