Internal Debt Issue And Sustainability Of Internal Debts: After 2000 Turkey Sample

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Abstract

Today, borrowing that has become a common problem of almost all countries has a great importance in the developing countries, for example Turkey, rather than developed countries. The reason is while internal debt is considered as provisional public revenue to balance the current economy in the developed countries, it is considered as consistent public revenue such as tax in the developing countries. From this view, internal debt that has increased over the years causes an accumulation called "snowball effect". Public internal debt at high levels is negatively affected by macro economic factors such like manufacturing, investment, inflation, distribution of income. Uncontrollable increases of the internal debts make sustainability matter of debts a current issue. In the study, it has been analyzed if internal debts were sustainable in Turkey's economy between the years of 2000 and 2014 by using the method of proportional analysis and it has been concluded that internal debts cannot be sustained especially in crisis periods.

Keywords: Internal Borrowing, Sustainability, Turkey's Economy

Introduction

Until the beginning of 20th century, justice, defense and safety services were the primary duties attributed to the state. However, needs of the society have been increasing so far; in addition, duties and liabilities undertaken by the state have been increasing evenly. As public expenditures increase continuously along with social needs by force of "Social and Modern State" concept and duties attributed to the state are more and complicated, gained revenues cannot meet the expenditures and as a result public financing deficit can be caused.

Even though it is not welcomed that public sector has a deficit since its expenditures cannot be met by ordinary public revenues, today we encounter this situation as an ordinary situation in both developed and developing countries. Expenditures that cannot be met by the ordinary revenues have directed the public sector to the fund seeking out of ordinary

revenue, internal borrowing that is qualified by classic economists as extraordinary revenue and that replaced by the tax nowadays has become a place of refuge for the public.

In Turkey, as internal borrowing has become a always used resource by financial, economic and political reasons especially since the midst of 1980s and growing amounts of debt have been raising importance of the internal borrowing. From past to present, as internal borrowing that has been a subject of many scientific researches, it is one of the most attractive subjects of public finance. While discussions made on internal debt and its economic effects have continued, increases in internal debt stock experienced especially by the developing countries have made the discussions on sustainability of internal debts a current issue.

Sustainability of debts

Sustainability Term and Definition related to Sustainability of Debts

Even though many definitions have been made related to "sustainability" term in the literature, unfortunately there isn't any clear definition about the exact meaning of sustainability (Slack and Bird, 2004, p.4). For Geither (2002, p.4), sustainability with the easiest form is a concept involving predictions and also solvency of the country.

In terms of budget deficits, sustainability is the success of the state to manage his financing resources so as to fulfill the current and future expenditure obligations. In other words, sustainability can be defined as the state can carry out his expenditures without causing any injustice between the current and future generations (Intergenerational Report, 2002, p.2). In this context, while political authority carries out the public services in the current period, it should carry out spending policies which will minimize the load on future generations.

The main reason why sustainability occurs in internal borrowing is that the state cannot pay cost of his debts. When the internal debts become unsustainable, the major part of collected taxes will be for capital and payment of interest of the internal debts. In that, the state has used more than the collected tax revenues in capital and payment of interest of the internal debt and supplied the amount that revenues are not enough by means of borrowing again. As well as paying off with debt might decelerate public services and economic growth, it might leave a big load on the future generations (Bal and Özdemir, 2010, p. 88).

In economy literature, under the assumption that the state would continue the current policies in the future, if it is understood that Debt/GDP rate will increase boundlessly, this kind of public debts are called as "unsustainable debts". What unsustainable debts mean is that the state will absolutely have to reduce his expenditures seriously one day and increase his

revenues in some way (Tüsiad, 1996, p.49). Otherwise, existence of this circumstance will be an abstraction way which will bring the researcher to the result of "non-sustainability of public debts" (Özgen and Karakaya, p.49).

Methods to be used to Measure the Sustainability of Debts

There are two different approaches to be taken into account in sustainability of debts. These are static approach and dynamic approaches. While relations between public revenues and public expenditures are analyzed in static approach, in the dynamic approach relations between rates of growth and budgetary constraints are analyzed (Slack and Bird, 2004, p.4) For Adams, Ferrarini and Park (2010, p.5), static sustainability means the ability of public to finance the debts based on a certain period. As for dynamic sustainability, it means the ability of public to pay debts regarding longer periods.

We can gather methods analyzing the sustainability of public debts under six titles. These are accounting approach, interperiod budgetary constraint approach, sustainability indicators approach, twin deficits method, method of proportional analysis and budgetary constraint equation (Özcan, 2011,p.230&Ulusoy and Cural, 2004, p.4).

