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# Budgetary Institutions in Turkey

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## Abstract

This paper examines institutional determinants of budget policy in Turkey. The discussion is based on an analytical framework, inspired by the recent literature, that treats budgetary institutions as mechanisms that may potentially resolve agency and common pool problems in a two-stage principal-agent set up that involves citizens, politicians and the bureaucracy. We first discuss the nature of inter-party competition and intra-party bargaining and examine how these generate distributive pressures on public resources. We then review the main features of Turkish budgetary institutions, and, in particular, the role of the central bureaucratic agencies. We conclude with a discussion of proposals for reform.

## 1. INTRODUCTION

Public deficits and their finance remain as one of the key unresolved policy issues in Turkey. Turkey is generally considered to be a successful reformer, especially because of the significant degree of liberalization that has occurred in the 1980s, in trade and finance, both domestic and international. In macroeconomic policy, however, Turkey is considered to be less successful, with inflation rates well above 50 percent in most of the 1990s. Turkey also went through a short-lived but quite severe crisis in 1994, when GNP declined by 6 percent. In general, budget deficits and the public domestic debt are seen as key factors that create macroeconomic instability or make the economy vulnerable to exogenous shocks.

The stock of domestic debt (as a percentage of GNP) has more than doubled since the beginning of the 1990s (Table 1). The ratio of public sector borrowing requirements (PSBR) to GNP have remained high, between 7-12 percent in the 1991-97 period. In 1998, the PSBR is estimated to be 8.7 percent of GNP despite an overall primary surplus of about 3 percent of GNP. In the second half of the 1990s interest payments have absorbed an increasing share of expenditures. On the other hand, the operational deficit, which excludes that portion of interest payments required to maintain the stock of public debt constant in real terms, has been quite low since 1994. Hence, a good part of interest payments has been absorbed to prevent inflationary erosion of the value of public debt.

While the size of the operational deficits suggests that, at least for the time being, fiscal aggregates are not out of control, worries remain. The crisis in 1994 still remains in the memories of participants in financial markets. There is a widespread belief that the crisis was induced by the government's effort to reduce interest rates beyond levels that would be acceptable to financial markets. In that period, the government cancellation of auctions of government papers virtually eliminated the market, and eventually precipitated a currency crisis. The political dynamics that resulted in the policy mistakes is seen to remain largely operative, potentially making the system vulnerable to gross mistakes in the future as well. The current means of maintaining fiscal discipline is regarded as fragile: the government is seen as unable to provide fundamental public services. In addition, most of the burden of the cuts in expenditures which occurred in recent years have been born by public investments. There is a parallel perception that the allocation of public expenditures entails significant waste. Patronage, clientelism and politicians' personal gains are seen to dictate the allocation of public funds, rather than a concern for the general public interest.

The purpose of this paper is to examine the institutional dynamics behind budget policy in Turkey. Recent literature (Campos and Pradhan, 1996, 1998; von Hagen 1992; von Hagen and Harden, 1994, 1995) has identified budgetary institutions as important determinants of fiscal policy and outcomes. This paper builds

on that literature and identifies some of the key institutional variables that seem to be especially important in the Turkish context. After reviewing these variables and discuss how they affect budget outcomes, we derive our key proposals for reform.

The paper is organized as follows: Section 2 provides an analytical framework that guides the discussion in the rest of the paper. Section 3 is devoted to the analysis of budgetary institutions in Turkey. After describing the key actors and their preferences, we examine the way in which political competition generates distributive pressures. We then discuss the extent to which budget institutions contain these pressures, paying particular attention to the role of central bureaucratic agencies. The section reviews in detail the procedural rules that regulate budget preparation, legislation, implementation and audit. Section 4 discusses expenditure outcomes under the current system. Section 5 proposes some elements of reform. Section 6 concludes the paper.

## **2. ANALYTICAL FRAMEWORK**

In this section we develop a simple model of representative democracy. The purpose of the model is to identify key problems that arise in assuring that the state behaves in the interests of the citizens. Budgetary institutions are conceptualized as mechanisms (or rules, procedures, incentive systems) that may potentially resolve these problems in the context of allocation of public resources.

The model outlined here is abstract and omits several factors and key players (such as the media) who play in important role in the implementation and monitoring of budget policy in real life. These factors will be introduced later in the sections devoted to the discussion of the Turkish case.

### *2.1. A principal-agent framework*

The proposed framework of representative democracy contains three main types of actors: the voters, politicians and bureaucrats. *The state* is treated as an entity endowed with the power to design and enforce rules. The state is operated by politicians who get elected by voters, and by bureaucrats. Elected politicians and bureaucrats together make up public officials, or agents of the state, who are authorized to use the state machinery to produce policy.

The primary principals in this simple model of representative democracy are the voters/citizens. Citizens can rely on their own (individual and collective) initiatives and the operation of markets for the provision of goods and services. However, the provision of some goods and services require collective action that citizens are not able to generate, because of well known problems such as free riding and absence of commitment mechanisms. These collective goods and services entail not only public goods traditionally defined, but also policies, rules and institutions that regulate interactions among the various actors in the public and private sectors, and which may potentially increase social welfare. From a normative point of view, the state is treated as an entity that acts as the agent of the citizens and whose purpose, in principle, is to provide these collective goods and services. The problem is that since the agents of the state have the capacity to use the state machinery to make rules that are binding for all citizens (in other words, state power is coercive), they are extremely powerful. The problem of the design of the state is to build and enforce institutions (rules, incentives, and accountability mechanisms) to make sure that the coercive power of the state is indeed used in the interests of the citizens rather than those of public officials or their affiliates.

The agency relation between the actors of the state and the citizens entails two stages of delegation (Figure 1). In the first stage, citizens delegate authority to politicians to produce public policy (including policy to raise revenues and use these resources to finance the provision of various goods and services). What is expected of politicians and of institutions that regulate their behavior is to aggregate diverse demands of individuals and social groups, and to on the basis of these demands to produce public policies which maximize social welfare. Given that politicians may have objectives that may diverge from those of the citizens, incentives must be created to make sure politicians act in the interest of the citizens. Institutions that

are established to ensure that politicians act in the interest of the citizens are called institutions (or mechanisms) of *political accountability*.

While politicians are authorized to design public policy, it is the task of the bureaucracy to implement these policies. Hence implementation entails a second stage of delegation, where now politicians act as the principals and bureaucrats as the agents. In this relation as well, the interests of the bureaucrats may be different from those of the politicians. For example, while politicians may be primarily interested in transferring a particular resource to a particular constituency in the most efficient and least cost manner, bureaucrats may be interested instead in maximizing their budget or their sphere of influence, or they may be affiliated with different interest groups, or they may wish to maximize the rents they appropriate, rents which become available due to superior information they possess in their fields of expertise. Institutions that ensure that bureaucrats act in the interest of their principals are named institutions of *administrative accountability*.

Institutions of political and managerial accountability include both formal and informal mechanisms. Possibly the most important formal institution is the constitution, which lays down the basic principles of the design the state. These would include both rules that regulate the relations between the citizens and the state, as well as those that regulate the agency relations within the internal organization of the state. Rules that define various types of government (such as presidential and parliamentary systems) and different types of electoral laws are additional examples of institutions of political accountability. Clearly elections are the most important tools of political accountability available to the citizens. The effectiveness of elections depends critically on the information available to the citizens with which they can evaluate the performance of the politicians and the bureaucrats. In addition, formal and informal institutions that affect party structures and the nature of party competition can also seen as part of political accountability mechanisms.

