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2005 fiscal notifications of acceding and candidate countries: overview and assessment

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MAIN RESULTS OF THE MARCH 2005 FISCAL NOTIFICATIONS PRESENTED BY THE CANDIDATE COUNTRIES

OVERVIEW

1. Background

All candidate countries were to submit fiscal notifications to the Commission services by 1 March 2005, in accordance with the commitments taken in the framework of the pre-accession fiscal surveillance procedure. This notification exercise is the fifth produced by the candidate countries after the annual exercises between 2001 and 2004, however the first one for Croatia, a candidate country since June 2004. Countries generally met this reporting deadline by submitting an initial notification, but most of them sent rectifications of different kinds after this date.

The framework of the fiscal notifications is now well known. All countries are familiar with the EU legal and methodological principles for the calculation of general government deficits and debt levels. The presentation of the notification tables and in particular the reconciliation between the national budget balance and the balance used in EU fiscal surveillance are both well understood. Significant efforts have been made to provide figures that comply as much as possible with the methodology and coverage required by the fiscal notifications.

The perspective of accession is a catalyst for reforms in the scope and the management of the national budgets. Budget presentations are being modernised, and the coverage of government operations by the national budgets is made more exhaustive. In particular, there has been a spectacular reduction in the number of off-budget and special funds accounts and operations. Also, the reference to central and general government in EU fiscal surveillance often leads to more systematic monitoring, supervision and controllability of the operations of local authorities and of social security.

2. Reported general government balances and debt levels

Table 1 shows the general government net borrowing/net lending figures reported in March 2005 and compares them with the figures reported in the previous notification.

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

	Notifi-cation	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**(1)	average 2001-04
Bulgaria	2005		**1.4**	**-0.2**	**0.6**	**1.3**	**-0.5**	0.8
	2004	***-0.5***	***0.2***	***-0.8***	***-0.1***	***-0.7***		
Croatia	2005		**-6.5**	**-4.2**	**-4.6**	**-5.2**	**-3.2**	-5.1
	2004							
Romania	2005		**-3.5**	**-2.0**	**-2.0**	**-1.4**	**-0.5**	-2.2
	2004	***-4.4***	***-3.5***	***-2.0***	***-2.0***	***-3.0***		
Turkey	2005		**-29.8**	**-12.3**	**-9.7**	**-3.9**	**-4.3**	-13.9
	2004	***-6.1***	***-29.8***	***-12.7***	***-8.7***	***-8.0***		

(1) planned

The latest notifications show that the general government deficits generally shrank in last year, and the surplus was rising for the case of Bulgaria, as compared to the previous year. The exception is Croatia, where the deficit has been rising over the past two years. The plans for the current year foresaw in the 2005 notifications a narrowing of the deficits in the case of Croatia and Romania, and widening in Turkey and a small deficit in Bulgaria after last year's surplus. Looking at trends over a longer 5-year period, Bulgaria's government balance was overall positive and Romania's deficit showed a clear trend of improvement, mostly due to falling interest payments and rising revenues. After in improvement from 2001 to2002, in Croatia, the deficit showed no further trend of narrowing, whereas Turkey's deficits widened sharply during the 1999 and 2001 economic and financial crises in the country but have, since then, come down considerably due to high primary surpluses and falling interest rates.

Table 2 displays the notified general government gross debt ratios and compares them with the figures submitted in March of last year.

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

	Notifi-cation	2000	2001	2002	2003	2004	2005[(1)]	change 2001-04
Bulgaria	2005		**66.2**	**54.0**	**46.3**	**38.8**	**33.4**	-32.7
	2004	***73.6***	***66.2***	***53.2***	***46.2***	***45.1***		
Croatia	2005		**40.1**	**39.9**	**41.5**	**44.2**	**43.7**	3.7
	2004							
Romania	2005		**23.2**	**23.3**	**21.3**	**18.5**	**17.5**	-5.7
	2004	***23.9***	***23.2***	***23.3***	***21.8***	***23.5***		
Turkey	2005		**103.7**	**93.4**	**86.7**	**79.7**	**77.2**	-26.6
	2004	***57.4***	***105.2***	***94.9***	***87.1***	***85.0***		

(1) planned

The gross debt ratios for the four candidate countries continued to vary considerably between 18.5% for Romania and 77% for Turkey at the end of last year. However, there has been a continued trend of falling general government debt ratios for Bulgaria and Turkey, which had exhibited high debt levels still some years ago, and a stabilisation of the comparably low level for Romania. Contrary to that, Croatia has seen a build up of general government debt. In Bulgaria and Turkey, positive primary balances contributed to overall falling deficit and debt figures, whereas in the case of Romania the primary balance shows only a small deficit.

Table 3: Main economic trends

annual averages	2000	2001	2002	2003	2004
Growth (GDP in real terms, change in %)					
Bulgaria	5.4	4.1	4.9	4.5	5.6
Croatia	2.9	4.4	5.2	4.3	3.8
Romania	2.0	5.7	5.0	5.2	8.3
Turkey	7.3	-7.5	7.9	5.8	9.0
Inflation (CPI, change in %)					
Bulgaria	10.3	7.4	5.8	2.3	6.1
Croatia	N.A.	N.A.	1.7	1.8	2.1
Romania	46.3	34.8	22.8	15.3	11.9
Turkey	54.9	54.4	45.0	21.6	8.6
Interest rate (5-year govt. bonds, % p. a.)					
Bulgaria	9.4	7.3	6.7	5.2	4.6
Croatia					
Romania	57.3	0.0	22.7	11.9	4.8
Turkey	-	-	-	-	-

Source: Eurostat

3. Economic background

The overall improvement of reported deficit and debt figures in acceding and candidate countries occurred against the background of generally favourable and improving macroeconomic conditions in these countries.

Table 3 gives some key indicators of economic development in the countries. In particular, growth rates have continued to be relatively high in 2004, and interest rates fell further. Inflation rates have come down considerably in Romania and in particular in Turkey, thereby reducing the growth of nominal GDP, and have remained at relatively low levels in Bulgaria and particularly in Croatia.

4. Quality and reliability of the notified deficit and debt figures

The March 2005 notifications have been assessed in detail in the country evaluations (see below). The purpose of the country evaluations is to review the figures and to analyze the reconciliation between the national budget figures and the notified figures. Also, EUROSTAT provided for the country sections a summary assessment of the compliance of the notified figures with the ESA 95 methodology. The country evaluations mention the various areas where progress has been made and where further improvement is required.

From a methodological point of view, there has been progress in the statistical quality of reported data in the countries compared to last year's notification (for Croatia it was the first notification). Yet, further efforts are needed in all four countries in order to compile deficit and debt data fully compatible with ESA 95 standards. In particular a better explanation of the relationship between notified debt and deficit figures, a better delimitation of the government sector and a closer institutional co-operation between Ministries of Finance, central banks and statistical offices are mentioned in as further challenges for more than one country. Table 4 summarizes the specific findings per country in this respect.

Table 4: Main findings as regards quality of notified data

Bulgaria	
	Noticeable progress in the quality of the notified data, through the introduction of accrual recording of most taxes and interest
	Further improvements are needed for full compli- ance with methodology, incl. more complete accrual recording and resolving outstanding issues on sector classification.
	Difficulties remain in explaining the link between net borrowing /lending and the change in debt. In this respect financial accounts for the government sector would be very beneficial.
	Availability and use of more complete and timely national accounts data would provide greater assurance of quality to the notification
Croatia	
	The figures seem plausible. However, Eurostat analysed the Croatian figures for the first time, and Eurostat has not yet provided technical assistance on public finance statistics to Croatia. Hence, a proper quality evaluation is not possible.
	IMF government finance statistics methodology (GFS 2001) has been applied, which is broadly compatible with ESA 95, providing a degree of assurance to the quality of the data.
	It seems that Statistical Office was not involved in the notification. Moreover, the IMF report on fiscal transparency (Nov. 2004) noted inadequate reconciliation of fiscal data published by the MOF, National Bank and Bureau of Statistics.
Romania	
	Some progress towards EU reporting requirements for government deficit and debt, such as recording taxes and social contributions and interest payments on an accrual basis.
	Further institutional co-operation is necessary in order to improve the quality and reliability of the data.
	Link between deficit and change in debt should be better explained and statistical discrepancies be reduced. Improvements in the quality and timeliness of financial accounts and of government sector data are important.
	Delimitation of general government should be closely analysed, applying ESA95 criteria to each individual unit. Eurostat decisions on public-private partnerships should be implemented.
Turkey	
	Revisions of some figures since the previous notification are mainly due to the availability of more definitive data and to corrections for the misinterpretation of some adjustment items.
	Some conceptual issues, especially as far as delimitation of general government and accruals recording, should be clarified with Eurostat.
	The Statistical Office should be more involved in the notification, especially for ESA95 methodological aspects, incl. delimitation of general government sector and sub-sectors.
	High priority should be given to further improve the quality of deficit and debt figures. One of the means in achieving this is compiling a full set of ESA95 non-financial and financial accounts for the general government sector and its sub-sectors.

EVALUATION OF THE FISCAL NOTIFICATION OF BULGARIA

1. Key fiscal indicators reported

The main figures reported by the Bulgarian authorities to the European Commission in March 2005 (compared to the figures reported in March 2004) are shown in Table 1 and Charts 1 and 2.

