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The Effects of Fiscal Policy Rules on Fiscal Balance: The Perspectives on Turkish Economy

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Maliye Politikası Kurallarının Mali Denge Üzerindeki Etkileri: Türkiye Ekonomisine Bakış

Abstract

In public finance theory fiscal rules have been one of the main stabilization tools in obtaining budget balance and public finance balance. Many developed and developing countries have implemented specific fiscal policy rules so as to struggle with domestic distortions in economy. Balanced budget or deficit rules, borrowing rules and debt or reserve rules have been the most important rules that have been implemented in specific countries. A fiscal rule should ensure the solvency of the state, contribute to sustainability of fiscal policies by avoiding pro-cyclical behavior of the fiscal policy instruments and be simple and credible so as to be implemented effectively. In Turkish economy a specific form of a fiscal rule has been implemented since 2000 economic crisis. During 2000-07 period the Governments used a specific form of fiscal policy rule –non-interest budget surplus of 6,5 percent- so as to reduce instability. Although strict fiscal policies based on this target helped public finance balance to improve, they led private investments to decrease and unemployment rates to increase in the long run.

Key Words : Fiscal Policy Rules, Public Finance Balance, Non-interest Budget Surplus.

JEL Classification Codes : H62, H68, K00.

Özet

Kamu maliyesi teorisinde mali kurallar, kamu mali dengesinin sağlanmasında temel araçlardan biri haline gelmiştir. Gelişmiş ve gelişmekte olan pek çok ülke ekonomideki istikrarsızlıklarla mücadele etmek için spesifik maliye politikası kurallarını yürürlüğe koymuşlardır. Denk bütçe veya bütçe açığına yönelik kurallar, borç stoku veya rezerve yönelik kurallar çeşitli ülkelerce yürürlüğe konulan en önemli kurallardır. İdeal bir mali kural iyi tanımlanmalı, şeffaf, basit, esnek olmalı, makroekonomik politikalarla uyumlu ve de etkin politika çalışmaları tarafından desteklenir olmalıdır. Türkiye ekonomisinde spesifik bir mali kural 2000 ekonomik krizinden bu yana yürürlüktedir. 2000–2007 yılları arasında Hükümetler istikrarsızlıkla mücadelede spesifik bir mali kural olarak % 6,5 oranındaki –faiz dışı bütçe fazlası- kuralını benimsemişlerdir. Belirli hedef üzerine odaklanan kuralcı mali politikalar kamu mali dengesinin sağlanmasına yardım etse de, uzun dönemde özel yatırımların azalmasına ve işsizliğin artmasına da yol açabilmektedir.

Anahtar Sözcükler : Maliye Politikası Kuralları, Kamu Mali Dengesi, Faiz Dışı Bütçe Fazlası.

1. Introduction

In macroeconomic theory, fiscal policy is an efficient instrument in achieving macroeconomic aims such as economic stabilization, economic growth and development. Especially, in achieving public finance balance in view of economic stabilization, some restrictive fiscal instruments –such as fiscal rules- gain importance. Because these rules have been used to ensure macroeconomic stability in both domestic and foreign markets, to enhance the credibility of the government's fiscal policy and aid in deficit elimination and to ensure long-term sustainability of fiscal policy. Many legal arrangements and other law, such as international contracts, budget plans, medium-term fiscal plans and policy rules form the legal framework of a fiscal rule. A fiscal rule should ensure the solvency of the state, be simple and credible and avoid pro-cyclical behavior of the fiscal policy instruments especially in the long run. In developing countries these restrictive fiscal instruments especially fiscal rules have been used respectively so as to achieve fiscal balance and economic stabilization.

In public finance theory fiscal rules have been one of the main stabilization tools in struggling with budget deficits and public finance imbalances. Many developed countries such as United States, Canada and Germany have implemented specific fiscal policy rules and used strict fiscal policies according to the constraints that have been based on these rules. Like the other countries Turkey has been using a fiscal policy rule since the beginning of 2000's. Especially after 2000 crisis, Turkish economy has entered a depression process together with high inflation. High budget deficits, domestic price increases, high domestic and foreign debt burden together with high interest rates triggered instability especially in public finance and economy as a whole.

During 2000-07 periods with 2000 Stabilization Program, 2001 Transition to Strong Economy Program (TTSEP) and 2003 Stabilization Program the Governments tried to reduce public finance deficits and high inflation rate by using strict fiscal policies. Here, one of the main targets of the stabilization programs is a specific fiscal rule -the budget rule-. In all programs the fiscal rule has been implemented in the form of non-interest budget surplus of 6,5 percent. The fiscal policies have been used strictly so as to achieve this non-interest budget surplus. The results of the implementation have been positive especially in public finance balance in the short run. High budget deficits and as a result high inflation have been reducing to stable: levels and price stability has been achieved.

However continuing to use restrictive policies so as to maintain fiscal discipline and price stability caused unemployment rates to increase and private investments to decline which is the disadvantage of these strict policies. The government insisted on using the budget rule so as to maintain public finance balance results a recessionary process in real sector.

In this paper in the first section the theory of fiscal rules will be analyzed. Here the definition and the methods of fiscal rules will be determined. Budget rules and the characteristics of an ideal fiscal rule will be examined. In the second section the implementation of budget rules (balanced budget rule) and their economic effects in specific countries (United States, Canada and Germany) will be analyzed. In the third section the implementation of budget rule - non-interest budget surplus of 6,5 percent- in Turkish economy after 2000 crisis and the effects of this rule on public finance balance and economy as a whole will be examined.

2. Theory of Fiscal Rules

Most developing countries have encountered public finance imbalances (high budget deficits, law tax revenues, high public expenditures, etc.) since mid-1980. So as to struggle with these problems fiscal rules have been considered important fiscal instruments especially in achieving budget balance. The governments tried to reduce especially the deterioration in public finance balance and price levels in domestic economy by using strict fiscal policies based on specific fiscal policy rules.

2.1. Definition

The literature on ‘‘fiscal frameworks’’ has expanded rapidly in the past few years, possibly owing to the introduction of the Stability and Growth Pact (SGP) in Europe, the adoption of the ‘‘golden rule’’ in the United Kingdom, and the implementation of various fiscal rules and fiscal responsibility laws in many countries (Manasse, 2007: 455).

