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TURKEY

PUBLIC EXPENDITURE MANAGEMENT SYSTEM

ASSESSMENT MAY 2008

Introduction

This report is the third standard assessment report on Turkey against the baselines that have been applied by Sigma for the assessment of the public expenditure management system in EU candidate countries. This report is an update of the 2006 report and is based on information gathered up to April 2008.

Since the previous report, the implementation of budgetary reforms has been pursued, generally according to the planned schedule. There is a wide involvement in implementing the reform measures. Decentralisation of Ministry of Finance responsibility to line ministries for budget management is effective; the improved budget preparation procedure, including the implementation of a Medium-Term Expenditure Framework (MTEF), is working effectively; line ministries and agencies have gradually started to prepare strategic plans and performance programmes; and “accountability reports” have been prepared.

1. Budget Legislation

The legal framework governing the Turkish budget system consists mainly of the Constitution and the Public Financial Management and Control Law no. 5018 (PFMC Law), enacted in December 2003, which is a public finance framework law. The PFMC Law was amended on 22 December 2005 by Law no. 5436 and on 25 April 2007 by Law no. 5628. The PFMC Law aims to introduce modern budgeting procedures. It replaced the General Accounting Law dating from 1927, which was based on the French financial management system of the time.

Secondary and tertiary legislation to implement the PFMC Law has been developed and is being implemented. This legislation includes several by-laws dealing with internal control, internal audit and performance-based budgeting, which were promulgated between 2005 and 2007; public internal audit standards, which were established in 2007; and guidelines for strategic planning and performance-based budgeting.

Debt management is regulated by Law no. 4749 of 2002 on Regulating Public Finance and Debt Management. Law Decree no. 178 of 1983 on the Organisational Structure and Duties of the Ministry of Finance, together with the PFMC Law, makes the Ministry of Finance (MoF) responsible for budget preparation, execution, revenue management, accounting and reporting¹.

External audit is regulated by the Law on the Turkish Court of Accounts (TCA). Article 68 of the PFMC Law specifies that the TCA may audit all general government organisations (central government, local administrations and social security funds). To bring external audit in line with generally accepted

¹ The Presidency of Revenue Administration, which is responsible for revenue collection, has been established as a semi-autonomous public administration, reporting directly to the MoF (Law no. 5345, May 2005), while the MoF General Directorate for Revenue Policy is responsible for tax policy formulation. The Undersecretariat of Customs is organised under the Prime Ministry. A state minister is responsible for customs.

international audit principles, a new law on external audit has been before parliament since 2006, but it has not yet been adopted.

To a large extent, the legal framework covers the basic requirements for sound budgeting². The Constitution (articles 161 to 164) and the PFMC Law (articles 18, 19, 42, 43 and 68) specify the deadlines for presenting the draft budget bill and final accounts to parliament, and regulate parliamentary debates on the budget. The PFMC Law recalls the fundamental principles of public financial management, including the unity of the budget, fiscal transparency and accountability requirements. It specifies the responsibilities and accountability requirements of ministers and heads of public administration (e.g. undersecretaries of ministries). It requires the preparation of medium-term fiscal projections, including a medium-term expenditure framework; this provision has been implemented since 2005. It also requires public agencies to prepare strategic plans and to develop performance-based budgets; this provision is gradually being implemented.

The PFMC Law outlines the central government budget-preparation process and provides general principles for budget implementation. It only sets down broad appropriation management rules. The law includes provisions for managing assets. It provides detailed requirements for reporting, preparing yearly "accountability reports" and submitting final accounts to the Turkish Grand National Assembly (TGNA). It defines the general principles for accounting and the procedures for preparing the chart of accounts.

The law includes detailed provisions for budget management within spending units, internal control procedures and internal audit. It defines gradual sanctions in case of mismanagement. It also includes some provisions on external audit, which are completed by the Law on the Turkish Court of Accounts (TCA). However, there is a mismatch between the requirements of external audit as defined in the TCA Law no. 832 and the requirements for external audit review as implied in the PFMC Law and its implementing legislation for public financial management.

The PFMC Law has brought significant changes to the distribution of responsibilities in budgeting. Line ministries have been made fully responsible for managing their budgets. The MoF budget offices within line ministries, which were involved in budget preparation and execution controls, were phased out in late-2005. Their activities have been transferred to the line ministries themselves. Within line ministries, the "strategy development units", which were established in 2006, are responsible for financial management, including budget preparation and internal control. On the other hand, however, the accounting offices of the central government's general budget are still branches of the General Directorate of Public Accounts (GDPA) of the MoF, with the exception of the accounting offices in the Undersecretariat of the Treasury.

The PFMC Law aims to cover all general government financial transactions and to make the coverage of the central government budget comprehensive. Initially, the provisional article 11 of the ninth part of the PFMC Law stated that the revolving funds, which are managed under special procedures, would be eliminated by the end of 2007. This did not happen. Whilst this deadline has not been met, it is nevertheless understood that the MoF is to prepare a new law by the end of 2008 in order to implement the reform of the revolving funds.