Administrative accountability mechanisms include administrative law, norms of bureaucratic ethics, and personnel and remuneration policy. This agency relation also is influenced by the amount of information available to the politicians about the behavior of bureaucrats.

It should be noted that mechanisms of administrative accountability often try to strike a balance. Even though the administration is primarily responsible to the politicians, and mechanisms try to facilitate the political monitoring of bureaucrats, they at the same time prevent politicians from abusing their authority over the bureaucracy in a way that weakens or undermines their accountability towards citizens. Hence in modern public sector management the bureaucracy is protected from excessive political discretion. The bureaucracy is expected to behave under a code of professional ethic which sometimes may encourage bureaucrats to act in ways which contradict the immediate interests of politicians, but which nevertheless agree with the public interest.

Similarly, one of the critical dimensions of the relation between the politician and the bureaucracy, which will be especially relevant for the discussions below on Turkey, is the ability of the politicians to appoint, promote and demote bureaucrats. Ability to appoint bureaucrats on the one hand allows politicians to work with persons who share similar social objectives. Hence, it is an effective means of discipline and control. On the other hand, excessive use of this power may have an adverse effect on the formation of professional and bureaucratic norms. In many countries, there are formal or informal rules that restrict the scope of political appointees. As will be discussed below, keeping administrative agencies relatively independent of political influence may be especially important in the case of those which play a key role in the budget process.

The first general problem that needs to be tackled in the design of the state, then, arises because interests of the agents typically diverge from those of the principals. This is a standard agency problem. Note that at both the political and administrative levels, informational problems that make it difficult for the principals to monitor the agents are potentially substantial. This enables agents to appropriate substantial amounts of informational rents. Accountability mechanisms try to minimize the impact of this divergence of interests, by providing appropriate rules and incentives. Note, however, these rules are typically severely "incomplete" since it is impossible to take account of all future contingencies. Hence design of appropriate incentives in

both stages is difficult.

## *2.2. Collective dilemmas*

The second general problem is that representative democracy itself suffers from collective dilemmas that the state is supposed to resolve. Various forms of this problem have been studied in recent years (e.g. Weingast, Shepsle and Johnsen, 1981; Chari and Cole 1993; von Hagen and Harden, 1995, Dixit and Londregan 1996). It is useful to distinguish two aspects of this problem. The first relates to the norms and institutions that regulate inter-party competition. For example, to the extent that political competition is carried out on the basis of promises of distribution of rents to constituencies, that is, to the extent that distributive politics is the main axis of political competition, more pressure will be generated on public resources. Dixit and Londregan (1996) have shown that distributive politics is akin to a non-cooperative game among political parties. Even though each party would like to promise less to voters, competition drives them to promise more<sup>1</sup>. If, on the other hand, the main instrument of political competition is efficiency in the production of public goods, then one might conjecture that this sort of competition would generate less distributive pressures on the budget.

The second relates to intra-governmental common pool problems. The typical problem here is that the benefits of public expenditures are often localized to specific constituencies (often dubbed "electoral districts" in the literature), whereas the financing of public expenditures often entails taxation (including inflation taxes) on a national scale. Therefore, each member of the cabinet (or member of parliament that can influence budget policy) internalizes all the benefits of public expenditures but only part of their cost. Such fragmentation also results in excessive expenditures (for example, von Hagen and Harden, 1995). The severity of this problem depends on the nature of budgetary institutions, as emphasized in the literature (Campos and Pradhan, 1996 and 1998, von Hagen, 1992, von Hagen and Harden, 1995), but also on the organizational and leadership structures of political parties (nature of intra-party bargaining, for short), as will be discussed in detail below. In addition, the form of the government (that is, whether there is a single party or majority government) is also expected to play a role.

The design of most states entail central agencies that can potentially help contain the centrifugal forces generated by collective dilemmas. These are agencies (often associated with the ministry of finance) which, compared to politicians are less subject to distributive pressures, and whose task is to act as the custodians of public monies. Regulations which provide central agencies with decision making or agenda setting authority, or which enhance their bargaining power can potentially limit distribution of public resources in exchange for political support<sup>2</sup>. The literature on budgetary institutions emphasize "strong ministries of finance" as an important institutional mechanism to overcome common pool problems in public expenditures.

Agency and common pool have three important potential welfare implications. The first problem is that collective dilemmas associated with distributive politics, whether originating from inter-party competition or from intra-party or intra-cabinet bargaining, tend to generate excess expenditures and a deficit bias (Chari and Cole, 1993; Velasco, 1998). Second, they tend to result in allocational inefficiencies, in the sense that public goods are underproduced and there are excessive transfers (political rents) to special interest groups (Persson, Roland and Tabellini 1997)<sup>3</sup>. Distribution of political rents often generates additional welfare losses, since, due to political constraints, these have to be made through inefficient fiscal instruments<sup>4</sup>. Third, there are potential welfare losses associated with cost effectiveness in policy implementation (bureaucratic rents).

The problems described above are potentially present in all representative democracies. However, countries differ in the extent to which institutions exist that contain the adverse consequences of both collective dilemmas and agency problems. Efficiency requires the effective operation of both political and administrative accountability mechanisms. It is possible to identify several features of such institutions. First, they should be able to moderate between the diverse distributive demands imposed on the state by different constituencies, and constrain political responses to these demands. Second, they should be able to limit the discretionary powers of the state actors, especially their capacity to distribute public resources to gain

advantage in political competition. Third, they should encourage the production of public goods and discourage particularistic transfers and political and bureaucratic rents. Fourth, they should encourage the generation of correct information in the system, so that principals can better monitor the agents.

### *2.3. The role of budgetary institutions*

This paper treats budgetary institutions as one of the most important mechanisms of political and administrative accountability. These institutions regulate interactions between the various actors (citizens, politicians and the bureaucrats) in the allocation of public resources, with the objective that these resources are allocated and used in the most efficient manner. The framework presented above, and the potential problems identified suggest three (not necessarily independent) criteria of efficiency:

- 1) fiscal discipline: resolve collective dilemmas, constrain deficit biases so as to achieve and maintain macroeconomic stability
- 2) allocative inefficiency: ensure that public resources are allocated so as to maximize social welfare (for example, constrain political rents and distributive transfers in favor of public goods)
- 3) cost efficiency: deliver public goods and services in the least cost manner (for example, constrain bureaucratic rents)

For the purposes of this paper, we find it useful to classify budget rules under two headings. First, budgetary institutions ensure the production, capture and dissemination of various types of information. Three aspects of this is especially relevant. First, they can generate information for the citizens on how public resources are used by politicians and bureaucrats. The presumption is that such information enhances political accountability by enabling citizens, for example, to make more informed choices during elections and vote out of office those politicians who are deemed to have misused these resources. In order to be useful, such information would need to be presented in formats which facilitate access and interpretation (for example, accordance with generally accepted reporting requirements). Second, information related to the activities of agents at each level of the principal-agent hierarchy within the state can be made available to the respective principals so as to facilitate monitoring. Third, it is presumed that better and more comprehensive information helps contain the adverse effects of collective dilemmas. When the budget does not provide timely and comprehensive fiscal data, the amount of public resources which individual agents of the state can control and allocate as they see fit is likely to increase, since the overall impact of such increases is not well detected. Overall, such these rules can be said to ensure *transparency*.