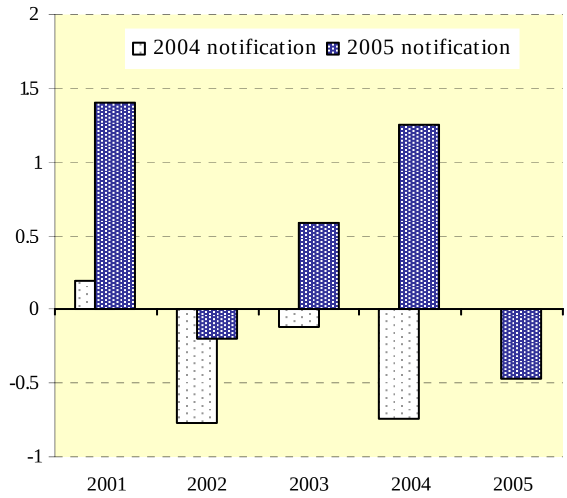
Table 1 - Bulgaria: General government indicators and nominal GDP

% of GDP	Notifi-cation	2000	2001	2002	2003	2004	2005 (1)
Net lending (+) / borrowing(-)	2005		**1.4**	**-0.2**	**0.6**	**1.3**	**-0.5**
	2004	***-0.5***	***0.2***	***-0.8***	***-0.1***	***-0.7***	
Primary net lending (+) / borrowing (-)	2005		**5.1**	**2.0**	**2.7**	**3.1**	**1.4**
	2004	***3.6***	***3.9***	***1.4***	***2.0***	***1.3***	
Gross debt	2005		**66.2**	**54.0**	**46.3**	**38.8**	**33.4**
	2004	***73.6***	***66.2***	***53.2***	***46.2***	***45.1***	
Gross fixed capital formation	2005		**3.5**	**3.0**	**2.8**	**3.1**	**3.3**
	2004	***3.7***	***3.5***	***3.0***	***2.8***	***3.2***	
Nominal GDP growth rate (%)	2005			**8.8**	**6.4**	**10.7**	**8.6**
	2004		***11.1***	***8.8***	***6.8***	***10.1***	

(1) planned

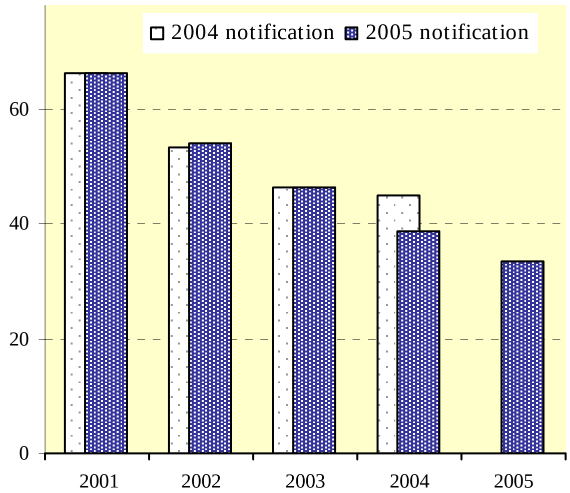
According to this year's notification, the general government is expected to run a deficit of 0.5% of GDP in 2005, after recording surpluses in 2003 and 2004. The data in the 2005 fiscal notification on general government net lending/borrowing and primary balance differ significantly from the 2004 notification. The 2004 fiscal outturn was much better than forecast in the 2004 fiscal notification. General government recorded a net surplus of 1.3% of GDP compared to an originally expected deficit of 0.7% of GDP. The main reason was better than expected revenues in 2004, leading the government to revise its cash budget target in the course of 2004 from a deficit of 1% of GDP to a surplus (Chart 1). Lower interest payments and methodological revisions due to the adjustment of certain revenues from cash to accrual based accounting also play a role in the improved outturn. This shift from cash-based to accrual-based accounting for certain kinds of revenues and interest payments also explains the revisions in the 2005 notification as regards net lending/borrowing and primary balance for the years 2001-2003. Interest payments have been reduced substantially from 2001 onwards and Bulgaria has been recording a primary

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



surplus over the reporting period. This is also the result of a decline in general government gross debt from close to 74% of GDP in 2000 to less than 39% by the end of 2004 (Chart 2). Over the reporting period Bulgaria built up a considerable balance in the fiscal reserve account, of 12.5% of GDP at the end of 2004, which is mostly held at the central bank and only to be used in exceptional circumstances. Gross fixed capital formation has moved in a corridor of between 3% and 4% of GDP over the reporting period except for 2003 when it was below 3% of GDP.

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



The debt-to-GDP ratio has declined by 7.5 percentage points in 2004. This was much higher than the one percentage point reduction expected in the previous notification. The gross debt ratio is expected to drop a further 5.4 percentage points in 2005. The different contributions to the change in debt, expressed in percentage points of GDP, from the primary surplus, interest and nominal GDP growth as well as other contributions are indicated in the upper part of Table 2. The primary budget surplus of 2.7% in 2003 and 3.1% in 2004 had a debt-reducing effect of the same size. Nominal GDP growth and declining interest rates make significant contributions to the reduction of the gross debt ratio, in particular in 2004 when the combined influence reached 2.6 percentage points. As can be seen in the lower part of Table 2, other contributions are playing the most important role especially in 2003 and 2005.

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

	2003		**2004**		**2005** (1)	
	*GDP % pts**		*GDP % pts**		*GDP % pts**	
Change in gross debt ratio	-7.7		-7.5		-5.4	
to which contribution of …						
• Primary balance	-2.7		-3.1		-1.4	
• Interest and nominal GDP growth	-1.2		-2.6		-1.1	
• Other	-3.8		-1.8		-2.8	
	mio. BGN	*% of GDP*	*mio. BGN*	*% of GDP*	*mio. BGN*	*% of GI*
General government net borrowing	-204	-0.6	-477	-1.3	197	0.5
+ Other contributions (2)	-1,316	-3.8	-679	-1.8	-1,165	-2.8
= Change in general government gross debt	-1,520	-4.4	-1,156	-3.0	-968	-2.3
General government gross debt	15,935	46.3	14,778	38.8	13,811	33.4

* differences of ratios to GDP in year t to ratios to GDP in year t-1

(1) planned

(2) Net acquisition of nominal assets, appreciation/depreciation of foreign currency debt and remaining statistical adjustments

These other contributions occur in three different ways. First, net acquisitions of financial assets in the form of currency and deposits tend to increase the debt ratio over the reporting period, except for 2005 when a 3.1 percentage point drop in the gross debt ratio is expected from the cutback in government holdings of currency and deposits. For 2005, the debt-reducing effect of state equity sale is expected to wane to 1.5% of GDP, from 3.0% in 2004. Second, adjustments following changes in the value of foreign-currency debt are considerable. These changes result from swap activities and, more importantly, because of the high importance of USD-denominated debt, from exchange rate movements. The depreciation in the value of foreign denominated debt following the appreciation of the euro and the Bulgarian lev against the US dollar contributed with a 1.1 percentage point reduction to the fall in the debt-to-GDP ratio in 2004. This was lower than the 5.1 percentage point contribution recorded in 2003. In 2005, the debt-reducing effect of the cutback in government holdings of currency and deposits will more than compensate the 1.2% percentage point increase due to the expected appreciation of the foreign denominated debt. Third, statistical discrepancies while being important in 2001 and 2002 play only a minor role in 2003 and 2004 contributing to the reduction in debt with 0.1 percentage points.

2. The macroeconomic context

The prudent fiscal stance during the reporting period has both contributed to and benefited from a favourable macroeconomic environment. The Bulgarian economy continued its expansion at a rate of 5.6% in 2004. GDP growth is expected to accelerate to 6% in 2005 before moderating to 4.5% in 2006. Growth was based on strong domestic demand fuelled by increases in net income, employment and bank credit. Final consumption grew moderately by 5%, while gross fixed capital formation increased rapidly by 12%, pointing to the ongoing replacement of Bulgaria's capital stock. The growth acceleration in 2005 will be based on strong domestic demand, stimulated by expansionary fiscal and wage policies triggered by the national elections to be held in June. A smooth downward adjustment is likely to follow in 2006, with public expenditure, wages and bank credits increasing at lower rates. This would rebalance the economy and bring it closer to its medium-term potential growth rate. The current account deficit, which had widened in 2003 to 9.3% of GDP, narrowed to 7.4% of GDP in 2004, with all its balances turning out better except for the trade deficit. Net inflows of foreign direct investment were at record highs and matched the current account deficit in both years. The deficit of the trade balance is expected to widen further in 2005, as a result of strong domestic demand. It is likely to decrease somewhat in 2006 due to more favourable terms of trade and a gradual improvement in competitiveness. Consumer price inflation was high in the first half of 2004, but came down in the second half to a year-on-year rate of 4% until December which resulted in an average rate of 6.1%. Unemployment decreased further from an annual average of 13.6% in 2003 to 12.0% in 2004 due to jobs being created in the private sector and in government schemes for long-term unemployment.

Table 3 - Bulgaria: Main economic trends

	annual averages	**2000**	**2001**	**2002**	**2003**	**2004**
Growth	GDP in real terms, change in %	5.4	4.1	4.9	4.5	5.6
Inflation	CPI, change in %	10.3	7.4	5.8	2.3	6.1
Unemployment	LFS, % of labour force	16.9	19.7	17.8	13.6	12.0
Current account	balance, % of GDP	-5.6	-7.3	-5.6	-9.3	-7.4
Interest rate	5-year govt. bonds, % p. a.	9.4	7.3	6.7	5.2	4.6
Exchange rate	BGN/EUR	1.953	1.948	1.949	1.949	1.953

Source: Eurostat

Due to higher than expected revenues in 2004, the general government budget achieved a surplus of 1.3% of GDP. The expected deficit in 2005 of 0.5% of GDP is in line with the planned budget deficit which seems achievable given the substantial flexibility built into the budget. The continuation of a primary surplus, debt buy-backs and high GDP growth will further reduce the debt-to-GDP ratio over the forecasting horizon to a more sustainable level. The government has continued its active debt management strategy with the objective of reducing risks by gradually shifting from a denomination in US dollar towards a denomination in euro, from short-term to long-term maturity, from floating into fixed interest rate bonds and from foreign to domestic financing.

3. Methodological issues

Main challenges

The data have been calculated by applying some accounting and definitional requirements (ESA 95) used for the fiscal surveillance of EU Member States. Some methodological progress has been made in this year's notification with regard to the use of accruals for interest payments and the calculation of some taxes. But further improvements are required in particular with regard to a more complete accrual recording and the clarification of issues on sector classification. Moving further to accrual-based accounting should make the government figures more stable and more comparable between successive years.

Transposition of national budget balances into ESA 95

Table 4 quantifies the transposition of the national budget balance into the ESA 95 general government net borrowing/net lending definition. The first line shows the actual (and for 2005 planned) figures of the most prominent budget balance which is in Bulgaria the State budget as approved by the Parliament (including the central budget, the ministries' budgets, the budget of the National Audit Office and the judiciary authorities' budget).