A fiscal policy rule is defined, in a macroeconomic context, as a permanent constraint on fiscal policy, typically defined in terms of an indicator of overall fiscal performance. The rules under consideration cover summary fiscal indicators, such as the government deficit, borrowing, debt, or major components thereof –often expressed as a numerical ceiling or target, in proportion to gross domestic product (GDP) (Kopits-Symansky, 1998: 2). It’s possible to consider the fiscal rules –in definition- below in detail (See Table: 1):

Table: 1
Major Types of Fiscal Policy Rules

Balanced budget or deficit rules:
- Balance between government revenue and expenditure (i.e., prohibition on government borrowing), or limit on government deficit as a proportion of GDP.
- Balance between structural (or cyclically adjusted) revenue and expenditure, or limit on structural (or cyclically adjusted) deficit as a proportion of GDP.
- Balance between current revenue and current expenditure (i.e., borrowing permitted only to finance capital expenditure).
Borrowing rules:
- Prohibition on government borrowing from domestic sources.
- Prohibition on government borrowing from central bank, or limit on such borrowing as a proportion of past government revenue or expenditure.
Debt or reserve rules:
- Limit on stock of gross (or net) government liabilities as a proportion of GDP.
- Target stock of reserves of extra budgetary contingency funds (e.g., social security funds) as a proportion of annual benefit payments.

Source: Kopits &Symansky, 1998: 2.

Fiscal rules have gained great importance since 1970’s when Bretton Woods collapsed with an increase in the role of public sector in economy. Since then although governments have started to intervene economy with the aim of encouraging private sector, the share of public sector –and as a result of public expenditures- increased so rapidly that public sector crowded out private sector instead. As public revenues –especially taxes- have not been collected sufficiently enough to cover public expenditures, public deficits started to increase rapidly. Governments had to use debt policy so as to cover the deficits because of the lack of tax revenues which led a vicious circle of debt-interest payment-budget deficits as a consequence of public finance balances deteriorated. Many economists recommended fiscal policy rules –specific fiscal instruments- so as to achieve fiscal discipline and obtain public finance balance. Many countries preferred to use fiscal policy rules to obtain their public finance balances and maintain fiscal discipline (Günay, 2007: 86–87).

In practice, fiscal rules have been adopted for a wide variety of reasons, such as (Kennedy-Robbins, 2001: 3);

- to ensure macroeconomic stability, as in post-war Japan;
- to enhance the credibility of the government’s fiscal policy and aid in deficit elimination, as in some Canadian provinces;
- to ensure long-term sustainability of fiscal policy, especially in light of population ageing, as in New Zealand; or

- to minimize negative externalities within a federation or international arrangement, as in the European Economic and Monetary Union.

Here the main aim seems to ensure macroeconomic stability and coordination of fiscal and monetary policies in both domestic and foreign markets.

2.2. The Methods of Arrangement

The budget rule is used in many different ways especially in developing countries. The methods of arrangement differ according to the tools of fiscal policy –taxes and expenditures- and of debt policy.

2.2.1. The Tolls of Fiscal Policy Rules

The statutory basis of existing and proposed fiscal rules can be found in a variety of instruments: constitution, law, regulation, policy guideline, or internationally treaty. The instrument selected by a given country is largely a function of custom, legal precedent, or convention. Although a constitutional provision or amendment would be expected to carry much greater weight than a law or a policy guideline, the latter may in fact be equally or even more binding (Kopits-Symansky, 1998: 8).

Countries using fiscal policy rules according to various legal arrangements are listed below (see Table: 2). Countries have used these rules in a specific period and removed later or continued to use till today.

As seen in Table: 2, fiscal policy rules having been implemented in various countries have been arranged in different legal ways. In practice the legal arrangements that the fiscal policy rules have been based on gain importance especially in developing countries. Various legal arrangements and other law, such as international contracts, budget plans, medium-term fiscal plans and policy rules such as specific monetary and fiscal policy rules (inflation-targeting and budget-surplus rules) form the legal framework of a fiscal rule.

2.2.2. Characteristics of An Ideal Fiscal Policy Rule

Fiscal rules should have specific characteristics so as to be effective to achieve the aim of economic stability. Otherwise these rules can not give the necessary support to other economic stability and as a result the optimal relationship between aims and tools of fiscal policy can not be obtained causing serious problems in economy, especially in public finance (Günay, 2007: 99).

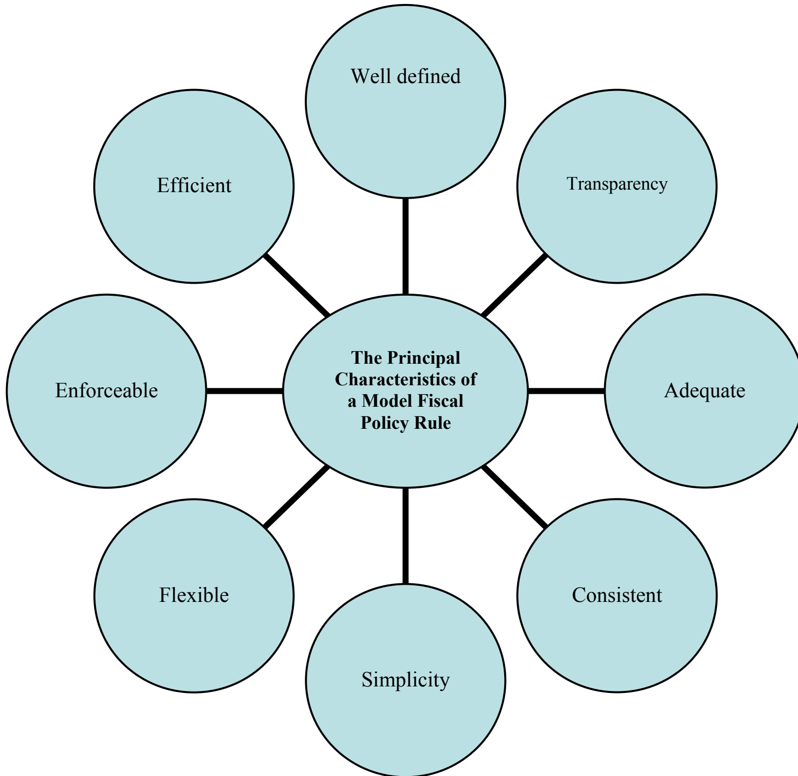
Table: 2
Fiscal Policy Rules in Selected Countries