Second, budget institutions establish specific procedures that need to be followed in the allocation of public resources, including the specification of what each actor can and cannot do at each stage. These rules can help ameliorate both agency problems and collective dilemmas. For example, it is often argued that setting the overall magnitude of expenditures before deciding on expenditure composition may contain the deficit bias<sup>5</sup>. The requirement that all expenditures during a year be authorized by the legislature through an annual budget law may enable politicians to resist distributive demands during the year by reducing discretionary authority over public resources (and enhance fiscal discipline). Various types of internal controls may limit the extent to which agents misuse public resources. Hence budgetary institutions serve as vehicles of *control and commitment*.

## **3. TURKISH BUDGETARY INSTITUTIONS**

### *3.1. The key actors and basic principal-agent relations*

Turkey has a parliamentary system of government. The authority to legislate lies with the Grand National Assembly (hereafter the parliament) which uses this authority in the name of the nation (to whom sovereignty belongs). The first stage of delegation therefore involves the delegation of legislative authority

from the nation to the parliament. Members of parliament (MPs) are appointed through elections. Except for several interruptions due to military takeovers, multi-party elections have existed since the 1950s.

According to the constitution, one of the primary duties of the parliament is to monitor the cabinet and the ministers<sup>6</sup>. The cabinet is headed by the prime minister, who is appointed by the president. The norm here is that the president appoints the leader of the party that has the largest number of MPs, although recently leaders who are perceived as likely to form a cabinet that is expected to survive a vote of confidence have also been appointed. The rest of the members of cabinet (the ministers) are selected by the prime minister, most frequently from among the governing parties' MPs. The cabinet is collectively responsible for the conduct of the "general policy" of the government. Each of the ministers is answerable to the prime minister and is responsible for the administrative units under it. As in most parliamentary systems, most laws drafted and proposed to the parliament originate with ministers and the cabinet.

The authority to spend money is delegated by the parliament to the cabinet through annual budget laws. The draft budget is presented by the cabinet and enacted by the parliament. Parliamentary oversight of public expenditures is carried out by the High Court of Accounts (HCA), which presents its audit (Statement of Conformity) to the parliament following the end of the fiscal year. Concurrently, the cabinet presents its Final Accounts Bill, which is voted by the parliament.

The cabinet implements its policies through administrative agencies (the bureaucracy). Administrative agencies report to their respective ministries. There are various forms of agencies. In addition to ministry departments or "general budget agencies", there are annex-budget agencies, state economic enterprises, and agency types funded by extra-budgetary funds and revolving funds. The annual budget covers the general and annex-budget agencies and a number of extra-budgetary funds.

A few qualifications can be made regarding the agency relation between the parliament and the cabinet. In most discussions of distribution of power in parliamentary democracies, the cabinet is regarded as accountable to the parliament. As mentioned above, this is true in the Turkish case as well, since oversight of the cabinet is identified as one of the constitutional duties of the parliament. However, since in most parliamentary systems MPs rarely defect from party policy on important legislative issues, and since in the case of majority governments parties that compose the government also hold the majority of seats in the parliament, the oversight capacity of the parliament is very restricted. Majority governments can enact whatever law they wish. At least in the case of majority governments, the oversight capacity of the parliament essentially boils down to the opposition's right to access information and make that public. The same is true for budgetary institutions. A majority government essentially can enact any budget that it likes. The reason that parliamentary oversight may enhance overall accountability is that, at least in principle, by requesting that expenditures be authorized through a budget, and by requesting, ex-post, a settlement of the annual fiscal accounts, parliamentary oversight provides better information to citizens and other stakeholders<sup>7</sup>. Likewise, the importance of the external audit provided by the High Court of Accounts lies ultimately in evaluating the quality and validity of the information disclosed by the government, and making that evaluation public.

Central control agencies play an important role in the preparation and implementation of the budget, though they are not constitutional entities. These are the Ministry of Finance (MOF), the Treasury, the State Planning Organization (SPO), the State Personnel Office, and, to an extent, the Central Bank. The MOF contains the general directorate for budget and fiscal control (expenditures), the general directorate for revenues (taxes), the general directorate for accounting, the property office and the state supply office. It has primary responsibility for the preparation and the implementation (appropriations release and internal controls) of the budget. Cash and debt management are under the responsibility of the Treasury, which has been separated from the MOF in the 1980s. The Treasury is responsible to the Prime Minister; however, in practice it is run by a minister of state<sup>8</sup>. The SPO is responsible for authorising public investment projects. Hence, it has an important role in the preparation of the investment component of the budget. The SPO is also an important actor in general macroeconomic management and prepares the annual economic programs<sup>9</sup>.

As with the Treasury, the SPO is organized under the Prime Ministry, but it is often headed by a state minister. The annual programs provide some key variables (inflation and exchange rate targets) which are used by the rest of the actors

in preparing the budget. A fourth important actor is the Central Bank. Even though the central bank does not take a direct role in the budget process, it is a key player both because central bank advances are potentially an important source of finance, and also because of the impact of monetary and exchange rate policy on markets for government securities. Finally, the State Personnel Office is responsible for recruitment and salary policy.

The division of key responsibilities among various central agencies creates a serious problem of fragmentation in budget policy. This problem is potentially aggravated by the fact that in the last decade most governments have been coalition governments. The High Planning Board, headed by the prime minister and consisting of the central agencies as well as key ministers engaged in economic policy is a forum of information exchange and collective decision making. However, the amount of coordination it provides is limited. As will be discussed in more detail below, the degree of inter-agency coordination is an important determinant of budget policy.

The next step in the analysis of budgetary institutions is to describe the objectives and incentives of each of the players described above. We start with politicians.

### *3.2. Political competition and the generation of political liabilities*

Electoral competition in Turkey is characterized by a deep-rooted legacy of "populism", or distributive politics, whereby the use of public resources to generate political support has become the main instrument through which a political party tries to gain advantage over its competitors. Since this is the predominant source of distributive pressures on the budget, it is worth examining it in some detail.

A candidate running for office faces two sets of competitive challenges. First, she has to compete within her party to become a candidate in (local or national) elections. Second, she has to compete with candidates from other parties to win elections. For intra-party competition, she has to gain the support both of the party leader, and of critical networks within the party. The first set of liabilities are generated when the candidate seeks the support of local and party notables, and of delegates who play an important role in the formation of party hierarchies across the country. Such support is generated in return for promises of patronage, or transfers, or procurement contracts, promises that would be realized in case the candidate is successful in gaining political influence. At the second stage, the candidate needs the support of voter constituencies. Party and local notables play an important role in this process as well, because of their organizational and networking skills. Promises of transfers to the electorate (for example, in terms of higher agricultural support prices in rural areas, or granting ownership of illegally occupied land in urban shantytowns) form the second large set of liabilities.

Note that this process of liability formation suffers from collective dilemmas as well. In principle politicians would prefer to bear less liabilities since that would increase their command over public resources. However, their resistance is severely limited by the threat of competition, much in the spirit of Dixit and Londregan (1996). From the perspective of constituents, the end result of distributive demands is likely to be macroeconomic stability and inflation. However, given that politicians are likely to be responsive to the distributive demands of the rest of the interest groups, each individual group will find it optimal to put pressure on politicians.