Table 4 - Bulgaria:
Transposition of national budget balances into ESA 95 net lending (+)/borrowing (-)

	2003		**2004**		**2005** (1)	
	mio. BGN	*% of GDP*	*mio. BGN*	*% of GDP*	*mio. BGN*	*% of GDP*
Most prominent national budget balance (2)	-101	-0.3	433	1.1	-35	-0.1
+ adjustment to central government net lending	364	1.1	-5	0.0	-28	-0.1
= Central government net lending (S.1311)	263	0.8	428	1.1	-63	-0.2
+ Local government net lending (S.1313)	-66	-0.2	31	0.1	-72	-0.2
+ Social security net lending (S.1314)	7	0.0	18	0.0	-62	-0.2
= General government net lending (S.13)	204	0.6	477	1.3	-197	-0.5

(1) planned

(2) State budget balance (the State budget includes the central budget, the ministries' budgets, the budget of the National Audit Office and the judicial authorities' budget)

Line 2 of Table 4 adjusts for four differences between the State budget balance and the ESA 95 concept of central government net borrowing. The first adjustment applies to financial transactions such as net loans granted to non-financial public enterprises. Such transactions were accounted as expenditure in the consolidated budget until 2001. Since then, an adjustment for these transactions was no longer needed. Second, an adjustment is necessary for differences between interest paid and accrued as well as other accounts receivable and payable. Throughout the reporting period, government accrued substantially more revenues (especially excises and VAT) than it received, accounting for a difference of 0.6% of GDP in 2003 and 0.4% of GDP in 2004. No significant adjustments are included for 2005. Third, an adjustment is made for the net lending/borrowing position of bodies which are not part of the central government but should be accounted as such under ESA 95 methodology. This adjustment for the balance of extra-budgetary accounts and funds fluctuated between a net borrowing of about 0.9% of GDP in 2002 and a net lending of approximately 0.4% of GDP in both 2003 and 2004. For 2005 a modest amount of net borrowing is expected. Fourth, a negative adjustment of around 0.9% of GDP due to the equity acquired by the government in the National Investment Company, a public entity set up to develop and exploit public infrastructure, is included in 2004. Regarding the other sectors of general government, local governments reported a small deficit in 2003 and ran a modest surplus in 2004. A small deficit is expected again for 2005. The Social Security sub-sector was close to balance in 2003 and 2004 but is expected to run a small deficit in 2005.

Stability of data[1]

There have been substantial revisions to the notified data on government net borrowing /lending for years 2001-2003, compared to the previous deficit and debt notification of March 2004. These are however almost entirely accounted for by the introduction of the accrual method of recording for taxes. In 2003, for example, the general government net borrowing /lending was revised from –0.1% to +0.6% of GDP, while the accrued tax adjustment amounted to +0.7% of GDP.

The 2001-2003 figures for government debt and for GDP show little change from the previously notified data.

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

Concerning the data in tables 2 and 3 of the notification, which describe the transition from the working balances to net borrowing (ESA 95 basis) and the change in debt, there are few revisions compared to the information notified a year earlier, except for those related to the introduction of accruals on taxes and on interest.

Compared to the forecast provided a year earlier, the figures for deficit and debt for 2004 (marked as half-finalised) are better than expected, reflecting above all the collection of revenues at central government level well in excess of the forecast amounts. In terms of the breakdown of debt by financial instrument, this fall in debt (to 38.8% of GDP) is explained by a reduction in the outstanding amount of long-term securities.

Deficit and debt methodology

Eurostat is aware that a working group has been created, involving Ministry of Finance and Statistical Office experts, to analyse the sector classification of institutional units. The work of this group is ongoing. Any reclassification into or out of the general government sector could have a significant impact on the notified data.

The most significant development in methodology in the March 2005 notification is the recording on an accrual basis of VAT, excise duties, corporate income taxes and profit taxes. In line with EU legal requirements, the recording takes into account the amount of these taxes unlikely ever to be collected. Based on the information provided by the authorities, the calculations seem sound and plausible, except that the adjustments for 2004 are not yet complete (they exclude corporate income taxes). Eurostat should however investigate further the compilation methods used.

It should be noted that other taxes, and all expenditure apart from interest, are still notified on a cash basis.

Calculation of accrued interest is made by the MOF debt management system on each debt instrument. The calculations are, according to the authorities, in line with ESA95 requirements. Nevertheless, the interest figures presented in table 1 under codes 'EDP D.41' and 'D.41 uses' are on a cash basis. The authorities have pointed out that the national accounts data (D.41 uses) are incorrect for year 2002 but will be revised to the EDP D.41 figure (there are no swaps or FRAs so the figures should be identical). National accounts data on interest for 2003 were not available at the time of the notification.

Central government net lending in 2004 (428.4m Leva) is after adjustment of 340m Leva for the acquisition by government of equity in ‘Public Investment Projects EAD’, a company solely owned by the state. This amount has been treated as a capital transfer paid by government, reducing the government surplus.

An estimate for net borrowing /lending of the Bank Consolidation Company for 2004 is missing.

Following correspondence with Eurostat, the Bulgarian authorities amended the recording in the notification of government-guaranteed debt reclassified as government debt in 2002 (255m Leva). This item is a significant factor contributing to the debt.

The statistical discrepancies shown in reconciling general government net borrowing /lending with the change in debt remain large for the years 2001 and particularly 2002, equivalent to 0.7% and 1.6% of GDP respectively. The statistical discrepancies for 2003 and 2004 are, however, modest.

Gross domestic product

Concerning the quality of GDP data, the conceptual and practical compliance with ESA95 has continuously improved but special attention needs to be paid to the exhaustiveness of national accounts data and related data sources before full compliance can be certified.

4. Conclusions

The figures reported provide evidence of Bulgaria's continuing commitment to high fiscal discipline by keeping the general government deficit below 1% of GDP and nearly balanced or in surplus in some years. The primary surplus, sustained economic growth and other factors have contributed to the substantial decline in the debt-to-GDP ratio from 74% of GDP in 2000 to expected 33.4% of GDP in 2005. The prudent fiscal stance taken in the reporting period has both contributed to and benefited from a favourable macroeconomic environment.

From a methodological point of view, the Bulgarian authorities have made a noticeable advance in the quality of the notified data, through the introduction of accrual recording of most taxes and of interest. Further improvements are still needed to ensure full compliance with the methodology, including more complete accrual recording, and resolution of outstanding issues on sector classification.

Some difficulties remain evident in explaining the link between net borrowing /lending and the change in debt. In this respect further efforts to produce financial accounts for the government sector would be very beneficial. Generally, the availability and use of more complete and timely national accounts data would provide a greater assurance of quality to the notification.

EVALUATION OF THE FISCAL NOTIFICATION OF ROMANIA

1. Key fiscal indicators reported

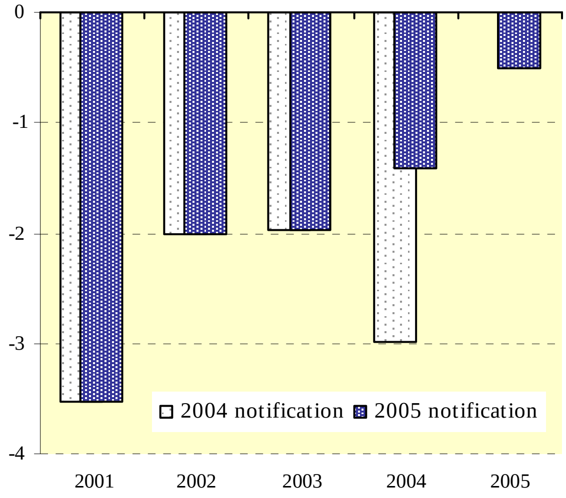
The main figures reported by the Romanian authorities to the European Commission in March 2005 (compared to the figures reported in March 2004) are shown in Table 1 and Charts 1 and 2.

Table 1 - Romania: General government indicators and nominal GDP

% of GDP	Notifi-cation	2000	2001	2002	2003	2004	2005(1)
Net lending (+) / borrowing(-)	2005		**-3.5**	**-2.0**	**-2.0**	**-1.4**	**-0.5**
	2004	***-4.4***	***-3.5***	***-2.0***	***-2.0***	***-3.0***	
Primary net lending (+) / borrowing (-)	2005		**-0.3**	**0.2**	**-0.4**	**-0.2**	**0.7**
	2004	***-0.7***	***-0.3***	***0.2***	***-0.4***	***-1.4***	
Gross debt	2005		**23.2**	**23.3**	**21.3**	**18.5**	**17.5**
	2004	***23.9***	***23.2***	***23.3***	***21.8***	***23.5***	
Gross fixed capital formation	2005		**2.4**	**3.0**	**3.3**	**3.4**	**3.7**
	2004	***1.9***	***2.4***	***3.1***	***3.2***	***3.0***	
Nominal GDP growth rate (%)	2005			**29.7**	**25.7**	**23.0**	**16.0**
	2004		***45.3***	***29.5***	***25.0***	***19.2***	

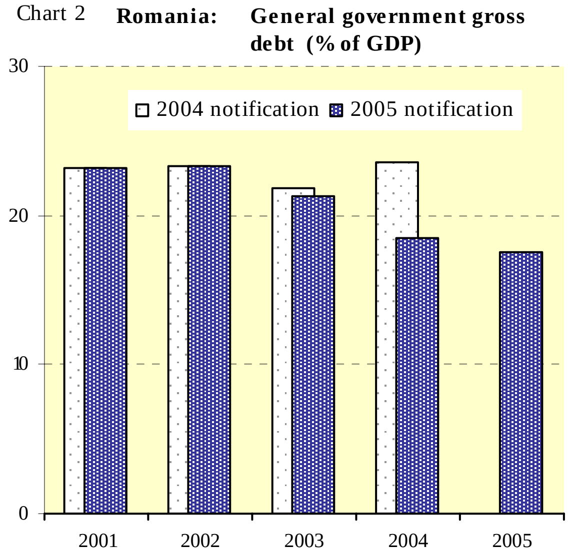
(1) planned

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



According to this year's notification, the consolidation of the Romanian fiscal position has continued, with the general budget deficit coming down from -3.5% of GDP in 2001 to a forecasted -0.5% of GDP in 2005 (Table 1). The 2004 general government deficit came out at -1.4% of GDP, substantially lower than the -3.0% projected in the 2004 fiscal notification. The decline in the deficit was due to a strong growth in revenues, in particular from profit tax, custom duties and excises, while expenditures slightly declined as percentage of GDP, mainly due to a substantial reduction in the cost of public debt. The deficit projected for 2005 differs marginally from the one included in Romania's Pre-Accession Economic Programme, which amounts to around 0.7% of GDP. In light of the fiscal reform initiated by the new government at the beginning of 2005, the 0.5% deficit target seems to be overambitious. The replacement of the progressive income taxation system with a single tax rate of 16% and the reduction of the profit tax from 25% to 16% remained underfinanced at the time of notification, and there is a tangible risk that the fiscal measures would generate an immediate revenue shortfall considerably higher than the around 1.1% of GDP (ROL 30,000 billion) projected by Romania.

Interest payments have been reduced substantially from 1.6% of GDP in 2003 to 1.3% of GDP in 2004, mainly due to a decline in market refinancing rates both on domestic and international markets, following the strong disinflation process and the sovereign rating upgrade. This witnessed a deterioration of the primary balance which after being in surplus in 2002 for the first time since 1999 returned to deficit positions in 2003 and 2004. Given the stabilisation of interest payments at around 1.2% of GDP and the ambitious reduction of the general government deficit, the primary balance is expected to turn positive again, reaching 0.7% of GDP in 2005.