In some countries, the law governing the budget system is an "organic law", constitutionally higher than other laws. However, in Turkey all laws have equal status under the Constitution. In the absence of any hierarchy in the Turkish legal framework, there is a risk that additional laws will dilute the provisions of the PFMC Law. Methods should be sought to ensure the primacy of the PFMC Law in fiscal management matters. In addition, as noted above, while some improvements in the legal framework are still needed, legal changes should concentrate on key measures, as a stable legal environment is required for sound management.

Law no. 4749 on Regulating Public Finance and Debt Management stipulates that the Treasury, which is responsible for debt management, is the single borrowing authority for the central government. The law establishes a framework for dealing with contingent liabilities.

The budget is unified, but three central institutions are involved in budget preparation, execution and internal control:

2 There is no international standard to define the basic principles and requirements for sound budget management. However, the European Commission Regulations nos. 2342/2002 and 2343/2002 of 23 December 2002 enumerate a number of basic principles (e.g. the principle of universality) that should be found in every budget system, while the IMF Code of Good Practices on Fiscal Transparency (IMF-1998) provides requirements for transparency and accountability.

- The MoF is responsible for budget preparation, budget execution, accounting and reporting, and revenue collection.
- The State Planning Organisation (SPO) is responsible, among other duties, for preparing the public investment programme and the macroeconomic framework.
- The Undersecretariat of the Treasury (“the Treasury”) is responsible for debt and cash management, and for exercising state ownership rights in state-owned enterprises and public banks.

Generally, such fragmented arrangements are not conducive to efficient budget formulation and control. As noted below, a number of co-ordination mechanisms have been established to limit this risk, but better unification of the processes and responsibilities should be sought to avoid making the quality of budget management dependent on these co-ordination mechanisms.

The baseline for budget legislation has been partly achieved. The PFMC Law, which is the public finance framework law, constitutes a sound basis for budget management. However, a new Law on the Turkish Court of Accounts (TCA Law), which would enable an external audit of budget execution according to the rules defined in the PFMC Law, has not yet been enacted. This fact constitutes a significant limitation to the progress of the PFMC reform.

2. Parliamentary/Executive Relationship

The relationships between the executive branch and the Turkish Grand National Assembly (TGNA) on budgetary matters are governed by the Constitution and the PFMC Law.

According to Article 162 of the Constitution, the budget must be presented to the TGNA 75 days before the beginning of the fiscal year. As a first step, the bill is reviewed by the TGNA’s Planning and Budget Committee. The members of this committee can propose any amendment to the bill. The committee must adopt a revised budget bill within 55 days. As a second step, the TGNA debates the budget bill as amended by the Planning and Budget Committee. Article 162 of the Constitution stipulates that during debates in the plenary session on the draft Budget Act, members of parliament may not propose amendments that would increase expenditures or decrease revenues for each section. According to the PFMC Law, the budget is voted on the basis of functions, i.e. according to the 10 main functions set out in the functional classification of government expenditures.

The budget bill must be approved by the TGNA before the start of the fiscal year. If, exceptionally, the law is not voted by the TGNA by the start of the fiscal year, the TGNA may pass a provisional bill authorising the executive to spend up to a certain percentage of the amount appropriated by the budget of the previous year pending the approval of a new budget (article 19 of the PFMC Law). In recent years, the budget has usually been approved on time.

With the implementation of the PFMC Law, the budget documentation presented to the TGNA has been improved. The budget documentation now includes the following documents:

- Budget memorandum, including a medium-term fiscal plan (see sections 5 and 6 below);
- Annual economic report;
- Schedule of tax expenditures (public revenues renounced due to tax exemptions, exceptions, reductions and similar practices);
- Public debt management report;
- Last two years’ budget realisations and estimates of the next two years’ revenues and expenditures of public administrations within the scope of general government;
- Budget estimates of local administrations and social security institutions, for information only.

Important progress has been made in recent years in terms of the contents of budget documents. However, further progress would be desirable, such as including in the budget documents information on the link between policy priorities, programme inputs and expected programme outputs, with a distinction between new policies and existing commitments. To this end, the preparation of performance programmes (also referred to as performance-based budgets) is starting gradually, but these reports have not yet been analysed by the TGNA’s Planning and Budget Committee. However, it cannot be expected to fully implement the performance budgeting approach supported by the PFMC Law at short notice.

Since 2006 the final accounts have been communicated to the Turkish Court of Accounts (TCA) within a time limit of six months after the end of the fiscal year. The final accounts are tabled in parliament with the General Conformity Statement (GCS) of the TCA in the following budgetary session of the TGNA. The TCA can perform audits at the request of the TGNA. The TGNA has made four audit requests since 2005.

“Accountability reports” are prepared by line ministries and main agencies and transmitted to the TGNA and to the TCA. The “accountability reports” should include general information of the administration, information on activities and performance information as per the strategic plans and the performance programme, resources used, and reasons for deviations from appropriations compared to the realisation of the approved budget. However, the “accountability reports” are neither audited nor debated by the TGNA.

The Planning and Budget Committee is one of the 17 committees of the TGNA. It has 40 members, of whom currently 25 represent the governing party and 15 the opposition. It is staffed by 21 employees, including three directors, nine experts and nine administrative staff. It is expected that six additional experts will be recruited in 2008. Taking into account the increased budget documentation and the new requirements of the PMFC Law, it is foreseen to restructure this committee into sub-committees.