It is often argued that political leadership may be an effective tool in resolving collective dilemmas within an organization. Parties whose leadership structures provide leaders with extensive power to use selective incentives may be able to internalize the externalities associated with collective dilemmas and protect the collective interests of the party (Cox and McCubbins, 1993, especially chapters 4 and 5). The nature of this



delegation can be thought of as an incomplete contract, or a set of rules that determine the actions that leaders can take under particular circumstances, or the nature and degree of discretion that they can assume. It has often been argued that political parties in Turkey have "oligarchic" leadership structures, that party leaders demand absolute loyalty from their members, and that they play an important role in deciding on party policy, in the internal advancement of party members and in determining which of the candidates will run for office (Turan 1995). However, this dominance comes at a significant price: In return for complete loyalty, party leaders have to cater to the distributive demands of their followers, especially those who represent significant networks of support<sup>10</sup>. This reciprocal web of interdependence for particularistic benefits has become the main glue that holds parties together. As a result, party leaders' incentives to pursue the collective interests of the party are weakened by the features of intra-party bargaining.

Features of both inter-party competition and intra-party bargaining make politicians very responsive to distributive demands. This tendency is further reinforced by expectations that guide voter behavior. Populism in Turkey has historical roots in the development of multi-party democracy and is deeply ingrained in the political culture (Heper and Keyman, 1997; Sunar, 1990). Distributive demands by constituencies are more than straightforward expressions of pursuit of self-interest. In addition, responding to constituency demands for government support have been seen as a primary *duty* of the state. The state has been perceived as an "institution that guarantees the livelihood of broad strata of the population" (Önis and Webb, 1994: 135; see also Heper, 1985).

### *3.3. The role of the central agencies*

Overall, compared to politicians, the central agencies are much less direct stakeholders in distributive politics. In addition, there is within the central agencies an overall negative sentiment against populism and distributive politics<sup>11</sup>. For example, the central agencies are likely to be more inclined to maintain macroeconomic stability, or to resist gross violations of allocative efficiency (e.g. in the case of blatant transfers of rents to interest groups). Potentially, then, the central agencies may play an important role in restraining the adverse effects of distributive politics. Alternatively, they can help insulate politicians from distributive pressures. Whether or not they play this role effectively depends on their bargaining power and which decisions are delegated to them during the budget process.

Among the various factors that influence their bargaining power, two seem especially important: The first is the personalities of top appointments (say at the level of undersecretary and deputy undersecretary). Strong and competent personalities increase agency independence, and expand the range of decisions that are likely to be less influenced by short term political priorities of the government. From the point of view of the cabinet, appointments of strong and competent personalities to central agencies may potentially act as an instrument of strategic delegation and enable politicians to be more resistant against distributive demands.

The second factor (not necessarily independent from the first) is the degree of inter-agency coordination. Division lines among central agencies (and among bureaucratic agencies in general) are thick, and procedural mechanisms for inter-agency coordination and cooperation are weak. Even though preferences of the central agencies are likely to be more or less aligned on issues such as fiscal discipline, there are also potential conflicts over distribution of authority. In other words, each agency would like to maximize its influence over public resources and policy decisions, a conflict which is potentially zero-sum. The fact that agencies which were originally organized under a single entity (MOF) have been separated in the recent past has exacerbated problems of trust between agencies<sup>12</sup>. These make cooperation on non-conflictual issues difficult and fragile as well.

Inter-agency coordination has also been weakened by the way responsibility for economic policy has been distributed in the cabinet. Since 1991, all governments except one have been coalition governments. There have often been two or three ministers responsible for economic and budget policy. Until recently, most of these Ministers were appointed by the senior coalition partner. Hence, the central agencies used to report to ministers from the same party, and the senior partners of coalition governments used to have control over

fiscal management. This has changed under the last few governments. Under the government before last, for example, the SPO and the Treasury reported to ministers from the senior partner, but the minister of finance was from the junior partner. However, even when agencies report to ministers from the same party, this does not guarantee enhanced coordination. There have been cases in recent history where problems between central agencies have risen due to lack of coordination and personal strife between ministers belonging to the same political party. This can be seen as a direct consequence of the fact that expertise in specific policy areas often has very low weight in ministerial appointments. Party leaders are more likely to appoint as ministers people who are loyal or who belong to key networks. As a result, coherent public policy is often not among ministers' top priorities, or even when it is, ministers are not necessarily well equipped to deal with it.

The degree of coordination among central agencies has increased over the years. Close cooperation between the treasury and the central bank in debt management is well recognized and appreciated by the financial markets. Furthermore, the SPO, the Treasury, and the MOF work together during budget preparation. However, such coordination is not fully institutionalized, and results from the personal efforts of bureaucrats. More importantly, the impact of these efforts is weakened by other shortcomings of the budget system, discussed below.

### *3.4. Budget coverage*

The term budget coverage is used to cover both dimensions of the budget process mentioned above (section 2.3). The first is coverage in terms of commitment and control, that is, whether activities which use public resources are carried out with prior authorization from the parliament through a budget law. The second is coverage in terms of the transparency function of the budget. That is, irrespective of whether authorized by the parliament, do all forms of expenditure of public resources get reported or accounted for?

The coverage of budget laws in Turkey is limited in both respects. An important part of public expenditures is undertaken without requesting the approval of the legislature (Figure 2). As a result, parliamentary oversight over the executive is further diminished. The fact that the government can spend public resources outside the budget both increases the government's discretion and reduces transparency since it becomes much more difficult for the public or the opposition to monitor how public resources are spent.

Important expenditure items not covered in the budget include the state banks' quasi-fiscal operations (especially subsidized credit), subsidies provided through SEEs (especially for agriculture), tax expenditures, contingent liabilities that arise from Treasury guarantees offered to debt issued by public agencies (such as local governments), capital commitments (commitments for future expenditures on investment projects approved by the SPO). There are also extra-budgetary funds and over three thousand revolving funds that are not covered by the budget.

Some of these off-budget activities are reported ex-post by the SPO. The annual programs contain data on "public sector balances" which document receipts, expenditures and borrowing requirements for key public sector entities (agencies covered by the consolidated budget, financial and non-financial state economic enterprises, local governments, social security institutions, revolving funds and extra-budgetary funds). However, important items such as contingent liabilities, part of quasi-fiscal activities of state-banks (see below), and tax expenditures are not reported at all<sup>13</sup>.

Quasi-fiscal activities of state banks and non-financial SEEs are especially important in terms of size, in terms of the amount of discretion they provide to politicians over public resources, and in terms of their lack of transparency<sup>14</sup>. More concretely, budgetary coverage of quasi-fiscal operations is limited in two respects: First, typically quasi-fiscal expenditures are spent without prior appropriations from the budget. Most of these activities generate "duty losses" which need to be compensated by the Treasury. Appropriations to cover these duty losses are made ex-post. Hence, these expenditures are very discretionary, and are carried out with incomplete or no prior authorization from the parliament<sup>15</sup>. Second, coverage is limited in terms of provision of information on the use of public resources. Even ex-post budgetary allocations against duty

losses do not fully compensate for them, so they accumulate over the years, sometimes at very high interest rates. Hence, not only some quasi-fiscal activities are not reflected in annual budgets (or even in total PSBR) for a number of years, in addition, at any point in time, the reported stock of domestic debt underestimates the total stock of liabilities of the government. Ultimately, these liabilities are recognized when The Treasury (typically) issues off-budget "non-cash" securities against them<sup>16</sup>. The stock of such non-cash government securities have remained at 4-5 percent of GNP in the 1993-97 period<sup>17</sup>.