	Target or Ceiling	Effective Period	Statutory Instrument	Government Level	Penalty for Noncompliance
Netherlands	Structural deficit limit	1961–74	Government policy	Central government	Reputational
Members of European Union	Medium-term overall balance Yearly deficit limit (3 percent of GDP)	Since 1997	International treaty	General government	Reputational Financial (from 1999)
United States	Yearly overall balance	Proposal	Constitutional amendment	Federal government	Judicial
Costa Rica	Yearly deficit limit (1 percent of GDP)	Proposal	Constitutional amendment	Public Sector	Judicial
Switzerland	Cyclically adjusted balance	Proposal	Constitutional amendment	Federal government	Reputational
New Zealand	Medium-term operating balance	Since 1994	Legal provision	Public Sector	Reputational
Germany	Yearly current balance	Since 1949	Constitutional amendment	Federal and sub-national governments	Judicial
Japan	Yearly current balance	1946–75 and proposed from 2003	Legal provision	Central government	Judicial
United States	Yearly current balance	Various	Constitutional amendment	Sub national governments	Judicial
Canada	Overall balance or deficit limit	Since 1993	Legal provision	Sub national governments	Judicial
Indonesia	No domestic borrowing	Since 1967	Government policy	General government	Reputational
European Union members	No borrowing from central bank	Since 1994	International treaty (Stage 2 of EMU)	General government	Judicial
Argentina, Canada, Chile, Ecuador, Hungary, Japan, Peru, United States	No borrowing from central bank	Various	Various	General government	Judicial
CFA franc zone members	Borrowing from central bank limited to 20 percent of last year's revenue	Since 1973	International treaty	General government	Financial
Brazil, Egypt, Morocco, Philippines, Slovak Republic	Borrowing from central bank limited as fixed proportion of last year's revenue	Various	Various	General government	Judicial or reputational
Members of European Union	Gross debt limit (60 percent of GDP)	Since 1997	International treaty (Stage 3 of EMU)	General government	Judicial

Source: Kopits & Symansky, 1998: 3.

According to Kopits and Symansky (1998), an ideal fiscal rule should have eight basic characteristics for describing "ideal". Ideally, a fiscal rule should be well defined, transparent, adequate, consistent, simple, flexible, enforceable, and efficient. In any case, the rule should, preferably, be fully adopted following a process of convergence. Here the principal characteristics of a model can be defined (see Shape 1).

Shape: 1
The Principal Characteristics of a Model Fiscal Policy Rule



It's useful to define these characteristics (Kopits-Symansky, 1998: 18-19):

a. Well defined: A fiscal rule should be well defined as to the indicator to be constrained, the institutional coverage, and specific escape clauses, in order to avoid ambiguities and ineffective enforcement.

b. Transparency: An essential characteristic of a durable fiscal rule is transparency in government operations, including accounting, forecasting, and institutional arrangements.

c. Adequate: Fiscal rules should be adequate with respect to the specified proximate goal.

d. Consistent: A closely related criterion is for a set of fiscal rules to be consistent internally, as well as with other macroeconomic policies or policy rules. For example; a fixed nominal exchange rate should be accompanied by an explicit restriction on monetizing budget deficits.

e. Simplicity: Rules should be characterized by simplicity to enhance their appeal to the legislature and to the public.

f. Flexible: Rules must be flexible to accommodate exogenous shocks beyond the control of the authorities.

g. Enforceable: A fiscal rule should be enforceable. Country experience indicates that institutional arrangements, including penalties, vary widely across countries without a clear pattern as to which arrangement is the most effective. An implication is the need for constitutional or legal statues, possibly accompanied by penalties for noncompliance and authority for enforcement, that are most appropriate for each country.

h. Efficient: Most rules cannot last for long unless they are supported by efficient policy actions. From this perspective, a fiscal rule may be viewed as a catalyst for fiscal reforms that would be necessary anyway to ensure sustainability.

According to the Buchanan and Wagner (1977); there are several qualities that any (such) rule must possess if it is to be effective. Firs of all, it must be relatively simple and straightforward, capable of being understood by members of the public. Highly sophisticated rules that might be fully understood only by an economists' priesthood can hardly qualify on this count alone. Secondly, an effective rule must be capable of offering clear criteria for adherence and for violation. Both the politicians and the public must be able readily to discern when the rule is being broken. Finally, and most importantly, the fiscal rule must reflect and express values held by the citizenry, for then adherence to the precepts of the rule may, to some extent, be regarded as sacrosanct. These three basic qualities add up to a requirement that any effective budgetary rule must be understood to "make sense" to the ordinary voter (Buchanan-Wagner, 1977: 183).

Main characteristics of an ideal fiscal rule are defined. Besides in a monetary union, an ideal fiscal rule should have some other important characteristics together with the ones above (Buiter, 2003: 98):

a. be simple;

b. ensure the solvency of the state;

c. relate to the consolidated general government and central bank;

d. be neutral as regards the size of the public sector;

e. avoid pro-cyclical behaviour of the fiscal policy instruments;

f. make sense also in the long run;

g. allow for important differences in economic structure and initial conditions;

e. aggregate into behaviour that makes sense at the level of the union as a whole;

h. be credible and

ı. be enforced impartially and consistently.

2.2.3. Budget Rules

The best known fiscal policy rules are those involving balance between government revenue and expenditure. This can be specified as the overall balance, the current balance, or the operating balance to be met each fiscal year. Alternatively, it can be defined over a longer period, in terms of a structural balance or a cyclically adjusted balance (Kopits-Symansky, 1998: 24). These definitions determining the budget balance can be analyzed in detail below (See Table: 3).

Table: 3: Alternative Definitions of The Budget Balance

Fiscal Indicator	Definition
1. Conventional budget balance	= Expenditure - Income
2. Total budget balance without grants	= Conventional balance (1) – grants
3. External budget balance	= govt expenditures – receipts (externally financed)
4. Domestic budget balance	= total balance – external balance
5. Primary budget balance	= total balance – interest payments
6. Operational budget balance	= primary balance + real interest payments)
7. Current budget balance	= current revenue – current expenditure
8. Consolidated budget balance	=Central + decentralized government balances
9. Cyclically neutral budget balance	= Expenditures – cyclically adjusted
10. Cyclically adjusted budget balance	= total balance – cyclically neutral balance
11. Benchmark budget balance	= normative year balance (as predetermined)
12. Structural budget balance	= cyclical effect of budget + benchmark balance
13. Full employment budget balance	= full employment exp. – full employment revenue
14. Liquidity budget balance	= total balance – net loans
15. Weighted budget balance	= weights allocated according to the importance of operational variables

Source: Jacobs, Schoeman, van Heerden, 2002: 5.

The most important budget rule is “balanced budget rule”. A country that implements the balanced budget rule can choose any of the alternatives above that describe budget balance as a target.

Like the other budget rules, balanced budget rule can be implemented in various ways (restrictions on debt, taxation and expenditure policies of the government). In budget procedure balanced budget rules can be classified in three main steps. The first step is the necessity of presenting the balanced budget proposal to the Parliament, the second step is the necessity of approving the balanced budget by the Parliament and third step is the necessity of achieving the balanced budget rule in practice. So as to be effective in practice the balanced budget rule should contain the following characteristics (Moğol, 2000: 423–424).

a. The rule should be constitutional rule,

b. It’s should necessitate year-end balance in the budget,

c. The scope of the rule should be wide enough to take the necessary measures in advanced, when a budget deficit occurs,

d. And it should contain some specific sanctions for the ones that do not.

