Chapter 13
Alignment of Turkey with the European Union in Public Financial Management and Control

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13.1 Introduction

Turkey was acknowledged as a candidate country of the European Union (EU) at the Helsinki Summit of December 10–11, 1999. Later in the European Council meeting of December 17, 2004, it was confirmed that Turkey fulfills the political criteria and on October 3, 2005, the accession negotiations officially started. There are 35 chapters for negotiations that aim at transposing the EU *Acquis* into national law. So far, 16 chapters were opened to accession negotiations, whereas only one chapter is temporarily closed (Current Situation in Accession Negotiations 2016).

The conditions for EU accession emphasize the requirement to establish a strong public administration in order to transpose and implement the EU *Acquis* effectively. In this regard, the European Commission outlined six key reform areas as the 'Principles of Public Administration'. The performance of the candidate and potential candidate countries in applying these principles is an indicator of their capacity for effectively implementing the EU *Acquis*. Public financial management (PFM) is one of the six areas mentioned above, for which the main requirements that should be followed during the European integration process are defined (SIGMA 2017a).

Public financial management is among the most important areas of reform achieved by Turkey in European Union accession process. While the progress in EU alignment on the general framework of PFM and the budget are assessed under the public administration reform, specific fields of public financial management are subject to different negotiation chapters.

The following sections will describe the general EU requirements and Turkey's level of alignment in the field of public financial management and its subsystems that are covered under different "chapters," namely, Taxation, Economic and Monetary Policy, and Financial Control, all of which have been opened to negotiations. Then,

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the projects that have been carried out in these fields under EU financial assistance will be briefly listed. In the end, there will be a section to discuss the progress achieved and further work to be done in these areas.

This study will not go into the details of the reforms carried out by Turkey in these areas, as they have already been discussed under various parts above. It will rather focus on Turkey's level of compliance in this area.

13.2 Alignment in the Main Pillars of Public Financial Management

The European Commission describes the three important pillars of EU enlargement process as public administration reform, rule of law, and economic governance. These pillars are interrelated and fundamental for the success of both political and economic reforms and implementation of EU legislation and standards. Public administration reform aims at increasing accountability, transparency, and effectiveness for better functioning of the state as well as implementing the reforms on the way to EU membership. Accordingly, public financial management (PFM) is an important element of public administration. In the enlargement process, PFM consists of a commitment to improving budget management through multi-year programs and also having a policy dialogue with the Commission (European Commission 2014c).

The public financial management system covers the whole cycle of budget from preparation to execution, accounting, reporting, external audit, and scrutiny. The system should be designed to achieve strategic allocation and efficient use of resources as well as fiscal discipline, and cover both revenue and expenditure management (European Commission 2018b).

SIGMA was asked by the European Commission to gather evidence and data to monitor the progress in the countries for the assessment of their public administration systems. In this context, SIGMA prepared, among others, key requirements and principles for a sound public financial management system as a guide for candidate countries. While preparing the key principles for its assessments on public financial management, SIGMA has also taken the Public Expenditure and Financial Accountability (PEFA) program as reference. PEFA identifies the key requirement for a good PFM system on budget management, internal control, internal audit, external audit, and public procurement (SIGMA 2017a).

Starting with early 2000s, significant reforms have been realized in Turkey in order to increase the quality of public services and the effectiveness of public financial management. The Law no. 5018 on Public Financial Management and Control (PFMC), which has been prepared in accordance with the EU *Acquis* and international standards, can be considered as the basis of these reforms. The reforms were strengthened by further legislation, such as the Law No. 4749 on Regulating Public Finance and Debt Management, Turkish Court of Accounts Law No. 6085 and Public Procurement Law No. 6518.

The main aim of Law No. 5018 is to ensure economic, effective and efficient acquisition, and utilization of public funds together with accountability and fiscal transparency. With the enactment of this Law, the scope of the budget has been broadened, multi-year budgeting, strategic planning as well as performance-based budgeting systems have been introduced, unification of public accounting has been ensured, effective internal control and internal audit systems have been established, and the scope of audit performed by the Court of Accounts has been extended. The Law No. 5018 regulates all phases of public financial management, from preparation to control and reporting.