There is practically no information generated to evaluate the performance of the spending agencies. Hence, the role of the budget in generating mechanisms for administrative accountability is limited to formal compliance requirements. There is also no information with which policy outcomes (welfare impact of expenditures) can be evaluated. Many ministries produce annual reports, which contain some information on policy outputs (amount of goods and services provided), but the budget process makes no use of these reports.

### *3.5. Features of budget preparation, legislation and implementation*

Specific procedures followed in budget preparation, legislation, and implementation are also important determinants of budget outcomes (von Hagen, Campos and Pradhan). A summary of the budget cycle in Turkey is provided in Table 2.

The budget preparation process in principle could provide a forum where the cabinet, with the help of the central agencies, establishes the strategic priorities of the government. The purpose here would be to aggregate over the different interests represented by the line ministries, both so as to maintain aggregate fiscal discipline, as well as to ensure that resources are allocated to areas that the government identifies as political priorities.

The literature suggests several institutional measures to reach these goals. It is often argued that strengthening the position of the prime minister and the minister primarily responsible for the budget (normally the MOF) against those of the line ministries is likely to help achieve or maintain aggregate fiscal discipline, since both are more likely to protect the collective interests of the government. Setting or agreeing on aggregate ceilings on expenditures in advance of bargaining over their composition is sometimes seen as a procedural measure that serves a similar purpose<sup>18</sup>. Another institutional device is a medium term fiscal planning framework that would provide estimates of future costs of alternative policies (called forward estimates in Australia, see Campos and Pradhan 1996, 1998). This would not only increase the quality of cabinet decisions, but also enhance transparency, and, consequently, the accountability of politicians to the citizens. Finally, a process of *evaluation* of the welfare impacts of alternative policies and an information and reporting system to support it would enhance allocational efficiency.

None of these institutions exist in Turkey. The system works as follows (Table 2). Bids are collected from central ministries, and then a bargaining takes place between line ministries and the central agencies. Fiscal aggregates are established as a result of agreements reached in this bargaining process. In some cases where serious cuts in the bids are needed (for example, due to a short-term stabilization program) these are carried out across the board. The budget preparation process entails no serious evaluation or prioritization. When the system works well (eg when the central agencies are given bargaining power, due, say, to strong undersecretaries), the preparation stage can produce realistic budgets which aim to maintain fiscal discipline.

It has been suggested that the features of the budget legislation process may also have an impact on aggregate fiscal discipline (von Hagen 1992, von Hagen and Harden 1994). The legislation stage has two components. First the budget proposal is presented to the parliamentary committee on planning and budgeting. The committee can propose any types of amendments on the budget. The government (be it single-party or coalition) holds the majority in the committee. The composition of this committee has varied over the years. In some exceptional years this committee has consisted of deputies who have expertise on economic and fiscal issues. However, in general, membership in the committee serves as a step of intra-party promotion,

and expertise has not been an overriding criterion in appointments into the committee. In recent years there have been examples where members of the committee have made marginally increased appropriations for their electoral districts.

The second stage is discussion in the general assembly and enactment by the parliament. The features of this process in Turkey are essentially similar to those that have been suggested to increase fiscal discipline (e.g. von Hagen, 1992). The constitution forbids amendments to decrease revenues or increase expenditures. In fact, in most cases proposed budgets are enacted without significant changes.

The stage that really determines budgetary outcomes in Turkey is implementation. Appropriations and cash releases are at the discretion of the Ministry of Finance and the Treasury, respectively. Due to high inflation both become extremely politicized and the whole implementation process becomes a grand bargaining game between the central agencies, the rest of the bureaucracy, ministers, members of parliament and others, including local governments. In particular, the MOF and the Treasury are under constant pressure from politicians to favor their expenditure items over others' in releasing appropriations or cash.

More importantly, there are various ways in which actual expenditures may exceed appropriations identified in the budget law. The most obvious way of doing that is through supplementary budgets, which a government can easily enact as long as it has a majority in the parliament. This mechanism has been extensively used in the past (almost every year in the last decade) so that now it has become a norm. Relative to budget laws enacted before the beginning of the fiscal year, supplementary budgets generate much less public debate. The expectation that supplementary budgets can be passed through the parliament without much difficulty, and without much public debate, makes budget preparation a less than completely serious activity. The budget law has lost its potential commitment value.

In addition to supplementary budgets, there are additional means through which actual expenditures may surpass appropriations in the budget law. A prominent mechanism is requesting "supplementary appropriations" in the Final Accounts Bill. Some of these complementary appropriations are allowed under the Public Accounting Law. Such "legal supplementary appropriations", as they are called in Turkey, are very small in magnitude, and only a small class of expenditures are eligible for this kind of treatment. However, in the past, governments have requested and obtained complementary appropriations for interest and personnel expenditures as well, without any clear legal basis. Overall, however, compared to supplementary budgets, the magnitude of supplementary appropriations has not been very large and have reached at most a few percentages of total expenditures.

The fact that the commitment value of budget laws is weak is evident from ex-post gaps between budgetary appropriations and realized expenditures. These gaps were about 4 percent of GNP in 1994 and 8 percent in 1997. Moreover, the deficit seems highly correlated with the gap (Figure 3).

### *3.6. External Monitoring*

Formal external audit of the budget is done by the High Court of Accounts. The constitution authorizes the Court of Accounts to audit, on behalf of the parliament, the revenues and expenditures of all public agencies covered by the consolidated budget. The audit of the budget is done primarily through a Statement of Conformity. HCA audits are not fully effective. First, the audit is restricted to compliance. The Court does not have a tradition of producing information on the allocative and cost efficiency of expenditures. Second, an important portion of public expenditures is outside the domain of the Court. The audit of state economic enterprises is carried out by the High Audit Board, which reports to the Prime Minister, and therefore is in principle open to political influence. Gonul (1997) estimates that about half of expenditure transactions (amounting to about 14 percent of public expenditures) escapes the HCA's audit. Third, and perhaps more importantly, the Statement of Conformity does not create much public debate and the HCA has not been very active in creating one. As a result, the HCA reports do not have much bite. In a few occasions, the HCA has warned members of the parliament of the illegality of some supplementary appropriations requested by the

government, but has not been successful in either stopping the parliament from granting them, or in creating a public awareness on the issue.

There are two additional sources of external monitoring that are becoming particularly important in Turkey: financial markets and the press. Financial markets in Turkey have been liberalized in the 1980s, and the Turkish lira is fully convertible since the 1989. As emphasized by Campos and Pradhan (1996), open financial markets potentially exert discipline on fiscal policy. In addition, the domestic banking system is the primary holder of government securities. Since 1994, when an attempt by the government to bypass the financial system by resorting to central bank advances resulted in a major financial crisis, the financial system is recognized by governments as an indispensable partner in financing deficits and rolling over the domestic debt. This has allowed the central agencies in taking albeit small steps in reducing the degree of discretion in public finances. For example, in the last two years the treasury has started announcing borrowing programs that specify the timing and magnitude of auctions of government securities that are to be held in the near future<sup>19</sup>. The degree to which these programs can actually discipline public expenditures depends on the costs (as perceived by the government and the bureaucracy) of deviating from them. While we do not have estimates of these costs, our current impression is that the Treasury has been successful in convincing governments of the benefits of adhering to these programs.