The baseline for the parliamentary/executive relationship has in large part been achieved. The legal framework defines the relationships between the executive branch and the Turkish Grand National Assembly (TGNA). Budget documentation has been improved. However, the planned strengthening of the Planning and Budget Committee, which would enable the committee to review performance programmes and “accountability reports”, has not yet been implemented.

3. Scope of the State Budget

According to the PFMC Law (as amended), general government operations are covered by: (i) the central government budget, (ii) the budgets of social security institutions, and (iii) the budgets of local administrations. The central government budget comprises: (i) 50 "general budget agencies", which consist of ministries, high institutions and a few general directorates (listed in Chart I of the PFMC Law); (ii) 118 semi-autonomous agencies, including 87 universities and higher education organisations (Chart II); and (iii) eight regulatory agencies (Chart III).

Since December 2000, 61 budgetary funds benefiting from special management arrangements and non-budgeted own revenues and eight extra-budgetary funds (EBFs) have been closed. Nevertheless, there are still five EBFs³ and more than 1400 revolving funds, which are managed separately from general budget expenditures⁴. Total expenditures from revolving funds accounted for 2.61% of GDP in 2007. Since expenditures from EBFs would account for about 0.5% of GDP, extra-budgetary spending from funds, including revolving funds, could exceed 3% of GDP in 2007, while central government expenditures accounted for 31.3% of GDP in 2007.

As noted above, the revised provisional article 11 of the PMFC Law (amendment of 22 December 2005) stipulates that the revolving funds are to be restructured. When preparing the restructuring plan of the revolving funds, it will be important to separate from the other funds the revolving funds that were set up with the purpose of encouraging the recovery of user charges. Provided that their transactions are included in the budget in gross terms, the revolving funds that were set up for cost recovery may be maintained, while the other funds should be eliminated, unless there is a strong case to justify maintaining them. According to the provisional article 11 of the PFMC Law, the budgets of the revolving funds and of the funds affiliated with the public administration should be included in the budgets of the relevant public administrations. Currently, the estimated revenues and expenditures of these funds are disclosed separately from the budgets of the public administrations.

Besides the problems posed by the remaining EBFs and the revolving funds, issues concerning foundations and the İller Bank (nominally an investment bank, which operates under the Ministry of Public Works and Settlement) have raised some concerns. Foundations solicit public donations, often at the same time as the services are provided. In the past their resources have been used partly to supplement line ministry activities, such as for the purchase of vehicles⁵. The ties between the foundations and line ministries were to have been

³ The remaining EBFs are the Defense Industry Support Fund, the Social Solidarity and Aid Fund, the Privatisation Fund, the Promotions Fund, and the Savings and Deposit Insurance Fund.

⁴ Source: The SPO, quoted in the IMF's *Report on the Observance of Standards and Codes—Fiscal Transparency Module* of March 2006.

⁵ IMF, op.cit.

severed⁶. However, there are still concerns about the financial transactions and expenditures of associations and foundations established under public administrations. The TCA is auditing these transactions at the request of the TGNA. The Iller Bank's financial transactions are included in the local government figures and in the general government balance reported by the State Planning Organisation (SPO). However, according to the IMF, the Iller Bank would have many characteristics of an extra-budgetary fund (EBF)⁷.

Quasi-fiscal activities, which consist of policy-driven spending implemented by government-owned banks and enterprises, were a major concern in the 1990s. These quasi-fiscal activities came under better scrutiny after the agreement with the IMF in May 2001, and quasi-fiscal losses began to be explicitly budgeted and reported. The draft budgets of all enterprises in which the Treasury's share is above 50 per cent (38 enterprises) are reviewed by the Treasury in order to address budget issues and expected risks. Duty losses of public corporations are currently monitored. Law no. 4603 of November 2000 on setting the legal framework for financial and organisational restructuring of state banks stipulates that the state may not assign any duties to public banks without paying in advance the amount due. Duty losses are therefore funded from the central government budget. This law stipulates that banks must determine their credit policies according to the amount of the budgeted subsidy. The Treasury pays the subsidy monthly on the basis of losses reported by the bank. At the end of the year, the Treasury controls and compares actual duty losses with Treasury transfers.

Expenditures financed by external aid are in principle included in the central government budget. However, there are probably some exceptions, which may concern military expenditures and some external grants.

Turkey has made progress in recent years in achieving the baseline related to the comprehensiveness of the central government budget. However, the reform of the revolving funds must still be prepared and implemented, and there five extra-budgetary funds (EBFs) remain. In addition, the situation of some entities, such as the Iller Bank, should be clarified.

4. Monitoring the Deficit and Government Debt

The main fiscal policy indicators are the overall balance, the primary balance of the central government budget, and the balances of the "consolidated government sector", as defined in the agreement passed with the IMF. The "consolidated government sector" defined in the IMF agreements consists of the central government budget data and the balances of three EBFs, the Unemployment Insurance Fund, social security institutions, and 22 state-owned enterprises. This definition is not aimed at exhaustive general government accounting, but focuses on the key – and fiscally most risk-exposed – components of public finances. The State Planning Organisation (SPO) publishes annual estimates of general government balances in the annual programmes and in the pre-accession economic programmes submitted to the European Commission⁸.