In its latest assessment of public financial management in accordance with the above mentioned key requirements and principles, SIGMA stated that most of the key elements of a strong public finances are in place and broad public finances remain robust in Turkey. However, gaps have been found in terms of fiscal rules as well as establishment of an independent oversight institution to monitor these rules (SIGMA 2017b). The main findings of SIGMA (2017b) on public financial management are as follows[1]:

In relation to *budget management*, the medium-term budgetary process is criticized due to the lack of a single institution who owns the entire process, not including the IPA funded projects in projections and not publishing sensitivity analysis or fiscal risk assessment. The exclusion of the revolving funds from annual budget is also found risky, as it creates a weakness in relation to Turkish Grand National Assembly's (TGNA) role in approving the budget, and in successful implementation of fiscal policy.

The unity of treasury is also mentioned in SIGMA reports, saying that the Law No. 5018 provides for a single treasury account. While the report states that the system of cash management and flows are well organized, it is criticized that the cash flows are on a rolling three-months basis rather than monthly.

As regards the *debt management*, while the establishment of a strategy and the downward path of debt-to-GDP ratio are mentioned, the coverage of controls around borrowing and the issuance of guarantees is identified as a point of concern. It is also stated that state enterprises and local authorities do not require prior approval for borrowing in the domestic market but does so for foreign borrowing. The increase of Treasury guarantees in recent years is also seen as a matter of concern.

On *budget transparency*, it is stated that the Ministry of Treasury and Finance publishes central government expenditure and revenue reports monthly and financial statistics of general government (central government, social security institutions, local authorities, and state-owned enterprises) quarterly and annually. The monitoring of revolving funds, however, is done by the Ministry of Treasury and Finance through Revolving Funds Financial Management System (SIGMA 2017b). Accordingly, the conditions are in place for budget transparency, and the TCA audits public

[1]This part covers the findings under PFM. The findings on internal control, internal and external audit will be discussed under Chapter 32-Financial Control section.

finances annually. Nevertheless, it is criticized that the monthly budget reports provide consolidated data only and variations from expectations are not explained in reports.

Furthermore, IMF's Country Report on Turkey also evaluates fiscal transparency in Turkey, mentioning that significant progress has been achieved in fiscal transparency practices over the past decade and a half and Turkey has substantially improved the comprehensiveness, timeliness, and reliability of fiscal information, which is publicly available. The report concludes that as a result of the reforms on fiscal transparency, Turkey has made significant progress against the principles of IMF's Fiscal Transparency Code (IMF 2017).

Regarding the *transparency of accounting and reporting practices,* SIGMA (2017b) emphasized that Turkey continued to improve and standardize accounting practices across the general government and further align with international standards and best practices.

Finally, in the area of *public procurement*, it is stated that the Public Procurement Law has been changed many times since its adoption and the main divergences from the EU *Acquis* include a number of exclusions from the Law and implementation of domestic preferences. The fragmented structure and non-alignment with the *Acquis* in public–private partnerships and concessions are also highlighted. It is also mentioned that a draft has been prepared for a new Public Procurement Law and a strategy is being prepared to harmonize public–private partnerships on concessions (SIGMA 2017b). These fields are worked on under Chapter 5: Public Procurement in accession negotiations. However, its details will not be discussed here as the chapter is not opened to accession negotiations yet.

Moreover, in the most recent Regular Report for Turkey, Turkey is criticized for not having an overarching public financial management reform program. Besides, budget transparency on especially public investment programs, civil society's participation in the budgetary process, and involvement of revolving funds into the budget process are stated as the areas to be improved (European Commission 2018a).

13.3 Alignment in Fiscal and Budgetary Surveillance

Sound public finances is one of the most important pillars in EU's economic governance system, which was broadly changed after the economic and financial crisis. As a result of the crisis, government deficits and debts in the member states increased, which revealed the weaknesses in surveillance of fiscal policies. As a response to these weaknesses, EU has taken a wide range of measures, the most important of which is the legislative packages known as the six-pack and two-pack. These two packages of measures aim at increasing economic policy coordination via strengthening budgetary surveillance under the Stability and Growth Pact with stronger sanction mechanisms as well as increased surveillance for Euro Area countries regarding national budgetary preparation under the European Semester process (European Commission 2014b).

European Semester, which was introduced in 2010, is a framework for coordination of economic policies in member states (Verdun and Zeitlin 2018). Through this process, the EU countries discuss their economic reforms and national budgetary plans and the progress is monitored by the European Commission at specific times during the year. The aim of European Semester is to ensure strong public finances; prevent and correct excessive macroeconomic imbalances; speed up structural reforms; and increase growth, jobs, and investment (Efstathiou and Wolff 2018).