Freedom of the press is, and has been for quite some time, fully operational on matters of economic policy. However, freedom of the press does not by itself imply effective monitoring and pressure by the public<sup>20</sup>. There are at least two additional conditions that need to be met. The first is an educated press coverage of economic policy issues. The level of expertise on economic policy issues has increased significantly in recent years. The second is an ability to focus public discussion on key issues. The problem of achieving efficiency in the allocation of public resources is not necessarily a straightforward problem. In order to enhance public awareness, critical themes such as excessive discretion, transparency and the coverage of the budget need to be placed on the agenda of public opinion. The press can potentially play an important role in focussing public attention on a number of key variables and concepts to monitor and evaluate fiscal policy. The Turkish press is becoming more competent in carrying out that function as well.

In recent years, there have been several occasions in which the press has played a significant role in introducing and publicising attempts by the bureaucracy to improve transparency and maintain fiscal discipline. The Treasury borrowing programs mentioned above were greeted with significant media support. Newspapers have been active in monitoring agricultural support prices, and specifying, most possibly on the basis of leaks from the central agencies, thresholds above which such prices would reflect "populistic behavior". In 1998, as a result of prodding from the central agencies, the government promised to refrain from issuing a supplementary budget. The media has been active in keeping that promise in the public agenda. To our knowledge, this was the first time that the media made an issue out of supplementary budgets. Similarly, the idea that excessive political discretion over the allocation of public resources may harm the public interest is being discussed more frequently by economic columnists.

#### **4. EVALUATION OF BUDGETARY INSTITUTIONS**

In this section we evaluate budgetary institutions in Turkey using the framework developed in Campos and Pradhan (1996). Their framework identifies three levels of assessment: aggregate fiscal discipline, strategic prioritization and technical efficiency. Following them, at each level we consider the key institutional arrangements, accountability and transparency mechanisms.

##### *4.1. Aggregate fiscal discipline*

###### A. Macro framework and coordination mechanism

The annual programs provide a limited macro framework. There is no multi-period framework or forward estimates. The program is published and available to the public.

## B. Dominance of central ministries

Even though formally the prime minister and the MOF are central figures in the budget process, their positions are weakened by the general prevalence of distributive politics.

## C. Formal constraints

There are no formal constraints on budget deficits or on the level of domestic or foreign debt. There is a constraint on the amount of central bank advances that the Treasury can utilize.

## D. Hard budget constraints

In principle expenditures cannot exceed appropriations in the budget. However, in practice this constraint is rendered meaningless through the use of supplementary budgets. There are no formal hard budget constraints on state economic enterprises.

## E. Comprehensiveness of the budget

Very limited. See figure 3.

Regarding accountability, two of the mechanisms mentioned by Campos and Pradhan exist in Turkey: Ex-post reconciliation is done through the Final Accounts Bill, which is not closely monitored by the public. Openness of financial markets exists fully, as mentioned above. Sanctions for central ministries do not exist.

## 4.2. *Strategic prioritization*

### A. System for comparing medium-term costs of competing policies

Both the Treasury and the SPO use macro-econometric models, however these are useful for comparing alternative macroeconomic scenarios, not for evaluating the allocative efficiency of fiscal expenditures. The SPO has expertise to evaluate investment projects, and follows key sectors closely. They do carry out some prioritization regarding investment expenditures but in a de-facto manner. In recent years, due to fiscal deterioration, the share of investment in budgetary outlays has been reduced significantly.

### B. Comprehensiveness of the budget

Very limited. See figure 3.

### C. Flexibility of line agencies

Almost non-existent.

### D. Breadth of consultations

There is almost no feedback from civil society, except for public pressure as reflected in the media. However, there is significant pressure that politicians do take into account, that results in distributive politics. For example, there is always pressure for higher agricultural support prices, or public wages and salaries.

### E. Use of objective criteria

None.

Reporting on outcomes and ex-post evaluations occur very rarely, if at all. The technical capacity of the parliament is limited as well. Hence, the accountability and transparency mechanisms identified by Campos and Pradhan (1996) do not exist.

#### *4.3. Technical efficiency*

##### A. Civil service pay and merit based recruitment/promotion

In general, civil service pay is lower than private sector standards. The role of merit in recruitment and promotion in central agencies is quite important. Line ministries are much more instruments of political patronage.

##### B. Managerial autonomy of line agencies

Does not exist.

##### C. Predictability of resource flow

Both appropriations and cash release are highly politicized. However, in 1998 the MOF and the Treasury tried to coordinate on a release program.

As mechanisms to encourage accountability and transparency in technical efficiency, Campos and Pradhan list clarity of purpose/task, introduction of fixed-term contracts for chief executives, creation of financial accounts and audits for line agencies, client surveys and contestability in service delivery. To our best knowledge, none of these exist for line ministries.

## **5. EXPENDITURE OUTCOMES**

The crisis in 1994 has affected the relation between the politicians and the central agencies. The spectre of major macroeconomic disruptions or financial crises seems to have convinced politicians to delegate more responsibility to the central agencies in the design and conduct of budget policy. In turn, the central agencies have used this opportunity to restrain public expenditures and prevent major macroeconomic disruptions. As a result, fiscal aggregates, as measured by operational deficits, have remained under control (Table 1). On the other hand, the central bureaucracy has not been able to engage in major reforms or drastic policy initiatives.

A few additional factors may have facilitated the maintenance of fiscal discipline over the last few years. First, payments on the accumulated domestic public debt have greatly reduced resources available for distribution. Here we also suspect that a prevalence of a type of money illusion has probably helped bureaucrats. The notion that a good part of interest payments in fact is primarily absorbed to compensate for the inflationary erosion of the stock of debt is somewhat new and foreign to politicians. Our sense is that the realization of the fact that fiscal aggregates have been under control is likely to increase pressures for distributive politics. In fact, especially the Treasury seems to have been careful in not creating a celebratory atmosphere over the performance of the last two years. Second, the fact that economic policy making has been fragmented at the cabinet level may have actually helped the hands of the bureaucrats. The increase in the degree of fragmentation within the cabinet has coincided with increased efforts for inter-agency coordination, and has helped central agencies in resisting demands for distributive transfers.

This sense of enhanced aggregate fiscal discipline has been gained at the expense of substantial costs in terms of various forms of inefficiencies. The first type of inefficiency is the under-provision of public goods and services (defined in general terms, including public policies) and over-production of particularistic goods and services. For the case of Turkey, the most evident public good that is under-produced is possibly macroeconomic stability. In addition, it has become increasingly clear in the last few years that the state has

faced severe difficulties in carrying out its most fundamental functions, including such things as the provision of law, order and justice. Expenditures for social services such as education and health are extremely low. The share of investments in total outlays from the budget has decreased from 19-20 percent in 1981-87 to less than 10 percent in the 1990s.

The distribution of public resources as rents, besides resulting in under-production of public goods, entails additional losses. We conjecture that inefficiencies of the sort examined by Coate and Morris (1997) are very large in Turkey. To give one example, the government cannot simply give lump-sum subsidies to their contractors that support them. Instead, these have to be disguised as public projects that consume real resources, but the social values of which are low. Indeed, there have been a large number of stories of unfinished public projects whose main beneficiaries are contractors. Similarly, it is well known that support prices for agricultural products have large distortionary effects (Kasnakoglu and Cakmak, 1998; nash, n.d.).