Indicators used regarding Sustainability of Debts

In this section, method of proportional analysis that is one of the abovementioned sustainability methods will be practiced for Turkey. In Turkey, discussions on sustainability of debts started after the economic crisis experienced in 2011. In this study, it has been tried to examine the sustainability of internal debts in Turkey's economy between the years of 2000 and 2014. In literature, method of proportional analysis that is a static method of analysis is generally used to measure sustainability of debts. In the method of proportional analysis, it is benefited from numeric data of previous years and analyses are performed by using rates related to sustainability of debts. It is a matter of debate which rate will bring true results in measuring the sustainability of internal debts. In the study, three indicators have been used in order to measure sustainability of internal debts. These are internal debt stock/GDP rate, primary surplus approach and the relation between reel rates of interest and reel rates of growth.

Internal Debt Stock/GDP

First of the indicators used in determining sustainability of internal debts is the share of internal debt stock into GDP. For Edwards (2002,p.3), if the ratio of public debt stock to national revenue remains stable in a economy in the long term as well, it means debts are sustainable. Therefore,

if ratio of internal debt stock to GDP does not increase in long term, then it will be found adequate for sustainability (Roubini, 2001, p.7). The most important point to be taken into consideration here is the borrowing level of public. In that, in any two countries which have 50% and 100% of internal debt stock/GDP rate, it is considered that sustainability is ensured as long as level of internal debt / GDP rates is consistent (Edwards, 2002, p.3).

Table 1: Ratio of Internal Debt Stock to GDP (2000-2014)

Years	İnternal Debt Stock/GDP	Years	İnternal Debt Stock/GDP
2000	21,8	2008	28,9
2001	50,8	2009	34,6
2002	47,7	2010	32,1
2003	46,3	2011	28,4
2004	44,1	2012	27,2
2005	37,7	2013	25,7
2006	33,1	2014	23,7
2007	30,2		

Source: Hazine Müsteşarlığı (https://www.hazine.gov.tr/tr-TR/Anasayfa)

In Table 1, when we look at ratio of internal debt stock to GDP between the years of 2000 and 2014 in Turkey, ratio of internal debt stock to GDP was 22% in 2000. Because of financial crisis experienced in 2001, GDP decreased and internal debt stock increased up to 51% because of an increase in rates of interest (TCMB, 2002, P.13). This situation accompanied discussions on sustainability of internal debts with internal borrowing and its economic effects (Koçak, 2009, p.74). For Edwards (2002, p.3), if ratio of internal debt stock to GDP is consistent in long term, then we can say internal debts are sustainable. Therefore, as these rates, in the Table 1, are high in 2001 to 2004 period and aforementioned rates are approximately 47,2%, internal debts are at an unsustainable level.

Ever-growing public deficits, absence of an effective tax policy to close these deficits and crises experienced in the banking sector at the beginning of 2000s can be presented as the reason of increase in internal debt stock in Turkey (Koçak, 2009, p.74). With the effect of the loan provided IMF-assisted Transition to the Strong Economy Program and 18th stand-by agreement, downtrend has been experienced in internal debt stock and internal debt load as from 2002. In the table, it is seen that internal debt stock that is 42,7% in 2002 decreases gradually and descends to 28.9% in 2008. Even though internal debt stock/GDP rate increases up to 35% because of the effects of global economic crisis experienced in 2008, this rate decreases to 24% in 2014 as the effects of crises decreases. We can say that internal debt stock / GDP rate follows a consistent way especially after 2005.

Primary Surplus Approach

Another indicator used in determining sustainability of internal debts is primary surplus. It is indicated that primary surplus term has become the

main topic, at first in 1994, by means of the stand-by agreement carried out with IMF. Government has followed a fiscal policy based on primary surplus indicator since 1994 and the main purpose of primary surplus has been to ensure sustainability of internal debts (Gürdal, 2008, p.420-421).

Primary surplus defined as subtracting total public expenditures from public revenues excluding interest expenditures (Gürdal and Yardımcıoğlu, 2005, p.22); informs us on how much money will remain in budget after the debt interest of budget is paid (Cansız, 2006, p.68). Primary surplus is quite important in terms of efforts of governments in order to achieve the targets they set to stabilize the economy in the countries which have higher budget deficits such like Turkey (Aydın, 2005).

If reel interest exceeds the reel rate of growth in a country where internal debt load is high, then this economy has no other choice but primary surplus. Giving primary surplus is provisional solution. As for permanent solution, it is to close total budget deficit including the interest. It can be realized by means of achieving the primary surplus as high as possible (Eğilmez, 2004).

For Ulusoy and Cural (2006, p.9), sum of ratio of primary surplus to national revenue and reel rates of growth should be higher than reel rates of interest in order to maintain the public debt at the same level in primary surplus approach. According to this circumstance, as reel interest are higher than sum of primary surplus and reel rates of growth during 2001-2004 and 2007-2009 in Table 2, it is a big problem in terms of realizing the internal debt. Therefore, internal debts are at an unsustainable level during this period.