The Statistics Bureau has recently prepared national accounts according to the ESA 95 standards. However, as there are still some discrepancies with European standards, a number of adjustments have been made to the published general government accounts so as to submit fiscal notifications to the European Commission. According to the European Commission's evaluations⁹, some conceptual issues concern, among others, the delimitation of the government sector and the cash basis of accounting for taxes and social security institutions. Also, it is unclear whether all arrears are duly reported, notably in the health and infrastructure sectors.

According to the IMF, the institutional framework established under the Debt Management Law no. 4749 appears to be well designed and implemented¹⁰. The Treasury publishes a monthly debt management report that contains detailed information and analyses on borrowing and guarantees. This report clearly distinguishes central-government debt, other public sector debt, external debt and domestic debt. It includes

⁶ According to the Law on Associations and Foundations no. 5072 of January 2004, none of the activities of these foundations should be under the scope of the general government. In addition, article 72 of the PFMC Law stipulates that "no real or legal person may collect any amount on behalf of the public, nor effect payment from the public revenues unless duly authorized pursuant to the laws".

⁷ IMF, op.cit.

⁸ Concerning the EBFs, the 2008 annual programme includes data for only the three EBFs that are included in the "consolidated government sector" defined in the IMF agreements.

⁹ European Commission (June 2006) *Fiscal Notifications of Acceding and Candidate Countries: Overview and Assessment* (Enlargement Papers, no. 28), Brussels.

¹⁰ IMF (November 2007), *Turkey: Financial System Stability Assessment*.

sensitivity analysis for debt servicing. Monthly information on debt is provided to the TGNA, and monthly statistics are published on the Treasury website. The Treasury establishes and publishes a monthly debt management strategy, notably to inform the markets.

Regarding the guarantees, the potential liability they represent for the Treasury on the basis of their risk exposure is not added to direct public debt. However, a “risk account” appropriation is included in the budget to cover possible losses from guaranteed debt stock. In addition, state borrowing and guarantee limits are submitted to the TGNA for approval. Article 5 of the Debt Management Law stipulates that: (i) the annual borrowing limit for the general budget of the central government is defined as the difference between the total initial appropriations and the estimated revenues indicated in the annual budget law; and (ii) the limit of guaranteed facility to be provided within the fiscal year shall be determined by budget laws every year.¹¹ According to article 8 of the law, sub-national governments and legal entities with more than half of their capital belonging to the government must obtain permission from the Treasury before receiving external financing without Treasury guarantees.

Law no. 5216 of July 2004 on Metropolitan Municipalities limits the debt stock (including interest) of metropolitan municipalities to no more than 1.5 times their annual revenue, while the debt stock (including interest) of other sub-national governments is limited to their annual revenue¹². New domestic borrowing of sub-national governments in excess of 10% of annual revenues requires the authorisation of the Ministry of the Interior. There are substantial payment arrears on servicing existing municipal debt, which creates uncertainties for fiscal sustainability¹³. It is unclear whether the available data on domestic borrowing from sub-national governments is complete; it should notably be checked whether suppliers’ credits are fully reported.

Build-Operate-Transfer (BOT) schemes and other forms of Public-Private-Partnership (PPP) agreements have benefited from the Treasury’s guarantees in the water and energy sectors. The guarantees related to PPPs are monitored in the same way as other guarantees. The related fiscal risk is covered by risk-account appropriation. The government has guaranteed minimum sale and price levels in the electricity sector, and the Treasury runs the risk of having to supplement the difference in the event that market demand and price projections fall below these thresholds.

According to the PFMC Law, the budget can include contingency appropriations, which should not exceed 2% of the general budget appropriations, and the MoF must disclose the use of these contingency appropriations within 15 days of the end of the year. This last provision has been implemented since the closure of the 2006 budget year.

Tools have been put into place to monitor the debt and the deficit. Nevertheless, there are potential risks concerning domestic borrowing of sub-national governments. Further improvements are still needed to ensure that the fiscal notifications to the European Commission are fully compatible with European standards. The baseline for monitoring the deficit and government debt has therefore been only partially achieved.

5. Medium-Term Expenditure Framework (MTEF)

Progress has been made in developing a multi-year approach to budgeting. Since the preparation of the 2006 budget, the following activities have been carried out during budget preparation:

- Adoption of a medium-term programme (MTP) by the Council of Ministers by the end of May: This programme, which is prepared by the SPO, includes basic macroeconomic policies, economic targets, and indicators projected for the following three years. It is published in the *Official Gazette*.
- Adoption of a medium-term fiscal plan by the High Planning Council (HPC) by 15 June: This fiscal plan is based on the macroeconomic projections of the MTP. It is prepared by the MoF. It includes the following three years’ aggregated fiscal targets and an “aggregate MTEF”, which gives expenditure ceilings for each line ministry and main spending-units by broad economic categories. This “aggregate MTEF” frames budget preparation. It is published in the *Official Gazette*.

¹¹ According to the draft amendments to the Debt Management Law concerning the TGNA, a new ceiling would cover both onlent loans and guarantees; these amendments have not yet been enacted.

¹² Law no. 5393 of July 2005 for other municipalities and Law no. 5302 of February 2005 for special provincial administrations.

¹³ IMF, ROSC-Transparency report, op.cit.