Finally, we suspect that cost efficiency in the provision of public goods and services is very low. News of corruption in public procurement have exploded over the last few years. This is one area where we suspect that there is extensive collusion between politicians and bureaucrats. While corruption in public procurement reflects major weaknesses in procurement regulations, it is facilitated by the compliance oriented execution of external audit.

## **6. ELEMENTS OF REFORM**

Reform of budgetary institutions should have two immediate objectives. The first is to reduce the degree of discretion in expenditure policy. The second is to increase the degree of comprehensiveness and transparency of fiscal accounts. Realization of these objectives would both increase fiscal control and constrain public expenditures, enhance the credibility of announced fiscal policy, and increase public confidence.

There are several measures that can be undertaken to reach these objectives. The most immediate step is making the fiscal implications of quasi-fiscal operations transparent. A partial approach to this problem would require closer monitoring of these operations, and instituting a system of flow of information that would generate the fiscal implications of these operations without a delay.

A more comprehensive approach to increase transparency would overhaul the government reporting requirements altogether. The most effective means of doing so would be to publish a balance sheet of the state, with its supporting documents<sup>21</sup>. Initially, the balance sheet may capture current assets and liabilities of the central government. The balance sheet can be accompanied with additional financial tables that capture contingent liabilities, commitments and cash flow. The primary data for the balance sheet is available in the Treasury and in the agencies that carry out quasi-fiscal operations. It is expected that treasury guarantees form the bulk of contingent liabilities, hence the primary data for that is also available. The main source of commitments is probably the stock of programmed and ongoing public investments, the record of which is available in the SPO.

The second element of budget reform focuses on increasing the comprehensiveness of the budget itself. This is essential to reduce discretionary expenditures. In most cases the current legal framework delegates the authority to generate duty losses to either the cabinet or the relevant agency. Hence, quasi-fiscal operations are undertaken with no link to the budget. The budget should impose limits on the maximum amount of duty losses that can be generated within the year. These limits should be treated like all the appropriations in the budget and should not be overridden by cabinet decisions. More generally, the budget should cover all public expenditures<sup>22</sup>.

Introduction of a medium term fiscal program is another potentially important component of reform. In the Turkish context, this would serve two purposes. First, it would play a crucial role in clarifying the medium term revenue and expenditure implications of current policies. This helps increase discipline on the current budget preparation process. It has been argued that the practice of providing forward estimates, and



reporting ex-post deviations from these estimates has helped increase the accountability of politicians and bureaucrats in countries which have reformed their budgetary institutions (Campos and Pradhan, 1996). Second, it would enhance the degree of coordination among the central agencies. Currently such coordination takes place during the preparation of the annual programs (published by the SPO) and the annual budgets. A medium term fiscal program would act as a more effective mechanism to coordinate the strategies and expectations of the central agencies.

Another element of reform is the de-politization the appropriations and cash rationing process. This can be achieved by having the MOF and Treasury jointly draw up an appropriations and cash release program and make that public. Some progress towards a coordinated and programmed release of expenditures has been made in the recent past.

The most important tools of discretion in the current system are supplementary budgets. Restricting supplementary budgets would require constitutional amendments<sup>23</sup>. However even an announcement of a commitment to avoid supplementary budgets may have some signalling value, especially if accompanied by additional actions that increase the transparency of fiscal accounts, and reduces the discretionary powers of the executive.

Most of the measures mentioned above target the establishment of aggregate fiscal discipline and consolidation of advances made in this regard over the last few years. One can also mention a second set of measures which primarily aim at increasing the allocative and cost efficiency expenditure policy. This requires better monitoring of public expenditure programs and evaluation of their impact on social welfare. The absence of evaluation in the current system not only generates cost and allocative inefficiencies, but also makes strategic prioritization at the budget preparation stage extremely difficult. As a result, whenever budget cuts have been necessary, they have been carried out across the board, without a strategic focus. Hence, absence of evaluation also further complicates the establishment of aggregate fiscal discipline. Substantial capacity for evaluation already exists, especially in the SPO, which houses a large number of sectoral experts. This expertise can be easily mobilized for evaluating specific programs that consume a large amount of resources.

The recent behavior of the central agencies strongly suggests that they are likely to be willing participants in a comprehensive reform program. They could even play a leading or guiding role under a benign or reform-minded government that is willing to delegate responsibility to the central bureaucracy. On the other hand, bureaucratic initiatives under an obstructionist government, or a government with strong tendencies of distributive politics, are likely to remain timid or unsuccessful. Any reform strategy that aims at substantially changing the existing inter-agency distribution of power or authority (as could be the case, for example, if one intended to reduce the degree of fragmentation) is likely to face significant resistance from the losing agency. Such resistance would probably result in an effective veto, unless the government in question is very strong, a prospect that does not seem to be likely in the near future.

## **7. CONCLUSION**

This paper has examined the institutional determinants of fiscal policy outcomes in Turkey. It has argued that the nature of political competition generates strong tendencies for distributive politics, which creates strong pressures to use public resources for political benefits. The budgetary institutions accommodate these tendencies in several ways. Budget laws cover only a portion of government expenditures, providing politicians with substantial amounts of discretionary public resources that can be spent outside the budget. Budget laws are not binding and supplementary budgets are frequently enacted. Independent external audit is weak. There is little evaluation of the welfare impact of public expenditures. Fiscal discipline, whenever achieved, is mainly established by across-the-board cuts in current expenditures and substantial reductions in public investments.

The central agencies are important players in the budget process, and especially after the crisis in 1994, have

played a crucial role in preventing runaway budget deficits and major macroeconomic disruptions. They have also engaged in several recent initiatives to enhance transparency and reduce discretion. However, they are not likely to engage in a comprehensive reform effort unless they perceive some support, or at least acceptance from the politicians.

The paper argues that enhancing transparency is a crucial step in the reform of budgetary institutions. This would entail expanding budget coverage so as to account for all activities using public resources. We propose that the most efficient means of achieving transparency is through the publication of a balance sheet of the government and supporting financial reports. Introduction of a medium term fiscal program would both enhance transparency and increase the degree of coordination among central agencies. The most efficient means of restricting the use of supplementary budgets is to change the constitution. However, our impression is that announcements of commitments to refrain from issuing supplementary budgets in a number of consecutive budget cycles would be an effective means to increase public awareness and increase the political cost of issuing supplementary budgets for future governments as well.

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## End Notes

<sup>1</sup> We do not intend to imply that redistribution is always undesirable. We would like to distinguish redistributive rents resulting purely from constituency politics (and which would be considered as wasteful by most citizens), from comprehensive redistributive social programs (which, for example, may target the poor) which would be seen by most citizens as socially beneficial. The distinction is admittedly vague for general purposes, but the framework is most useful for cases where the distinction is evident and easily recognized. Dixit and Londregan (1996) make a similar point.

<sup>2</sup> If the central agencies are to play this role, then they must not collude with politicians. One factor which may prevent collusion is an institutional culture (a collective preference, or a code of ethics) that favors the "public interest", and which is critical of distributive politics.

<sup>3</sup> Persson, Roland and Tabellini (1997) show that under some conditions, including that the social welfare function is symmetric, the socially optimal policy would entail no distributive transfers, and all resources would be used to finance the production of public goods at the first-best level. They further show that most political institutions fail to generate the socially optimal policy.