Relative to GDP, general government gross debt has decreased steadily since 2002, and will continue to do so in 2005. Last year's fiscal notification forecasted an increase in the public debt level from 21.8% to 23.5% of GDP in 2004. However, the debt-to-GDP ratio has declined noticeably by 2.8% of GDP in 2004, reaching 18.5% of GDP (Chart 2). Stronger than anticipated nominal GDP growth, lower than expected interest payments and currency appreciation which decreased the part of the debt denominated in foreign currencies contributed to the improvement of the public debt level and sustainability. Considering the envisaged budget deficit cutback in 2005, the continuation of high nominal GDP growth and appreciation of the Romanian leu, the public debt level is projected to further decline by 1% of GDP in 2005. The decline of the debt-to-GDP ratio could actually be significantly higher than anticipated, if the substantial increase in general government deposits and currency holdings at the end of 2004, which stem mostly from privatisation receipts and amount to 1.5% of the forecasted GDP for 2005, would be used in 2005 for financing and redeeming public debt.

The different contributions to the change in debt, expressed in percentage points of GDP, are indicated in the upper part of Table 2. The considerable influence of nominal GDP growth and decline in interest payments fully offset the primary deficits recorded in 2003 and 2004 and represented the largest contribution to debt reduction. In 2005, the primary surplus of 0.7% of GDP is expected to play a major role in diminishing the debt-to-GDP ratio, although the uncertainties surrounding the impact of the currently underfinanced tax cuts on the revenue-to-GDP ratio may prevent this from happening.

As shown in Table 2, other contributions play an important role in all years. These occur in three different ways: (1) Net acquisitions of financial assets such as government deposits and currency holdings started to play a large role in 2004, but with an effect on the debt level that may only occur in 2005. Privatisation receipts have already reduced the debt-to-GDP ratio by 0.3 percentage points in 2003 and 0.6 percentage points in 2004. (2) Adjustments following changes in the value of foreign-currency debt represent another important contribution. The depreciation of the national currency against other currencies contributed to an increase in nominal debt of 1.1% of GDP in 2003, while the appreciation in 2004 has reduced the debt-to-GDP ratio by 1%. (3) Statistical discrepancies are large, although having diminished.

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

	2003		**2004**		**2005** (1)	
	*GDP % pts**		*GDP % pts**		*GDP % pts**	
Change in gross debt ratio	-1.9		-2.8		-1.0	
to which contribution of …						
• Primary balance	0.4		0.2		-0.7	
• Interest and nominal GDP growth	-3.1		-2.7		-1.3	
• Other	0.8		-0.3		1.1	
	Billions ROL	*% of GDP*	*Billions ROL*	*% of GDP*	*Billions ROL*	*% of GDP*
General government net borrowing	37,675	2.0	33,167	1.4	13,620	0.5
+ Other contributions (2)	16,013	0.8	-7,122	-0.3	29,180	1.1
= Change in general government gross debt	53,688	2.8	26,045	1.1	42,800	1.6
General government gross debt	406,123	21.3	432,168	18.5	474,968	17.5

* differences of ratios to GDP in year t to ratios to GDP in year t-1

(1) planned

(2) Net acquisition of nominal assets, appreciation/depreciation of foreign currency debt and remaining statistical adjustments

2. The macroeconomic context

The relatively prudent fiscal stance taken in the reporting period has both contributed to and benefited from a favourable macroeconomic environment. In 2004, Romania's economic recovery continued, as real GDP grew by 8.3% (see Table 3). Growth was increasingly driven by domestic demand, spurred by household consumption growing by 10.8%. Gross fixed capital formation increased rapidly at 10.1%, pointing to the ongoing replacement of Romania's capital stock. In 2005, real GDP growth is expected to return to the more sustainable trend of 5-6%, due to a slight deceleration of private consumption and a more normal agricultural output, in the absence of the outstanding weather conditions from 2004.

Table 3 - Romania: Main economic trends

	annual averages	**2000**	**2001**	**2002**	**2003**	**2004**
Growth	GDP in real terms, change in %	2.0	5.7	5.0	5.2	8.3
Inflation	CPI, change in %	46.3	34.8	22.8	15.3	11.9
Unemployment	LFS, % of labour force	6.8	6.6	7.4	8.5	8.4
Current account	balance, % of GDP	-3.7	-5.5	-3.4	-6.1	-7.5
Interest rate	2-year govt. bonds, % p. a.	57.3		22.7	11.9	4.8
Exchange rate	ROL/EUR	19935	26010	31248	37547	40532

Source: Eurostat

Although exports accelerated to a double-digit growth rate, they continue to be outpaced by rapid import growth of both consumer and investment goods. As a result, the current account deficit widened significantly to 7.5% of GDP in 2004. Net foreign direct investment of around 6.9% of GDP facilitated the financing of the deficit, so that on the back of significant foreign currency inflows, the foreign reserves of the Central Bank increased by 66% in 2004, covering 5.2 months of imports. Average consumer price inflation remained on a downward path, declining from 15.3% in 2003 to 11.9% in 2004 and it is expected to shrink further to 8.2% in 2005. This continued fall is underpinned by a moderation of inflationary expectations and strong appreciation of the currency. The unemployment rate slightly declined to 8.4% against the background of slowly falling employment.

Against the background of strong revenue growth, the fiscal policy stance was adjusted during 2004 in order to bring the general government deficit down to 1.4% of GDP, compared to the originally budgeted 3.0% of GDP. In 2005, the fiscal stance is affected by the significant relaxation of income and profit taxes, which Romania estimates would imply an immediate revenue loss of around 1.1% of projected 2005 GDP. As the reform remains partly underfinanced, the significant revenue shortfall could lead to an overshooting of the general government deficit projected at 0.5% of GDP unless a fiscal adjustment is carried out. Romania’s moderate general government debt-to-GDP ratio went down to 18.5% of GDP in 2004 and the expected positive impact of privatisation receipts on debt developments in 2005 may alleviate the impact from a possible higher deficit. The government continued its active debt management strategy and succeeded in extending the average maturity of debt by issuing domestic paper over three and five-year maturity horizons, with both fixed and variable interest. The intentions to finance debt externally through a Eurobond issue were not finalized in 2004, but a bond issue may be launched on the international capital markets in 2005.

3. Methodological issues

Main challenges

The data have been calculated by applying to a large extent the accounting and definitional requirements (ESA 95) used for the fiscal surveillance of EU Member States. Progress has been made in this year’s notification in moving from a cash basis to an accrual basis. However, statistical discrepancies are still significant and further progress is required, such as an improved accounting of debt redemptions and public-private partnerships, improved explanation of the link between the deficit and change in debt, clearer classification of units and strict observance of the fiscal notification format, in order to fully meet the ESA 95 requirements.

Transposition of national budget balances into ESA 95

Table 4 quantifies the transposition of the national budget balance into the ESA 95 general government net borrowing/net lending definition. The first line shows the actual (and for 2005 planned) figures of the most prominent budget balance which is the cash State budget as approved by the Romanian Parliament.

Line 2 of table 4 adjusts for some major differences between the State budget balance and the ESA 95 concept of central government net borrowing. The first adjustment was made because the State budget balance includes financial transactions, that according to ESA 95 should be recorded “below the line”, such as net loans granted to non-financial public enterprises, repayment of their defaulted debts, receipts from privatisation and payments from privatisation for the redemption of public debt. It is still to be completely clarified the link between revenues from privatization used to redeem public debt in 2004 and the increase in deposits and currency holdings shown in Table 3A. In order to arrive at the ESA 95 balance, privatisation revenues which are usually included in the State budget balance must be eliminated and consequently they account for a significant negative adjustment over the reporting period. Second, the difference between interest paid and accrued for internal and external loans, as well as other accounts receivable and payable represent another adjustment needed according to ESA 95 methodology. It is estimated that the change in the financing composition of the debt by decreasing the amount of T-Bills issued at a discount will turn positive the adjustment from the difference between accrued and paid interest in 2005. Third, a smaller adjustment is needed for the net lending/borrowing position of bodies which are not part of the central government but should be accounted as such under ESA 95 methodology, such as public institutions partially or fully financed from extra-budgetary incomes. Finally, it is estimated that in 2005 no adjustment will be necessary related to capital transfers by the government to the banking sector following the purchase of non-performing loans by the defeasance body (AVAB). The adjustment was important early in the reporting period, but has become negligible since 2002.

Table 4 - Romania:
Transposition of national budget balances into ESA 95 net lending (+)/borrowing (-)

	2003		**2004**		**2005** (1)	
	Billions ROL	*% of GDP*	*Billions ROL*	*% of GDP*	*Billions ROL*	*% of GDP*
Most prominent national budget balance (2)	-75039	-3.9	-67631	-2.9	-57550	-2.1
+ adjustment to central government net lending	30626	1.6	30100	1.3	34778	1.3
= Central government net lending (S.1311)	-44413	-2.3	-37531	-1.6	-22771	-0.8
+ Local government net lending (S.1313)	2343	0.1	3494	0.1	-1352	0.0
+ Social security net lending (S.1314)	4395	0.2	870	0.0	10504	0.4
= General government net lending (S.13)	-37675	-2.0	-33167	-1.4	-13620	-0.5

(1) planned
(2) State budget balance (the State budget includes the central budget, the ministries' budgets, the budget of the National Audit Office and the judicial authorities' budget)

Regarding the other sectors of general government, local governments ran broadly balanced budgets over the reporting period, with a minor impact on the general government net balance. The balance for the Social Security sub-sector has remained in surplus in all years except for 2004, where increased pension and social security allocations stretched the finances.

Stability of data[2]

The data for 2001-2003 are reported as final. Data for 2004 are reported as half-finalised.

Compared to the previous notification of March 2004 the net borrowing/net lending of general government remains unchanged for 2001 and 2002 at respectively -3.5% and -2.0% of GDP.

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

Although for 2003 general government net borrowing was unrevised at 2.0% of GDP, net borrowing of central government worsened from -1.9% to -2.3% of GDP, while that of local government and social security sub-sectors (respectively zero and -0.1% of GDP) turned into a surplus of 0.1% and 0.2% of GDP. The upward revision in net borrowing of central government is due to the reclassification of the national road company inside the general government sector, while the improvement for the two other sub-sectors is due to updates of data sources.

For the year 2004 the net borrowing of general government improved from -3.0 % forecast in March 2004 to -1.4% of GDP. The 2004 debt increased slightly in absolute terms, but in terms of GDP fell to 18.5%, considerably lower than in 2003 (21.3% of GDP, revised from 21.8%). The level of general government debt for 2001 and 2002 remains unchanged compared to the 2004 notification.