- Then, on the basis of the “aggregate MTEF”, line agencies prepare forward estimates, or a “detailed MTEF”, together with their submissions for the annual budget. These forward estimates are included in the budgetary documents and presented in the same format as the budget.

The High Planning Council (HPC) is composed of the Prime Minister acting as the chair, the Minister of State for Treasury, the Minister of Finance and the ministers managing the most significant investment budgets (Ministers of Transport, Industry and Trade; Energy and Natural Sources; and Public Works and Settlement), and the Undersecretary of the SPO.

Key line ministers in public service delivery, such as the Minister of Education or the Minister of Health, are not members of the HPC. Depending on the topics to be discussed by the Council, the chair may invite other ministers and policy-makers to participate.

The MTEF prepared in June is used to provide a framework for line ministries' budget preparation, but line ministries may present additional requests that exceed the MTEF ceilings. There may be significant discrepancies for the same year t between the expenditure projections of the year t to $t+2$ MTEF and of those of the year $t-1$ to $t+1$ MTEF, prepared the previous year.

Implementing an effective multi-year budgeting system will take time, but efforts should be engaged to strengthen the MTEF procedure, with a view to ensuring that the MTEF ceilings will be more effective during budget preparation.

Progress has been made in medium-term programming and planning. Since 2006, the budget has been placed within a multi-year perspective. However, it would be premature to assess the impact of this important reform. Actions to ensure the effectiveness of the multi-year budgeting approach should be pursued.

6. Budget Process

The budget preparation cycle is organised as follows:

- In May-June, as set out in detailed section 5 above, the medium-term programme (MTP) and the medium-term fiscal plan, which includes an “aggregate MTEF” are adopted and published in the *Official Gazette*.
- By the end of June, following the HPC meeting, the Ministry of Finance issues a budget call and a budget preparation guide. The SPO issues an investment circular and an investment programme preparation guide. These documents, published in the *Official Gazette* by the end of June, recall general principles and objectives. They include calculation methods, sample schedules and tables to be used for preparing budget submissions. The MTEF provides the expenditure ceilings that set the framework for line ministries' budget preparations. As noted, separate ceilings are established for broad economic categories of expenditure (personnel, goods and services, investment, etc.);
- In late June and in July, line ministries and other agencies prepare their budget submissions. They submit their budget submissions to the MoF and their investment project proposals to the SPO by the end of July. Their investment project proposals must be consistent with the budget submission sent to the MoF. The general budget revenue projections are prepared by the MoF, while for other revenues draft projections are prepared by the relevant agencies.
- In August-September, following submission of the budget proposals to the MoF, meetings are held with line ministries on their budget submissions. The investment project proposals are scrutinised by the SPO.
- In September, the MoF drafts the budget bill and a budget memorandum.
- In the first week of October, the macroeconomic indicators and budget figures are reviewed by the HPC.
- By 17 October, the budget bill is approved by the Council of Ministers, tabled in the TGNA and enacted according to the procedure discussed above (section 2).

The budget preparation calendar and the deadlines for presenting the budget bill to the TGNA are respected. The guidelines provided by the MoF and the SPO allow expenditure items – such as personnel expenditure and investment projects – to be reviewed in detail.

Prior to 2005, budget preparation within line ministries was supervised by the MoF budget offices located in line ministries. As from 2006, line ministries have been made fully responsible for preparing their budget submissions; the “strategy development units” are responsible for budget preparation within line ministries.

Strategic planning is being developed according to the implementation schedule defined in the by-law on “principles and procedures for strategic planning in public administration”. About 50 strategic plans have already been prepared by line ministries and main agencies. These plans have been reviewed by the SPO. It is expected that 148 central government ministries and main agencies will have prepared their first strategic plan by 31 December 2009. In parallel to their strategic planning calendar, line ministries and main agencies have started preparing performance programmes (“performance-based budgets”). These programmes are transmitted to the General Directorate of Budget and Financial Control of the Ministry of Finance.

The development of a performance culture throughout the government will take time. Therefore, it is difficult to assess the effectiveness of the actions that have been engaged recently. It will be necessary to ensure that the support infrastructure will be adequate for the exercises that are to be carried out and/or to ensure that the methodology is suitable for the existing accounting systems and human resource capacities. For example, the performance-based budget of the Ministry of Finance has allocated indirect costs to each strategic objective and each activity. Using cost-accounting methods allows the estimation of the full costs of activities. However, developing such exercises may prove difficult in many ministries¹⁴. It will be necessary to assess the results of the current experiences before moving forward and, for example, before considering a revision of the budget classification.

Despite progress made, the budgeting process still presents some weaknesses. As noted above, the role of the MTEF, prepared in June, needs to be reinforced. The MoF and the SPO co-ordinate to ensure consistency between the investment programme and the budget. The total investment budgets of line ministries and main agencies are determined by both the MoF and the SPO together. Nevertheless, the recurrent and investment budgets are prepared in separate processes. Separate MTEF ceilings for the investment and the recurrent budgets are prepared in June and announced to line ministries. This procedure leads to inefficiencies in resource allocation, notably because it does not encourage line ministries to make trade-offs between recurrent spending and investment and to review the recurrent costs of investment projects.

The budget process baseline has been partially achieved. The budget-preparation calendar is generally respected, but there are inefficiencies in resource allocation, which is notably attributable to the fragmented budgeting processes.