Analyzing the country cases, it can be seen that the balanced budget rules that have been taken into force in both constitutional and legal framework differing various ways. For instance; while some countries necessitate the budget balance in the end of the year, some others necessitate general equilibrium in economy. Besides some countries give importance to balance the current budget while others to balance the general budget and the budget tried to be balanced in terms of both current year budget and capital budget (Günay, 2007: 121). Here the choice of the budget process is important.

3. Balanced Budget Rules in Practice: Specific Country Cases

In many countries balanced budget rules have been taken into force in legal or constitutional framework so as to obtain and maintain fiscal discipline. These countries vary in a large extent containing both developed countries such as USA, Canada, Germany and developing countries such as Latin America (Argentina, Peru, and Chile), Moldavia, Serbia, Latvia, Azerbaijan.

3.1. United States of America

In the Unite States a federal state, many important steps have taken to implement the constitutional balanced budget rule in both federal and federate

governments. In this country the balanced-budget amendment to the constitution, proposed on several occasions (in 1982, 1995, and 1997) but so far rejected, would require the government to balance the federal budget each fiscal year. The rule could be waived only by a three-fifths majority of each house of Congress or in the case of an armed conflict or a threat to national security (Kopits-Symansky, 1998: 25).

Sub national levels of government in the United States are subject to the so-called golden rule: current revenue and current spending must balance each fiscal year. Nonbank borrowing is permitted to finance investment projects under certain well-defined conditions. In the United States, all state governments (with the exception of Vermont) follow the current balanced-budget rule under varying degrees of stringency. Whereas in certain U. S. States it is sufficient to enact a balanced budget, in others it is also necessary to implement it. A number of states do not permit carryover of unspent appropriations or of payables from one fiscal year to the next to meet the rule. Some states prescribe the creation and utilization of contingency reserves, and most states impose various kinds of limits on the amounts and types of debt that may be issued (Kopits-Symansky, 1998: 25).

In Table: 4 the states where the balanced budget rule is implemented and the legal framework that this rule is based on in USA is analyzed. Constitutional restrictions are denoted by “C” while legal restrictions by “L”. In many states in USA balanced budget rule is implemented. Except Vermont in all states a kind of balanced budget rule is taken into force.

3.2. Canada

In Canada a constitutional balanced budget rule in federal government has not been implemented yet. However the government has aimed to help the public finance management to function properly and to control public expenditures by making laws such as Public Finance Management Law and Public Expenditure Control Law. Here the main target is obtaining fiscal discipline.

More recently, at the sub national level, in Canada, six provincial governments (Alberta, Manitoba, New Brunswick, Nova Scotia, Quebec, and Saskatchewan) and two territories (Northwest and Yukon) have enacted balanced-budget rules. They range in stringency from requiring actual overall balance or limiting deficits (equivalent to 1 percent of expenditures or revenues) each year to prescribing current balance over a four- or five –year period. Escape clauses, permitting deficits, can be invoked in the event of an emergency or disaster (or in one case, a significant revenue fall beyond the control of the authorities). Some governments are required to observe the rule only on an ex ante basis; for others, the obligation extends to realized budget outcomes as well (Kopits-Symansky, 1998: 25).

Table: 4
Balanced Budget Rules in The U.S. States

State	Gov. Submits Balanced Budget (1)	Leg. Passes Balanced Budget (2)	May Carry-Over A Deficit (3)	May Not Carry Over into Next Biennium (4)	May Not Carry Over into Next Fiscal Year (5)
Alabama	-	-	-	-	C
Alaska	L	-	C	-	-
Arizona	-	-	-	-	C
Arkansas	-	-	-	-	L
California	C	-	C	-	-
Colorado	-	-	-	-	C
Connecticut	L	L	L	-	-
Delaware	-	-	-	-	C
Florida	-	-	-	-	C
Georgia	-	-	-	-	C
Hawaii	C	-	-	C	C
Idaho	-	-	-	-	C
Illinois	C	C	-	-	-
Indiana	-	-	-	-	C
Iowa	-	-	-	-	C
Kansas	-	-	-	-	C
Kentucky	-	-	-	C	L
Louisiana	-	C	-	-	-
Maine	-	-	-	-	L
Maryland	C	C	C	-	-
Massachusetts	C	-	-	-	-
Michigan	-	-	C	-	-
Minnesota	-	-	-	C	-
Mississippi	-	-	-	-	L
Missouri	-	-	-	-	C
Montana	-	C	-	C	C
Nebraska	-	-	-	-	C
Nevada	L	C	-	-	-
New Hampshire	L	-	-	-	-
New Jersey	-	-	-	-	C
New Mexico	-	-	-	-	C
New York	C	-	-	-	-
North Carolina	-	-	-	-	C
North Dakota	-	-	-	C	-
Ohio	-	-	-	-	C
Oklahoma	-	-	-	-	C
Oregon	-	-	-	C	-
Pennsylvania	C	L	C	-	-
Rhode Island	-	-	-	-	C
South Carolina	-	-	C	-	C
South Dakota	-	-	-	-	C
Tennessee	-	-	C	-	C
Texas	-	C	-	C	-
Utah	-	-	-	-	C
Vermont	-	-	-	-	-
Virginia	-	-	-	C	-
Washington	-	-	-	C	-
West Virginia	-	-	-	-	C
Wisconsin	-	-	C	-	-
Wyoming	-	-	-	C	-

Source: Bohn & Inman, 1996: 57-58.

There is no balanced budget legislation at the federal level in Canada. In 1990, a federal legislation provided that the Unemployment Insurance account be managed on a self-financing basis. The Spending Control Act of 1991, which set limits for aggregate program spending, constrained federal government expenditures met the requirements of the Spending Control Act which was not extended beyond 1996 since subsequent budgets became more restrictive than the legislation (Tellier-Imbeau, 2004: 4).

In Canada various legal measures have been taken into force so as to reduce and remove budget deficits in various states (See Table: 5).