Concerning gross fixed capital formation, there is a slight upward revision for 2003 together with a significant increase in the 2004 data.

The downward trend in interest payments for the period 2001-2004 is due to the decrease in the interest rates on the domestic market together with an appreciation of the Romanian currency vis-à-vis the euro and US dollar observed in 2004.

Compared to the previous notification only slight revisions of GDP occurred.

Deficit and debt methodology

Delimitation of the general government sector seems to be generally in line with ESA 95 methodology. Nevertheless an analysis in depth of some units (self-financing units) to be included or excluded from the general government sector should be undertaken in the near future.

The national road company which was previously classified outside general government sector has been reclassified inside the sector. This has an impact on the accounts from 2003 onwards. Romanian hospitals are classified inside the central government sub-sector, whilst the rural credit guarantee fund is excluded from the general government sector. The impact of private public partnerships (PPP) on general government accounts is not yet known, but is currently being investigated.

The working balance of central government includes the outturn of the State Budget as well as the special funds, and is compiled on a cash basis. The State Treasury fund and public institutions financed from extra-budgetary incomes are not included, but an adjustment is recorded under ‘net borrowing/net lending of other central government bodies’. The working balance includes EU grants received and paid. This cash balance does not have any impact on the deficit as the amounts received are equal to the amounts paid.

Financial transactions included in the public accounts appear to be treated correctly in table 2. Privatisation receipts are separately identified. The item “other financial transactions” includes payments made from privatisation receipts for the redemption of public debt.

Taxes and social contributions are recorded using the “time-adjusted cash” method and seem to comply with ESA95.

The item 'other adjustments' relates to capital transfers made by government to the banking sector following the purchase of non-performing loans by the defeasance body (AVAB). The method of recording seems to comply with ESA 95. However the issue of capital injections in general should be examined further.

Reconciliation between general government net borrowing /net lending and the change in gross debt is rather difficult to assess due to the fact that financial accounts have been compiled up to 2000 only.

No government debt is held by other government sub-sectors. This means that general government consolidated debt is equal to the non-consolidated debt. The main bulk of government issuing procedures consists of Treasury bills which are systematically issued below par. However it seems that the adjustment line “redemptions of debt above /below nominal value" is incorrectly used. The difference between market and nominal value should be recorded rather than the difference between the issuing price and nominal value.

The main factor explaining the increase in general government debt for 2004 is a significant net acquisition of government deposits, though the impact is largely offset by sales of shares and other equity (privatisation) as well as by appreciation of the Romanian currency vis-à-vis the euro and US dollar in 2004.

The statistical discrepancies are still quite important and efforts should be made to reduce them.

There have been no UMTS licence allocations in Romania. The government has not been involved in any swap or FRA arrangements.

Gross domestic product

Concerning the quality of GDP data, the conceptual and practical compliance has continuously improved but further efforts are needed as concerns data sources. There is still some distance to go before full compliance with the 'acquis communautaire' can be certified. Exhaustiveness problems still exist, particularly in relation to a not fully reliable business register and the self-employed and the robustness of the adjustments.

4. Conclusions

The figures reported provide evidence of Romania’s commitment to continued fiscal discipline by keeping the general government deficit within prudent limits. The fiscal reform initiated by the new government makes the attainment of the expected 2005 general government deficit uncertain, but could in conjunction with further progress in tax collection help improve the sustainability of public finances by strengthening supply side conditions in the economy in the medium-term.

From a methodological point of view, the authorities have made some progress towards satisfying EU reporting requirements for government deficit and debt, such as recording taxes and social contributions and interest payments on an accrual basis.

However, further institutional co-operation is necessary in order to improve the quality and reliability of the data. In particular, the link between the deficit and change in debt should be better explained, and the statistical discrepancies reduced. Efforts to improve the quality and timeliness of financial accounts and of government sector data under the ESA 95 transmission programme are important in this respect. In addition, delimitation of general government should be closely analysed, applying ESA 95 criteria to each individual unit, and Eurostat decisions regarding public-private partnerships should be implemented.

EVALUATION OF THE FISCAL NOTIFICATION OF CROATIA

1. Key fiscal indicators reported

On 1st March 2005, the Croatian authorities reported key fiscal indicators to the European Commission for the first time. A revised version was send a few weeks later. Reported figures are shown in Table 1 and Charts 1 and 2. As this is the first fiscal notification submitted by the Croatian government, the usual comparison with data reported a year earlier is not possible.

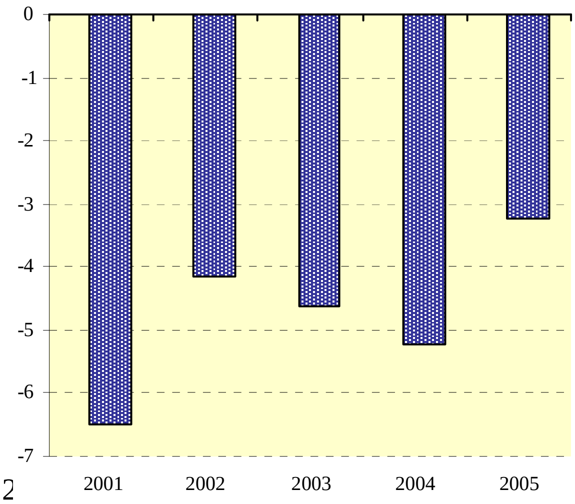
Table 1 - Croatia: General government indicators and nominal GDP

% of GDP	Notifi-cation	**2000**	**2001**	**2002**	**2003**	**2004**	**2005** (1)
Net lending (+) / borrowing(-)	2005		**-6.5**	**-4.2**	**-4.6**	**-5.2**	**-3.2**
	2004						
Primary net lending (+) / borrowing (-)	2005		**-4.3**	**-2.1**	**-2.5**	**-3.1**	**-1.0**
	2004						
Gross debt	2005		**40.1**	**39.9**	**41.5**	**44.2**	**43.7**
	2004						
Gross fixed capital formation	2005		**2.5**	**3.9**	**5.4**	**4.6**	**4.4**
	2004						
Nominal GDP growth rate (%)	2005			**8.3**	**7.6**	**7.2**	**7.4**
	2004						

(1) planned

According to the figures reported, the general government deficit declined from 6.5% of GDP in 2001 to 4.2% in 2002, followed by an increase to 4.6% in 2003 and to 5.2% in 2004. For the year 2005, a major reduction of the fiscal deficit to 3.2% of GDP is projected (Table 1). The general government deficit in 2004 turned out to be significantly larger than the government's policy target of 4.5% of GDP, partly due to a change in the reporting methodology. The policy target for 2004 was defined on the basis of GFS 1986, while reporting in this fiscal notification follows GFS 2001 standards. According to preliminary budget estimates of the Ministry of Finance for 2004, the general government deficit on GFS 1986 reached 4.9%. These estimates point to lower than planned revenues. In particular, expected one-off revenues from dividend payments were lower than planned. Moreover, revenues from indirect taxes turned out to be significantly lower towards the end of the year as compared to budget plans. Public spending has been broadly in line with the 2004 budget, however payment arrears accumulated further, in

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

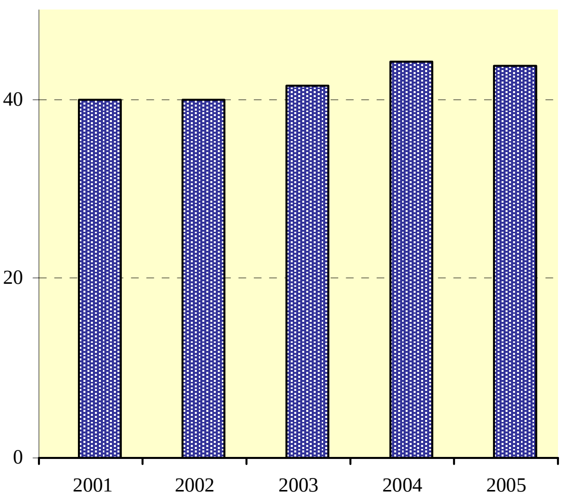


particular in the health care system, raising the deficit by almost 0.2 percentage points. Moreover, the assumption of state guarantees for liabilities of public companies (shipyards, the railway system) had a significant impact on the fiscal deficit of around 1.3% of GDP. The general government deficit projected for 2005 (3.2% of GDP) differs from the policy target set in Croatia's first Pre-Accession Economic Program of 3.7% of GDP. However, as for the budget figures for 2004, this deviation may also result from the change in the accounting methodology. In any case, numbers reported imply a substantial reduction of the fiscal deficit in 2005 by 2.0 percentage points. This requires a substantial fiscal adjustment in the remainder of the year which is rather unlikely to happen. It should be noted that the government has not yet started implementing important underlying fiscal measures for the implementation of the 2005 budget. This concerns, inter alia, the change in the pension indexation formula as well as measures to control health care spending. Also, the announced reduction of subsidies to the enterprise sector has not yet materialised through appropriate action. Moreover, given the shortfalls in revenue collection in late 2004, the 2005 projections may now seem overly optimistic. Therefore, there is a tangible risk that the 2005 deficit will actually turn out to be significantly higher than foreseen in this fiscal notification.

Interest payments have been broadly stable as a share of GDP, amounting to 2.1 to 2.2% throughout the reference period, despite a significant increase of public debt. This demonstrates Croatia's good access to international finance at favourable financing conditions. However, a still increasing debt and the government's intention to gradually replace external by domestic debt may imply higher borrowing costs for the immediate future.

The stock of general government gross debt increased steadily in national currency terms during the reference period, by around 8% in 2002, and by around 12 and 14% in 2003 and 2004, respectively. Also as a share of GDP, gross debt increased markedly during the reference period, from 40.1% in 2001 to 44.2% in 2004 (chart 2). The rise was particularly strong in 2004, when it increased by 2.7 percentage points compared to the year before. For 2005, the fiscal notification reports a further increase in the stock of public debt. The stock of debt in terms of GDP is however projected to be slightly reduced by 0.5 percentage points (see chart 2).

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



The different contributions to the change in debt, expressed in percentage points of GDP, are indicated in the upper part of Table 2. The considerable influence of nominal GDP growth together with stable interest payments could somewhat dampen the effect of significantly increasing primary balances in 2003 (2.5% of GDP) and 2004 (3.1%) as compared to 2002 (2.1%). In 2005, the expected reduction of the primary deficit to 1.0% of GDP should play a major role in diminishing the debt-to-GDP ratio. However, as outlined above, uncertainties surrounding the implementation of the 2005 budget may prevent this from happening.