Table 2: Ratio of Primary Surplus to GDP (2000-2014)

Years	Primary Surplus /GDP	Real Growth	Real İnterest Rate
2000	4,3	6,8	-10,9
2001	5	-5,7	27,2
2002	3,4	6,2	13,1
2003	4	5,3	16
2004	4,7	9,4	14,5
2005	5,8	8,4	6,3
2006	5,4	6,9	7,2
2007	4,2	4,7	9,1
2008	3,5	0,7	8,1
2009	0	-4,8	6,6
2010	0,7	9,2	0
2011	1,9	8,8	2,8
2012	1,3	2,1	0
2013	2	4,2	0,9
2014	1,6	2,9	0,9

Source: HM (https://www.hazine.gov.tr/tr-TR/Anasayfa), World Bank, DPT: Economic and Social İndicators

In Table 2, when we analyze the rates of primary surplus took place between the years of 2000 and 2014 in Turkey, it is seen that non-interest budget has a surplus continuously from 2000 to 2009. However, along with the economic crises experienced in 2001, even though reel growth is low and reel rates of interest are high in this period and thus it creates a problem for sustainability of borrowing, it is seen that non-interest public budget has a surplus.

In 2001, within the macroeconomic program practiced to provide sustainability of internal debts, it has been decided to increase primary surplus that is the main purpose, to take measures to increase the revenue and provide the spending discipline in order to ensure a sustainable structure for public financing and to restructure the banking system (TCMB, 2001, p.7). We can hence say that the applied program has left a positive impression on non-interest public budget. According to Table 2, primary surplus that has been 4,3% in 2000 increases up to 5% in 2001. Primary surplus that has decreased to 3,3% in 2002 has increased up to 4% in 2003 and then increased up to 5,8% in 2005.

An increasing of primary surplus above 5% means that financial discipline is maintained in budget. Besides, net internal borrowing has been affected in reducing manner as primary surplus has been at higher levels as from 2000. This decrease is affected by the increase in national revenue and improvement in borrowing conditions along with high primary surplus. As from 2006, ratio of primary surplus to GDP has tended to decrease and decreased to 0% in 2009 by the effect of 2008 crisis. Primary surplus has increased again in 2010 and has been 1,6% in 2014.

Even though ratio of primary surplus to GDP is an important indicator to measure sustainability of internal borrowing, it is not a measure which will ensure to reach correct results singly. Therefore, it is required to evaluate reel rates of interest and reel rates of growth together with non-interest budgetary balance for sustainability of internal borrowing.

Relation between Reel Internal Debt Interest Rates and Reel Growth in Turkey

Another indicator used in measuring sustainability of internal debts is to compare reel internal debt interest rates with reel rates of growth. Reel rates of growth should be above the reel rates of interest so that internal debt is sustainable (Ulusoy and Cural, 2006, p.12).

When reel interest is equal to reel rate of growth or is higher than reel rate of growth, this rate will decrease over the time and it will possible to turn the debt even if debt stock/GNP has been 100% at the beginning (Önder and Kirmanoğlu, 1994, p.20). However, if reel internal debt interest is higher than reel rate of growth, then it will be required to borrow again for

financing of interests. If this mechanism becomes chronic, ratio of debt stock to national revenue will increase (Ceyhan, 2004, p.35). For Roubini (2001, p.4); when reel rate of growth is higher than rate of economic growth, ratio of debt stock to national revenue will increase continuously day by day. As long as reel rates of interest doesn't increase more than the growth rate of national revenue, public debt stock may increase boundlessly.

When we analyze the relation between reel internal debt interests and reel growth, we see that these two factors affect each other oppositely. For example, it is seen that there is a decrease in reel rates of growth in periods in which reel internal debt interests increase and there is an increase in reel growth when reel interests decrease. Therefore, rate of increase in internal debt stock is illustrated in Table 3 in order to analyze effect of relation between reel growth and reel internal debt interests on the internal debt stock.

As seen in Table 3, interest rates of reel internal borrowing and reel interest rates between the years of 2000 and 2005 are higher than reel growth. While reel growth is about at 4% within this four-year period, average of reel internal debt interests is 18%. In addition, as seen in Table 3, during this four-year period in which reel growth is lower than reel internal debt interest rates, rate of increase in internal debt stock is higher than 15%. On the other hand, in the period between the years of 2005-2010, especially in 2008 and 2009, reel internal debt interest rates are higher than reel growth. Consequently, excluding 2005, we can say that a risk to sustain the internal debts has been in question in period between the years of 2000-2010, and reel interest is paid above the rate of growth in internal growing in this period.