Table: 5
Anti-deficit Legislation Adopted by The Provinces and Territories and Their Dates of Assent

The Provinces and Territories	Laws and Dates of Assent
Alberta	- Deficit Elimination Act (May 14, 1993) - Balanced Budget and Debt Retirement Act (April 24, 1995)
Saskatchewan	- The Balanced Budget Act (May 18, 1995)
Manitoba	- The Balanced Budget, Debt Repayment and Taxpayer Protection and Consequential Amendments Act (November 3, 1995)
Quebec	- An Act Respecting the Elimination of the Deficit and a Balanced Budget (December 19, 1996)
New Brunswick	- An Act Respecting the Balancing of the Ordinary Expenditures and the Ordinary Revenues of the Province (May 7, 1993) - Balanced Budget Act (April 13, 1995)
Nova Scotia	- Financial Measures Act (May 17, 1996)
Northwest Territories	- Deficit Elimination Act (April 27, 1995)
The Yukon	- Yukon Taxpayer Protection Act (April 26, 1996)

Source: Millar; 1997: 37.

In Table: 4, it can be clearly seen that in Canada especially in reducing budget deficits and public expenditures and obtaining fiscal discipline as a result, various important legal arrangements have been taken into force in provinces and territories rather than federal governments.

3.3. Germany

In Germany, the federal government and many of the regional governments are constitutionally obligated to adhere to the “golden rule”, that borrowing should only finance capital expenditures. However, the rule has imposed little budgetary discipline because it is usually applied ex ante rather than ex post. In addition, investment at the federal level is broadly defined, including financial as well as nonfinancial assets and

excluding privatization and depreciation. It excludes special funds and can be suspended if the government determines that the economy is not operating at the "national equilibrium". More recently, German stability programs have undertaken to keep annual nominal spending growth at or below 2 percent at the level of the general government. However, rules to deal with spending overruns are not specified (Daban, etc., 2003: 10-11).

In the run-up to the European Monetary Union, an intense debate took place in Germany on the design of an Internal Stability Pact (ISP). Agreement, however, was stalled by major differences in needs and economic strength among Lander and by constitutional problems. Following the ECOFIN Council's recommendation to the German authorities to agree upon an ISP, the responsibilities of the Financial Planning Council were reinforced and Article 51 (a) of the General Budget Law was modified. The new draft of Article 51, which was to have come into force January 1, 2005, specifies that all levels of governments will be responsible for avoiding the excessive deficit procedure (Article 104 of the EU Treaty) and proclaims the overall aim of deficit reduction to meet the close-to-balance target of the SGP. In particular, Article 51 (a) establishes that for all levels of governments the Financial Planning Council will issue recommendations on budgetary policies, discuss the consistency of budgetary developments with Article 104 of the EU Treaty and the SGP, and will make recommendations in case of deviations. In response to the Commission's recommendation to the Council (January 30, 2002) to issue an early warning to Germany, the implementation date of Article (51 (a) was carried forward to July 1, 2002. These legal modifications strengthen the rules beyond the previous framework; however, the lack of sanctions for governments not complying with the Financial Planning Council's recommendations could jeopardize their effectiveness in practice (Daban, etc., 2003: 40).

Sub national levels of government in Germany are subject to the so-called golden rule. Their current revenues and current spending must balance each fiscal year. Nonbank borrowing is permitted to Finance investment projects under certain well-defined conditions. In Germany, most Lander are subject, in principle, to the golden rule. In practice, however, there has been considerable latitude in defining current and capital expenditures. Moreover, the rule is applied to the approval of the budget rather than to the execution (Kopits-Symansky, 1998: 25). It can be seen that in various countries specific fiscal rules have been implemented so as to achieve public finance balance.

4. Evaluation of Fiscal Rules in Turkish Economy

In Turkish economy public finance balance has deteriorated seriously especially since the end of 1990's when both domestic and foreign disturbances took place. After 1998 Asian crisis while the foreign trade balance started to deteriorate because of high foreign debt together with high current account deficit, domestic economy faced with high public deficits leading high inflation rates and low growth rates.

4.1. 2000 Crisis and The Interrelation Between Budget Rule and Public Finance Balance

In Turkey after 1998 Asian crisis problems resulting from both domestic and foreign balances increased leading to 2000 Crisis in economy. High debt burden together with high public expenditures caused public deficits to increase, the process which was triggered by political instability. Because of inadequate tax revenues budget deficits continued to increase rapidly. The government had to use debt policy to cover the deficits which caused interest rates to rise. High interest rates led private investments to decrease and unemployment rates to increase leading depression in real sector.

During the process in which a depression threatened economic growth, foreign debt increased leading current account deficits to increase as well. Also high public expenditures and as a result high public deficits triggered high inflation rate. Chronic inflation, high budget deficits, high domestic and foreign debt rates and structural problems in both real and financial sectors –leading high unemployment rates- caused the economy to enter a recessionary process.

Considering the public revenues and expenditures between 1998-2000 periods, it can easily be seen that a serious deterioration took place in public finance balances (See Table: 6).

Table: 6
The Share of Taxes and Public Expenditures and Non-interest Surplus in Gross National Product (GNP) (1998–2000, % percent, Annual)

Years	1998	1999	2000
Taxes	21,8	24,0	26,4
Public Expenditures	29,1	35,8	37,4

Source: Republic of Turkey Prime Ministry Undersecretariat of Treasury, <www.hazine.gov.tr>, 01.02.2008.

In Table: 6 during 1998–2000 periods both taxes and public expenditures rise but the increase in public expenditures had exceeded the increase in taxes. In 1999, the year when the crisis occurred, while taxes/GNP ratio was 24,0 percent, public expenditures/GNP ratio was increased by 35,8 percent. Again in 1998 public expenditures/GNP ratio was only 29,1 percent but in 1999 was increased by 35,8 percent which shows a great increase in public expenditures leading high public deficits.

In 2000 taxes/GNP ratio was increased by 26,4 percent but public expenditures/GNP ratio was increased by 37,4 percent. In 2000 the increase in public expenditures was serious relative to both the increase in taxes/GNP ratio (26,4 percent) and the increase in public expenditures/GNP ratio in the previous year, 1999 (35,8 percent). In

the face of these problems the government decided to implement 2000 Stabilization Program in which a budget rule was decided to be taken into force (See Table: 7).

Table: 7
Budget Rule in 2000 Stabilization Program and Public Finance Balance

- Achieving Fiscal Discipline - Using A Budget Rule –non-interest budget surplus of 6,5 percent- - Reducing Public Expenditures –especially interest payments- - Increasing Public Revenues –especially taxes-

In Table: 7, the main patterns of fiscal policy in 2000 Stabilization Program consisted of achieving fiscal discipline, using a budget rule, reducing public expenditures and increasing public revenues. Actually achieving fiscal discipline contained all the other aims. Because so as to achieve fiscal discipline the government had to reduce public expenditures and increase public revenues. This policy is known as an orthodox fiscal policy.