<sup>4</sup> In a recent paper Coate and Morris (1997) show that, when information is imperfect, governments may choose to use inefficient instruments to transfer public resources to special interest groups because they would like to disguise such transfers and present them as public goods that benefit ordinary citizens.

<sup>5</sup> As will be discussed below, there is some controversy on this proposition.

<sup>6</sup> The executive consists of the Presidency and the Council of Ministers (the cabinet), including the prime minister. The presidency, even though quite influential in other aspects of government (especially recently) has a more minor role in budget policy.

<sup>7</sup> Other important stakeholders are financial markets and the media. See below.

<sup>8</sup> The number of ministers of state has increased over the years. Many have been created by party leaders in order to reward high-ranking party loyalists and notables.

<sup>9</sup> The SPO also prepares "five year economic plans". While the plans do provide a general direction, they are not binding, and do not play an important role in policy discussions.

<sup>10</sup> Also, party notables' threat of exit (more correctly, the threat of joining another party) has proven to be very effective in making leaders responsive to their demands, as evidenced by "markets of parliamentarians" that surface every so often.

<sup>11</sup> We might add that recruitment in central agencies is done on a merit basis, and the general level of competence is higher than the rest of the bureaucracy.

12 There are certain issues that immediately thickens the division lines and instigates turf battles. For example, whether or not the Treasury should remain in its current status, or should be returned to the MOF is one such issue. In general, any proposal that disturbs the status quo by redistributing power from one agency to another is sure to be vetoed by the losing agency. Distribution of credit and blame is also a potential source of conflict.

13 Not only to the general public, but the government itself does not have a clear idea on the magnitude of most of these items.

14 Some components of quasi-fiscal activities of state banks are discussed in detail in Atiyas, Bal-Gündüz, Emil, Erdem and Özgün (1998).

15 There are some quasi-fiscal activities (such as some subsidized agricultural credit lines) that are not even eligible to be considered as duty losses. Losses associated with these particular activities need to be financed by the public agency in question.

16 The Treasury also engages in debt restructuring with the other public entities, including the Central Bank. These off-budget operations transfer resources to public entities (especially SEEs) against equivalent obligations to the Treasury, typically to service debt liabilities to third parties.

17 In the same period, total domestic debt has increased from 13 to 20 percent of GNP (see Table 1). Atiyas et.al. estimate that as of the end of 1997, the stock of duty losses at two state banks (that is, claims on the Treasury awaiting some sort of repayment through budgetary allocations or non-cash securities) were about 3.6 percent of GNP. In the same year, the flow of duty losses generated by these two banks, net of payments by the treasury, was about 0.9 percent of GNP.

18 This is a controversial issue. Even though most public sector financial management experts argues that so called "top-down" budgeting enhances aggregate fiscal discipline, Hallerberg and von Hagen (1997) argue that what resolves the common pool problem is not the sequencing of budget decisions (aggregate first, components later) but the centralization (delegating the decision on the aggregate budget to an agenda setter).

19 While initially these were announced on a monthly basis, a six-month program was announced in July 1998, and a 3-month program in January 1999.

20 For example, the press may collude with government officials on mutually beneficial issues and to the detriment of public interest. Such collusion occurs frequently in Turkey.

21 For a discussion of basic principles that should guide the the design of a balance sheet of the state in the Turkish context, see Emil (1997).

22 In recent years budget laws have provided upper bounds on the amount of guarantees that can be advanced by the Treasury. The effect of these bounds have been limited because the cabinet was given the authority to increase these limits.

23 For example, one proposal could be to require a super-majority in the parliament.

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Table 1: Public Debt and Deficits

	1991	1992	1993	1994	1995	1996	1997
Domestic Debt/GNP	8.14	11.66	12.77	13.98	14.55	18.55	20.02
PSBR/GNP	7.41	10.16	10.57	12.01	7.89	8.95	8.17
Primary Deficit/GNP	5.39	5.61	-4.79	-1.18	-2.51	-1.20	0.86
Operational Deficit/GNP	7.73	7.70	8.06	0.95	-0.92	3.42	1.44

Source: Atiyas, Bal-Gündüz, Emil, Erdem, Özgün (1998), Tables 3.1 and 3.2.

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**Table 2: The Turkish Budget system**

**Actors**

Spending agencies  
Central control (MOF, Treasury, SPO, Prime Minister)  
Cabinet  
Parliament, Planning and Budgeting Committee  
Parliament, General Assembly  
High Court of Audit

**The budget cycle**

1. Budget preparation by the government  
Budget call issued by the Prime Minister  
MOF issues Guide for Budget preparation  
Budget proposals drafted by spending ministries (June, July)  
Budget proposals evaluated by the central agencies  
Negotiation between central agencies and spending ministries and agreement  
(August and September)  
Central agencies and the government settles the final ceilings (September)  
Budget Law Proposal (October)
  2. Budget Legislation  
Budget Law evaluated by the Budget and Planning Committee (55 days)  
Amendments by the Committee  
Resettlement of the budget and draft budget law  
Discussions in the General Assembly  
Budget vote
  3. Budget Implementation  
Appropriations release by the MOF  
Cash release by the Treasury
  4. Audit  
MOF prepares draft Final Accounts Bill  
High Court of Audit issues statement of general conformity  
General Assembly approves the Final Accounts Bill
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Figure 1: Principal-Agent Relations in a Representative Democracy

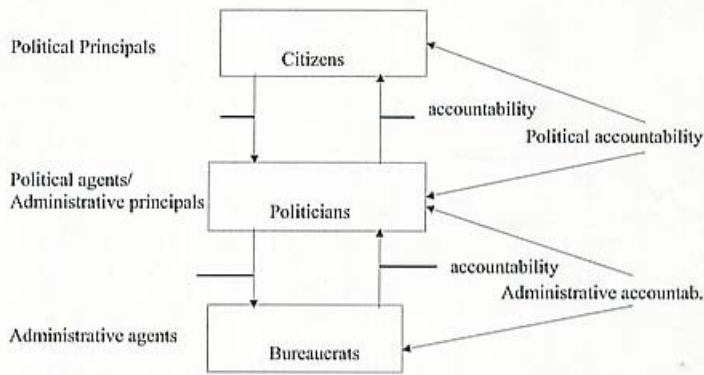
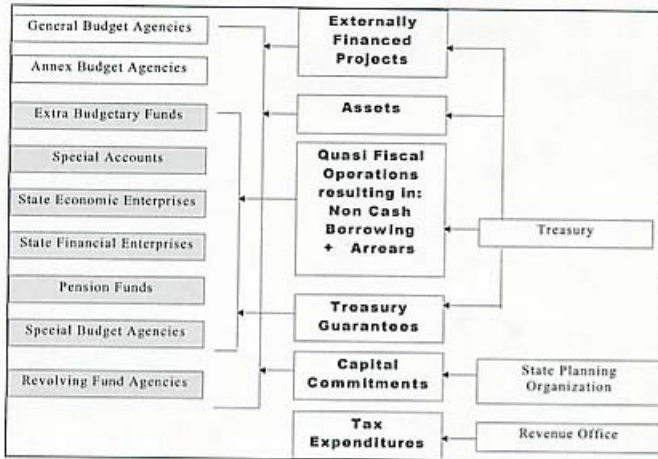


Figure 2. Non-Budgeted Activities



**Figure 3: Budget Deficits and Realization Gaps (% of GNP)**