7. Budget Management of Public Investments

As indicated above, investment programming is co-ordinated by the SPO. The SPO reviews in detail the investment requests of line ministries, verifying whether the projects included in these requests have undergone a feasibility study.

In principle, if the proposed projects have not been studied for feasibility, they cannot be included in the budget. The PFMC Law confirms this procedure and stipulates that an “investment project which does not have a feasibility study, including environmental analysis and cost-benefit or cost-efficiency analysis, and those which are examined and not approved for feasibility by the SPO shall not be included in the investment programme” (article 25).

The investment programme prepared by the SPO sets out in detail the investment component of the budget by project. Its scope is wider than the central government budget, because it also covers the investment projects of state economic enterprises and provincial banks, and foreign-financed projects of local administrations. The investment programme is finalised by the SPO after the budget has been enacted. The programme is published in the *Official Gazette* by a decree of the Council of Ministers within 15 days following the entry into force of the Budget Law (article 19 of the PFMC Law). The current procedure ensures consistency between the investment programme and the budget from a financial point of view. As noted above, this arrangement is not conducive to efficient resource allocation. Nevertheless, the activities currently performed by the SPO, in the public investment area, are essential to ensure that the most cost-effective projects are selected. Therefore, before considering a revision of the current arrangements in

¹⁴ Several countries that carry out programme budgeting prefer grouping indirect costs related to support services at ministerial level into a “support (or administrative) programme” instead of distributing these indirect costs among operational programmes.

investment programming, capacity in investment project preparation and screening should be strengthened within line ministries.

A National Fund has been established within the Treasury to manage EU assistance allocated to Turkey. As a result of the signature of a Memorandum of Understanding in 2002, the European Commission transferred its contracting authority to the Turkish Government in October 2003 and to the structures of a Decentralised Implementation System (DIS). Whilst Turkey was accredited for the use of the Pre-Accession Instrument for Turkey, the process of preparing for accreditation of IPA funds is now underway. Projects to be implemented and financed from EU funds must be included in the investment programme. The national co-financing portion of these projects is currently budgeted as a global item. In the investment programme, domestic counterparts are designated on a project-by-project basis.

In recent years, some flexibility has been given to implementing agencies during the project implementation process, especially as a result of certain measures taken, such as aggregating several similar projects under a single project and allowing investing institutions enough room to make the necessary changes among the sub-projects. It is expected that more flexibility will be granted to implementing agencies in the future.

Turkey has partially achieved the baseline for budget management of public investments. Procedures have been put in place to supervise investment programming and project selection of line ministries. The SPO, which is staffed by competent professionals, scrutinises investment requests. Since investment programming is somewhat disconnected from recurrent budget preparation, there are risks of inefficiencies in resource allocation, but before considering a revision of the current arrangements in investment programming, capacity in investment project preparation and screening should be strengthened in line ministries.

8. Budget Execution and Monitoring

The government's budget reform programme is aimed at streamlining the current budget-execution system. Budget offices and heads of finance offices have been phased out. The personnel of budget offices have been partially transferred to spending-units. In addition, the previous numerous centralised controls over budget execution of spending agencies performed in budget management have been transferred to spending agencies. Turkey has taken a holistic approach in the establishment of an internal control system to assist management in implementing the activities specified in the strategic plans and performance programmes. Internal control is being developed and a department for internal control has been established within the strategy-development units of spending agencies; the regulatory framework has been set up. However, the new internal control procedures have not yet been fully implemented, as they have a broader remit than ex ante controls.

Accounting offices are responsible for payment transactions and accounting. Concerning the general budget of the central government, approximately 1600 accounting offices spread throughout the country are MoF offices, and are staffed and controlled by the General Directorate of Public Accounts (GDPA), except for the three accounting offices in the Undersecretariat of the Treasury¹⁵. According to article 61 of the PFMC Law, accounting services for the general budget continue to be provided by the MoF, but their function focuses on accounting and payment transaction processing, with regularity control being placed under the responsibility of line ministries. The accounting offices of agencies outside the general budget (e.g. universities) are under the responsibility of the relevant agencies.

The Treasury is responsible for cash management. Borrowing and debt service payments are administered centrally by the Treasury. Funds are released to spending agencies according to a quarterly cash plan prepared by the Treasury in close co-ordination with the MoF and line agencies. The payment transactions are subsequently made through the accounting offices.

At the central level, the cash management system consists of the "central system", which covers the accounting offices of the headquarters of line ministries and main agencies. In this system, line ministries' bank accounts are kept with the Central Bank. Upon the request of the accounting offices, the Treasury transfers funds to the line ministry's account at the Central Bank, and the line ministry subsequently effects payments from this account.

¹⁵ The three accounting offices in the Undersecretariat of the Treasury are the State Debt Accounting Office, the Domestic Payments Accounting Office, and the Foreign Payments Accounting Office.

For the accounting offices of subsidiary units, progress towards a treasury single account has been made recently. The accounts are still kept with the Agricultural Bank (*Ziraat Bankasi*), but with the new system each accounting office holds one account for payments and one account for receipts. As from September 2007, accounting offices can use only the amounts in their payment accounts, which have been transferred from the Treasury for payment, and they cannot use the amounts in their receipt accounts. Another progress in the system is that accounting offices are using the Say2000i IT system for their cash requests. So the Treasury can monitor the cash needs of these units one day prior to their payments. Also, the balances of these accounts are transferred to the Treasury daily, instead of the previous weekly transfers.