In Turkish economy this restrictive fiscal policy was used many times before. Here the main difference between this policy and the other fiscal policies having been used in previous years is that this restrictive fiscal policy would planned to be used by implementing a restrictive budget rule - a non-interest budget surplus of 6,5 percent-. This means that the government would have to reduce budget deficits by decreasing public expenditures and increasing public revenues but by this restrictive policies as a result would have to create a non-interest budget surplus of 6,5 percent. With this aim the government tried to have budget surplus. Increasing income tax by 0,3 percent, indirect tax by 0,5 percent, value-added tax by 0,4 percent was the revenue-rising pattern of the budget policy. Reducing public expenditures/GNP ratio by 1,5 percent was the expenditure-reducing pattern of the budget policy (Yeldan, 2001: 572). Both the patterns were the parts of the main aim - achieving fiscal discipline- and reducing the deterioration in public finance balance as a result.

In 2000 Stabilization Program the budget rule –non-interest surplus of 6,5 percent- also contained specific fiscal targets in view of both fiscal policy and public sector reform. Fiscal targets relating fiscal policy consisted of restrictive tax and expenditure policies. According to these targets the government aimed at increasing public revenues (both indirect taxes –value-added tax rates by 2 percent, value- added tax rates on communication services such as telephone and energy such as natural gas, motor vehicles tax- and direct taxes –corporate tax rates, stoppage on income from liberal professions and real estate by 20 percent-) and reducing expenditures (both personnel expenditures and interest payments). Fiscal targets relating public sector reform consisted of public debt management, tax reform and public employment. According to these targets Public Debt

Management Law was intended to be agreed until June 2001, Tax Reform Plan was aimed to be agreed by January 2002, the number of tax auditing staff was planned to be increased, less effective public investment projects were planned to be canceled incrementally. Over-employment in State Economic Enterprises (SEE's) was planned to be reduced incrementally (Esen, 2002: 18-19).

The budget rule in the Program was relatively successful in the short-run. Here non-interest budget surplus of 6,5 percent was tried to be achieved in 2000 relative to 1999. (See Table: 8).

Table: 8
The Share of Non-interest Surplus in Gross National Product (GNP) (1999–2000, % percent, Annual)

Years	1999	2000
Non-interest budget surplus	1,5	5,7

Source: Republic of Turkey Ministry of Finance, General Directorate of Budget and Fiscal Control, <www.bumko.gov.tr>, 01.02.2008; T.R. Prime Ministry State Planning Organization, <www.dpt.gov.tr>, 11.02.2008.

In Table: 6, when the non-interest budget surplus was 1,5 percent in 1999 after the implementation of the Program in 2000 the realization in the target reached to 5,7 percent showing that strict fiscal policies and the budget rule had positive effects on public finance balance. Because the budget rule had a demand-restricting effect on economy which reduced expenditures and led the public budget to be balanced as a result. While public deficits/GNP ratio was 15,3 percent in 1999, by using the budget rule this ratio reduced to 10,7 percent in 2000. Besides revenue-increasing and demand-restricting effect of the rule can be clearly seen considering the realization of public revenues and expenditures. Real growth rate of public expenditures remained at 9,9 percent but real growth rate of tax revenues increased to 18,3 percent (Yeldan, 2001: 578).

According to the budget rule strict measures concerning both public deficits –including budget deficits- and public revenues –including privatization revenues- have been used. The program concerned specific targets such as non-interest budget surplus of 6,5 percent. Privatization revenues were added to public revenues aiming at using privatization as a tool of increasing public revenues. Interest payments were considered to be a serious burden on public finance balance and specific public deficit targets were assigned so as to monitor and control interest payments (Sak, 2000: 25). Here the aim is again to reduce public deficits. As a result a harmonization between public revenues and public expenditures occurred by using orthodox fiscal policies and a strict budget rule of 6,5 percent.

Despite the positive effects of these policies on public finance balance, they caused a serious decrease on real investments leading a consequent deterioration in resource allocation in economy. In spite of these restrictive effects on real economy, public finance balance has been affected by the use of budget rule positively. In 2000-2001 period non-interest public balance/GNP ratio has improved. While non-interest public expenditures/GNP ratio was 20,8 percent in 2000, it reduced to 19,9 percent in 2001. Government expenditures/GNP was 4,6 percent in 2000 but increased to only 5,1 percent in 2001 (Republic of Turkey Prime Ministry Undersecretariat of Treasury, www.hazine.gov.tr, Erişim: 01.02.2008). But the restrictive effects of fiscal policies triggered depression. Depressed economic conjecture led increases in public good prices and in unemployment rates which as a result reduced economic growth. Especially after November 2000 Crisis as structural policies were not implemented so as to remove the problem, the effects of the crisis prevailed in especially financial sector leading February 2001 Crisis.

4.2. 2001 Crisis and the Interrelation between Budget Rule and Public Finance Balance

The main reasons of 2001 Crisis are the unstable: structure of exchange rate market –access demand to exchange-, subsequent financial crisis, high foreign debt, high current account deficits, political instability and a high non-interest budget surplus target (6,5 percent). Banking crisis reduced the credit demands of private investors leading decreases in private investments and increases in unemployment rates which as a result of a depression in real economy. In this period the budget rule although has helped to achieve budget balance in the short run, affected real sector investments negatively leading them to reduce in the long run. Increased public deficits together with high foreign debt ratios and high current account deficits triggered 2001 Crisis. All these problems led Turkish economy in a chaos. GNP reduced by 9,4 percent in terms of fixed prices and by 26,6 percent in terms of dollars. Turkish Lira (TL) depreciated which as a result deteriorated domestic demand but improved current account balance by causing exports to get cheaper and reducing current account deficits (Ongun, 2002: 72).

As a result of 2001 Crisis Turkish economy shrank by 9–10 percent in terms of real GNP, unemployment rates to GNP ratio reached to 13 percent, interest payments of domestic debt exceeded tax revenues leading to a great increase in debt burden (both in foreign and domestic terms), taxes could not be collected sufficiently enough to cover the increases in public expenditures causing public deficits to increase sharply, prices began to increase leading an inflationary process. In these circumstances the government decided to implement Transition to Strong Economy Program (TTSEP) so as to obtain stability in economy (Kızılot, 2002: 95). In TTSEP, the budget rule - non-interest budget surplus target (6,5 percent)- was still one of the main tools of the fiscal policy targets (See Table: 9).