As can be seen in Table 2, other contributions to the change in gross debt appear to have played a negligible role in 2003 and 2004. Significant negative net acquisitions of financial assets in 2003 in the context of privatisation were largely offset by adjustments and other statistical discrepancies, resulting in an overall neutral effect on debt developments. In 2004, very small changes in the net acquisition of financial assets also reflect a substantial slowdown in the pace of privatisation.

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

	2003		**2004**		**2005** (1)	
	*GDP % pts**		*GDP % pts**		*GDP % pts**	
Change in gross debt ratio	+1.7		+2.7		-0.5	
to which contribution of …						
• Primary balance	2.5		3.1		1.0	
• Interest and nominal GDP growth	-0.7		-0.6		-0.8	
• Other	-0.1		0.3		-0.7	
	mio. HRK	*% of GDP*	*mio. HRK*	*% of GDP*	*mio. HRK*	*% of GDP*
General government net borrowing	8,950	4.6	10,851	5.2	7,177	-3.2
+ Other contributions (2)	-240	-0.1	533	0.3	-1,500	-0.7
= Change in general government gross debt	8,710	4.5	11,384	5.5	5,677	2.6
General government gross debt	80,203	41.5	91,587	44.2	97,264	43.7

* differences of ratios to GDP in year t to ratios to GDP in year t-1

(1) planned

(2) Net acquisition of nominal assets, appreciation/depreciation of foreign currency debt and remaining statistical adjustments

2. The macroeconomic context

As indicated in table 3, the Croatian economy has experienced relatively strong real GDP growth during the reference period, although it has decelerated since 2003 as a result of a tighter stance of monetary policies. Growth was mainly driven by strong domestic demand with significant growth rates of private consumption and of public investment in roads and housing. Domestic demand fuelled imports, which grew stronger than exports throughout the reference period, contributing to a higher trade deficit that increased from 20.7% of GDP in 2001 to 27.3% in 2003. Net exports continued to be a drag on growth in 2001 to 2003. A high credit growth to the non-government sector was largely financed abroad leading to higher current account deficits and a rising external debt-to-GDP ratio. In 2002, the current account deficit reached 8.7% of GDP, 5 percentage points higher than a year before. In 2003, it declined to 7% of GDP and to below 5% of GDP in 2004. The external debt-to-GDP ratio increased markedly and continuously from around 57% in 2001 to 67% in 2002 and 82% in 2003. At end-2004, the external debt ratio stood at 83%. Since 2003, restrictive monetary policy measures helped partly reducing credit growth and domestic demand to more sustainable levels since 2003. Average consumer price inflation remained below 2% in 2002 and 2003, before it slightly accelerated to 2.1% in 2004, mainly as a result of higher energy prices and an increase in excises. A stable exchange rate to the euro during the reference period has contributed to price stability. Since 2003, labour market reforms have increased incentives for job seeking and impacted positively on labour market participation. As a result, the unemployment rate declined in 2003 and 2004, also due to modest growth of employment during this period.

Table 3 - Croatia: Main economic trends

	annual averages	**2000**	**2001**	**2002**	**2003**	**2004**
Growth	GDP in real terms, change in %	2.9	4.4	5.2	4.3	3.8
Inflation	CPI, change in %	N.A.	N.A.	1.7	1.8	2.1
Unemployment	LFS, % of labour force	21.4	22.3	22.5	19.5	18.2
Current account	balance, % of GDP	-2.6	-3.6	-8.6	-6.9	-4.7
Interest rate	5-year govt. bonds, % p. a.					
Exchange rate	HRK/EUR	7.635	7.471	7.407	7.563	7.496

Source: Datastream

3. Methodological issues

Main challenges

As mentioned above, data in Croatia's first fiscal notification are reported on the basis of GFS 2001. The main challenge will thus be to gradually introduce ESA 95 standards for deficit and debt reporting.

Transposition of national budget balances into ESA 95

Table 4 quantifies the transposition of cash budget balances into the GFS 2001 net lending/net borrowing position. The first line shows the actual (and for 2005 planned) figures for the most prominent budget balance, which in the case of Croatia is the central government budget balance after net acquisition of non-financial assets. In other words, the net acquisition of non-financial assets is treated as expenditure above the line. The budget balance reported for 2004 of HRK 4,097 million (or 2% of GDP) represents a preliminary estimate of the budget outcome, significantly higher than the budget plan, i.e. the balance adopted by the Parliament of HRK 2,751 million (or 1.3% of GDP).

Table 4 - Croatia:
Transposition of national budget balances into ESA 95 net lending (+)/borrowing (-)

	2003		**2004**		**2005** (1)	
	000 HRK	*% of GDP*	*000 HRK*	*% of GDP*	*000 HRK*	*% of GDP*
Most prominent national budget balance (2)	-4,210,417	-2.2	-4,097,400	-2.0	-3,207,502	-1.4
+ adjustment to central government net lending	-5,206,278	-2.7	-6,708,178	-3.2	-3,575,314	-1.6
= Central government net lending (S.1311)	-9,416,696	-4.9	-10,805,578	-5.2	-6,782,816	-3.0
+ Local government net lending (S.1313)	352,725	0.2	-104,578	-0.1	-348,629	-0.2
+ Social security net lending (S.1314)	114,368	0.1	59,277	0.0	-46,000	0.0
= General government net lending (S.13)	-8,949,603	-4.6	-10,850,879	-5.2	-7,177,445	-3.2

(1) planned
(2) Consolidated central budget (the consolidated central budget includes the central budget as well as extrabudgetary funds - Croatian Waters, Environment Protection Fund, Croatian Motorways, Croatian Roads, State Agency for Deposit Insurance and Bank Rehabiliation, Croatian Privatisation Fund)

Line 2 of table 4 adjusts for the difference between the central government cash balance and the GFS 2001 net lending/net borrowing position of the central government. The size of adjustment is indeed quite significant in both 2003 and 2004, representing 2.7% and 3.2%

of GDP, respectively. In the case of Croatia, the adjustments comprise three distinct issues. First, since GFS 2001 net lending/borrowing is an accrual concept an adjustment is made for the change in arrears that are not accounted for in the central government cash balance. For the years 2003 and 2004 an increase in arrears is reported while a net repayment of arrears is foreseen for the year 2005. Second, the adjustment includes the net lending/borrowing positions of extra-budgetary funds that are not included in the central government budget accounts. They are quite significant in both 2003 and 2004, adding 2.4 percentage points and 1.8 percentage points, respectively, to the consolidated central government deficit. For the year 2005, a much lower net borrowing of extra-budgetary funds of 1.1% of GDP is planned. A third adjustment is made for the amount of state guarantees that have been called in by public companies. While the effect was negligible in 2003, called in guarantees had a significant impact of 1.3% of GDP in 2004. For 2005, guarantees are projected to increase the GFS 2001 deficit by 0.9 percentage points.

Regarding the other sectors of the general government, local governments recorded a low deficit in 2004 following low surpluses in all the preceding years of the reporting period. The budgets of the social security sub-sector have remained balanced in 2003 and 2004, after they have recorded a deficit of 0.4% of GDP in both 2001 and 2002. Therefore, the net lending/borrowing position of the general government does not differ much from the consolidated central government balance.

Stability of data[3]

This is the first notification of government deficit and debt received by Eurostat from Croatia. Therefore it is not possible to analyse revisions to the data over time.

Concerning the consistency of the data over the years provided in the notification, there is a persistent general government deficit which is essentially accounted for by central government. However, social security funds moved from a net borrowing of 0.4% of GDP in 2002 to a net lending of 0.1% of GDP in 2003.

Data for all years (2001 onwards) are considered not yet finalised.

Eurostat is not aware of any significant changes in classification of units inside /outside the general government sector during the period since 2001.

Deficit and debt methodology

The notification appears to be arithmetically correct. However, data reported in the line 'contribution of the sub-sector to the general government debt' is in fact the change in the debt of the sub-sector.

In compiling the notification, IMF methodology (GFS 2001) has been followed. It is not yet possible to make the adjustments needed to comply with ESA 95, and no account has yet been made of various Eurostat decisions on government deficit and debt methodology.

As the data are based on GFS 2001, it is normal that no adjustments appear in table 2 for financial transactions. Adjustments have been made in table 2 for debt assumption arising from guarantees. We are not in a position to verify the amounts.

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

The data are presented on a cash basis. There are adjustments in the tables for accruals of expenditure (excluding interest) but not for revenue. Net borrowing /net lending of two extrabudgetary funds of central government (Croatian Roads and Croatian Motorways) are on an accrual basis. It is noted that no adjustments are recorded at all in table 2D (social security funds).

The statistical discrepancy in table 3 is very large in 2002 (2.4% of GDP) and large in 2003 (0.9% of GDP).

Concerning net acquisition of financial assets, there is a very large acquisition of currency and deposits in 2002, and sizable amounts recorded as reduction in shares and other equity in 2001-3. Large amounts are recorded each year under acquisition of assets in loans and in shares and other equity. In the case of loans, the increase each year is bigger than the decrease. It is not yet clear whether these relate to performing loan and equity assets, or whether any amount should be more suitably recorded as a capital transfer (rather than as a financial transaction) from government to other sectors.

No adjustment is shown in table 3 for appreciation or depreciation of foreign currency debt, and yet over half of the central government debt is known to be foreign. There are no figures in 2001 on net acquisition of financial assets of local government, except in currency and deposits, whereas figures appear for the years 2002-2004. Concerning social security funds, there is a big sell-off of shares recorded in 2001, equal to 0.5% of GDP.

4. Conclusions

Croatia's first fiscal notification shows a continued rise of the general government deficit since 2002. Moreover, actual deficits in 2003 and 2004 were larger than planned, pointing to difficulties in the implementation of the budget, both on the revenue and spending side. Against this background, the budget for 2005 envisages a significant downward adjustment of the general government balance to address current fiscal and external imbalances. However, it appears that necessary fiscal measures that were planned to be adopted in early 2005 have been substantially delayed, pointing to a weak commitment to fiscal discipline.

From a methodological point of view, overall, the notified figures seem plausible. However, as this is the first time Eurostat has analysed the Croatian figures, and as no technical assistance on public finance statistics has yet been provided to Croatia by Eurostat, it is not possible to provide a proper quality evaluation.

It should be noted that the Croatian authorities have adopted the government finance statistics methodology of the IMF (GFS 2001), which is broadly speaking compatible with ESA 95, so this provides a degree of assurance to the quality of the data.

On the issue of cooperation among national statistical authorities, it seems that the deficit and debt notification has been sent by the MOF with no involvement from the Statistical Office. Moreover, the IMF report on fiscal transparency (November 2004) remarked that there was inadequate reconciliation of fiscal data published by the MOF, Croatian National Bank, and Croatian Bureau of Statistics. However, a working group comprising these authorities has been established, to examination delimitation of the general government sector according to ESA 95.