Budget execution is monitored regularly. The Say2000i IT system is implemented in all accounting offices for the central government general budget. This system allows budget execution to be monitored in real time on a cash basis. Summary budget execution reports are published monthly on the GDPA's website.

The SPO is responsible for monitoring investment expenditures. Institutions send information on the implementation of investment projects to the SPO on a quarterly basis. This information is consolidated by the SPO and published as a "Public Investment Report".

The PFMC Law includes a general provision that limits transfers between budget items to 5% of the amount of the appropriation, unless a different ratio is specified in the annual budget law. No transfer is to be carried out from personnel expenditure, interest expenditure and risk account items to other items. Protecting personnel expenditures does not encourage spending agencies to make savings in this area. A "budget item" is specified in the annual budget law and corresponds to the lowest level of the functional and administrative classifications and to the second level of the economic (input) classification (e.g. nine categories for goods and services). Detailed input controls could hamper efficiency in programme implementation, but to make budget execution more flexible, the ratio limiting transfers between budget items has been increased to 20% in the annual budget law, instead of 5% in the PFMC Law. The transfers of up to 20% are carried out by the agencies, while transfers exceeding 20% require the authorisation of Ministry of Finance.

Systematic commitment accounting and reporting are not carried out. However, the Say2000i system, which is a web-based accounting system operated by the GDPA, has the functionality for monitoring commitments. The budget does not include "commitment appropriations". Authorisation can be made for legal commitments that can be undertaken in the budget year, and annual payment authorisation can be made; however, there is no monitoring of multi-year commitments. It is therefore advised to consider the elaboration of instruments for managing and controlling multi-year commitments.

Significant progress has been made. The baseline for budget execution and monitoring has been partially achieved. The internal controls of central agencies have been partially modernised. However, the new internal control and audit systems must still be considerably enhanced and made fully operational. Commitment control and reporting should be reinforced. Actions to streamline cash management, which are moving in the right direction, must be pursued.

9. Accounting and Reporting

The GDPA of the MoF is responsible for government accounting. Detailed accounting records are kept in accounting offices.

There is a unified accounting and budget classification for budget organisations. Some form of a partial accrual accounting system has been implemented. Since January 2006, the chart of accounts of local government is consistent with the general accounting framework. In 2007 the chart of accounts for revolving funds was harmonised with the chart of accounts for general government. Nevertheless, for the moment, extra-budgetary funds (EBFs) have different charts of accounts. Accounting manuals now exist and all institutions have guidelines.

The budget classification system includes a functional classification – based on the Classification of Functions of Government (COFOG) – and an economic classification of expenditures compatible with the Government Financial Statistics (GFS) standards.

In-year financial reports of the central government are published monthly. The Say2000i system has facilitated in-year reporting. The GDPA publishes on its website monthly financial reports on the central government budget. Four regulatory and supervisory institutions are covered by the Say2000i system, but the rest are not, although they send their financial data monthly to the MoF. According to article 53 of the PFMC Law, financial reports from social security institutions and local government authorities should be published

quarterly by the MoF. However, the MoF is facing difficulties in gathering in-year financial reports from social security institutions. So far no data has been compiled from social security institutions.

As noted above, the final accounts are communicated to the TCA within six months of the end of the fiscal year. They are tabled in parliament, together with the General Conformity Statement (GCS) of the TCA, in the subsequent budget session of the TGNA.

At the end of the fiscal year, the public accounts are kept open for a complementary period of one month so that deferred payments can be made. Spending-units that have used their approved allocation may benefit from advance payment, which should also be regularised within one month of the end of the fiscal year¹⁶. Advanced payments are authorised within the limits of budget appropriations, but nevertheless such a practice often presents potential fiscal risks and should be eliminated.

All ministries and main agencies prepare annual activity reports (referred to as “accountability reports”). The MoF compiles the reports and drafts a consolidated “accountability report” on central government institutions and social institutions. Individual reports are copied to the Planning and Budget Committee of the TGNA and to the TCA for audit. However, no such audits have yet been carried out due to the lack of legal mandate for the TCA. “Accountability reports” are also copied to the TGNA’s Planning and Budget Committee.

The current system of accounting and reporting for institutions meets the basic requirements of monitoring, but the charts of accounts of EBFs still have to be made consistent with the government’s unified accounting framework. The baseline has therefore been partially achieved.

10. Capacity for Upgrading the Public Expenditure Management System

A centralist tradition and a system governed by a General Accounting Law dating from 1927 have created a regime that emphasizes strong control over inputs through the extensive use of ex ante approvals by central agencies. The current reform involves a dramatic change in the budgeting culture. It addresses good governance procedures and the implementation of accountability approaches. Such changes require time and technical capacity, long-term political commitment, and proper arrangements to manage the change. In this regard, there is currently a good commitment to change in the executive branch.