Table: 9
Budget Rule in 2001 TTSEP and Public Finance Balance

- Achieving Fiscal Discipline - Continuing to Use The Budget Rule –non-interest budget surplus of 6,5 percent- - Implementing Restrictive Budget Policies - Achieving Sustainable Economic Development

In Table: 9 the main patterns of fiscal policy consisted of again achieving fiscal discipline, using the budget rule, continuing to implement restrictive budget policies and achieving sustainable economic development. Here the main difference between the fiscal policy aims of 2000 Stabilization Program and 2001 TTSEP was that in 2001 TTSEP the government decided to increase economic development and growth by using efficient fiscal policies. So as to achieve fiscal discipline using the budget rule was again be the main instrument. Also the government continued to implement restrictive budget policies especially by reducing public expenditures with the aim of achieving public finance balance. The results of the implementation of the budget rule although seemed to be effective in 2001, were not successful enough to balance the budget in 2002 (See Table: 10).

Table: 10
The Share of Taxes, Public Expenditures and Non-interest Surplus in Gross National Product (GNP) (2001–2002, % percent, Annual)

Years	2001	2002
Taxes	28,6	27,4
Public Expenditures	45,6	42,0
Non-interest budget surplus	6,8	4,3

Source: Republic of Turkey Ministry of Finance, General Directorate of Budget and Fiscal Control, <www.bumko.gov.tr>, 01.02.2008; Republic of Turkey Prime Ministry Undersecretariat of Treasury, <www.hazine.gov.tr>, 01.02.2008.

According to Table: 10 while the share of public expenditures in GNP was 45,6 percent in 2001, it reduced to 42,0 percent in 2002 as a result of strict expenditure policies and the use of budget rule. The government tried to achieve the non-interest budget surplus target (6,5 percent) by reducing public expenditures. The tax revenues could not be increased indeed slightly decreased. In 2001 taxes/GNP ratio was 28,6 but reduced to 27,4 in 2002. While non-interest budget surplus/GNP ratio was 6,8 in 2001, it was only 4,3 percent in 2002 showing that the reduction in public expenditures was not enough to balance the budget. In this period although reducing the expenditures the government was not successful enough in increasing tax revenues and achieving non-interest budget surplus target.

Between 2000 and 2001 orthodox policies helped to balance the budget. Considering the fiscal indicators the consolidated budget surplus/GNP was 4,6 percent in 2000 and reached to 6,8 percent in 2001. The government tried to keep the nominal increases in non-interest expenditures below nominal increases in GNP by reducing public expenditures not by increasing taxes which was criticized by economists. Because reducing expenditures include reducing wages and salaries in public employment which was one of the main reasons of the sharp increase in unemployment rate in 2001 (Bağımsız Sosyal Bilimciler, 2002: 14–15). In spite of the fact that these restrictive policies led temporary positive effects on 2001 budget –especially by using the budget rule- they caused a recessionary process in real sector-especially causing unemployment rates to increase and private investments to decrease-.

Using structural policies to achieve a sustainable economic development and growth rate was the other aim of the Program. But unfortunately the policies needed to achieve this aim included a relatively loose fiscal policy so as to encourage private sector to increase their real investments. However the restrictive fiscal policies –including the budget rule- so as to achieve public finance balance was the first choice of the government. As a result of strict policies the public budget was balanced which was a real success in the short-run but real sector balance could not be recovered indeed deteriorated leading higher unemployment rates and lower private investments/GNP ratios which in turn a real failure in the long-run. Effects of TTSEP on economy as a whole seemed to be disappointing at the end of 2001. Increased political and economic instability necessitated a new reconstruction process. In the second quarter of 2002 with a general election a new government came into force and presented a new economic plan -2002 Emergent Activity Plan- and a new stabilization program -3 March 2003 Stabilization Program- including the budget rule.

4.3. 2003 Stabilization Program and The Interrelation Between Budget Rule and Public Finance Balance

In 2003 Stabilization Program especially fiscal policy targets do not differ from the previous ones except slight changes such as making revenue and expenditure reforms in the public budget. This target is actually similar to the targets of previous programs taking into consideration the results of the program because all the programs had the same target of reducing budget deficits by using restrictive policies, only the implementation of tools differs slightly (See Table: 11).

Table: 11
Budget Rule in 2003 Stabilization Program and Public Finance Balance

- Reducing Public Expenditures - Increasing Tax Revenues - Making Tax Reform - Reducing Budget Deficits - Continuing to Use The Budget Rule –non-interest budget surplus of 6,5 percent-

As seen in Box 4, 2003 Stabilization Program differs from the other programs in the way that it involved tax-expenditure reforms in addition to restrictive expenditure policies. Removing fiscal beginning arrangement, widening tax base, simplifying tax law and implementing tax peace project were the main targets of the tax policy. Here the aim was to increase tax revenues so as to reduce public deficits. In view of public expenditures reducing the expenditures was still the main target which the government intended to achieve by not only reducing personal expenditures and interest payments but also making new arrangements in public finance management (Şimşek, 2004: 216). Again so as to balance the public budget the government continued to implement the budget rule and tried to achieve the non-interest budget surplus target (6,5 percent) by using the restrictive tax-expenditure policies mentioned above. Here the main aim was to attain public finance balance. Considering the share of taxes and public expenditures in GNP in 2002-2004 periods, slight improvement could be seen in the balance (See Table: 12).

Table: 12
The Share of Taxes and Public Expenditures and Non-interest Surplus in Gross National Product (GNP) (2002–2004, % percent, Annual)

Years	2002	2003	2004
Taxes	27,4	29,9	30,2
Public Expenditures	42,0	39,3	32,8
Non-interest budget surplus	4,3	5,2	6,1

Source: Republic of Turkey Ministry of Finance, General Directorate of Budget and Fiscal Control, <www.bumko.gov.tr>, 01.02.2008; Republic of Turkey Ministry of Finance, General Directorate of Revenue Policies, <www.gep.gov.tr>, 01.02.2008.

According to Table: 12, between 2002–2004 period taxes/GNP ratio increased consistently. In 2002 this ratio was 27,4 percent and increased to 29,9 percent in 2003 and to 30,2 percent in 2004. The main reason of this increase was the tax reform, revenue-increasing policies and of course the budget rule. A similar positive effect of strict policies can be seen in view of public expenditures. In 2002 public expenditures/GNP ratio was 42,0 percent, then reduced to 39,3 percent in 2003 and to 32,8 percent in 2004. The main reason of this reduction was the use of budget rule and demand-restricting policies. The

non-interest budget surplus /GNP ratio was 4,3 percent in 2002, increased to 5,2 percent in 2003 and to 6,1 percent in 2004. The budget rule seems to be effective during this period because by using strict fiscal policies, the government tried to achieve the target of budget rule (6,5 percent).