EVALUATION OF THE FISCAL NOTIFICATION OF TURKEY

1. Key fiscal indicators reported

The main figures reported by the Turkish authorities to the European Commission in March 2005 (compared to the figures reported in March 2004) are shown in Table 1 and Charts 1 and 2.

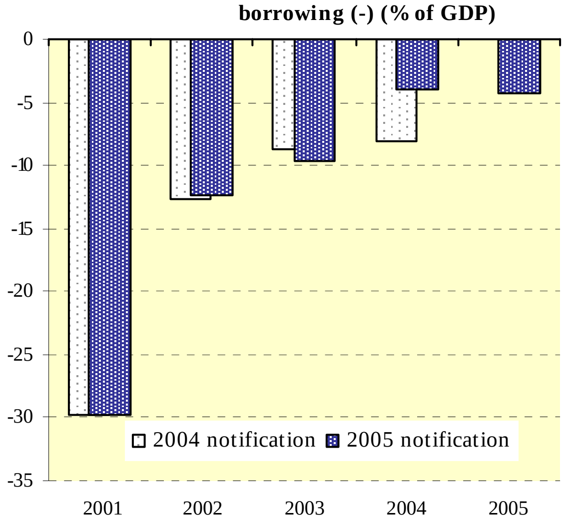
Table 1 - Turkey: General government indicators and nominal GDP

% of GDP	Notifi-cation	**2000**	**2001**	**2002**	**2003**	**2004**	**2005** (1)
Net lending (+) / borrowing(-)	2005		**-29.8**	**-12.3**	**-9.7**	**-3.9**	**-4.3**
	2004	***-6.1***	***-29.8***	***-12.7***	***-8.7***	***-8.0***	
Primary net lending (+) / borrowing (-)	2005		**-2.7**	**7.0**	**7.6**	**7.9**	**7.4**
	2004	***7.9***	***-2.7***	***7.1***	***9.6***	***7.6***	
Gross debt	2005		**105.2**	**94.3**	**87.2**	**80.1**	**77.2**
	2004	***57.4***	***105.2***	***94.9***	***87.1***	***85.0***	
Gross fixed capital formation	2005		**5.3**	**5.1**	**4.2**	**3.8**	**4.4**
	2004	***5.1***	***5.3***	***5.1***	***3.9***	***3.9***	
Nominal GDP growth rate (%)	2005			**55.6**	**29.6**	**19.7**	**12.1**
	2004		***43.2***	***54.7***	***30.8***	***17.1***	

(1) planned

The 2005 notification illustrates an acceleration of the fiscal consolidation, which has started after the 2001 financial crisis. The general government deficit fell from almost 30% of GDP in 2001 to less than 4% of GDP in 2004. The latter crisis had a major impact on Turkey's public finances: the general government deficit rose from 6.1% of GDP in 2000 to 29.8% in 2001 and the debt ratio increased from 57.4% of GDP in 2000 to 105.2%. In order to improve the sustainability of public finances, the Turkish authorities have been targeting substantial primary surpluses, which were above 7% of GDP during most of the reporting period. Only in 2001, substantial expenditures to cover the losses of state banks led to a primary deficit of 2.7% of GDP. The acceleration in the fiscal consolidation experienced in 2004 stems chiefly from a faster fall in real domestic interest rates in 2004. Another important feature of Turkey's public finances is the high burden of interest payments. Since 2001, real domestic interest rates have been high, reflecting high economic uncertainty and a tight domestic capital market. In addition, interest rates are closely related to exchange rate fluctuations and changes in market

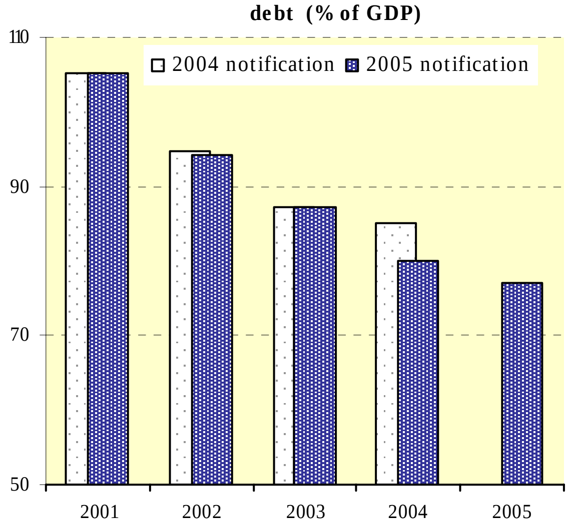
Chart 1 **Turkey: General government net borrowing (-) (% of GDP)**



sentiment. Improved EU-Membership prospects and the anchor provided by the IMF-programme have enhanced macroeconomic stability. As a result, financing costs, which are highly pro-cyclical and are difficult to predict, came down faster than anticipated in 2004. During the reporting period, the financing costs fell from 27.1% in 2001 to 11.8% in 2004. Solely in 2004, the interest rate burden declined by 5.5% of GDP. For 2005, a very modest decline of just 0.1% to 11.7% of GDP is foreseen. Gross fixed capital formation is relatively low and has further declined from slightly above 5% of GDP during 2001-2002, to 3.8% in 2004. In 2005, GFCF is expected to increase, for the first time in five years, by 0.6%. Due to decreasing inflation, nominal GDP growth decelerated from 55.6% in 2002 to 19.7% in 2004. In 2004, a further slowdown in nominal growth is assumed. However, the declining nominal growth mainly reflects declining inflationary pressures, while real output growth remains strong.

Another major change from the 2004 notification is a better alignment of the treatment of accrued interest with ESA 95 standards in 2003. This measure led to a deterioration of the primary balance by nearly 2 percentage points. I n 2004, the primary surplus is just 0.3% higher than the estimate notified last year. For the first time in the notification period, the primary surplus is expected to fall in 2005, by 0.5%.

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



After the sharp increase in the debt level from 57.4% in 2000 to 105.2% in 2001, the debt-to-GDP ratio has been declining, reaching 93.4% in 2002 and 79.7% in 2004. For 2005, a further reduction in the debt ratio by 2.5 percentage points is planned (Chart 2).

Table 2 takes a closer look at the factors behind the debts dynamics. The upper part of the table analyses the annual change in the debt-to-GDP ratio and decomposes these changes into several underlying factors: the impact of the primary surplus, the combined effect of interest rates and nominal GDP growth and all other factors. During 2003-2004, the debt-to-GDP ratio declined substantially, by about 7.0 percentage points annually. In 2005 a further reduction by 2.5 percentage points is expected. The most noteworthy aspect in this context is the important, but declining role of nominal GDP growth and interest payments for the dynamics of debt ratio. As can be seen in Table 2, “interest and GDP growth” reduced the debt ratio by respectively 4.0 and 2.5 percentage points in 2003 and 2004. In 2005, this category is expected to have a debt-ratio increasing impact of 3.1 percentage points. The main underlying reason for this development is the sharp decline in nominal GDP growth rates due to decreasing inflationary pressures. As a result, the net effect of nominal GDP growth and interest rate will change from a debt reducing factor in 2002-2004 to a debt increasing factor in 2005. The primary surplus is the most important factor for the reduction in the debt ratio, as it reduces the debt-to-GDP ratio by over 7% throughout the reported period.

The lower part of table 2 shows the absolute changes in the debt level and differentiates between the impact of general government net borrowing and other contributions. This latter category comprises three different variables which affect the debt level, besides the general government net borrowing. The first item contains adjustments for net acquisitions of financial assets in the form of currency and deposits, securities, loans as well as shares and other equity. The most significant item in this group is the loans to the Savings Deposit Insurance Fund item, which have been particularly important in the aftermath of the 2001 crisis. Exceptionally in 2003, additional loans to the SDIF to cover the losses incurred by Imar bank increased the debt ratio by 2% of GDP. The category "other financial assets" raises the debt by another 3.4-4.5% of GDP. Given the significance of those transactions, a more detailed explanation would have been useful. The second group summarises changes in the value of existing assets and loans, or foreign exchange assets and liabilities. In this group, the most significant impact came from exchange rate fluctuations, which increased debt by 18.2 percentage points in 2001 and by 6.2 percentage points in 2002. In 2003 and 2004, the appreciation of the currency decreased the debt by respectively 2% and 1%. Issuances below par increased debt by between around 5% of GDP in 2001-2003. Besides the general government net borrowing, this was the most important single factor for the change in the general government debt. Finally, statistical discrepancies increased the debt by at least 2½% of GDP during the reporting period.

In 2003, the general government deficit amounted to 9.7% of GDP, while other adjustments accounted for 4.9% of GDP. In 2004, the impact of other adjustments on the debt level declined to only 7.3% of GDP, while the general government deficit was 3.9% of GDP. In 2004, the Turkish authorities expect a deficit of 4.3% of GDP, while other adjustments affecting the debt level are expected to fall further to 1.7% of GDP. Overall, the notified data indicate a continuous decline of all debt relevant factors, with the notable exception of a ½ increase of general government borrowing in 2005.

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

	2003		**2004**		**2005** (1)	
	*GDP % pts**		*GDP % pts**		*GDP % pts**	
Change in gross debt ratio	-7.1		-7.2		-2.9	
to which contribution of…						
• Primary balance	-7.6		-7.9		-7.4	
• Interest and nominal GDP growth	-4.2		-2.6		3.1	
• Other	4.7		3.3		1.4	
	mio. YTL	*% of GDP*	*mio. YTL*	*% of GDP*	*mio. YTL*	*% of GDP*
General government net borrowing	35,011	9.7	16,797	3.9	20,956	4.3
+ Other contributions (2)	17,020	4.7	14,117	3.3	6,569	1.4
= Change in general government gross debt	52,031	14.5	30,914	7.2	27,525	5.7
General government gross debt	313,794	87.2	344,708	80.1	372,233	77.2

* differences of ratios to GDP in year t to ratios to GDP in year t-1

(1) planned

(2) Net acquisition of nominal assets, appreciation/depreciation of foreign currency debt and remaining statistical adjustments

2. The macroeconomic context

The 2001 financial crisis has dramatically affected Turkey's public finances. As observed in Table 3, output growth contracted sharply in 2001 and rebounded firmly in the last three years. Overall, economic growth has been above average during this period. However, one has to bear in mind the dramatic contraction during previous crises in 1994 and 1999. Indeed, by 2003, Turkey had just reached its output levels of the early and mid-90s.