Table 3: Relation Between Reel Internal Debt Interest Rates and Reel Growth

Years	Real Interest Rate	Real Growth Rate	Internal Debt Growth Rate
2000	-10,9	6,8	59
2001	27,2	-5,7	235,4
2002	13,1	6,2	22,7
2003	16	5,3	29,8
2004	14,5	9,4	15,4
2005	6,3	8,4	9
2006	7,2	6,9	2,7
2007	9,1	4,7	1,5
2008	8,1	0,7	7,6
2009	6,6	-4,8	20
2010	0	9,2	6,9
2011	2,8	8,8	4,5
2012	0	2,1	3,3
2013	0,9	4,2	4,2
2014	0,9	2,9	2,8

Source: HM (https://www.hazine.gov.tr/tr-TR/Anasayfa), World Bank, DPT: Economic and Social Indicator

In the countries, rates of interest can be decreased by ensuring price stability in economy and breaking the expectation of inflation. Hence, as a result of the rate of inflation decreased and society's expectation of inflation was broken relatively after 2001, it is seen that interests have decreased in public borrowings (Saraçoğlu, 2002, p.66). As it is seen in Graphic 3, rate of interest starts to decrease after 2001 and is under the reel rate of growth in 2005, 2010, 2011, 2012, 2013 and 2014.

In Table 3, the years in which rate of increase in internal debt stock is at the highest level are the years in which difference between reel growth and reel internal debt interest is at the highest level. For example, in 2010 that is one of the years in which reel internal debt interest is at the highest level, rate of increase in internal debt stock is 235%. Therefore, internal debt stock increases rapidly in the period, between the years of 2000 and 2014, when reel internal debt rates are higher than reel growth. As it is seen, it is not likely to sustain the public debts in long term because reel internal debt interest rates are always higher than reel growth, significant rate of growth cannot be ensured and reel interests cannot be decreased and then public goes round in circles of debt.

Table 4: Results of Domestic Debt Sustainability in Turkey (2000-2014)

Years	2000	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Domestic Debt / GDP		X	X	X	X										
Primary Surplus Approach		X	X	X	X			X	X	X					
Real interest / Real Growth		X	X	X	X		X	X	X	X					

Table 4 illustrates an abstract of results we obtained in the study. According to the results obtained from the factors - internal debt stock/GDP, primary surplus approach and relation between reel interest and reel growth - used in order to measure sustainability of internal debts, the years in which internal debts are unsustainable are illustrated as "X".

Conclusion

Sustainability term is introduced if state cannot pay the cost of borrowing. Non-sustainability of debts means that a large part of tax collected and any other source of income will be allocated to the repayment of debt. Due to this situation, investments and therefore economic growth will decelerate and at the same time, a load will be formed on the future generation. Because of this, sustainability of internal debts has been becoming more important.

In this study, sustainability of internal debts are analyzed in direction of three indicators internal debt stcok/GDP, primary surplus approach and relation between reel internal debt interest rates and reel growth)which are generally accepted in the literature between the years of 2000 and 2014 in

Turkey. It is accordingly seen from three indicators that internal debts are unsustainable in 2001, 2002, 2003 and 2004 in Turkey. In addition, it is seen from two of three indicators that internal debts are unsustainable in 2007, 2008 and 2009. In these years (2007, 2008 and 2009), however, concerns on sustainability of internal debts are decreased by the reasons that deviations from threshold values are low, reel rates of interest are continuing to decrease, economic growth is consistent, etc. We must pay attention that the years when debts were unsustainable were the years when Turkey experienced an economic crisis.

It is quite important to increase the primary surplus at the determined level in order to decrease the interest payment of internal debt which increased up to higher levels in order to decrease the internal debt stock and maintain the sustainability of internal debts. The main determinant factor in creating primary surplus is the tax revenues that have an important place in public revenues. In this context, in order that tax revenues can be increased up to the intended level, tax loss and tax evasion should be prevented by tax discipline and tax should expand on base. In addition to this, the main target should be determined as practicing a strict fiscal policy and also having primary surplus in order to ensure sustainability of internal debts under a high load of debt. Using the primary surplus in debt management effectively is quite important in terms of easing the load caused by internal debts in terms of public sector.

Ensuring the fiscal discipline and transparency together with implementation of debt policies consciously in the markets pertaining to public finance and debt management is required to reach a sound economic structure and realize a long term development in the economy. Therefore, the fields that these resources attained through debt is used is of importance. Utilizing these resources in productive and efficient fields that enhances the investment and export will relieve the economy while repaying the debt. Together with this, government debt policy should be sustained by considering transparency in order to pursue its debt cycle. To be able to render the borrowing accountable, Treasury debt management should be monitored by independent audit institutions.

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