During 2003-2005 restrictive fiscal policies had affected public finance balance positively. Inflation rate and public deficits reduced by using the budget rule together with other strict policies. Doubts about debt sustainability lessened and as a result risk Premium was reduced. Decreasing the interest rates and strengthening the value of TL also helped inflation rate to decline and an efficient control on domestic demand was attained which as a result led a sTable: process in at least public finance point of view. However continuing to use restrictive policies so as to maintain fiscal discipline caused unemployment rates to increase and private investments to decline which is the disadvantage of these strict policies. The government insisted on using the budget rule so as to maintain public finance balance results a recessionary process in real sector.

By 2005 the effects of the economic program having been implemented since 2003 on public finance have been relatively positive. By continuing to use budget rule together with strict tax-expenditure policies, the government achieved to reduce budget deficits which as a result helped to form budget balance. Between 2005–2007 periods these strict policies continued to contribute to the public finance balance although having restrictive effects on real sector. The realization in public finance indicators show that especially by using the budget rule public finance balance improved (See Table: 13).

Table: 13
The Share of Taxes and Public Expenditures and Non-interest Surplus in Gross National Product (GNP) (2005–2007, % percent, Annual)

Years	2005	2006	2007
Taxes	31,4	31,4	31,0
Public Expenditures	30,1	30,1	31,3
Non-interest budget surplus	7,7	7,2	5,3

Source: Republic of Turkey Ministry of Finance, General Directorate of Budget and Fiscal Control, <www.bumko.gov.tr>, 01.02.2008; T.R. Prime Ministry State Planning Organization, <www.dpt.gov.tr>, 11.02.2008.

In Table: 13 while taxes/GNP ratio and public expenditures/GNP ratio changed slightly between 2005 and 2007 the budget rule seemed to be used more effectively. In 2005 non-interest budget surplus /GNP ratio was 7,7 percent and in 2006 was 7,2 percent. However in 2007 it reduced to 5,3 percent but still the government tried to catch the target (6,5 percent). According to the main public finance indicators of 2008 Economic Program,

it seems that the government intends to continue to use the budget rule and strict fiscal policies so as to maintain public finance balance. Taxes/GNP ratio is aimed to be 26,1 percent while public expenditures/GNP ratio be 31,0 percent. Non-interest budget surplus /GNP ratio does not change and is aimed to be kept in 5,3 percent.

The general election in 2007 imposed a high cost on especially government budget and led public expenditures to increase. Still interest payments continue to be serious burdens on the public budget threatening public finance balance. Continuing to use budget rule together with strict fiscal policies the public finance balance does not seem to deteriorate at least in the short run. But the recessionary process continues in real sector so these strict policies should be loosening by time without causing deterioration in public finance balance so as to encourage private investments and reduce the depression in real economy.

5. Conclusion

Fiscal policy rules have gained importance since 1970's when the role of public sector in economy increased. Since then the share of public sector and expenditures increased rapidly and public sector crowded out private sector. Because of insufficient collection of public revenues, especially taxes together with high public expenditures, public deficits increased rapidly. As a result public finance balances deteriorated. In these circumstances many countries preferred to use fiscal policy rules to obtain their public finance balances and maintain fiscal discipline.

In stabilization theory especially in public finance one of the most important tools that have been used so as to obtain public finance balance and maintain economic balance as a whole is fiscal policy rules. In the world these rules have gained importance especially in reducing public deficits and liquidity in economy. These rules have been used by governments especially in some developed countries such as United States, Canada and Germany in achieving public finance balance and in reducing inflation in domestic markets. Balanced budget or deficit rules, borrowing rules and debt or reserve rules have been the most important rules that have been implemented in specific countries.

Balanced budget or deficit rules necessitate a balance between government revenue and expenditure such as a prohibition on government borrowing or limit on government deficit as a proportion of GDP. Balance between structural revenue and expenditure or limit on structural deficit as a proportion of GDP or balance between current revenue and current expenditure are specific forms of balanced budget or deficit rules. Borrowing rules contain prohibition on government borrowing from domestic sources and prohibition on government borrowing from central bank or limit on such borrowing as a proportion of past government revenue or expenditure. Debt or reserve rules consist of limits on stock of gross (or net) government liabilities as a proportion of

GDP and target stock of reserves of extra budgetary contingency funds as a proportion of annual benefit payments.

Fiscal policy rules have been aimed to achieve some specific targets such as ensuring macroeconomic stability in both domestic and foreign markets of the country, enhancing the credibility of the government's fiscal policy and aid in deficit elimination, ensuring long-term sustainability of fiscal policy and minimizing negative externalities within a federation or international arrangement. Various legal arrangements and other law, such as international contracts, budget plans, medium-term fiscal plans and policy rules such as specific monetary and fiscal policy rules (inflation-targeting and budget-surplus rules) form the legal framework of a fiscal rule. A fiscal rule should be simple and credible, ensure the solvency of the state, relate to the consolidated general government and central bank, avoid pro-cyclical behavior of the fiscal policy instruments especially in the long run and be enforced impartially and consistently.

In Turkish economy a specific form of a fiscal rule has been implemented since 2000 economic crisis. Between 2000 and 2002 public finance balance deteriorated seriously and both domestic and foreign disturbances took place. Foreign trade balance started to deteriorate because of high foreign debt together with high current account deficit and high public deficits leading high inflation rates and low growth rates occurred. In these circumstances the Governments decided to use strict fiscal policies so as to reduce public finance deficits and high inflation rate. In doing so one of the main targets of the stabilization programs is a specific fiscal rule -the budget rule-. In all programs the fiscal rule has been implemented in the form of non-interest budget surplus of 6,5 percent. The fiscal policies have been used strictly so as to achieve this non-interest budget surplus. In the short run high budget deficits and high inflation rates have been reduced but in the long run continuing to use strict policies led unemployment rates to increase and private investments to decrease. The government insisted on using the budget rule so as to maintain public finance balance results a recessionary process in real sector. Between 2005–07 period non-interest budget surplus of 6,5 percent has still been the target of the program but at the end of 2008 some important legal and administrative arrangements were made in National Accounting System which caused a slight deviation from the target. With this arrangement although the National Income has seemed to be increased and public debt be decreased the non-interest budget surplus seemed to be declined to a level below the target. The effects of the implementation on economy –both in domestic and foreign markets- will occur more clearly until the end of the year.

In spite of the fact that the implementation of a fiscal policy rule has improved public finance balance together with inflation rates, it has led private investments to decrease in real sector. In reducing this negative effect of the implementation on real economy, the government may determine a new target below the current level and encourage the private investors to invest on real assets. To accelerate this process strict

fiscal policy can be loosen without permitting budget deficits and inflation rates to increase in time.

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