Inflationary pressures have declined significantly. Annual consumer price inflation has declined from 55% in 1999 to 10% in 2004. The sharp output contraction in 2001 led to a marked increase in unemployment, rising from 6.6% of the labour force in 2000 to over 10% in 2002-2004. So far, the robust real GDP growth observed since 2002 has only very recently yielded some significant job creation. So far, the fiscal impact of this deterioration in the labour market has been limited, mainly due to the fact that the unemployment system has been introduced in 1999 only and the number of entitled persons still is relatively small. The current account remained relatively balanced, fluctuating between a deficit of 5.1% of GDP and a surplus of 2.4% over the reported period. However, developments in 2004 point at an increasing external exposure of the Turkish economy, in particular since the current account deficit has been in large part financed by short-term capital inflows, which were, in large part, attracted by relatively high interest rate differentials. Foreign direct investment inflows have remained negligible.

Table 3 - Turkey: Main economic trends

	annual averages	**2000**	**2001**	**2002**	**2003**	**2004**
Growth	GDP in real terms, change in %	7.3	-7.5	7.9	5.8	9.0
Inflation	CPI, change in %	54.9	54.4	45.0	21.6	8.6
Unemployment	LFS, % of labour force	6.6	8.5	10.4	10.5	10.3
Current account	balance, % of GDP	-5.0	2.4	-0.8	-2.9	-5.2
Interest rate	5-year govt. bonds, % p. a.	-	-	-	-	-
Exchange rate	YTL/EUR	0.576	1.102	1.431	1.682	1.771

Source: Eurostat

Despite relatively weak growth in disposable income and high unemployment, the Turkish authorities managed to achieve substantial primary surpluses. Therefore, they have increase tax revenues by raising tax rates and reducing public expenditure, primarily by moderate increases of public sector wages and linear expenditure cuts. However, education and health have been largely exempted.

3. Methodological issues

Main challenges

The data have been calculated by applying as far as possible the accounting and definitional requirements (ESA95) used for the fiscal surveillance of EU Member States. Some progress has been made in this year's notification in improving the accounting of accrued interest and in providing data, in particularly in 2003. As in previous years' notifications, the information on social security institutions and local governments still remains limited.

Transposition of national budget balances into ESA 95

Table 4 sets out the transposition of the national budget balance into the ESA 95 general government net borrowing/net lending definition. The first line shows the actual (and for 2005 planned) figures of the most prominent budget balance which is in Turkey the central government budget deficit (the official budget announced by the Ministry of Finance). The transposition from the national budget concept into ESA 95 requires a series of adjustments: First, the treatment of financial transactions - such as loan or equity sales and purchases - has to be adjusted to ESA 95 standards. In the case of Turkey, the main change is related to appropriations for guarantee payments and expected privatisation revenues. The size of those corrections is generally rather limited, as it reduces the deficit by less than 1%. Second, in another step, the accounting of accrued receivables and payables such as revenues and interest payments is aligned with ESA 95 standards. In contrast with earlier years, when this alignment was rather neutral, central government accrued significantly more interests than it paid in 2004, which explains in large part the reduction of over 2% of GDP. For 2005, the Turkish authorities do not expect a significant correction. A third adjustment refers to the institutional setup, taking into account the net borrowing or lending of other central government bodies, which are not included in the central government budget. In the case of Turkey, those are mainly extra-budgetary and revolving funds. On average, those institutions register a budgetary surplus of about 1% of GDP. Finally, adjustments for other transactions, such as transfers related to the previous duty losses of state banks, are taken into account, amounting to some ¼% of GDP. In sum, these adjustments result in an ESA 95 central government deficit, which was during the reporting period lower than the deficit based on the national definition. In large part due to accrued interests, as explained above, the difference between both measures increased significantly between 2003 and 2004, from 1.5% of GDP to 3.1% of GDP. In 2005 the deficit reducing impact is expected to fall to 1.7% of GDP.

Table 4 - Turkey:
Transposition of national budget balances into ESA 95 net lending (+)/borrowing (-)

	2003		**2004**		**2005** (1)	
	mio. YTL	*% of GDP*	*mio. YTL*	*% of GDP*	*mio. YTL*	*% of GDP*
Most prominent national budget balance (2)	-40,204	-11.2	-30,313	-7.0	-29,138	-6.0
+ adjustment to central government net lending	2,999	0.8	8,896	2.1	3,161	0.7
= Central government net lending (S.1311)	-37,205	-10.3	-21,417	-5.0	-25,977	-5.4
+ Local government net lending (S.1313)	-1,630	-0.5	-157	0.0	-97	0.0
+ Social security net lending (S.1314)	3,823	1.1	4,777	1.1	5,118	1.1
= General government net lending (S.13)	-35,011	-9.7	-16,797	-3.9	-20,956	-4.3

(1) planned
(2) State budget balance (the State budget includes the central budget, the ministries' budgets, the budget of the National Audit Office and the judicial authorities' budget)

As far as the other sectors of the general government are concerned, the main impact on the overall balance comes from the social security institutions, reducing the general government net lending by just over 1% of GDP during 2003-2005. Local governments have only a very limited impact on the ESA95 general government deficit.

Stability of data[4]

Data have been provided for the years 2001-2004 and planned figures for 2005. As compared to the March 2004 notification there have been revisions of data, especially to general government net borrowing for 2002-2004, mostly due to revision of the central government sub-sector. In addition, local government figures for 2003 are revised.

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

Net borrowing figures are reported for sub-sectors. However, there is very little data showing their calculation. It is not possible to say if the net lending /net borrowing of sub-sectors is correctly calculated, as there may be problems arising from classification of institutional units and accrual valuation for local government and social security funds.

General government net borrowing was revised down by 0.4 percentage points in 2002 (from 12.7% of GDP to 12.3%) but worsened by 1 percentage point in 2003 (from 8.7% of GDP to 9.7%). The 2003 revision is mostly due to a change in net lending of extra-budgetary funds and revolving funds, and a correction in the sign of accounts receivable related to securities issued for the rehabilitation of some banks. For 2004, general government net borrowing was revised from a forecast of 8.0% of GDP in March 2004, to 3.9%. The main factor was an improvement for central government, resulting from a better than expected public accounts balance and a positive adjustment for accruals.

Compared to the previously notified data, interest expenditure of the general government sector is almost unchanged but is very high, particularly for earlier years: 27.1% of GDP in 2001, 19.3% in 2002, 17.3% in 2003 and 11.9% in 2004. These data may require closer examination.

Deficit and debt methodology

In the Turkish notification, the transition from public accounts deficit to the net borrowing of general government starts from the official central government budget balance. In 2003 and 2004 a balance of the 'Risk Account' was recorded as financial transaction (loans granted) and therefore eliminated in the calculation of ESA95 net lending /net borrowing. Financing and expenditure of this account may give rise to further discussion with Eurostat in order to clarify the recording and amounts involved.

The issue of difference between interest accrued and interest paid should be clarified. In table 2 it is not clear what is the link between interest recorded in the line 'difference between interest paid and accrued', and interest included in 'other accounts receivable' and 'other accounts payable'. Also the reasons for the differences between the interest adjustments recorded in tables 2 and 3 should be clarified.

Other accounts receivable and payable of central government cover mainly taxes. It seems that the other revenue of central government is already recorded on an accrual basis. The amounts of taxes unlikely to be collected are monitored separately in an account called “receivables from prosecuted revenues” and deducted from tax receivables.

The figures for accounts receivable are very significant over the whole period and continuously increasing. Social contributions and social benefits are still recorded on a cash basis. However, accruals for these can be expected for the future.

Net borrowing of the central government sub-sector is highly predominant within the general government total. Central government contains the following agencies with their own special budget: TRT-General Directorate of Turkish Radio and Television Institution, General Directorate of National Lottery Administration, YURTKUR- General Directorate of Higher Education Credit, Hostels Institution and AOÇ- Atatürk State Farm. From the information received, the AOÇ- Atatürk State Farm and the National Lottery Administration should not be recorded inside the general government sector. For 2003, the AOÇ- Atatürk State farm reported a surplus of 1,35 trillion TL while the National Lottery Administration has a surplus of 103,1 trillion TL. As far as the other agencies mentioned above are concerned, their inclusion in the general government sector will be subject of further discussion with Eurostat.

For the compilation of the local government sub-sector an annual survey is conducted providing figures on a cash basis. For the deficit and debt notification the results of the survey are compared and completed with figures provided by central institutions including Ministry of Finance, the Undersecretariat of Treasury, social security institutions.

In the calculation of net lending of the social security funds, their financial balance is used. However the figures are available only on a cash basis for the moment.

Concerning the recording of consolidated debt, central government holds debt of the local government, but the amounts are very low. In 2003 and 2004 depreciation of general government consolidated debt in foreign currency can be noted, whereas in previous years an appreciation was recorded.

There are still high statistical discrepancies between the deficit and the change in general government consolidated debt, of about 13.8% of the change in debt for 2001, 9.5% in 2002, 9,9% in 2003, increasing in 2004 to 36.6%, when an improvement was expected starting from fiscal year 2004.

Gross Domestic Product

Concerning the quality of GDP data, ESA 95 is adopted as a general framework. To achieve a conceptual and material compliance numerous development projects have been launched, including the exhaustiveness of national accounts data. Only after these projects have been completed can an assessment be made as to full compliance. Revised GDP data taking into account the results of these projects are expected in 2005.

4. Conclusions

The 2005 fiscal notification illustrates the successful efforts made in Turkey since 2001 in correcting fiscal imbalances. In 2004 in particular, the rapid decline in real domestic interest rates - in combination with favourable real effective exchange rate developments - led to a very significant decrease of the fiscal burden caused by the 2001 financial crisis. The Turkish authorities achieved substantial primary surpluses after 2001. Those surpluses not only reduced the debt ratio, but also helped to bring down interest rates by strengthening market confidence. An in-depth assessment of Turkey’s debt dynamics demonstrates a growing importance of the adherence to significant primary surpluses and of a further reduction of financing costs.

From a methodological point of view, there have been revisions of some figures since the previous notification, mainly due to the availability of more definitive data and to corrections for the misinterpretation of some adjustment items.

There are still some conceptual issues which should be clarified with Eurostat, especially as far as delimitation of general government and accruals recording are concerned. The National Statistical Office should be more involved in the preparation of the notification figures, especially for the ESA 95 methodological aspects, including those referring to delimitation of general government sector and sub-sectors. A full assessment of the data by Eurostat remains difficult. Eurostat recommends that the authorities give high priority to further improvement in the quality of the deficit and debt figures. One of the means in achieving this is the compilation by the statistical authorities of a full set of ESA 95 accounts (non-financial and financial) for the general government sector and its sub-sectors.