Turkeys Public Finances: Time for a Fiscal Policy Pivot?

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New World Bank report recommends shift to more sustainable growth model
The World Bank today launched a new report, Turkey in Transition: Time for a Fiscal Policy Pivot?, at a conference held in Ankara in partnership with the Ministry of Finance and the Ministry of Development.
The report documents the central role played by fiscal policy over the last decade in supporting initial macroeconomic adjustment and creating the space for rapid economic progress and improved social outcomes. However, it argues that fiscal policy needs to adjust to support the increase in national savings, reduce the reliance on cyclically volatile consumption-based taxes, and, in turn, lay the foundation for sustained growth in the coming period.
According to the report, over the past decade, Turkeys prudent fiscal policy was supported by structural changes in the economy. In the aftermath of the 2001 banking crisis, expenditure restraint helped contain fiscal deficits. Revenue growth was supported by a compositional change in revenues from direct to indirect - or consumption-based - taxation. With declining informal employment as agricultural labor shedding gathered pace, increases in social contributions also boosted revenues.
The report notes that rising government revenues and the dramatic reduction in interest payments made room to increase social expenditures - by about 5 percentage points of GDP. Health and pension expenditures dominated the rise in government spending and help explain better the social outcomes observed over the period.
The consolidation of public finances also helped the country attract greater international capital flows, reinforcing the decline in interest rates and fuelling private sector growth. However, the report says that the access to cheap global liquidity also precipitated a trend decline in domestic savings and a corresponding increase in external imbalances.
According to the report, the dynamics of fiscal outcomes and private investment and savings in Turkey raise a series of tradeoffs for policy going forward. The recommendations in the report include: (i) shifting spending towards public investment, and restraining growth in current spending to establish a growth model less dependent on debt-financed consumption; (ii) shifting from consumption-based taxes to higher effective capital taxation, which will enable Turkey to grow faster with higher domestic savings and continued fiscal prudence; (iii) finding alternative sources of revenues, such as broadening of the tax base and taking structural measures to boost employment creation, perhaps combined with expenditure cuts, to offset the diminishing incremental revenues from structural change; and (iv) increasing the female labor force participation rate to continue to support general government revenues as more women come into the formal labor market.

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