Despite this favourable climate for reform, special attention should be given to change management. Staff in the MoF and line ministries involved in budget management will have to change their working methods in order to achieve the objectives spelled out in the PFMC Law. As several central agencies are involved in the design and implementation of the reform, co-ordination is crucial. Administrative decentralisation does not mean losing control, but it requires different structures and directive guidelines for devolving authority and responsibility. Furthermore, it requires the development of follow-up procedures for budget execution, including reporting on the efficiency of the internal control system.

For the moment, the reform measures have been implemented successfully without setting up special arrangements, thanks to good co-operation among the core agencies involved in the reform. However, the reform will face a long phase of trial and error processes, which will require close monitoring so as to draw lessons from experience. This could call for strengthening and formalising supervision mechanisms. The strategic development units (SDUs) of line ministries and main agencies are playing a key role in the arrangements for managing public expenditure. It will be important to pursue actions to strengthen them.

Training activities have already been carried out. Thus the training department of the General Directorate for Budget and Fiscal Control (GDBFC) of the MoF has delivered various training and awareness seminars for implementing the PFMC Law. In 2008 its training and conferences activities should reach more than 1400 persons. These efforts should be pursued further and should also be addressed to relevant top management levels.

The Dutch Government, through the MATRA programme, is providing support for the implementation of the PFMC Law. The GDPA benefits from an Italian twinning project to publish government financial accounts according to the ESA 95 standards.

¹⁶ According to article 51 of the PFMC Law, under special circumstances this period may be extended to five months for non-budgetary transactions.

11. Summary and Follow-Up Actions

The planned reforms in budget management are headed in the right direction and should contribute to improving fiscal discipline and to increasing effectiveness and efficiency in public expenditure management. There seems to be a broad consensus for implementing the reforms, which will be a key factor in the successful implementation of reform measures. However, reforming a budget system is a continuous and learning-by-doing process, which needs to be monitored closely in order to address any implementation risk, assess the results achieved, and take correctives measures in a timely manner.

Reform Implementation Risks

Any budget reform involves the risk of not achieving the results intended. Special attention should be paid to the following areas:

- Poorly co-ordinated reform measures diminish their effectiveness. It will be important to ensure good co-ordination between the various actors involved in the reform in order to address reform implementation problems in a timely manner.
- The fact that a modern internal control system and internal audit have not yet been fully established presents risks, particularly as responsibilities have been transferred from the MoF to line ministries.

Unifying Budget Processes

Ideally, budget and fiscal management processes should be fully unified under the responsibility of the MoF, with the SPO focusing on strategic issues and the Treasury acting as an MoF agent for debt and cash management. However, hastily transferring responsibilities from one agency to another could pose difficulties in implementing the planned reform measures and in reaching common objectives. In addition, the SPO has skills in the screening of investment projects, which is crucially important for improving the cost-effectiveness of the investment programme. Therefore, in the short term, the focus should be placed on processes (performed by the MoF, SPO and Treasury) rather than on organisations, through strengthening the budget-policy link and co-ordination mechanisms for budgeting. Of course, in the long term, it would be advisable to unify the organisational arrangements for fiscal management.

Strengthening the Strategic Development Units

Organisational learning has just begun and, as noted above, it will be important to pursue actions to strengthen the strategic development units (SDUs), which may include the development of training curricula based on the existing survey on SDUs. This should contribute to enhancing the operational capacity of SDU staff with the necessary skills and competencies. .

It will also be useful to develop an SDU network, with a view to sharing experiences and improving working methods. The SDU in the Prime Minister's Office, which has already carried out surveys and studies on the SDUs, and the SDU of the Ministry of Finance, which is developing some managerial tools, should both play a key role in developing this network.

Managing Change

To ensure close co-ordination in designing and implementing reform measures, all key actors should be involved, and the main decision-makers should ensure an overall supervision of the reform. Despite the fact that the arrangements for managing the reform were not fully formalised and were placed under the responsibility of various core ministries or undersecretariats, so far the Government of Turkey has been successful in implementing the reform measures.

However, as noted above, reforming government financial management is a learning-by-doing process, which calls for very close co-ordination between the main actors over a long period. In the absence of special inter-ministerial arrangements for steering reform implementation, the High Planning Council (HPC) should play a key role. To co-ordinate effectively the development of a performance-based approach, the HPC should include line ministers involved in public service delivery, such as the ministers responsible for education and health affairs.

Independent quality assessment should be undertaken regularly to review progress in reform design and implementation.

Phasing Reform Measures

The PFMC Law provides an adequate framework for modernising the budget system, including – among other elements – the development of a performance orientation in budgeting, the development of a multi-year approach to budgeting, and the establishment of internal audit. However, implementing such a comprehensive reform requires continuous efforts over a long period. Reform measures therefore need to be prioritised and properly phased in, taking into account priorities, inter-linkages among the various measures, training activities and actions to manage change. First, the important steps already made, and reviewed above, should be consolidated.

To this end, priority actions may include both training and strengthening of the procedures for making multi-year budgeting more effective; setting out measures to ensure that all tables of the fiscal notification to the European Commission fit European standards, drawing lessons from the performance budgets already prepared in order to identify realistic improvements; and pursuing the strengthening of internal financial controls and audit. In a second stage, further steps in developing performance-based budgeting could be considered, which might include actions such as implementing a programme classification in the budget or developing a contractual approach where relevant. However, it should be kept in mind that haste could derail the reform programme.