The Stability and Growth Pact, which is considered as a supranational fiscal rule, is a part of the European Semester and can be regarded as the fiscal framework of the EU. It is built on a preventive and a corrective arm. The preventive arm aims to ensure that the member states' fiscal policies are consistent with principles of fiscal responsibility and prudence stated in Maastricht Treaty. The corrective arm describes the procedures to be followed when a country is already in the excessive deficit procedure after exceeding the budget deficit limit of 3% of GDP (Corbacho and Ter-Minassian 2013).

Another legislative measure included in the abovementioned packs is the Council Directive 2011/85/EU, which lays down detailed rules for national budgets of Euro Area countries. This Directive requires countries to make the fiscal data publicly available, ensure that their fiscal planning is based on realistic and up-to-date forecasts, operate specific fiscal rules to prevent excessive public deficit or debt, establish a credible and effective medium-term budgetary framework, operate comprehensive public accounting systems and ensure consistency of all accounting procedures in all areas of government activity (Council of the European Union 2011).

The EU strengthened its economic governance exercise also with the enlargement countries to prepare them for their participation in the European Semester after becoming an EU member. The European Commission's support to these countries includes improving economic governance and competitiveness. It is built on the experiences of European Semester process. The candidate countries are expected to improve economic governance systems (European Commission 2014c).

The level of alignment of the candidate countries to European Union's fiscal surveillance mechanisms is followed under Chapter 17, Economic and Monetary Policy. "The *Acquis* in this area covers the independence of central banks in Member States, prohibiting direct financing of the public sector by the central banks and prohibiting privileged access of the public sector to financial institutions. Moreover, Member States are expected to coordinate their economic policies and are subject to the Stability and Growth Pact on fiscal surveillance." (European Commission 2006a, p. 2).

Turkish legislation in the economic and monetary policy area is already significantly convergent with the relevant *Acquis*. Turkey implements a medium-term budgetary framework and the main documents that determine the general framework are National Development Plan, Medium-Term Program, Medium-Term Fiscal Plan, Annual Program, and Pre-accession Economic Program (called Economic Reform Program since 2015). Turkey participates in the pre-accession economic policy coordination and surveillance procedures since 2001, by submitting annual Pre-accession

Economic Programs and Fiscal Notifications to the EU. Accordingly, this Chapter was opened to accession negotiations on December 14, 2015, without any opening benchmarks.

Turkey has been successful in ensuring the sustainability of public finances in the last years. By the end of the year 2017, general government deficit/GDP was realized as 1.8% and the public debt/GDP ratio was 28.3%, which are below the reference values (3% and 60%, respectively) on public finances stated in the Treaty on the Functioning of the European Union. However, the economic and social incentives of the government as well as the high increase in exchange rates created some amount of cost on the fiscal balances. As a result, budget deficit and public debt/GDP ratios are expected to increase to 2.4% and 31.1%, respectively, by the end of 2018 (Hazine ve Maliye Bakanlığı 2018). According to the European Commission, although the public finances of Turkey had been improving until 2016, it has deteriorated in the last two years, due to temporary measures on both the expenditure and revenue side of the budget. However, government debt is considered to be sustainable (European Commission 2018d).

On the other hand, Turkish Statistical Institute has completed the work on transition to ESA-2010 system and revised national accounts were published on December 12, 2016 (TÜİK 2016). The revision of the GDP data to comply with the European System of National and Regional Accounts (ESA-2010) and improvement of the methods used to estimate the national accounts are mainly emphasized as progress in the most recent Regular Report for Turkey. The areas where further improvement is needed are stated as implementing ESA-2010 for also government accounts, introducing numerical fiscal rules or an independent fiscal council that monitors fiscal policy independently, increasing credibility of macroeconomic forecasts and publishing government finance statistics also on an accrual basis (European Commission 2018a).

13.4 Alignment in Public Financial Control

Starting with 2000s, public administration reform of many EU member states have been intensified in the area of public internal control. Internal control systems differ from country to country, as they need to adapt the country's own governance system (European Commission 2014a). Although some countries have a centralized system and some are more decentralized, the main principles for public financial management and control are implemented by all countries.

The EU encourages the candidate countries to reform their governance systems so as to bring managerial accountability and ensure sound financial management, including audit of public funds (European Commission 2018a). In this context, Chapter 32: Financial Control is one of the 35 negotiation chapters and "it covers four main policy areas, namely public internal financial control (PIFC), external audit, the protection of the EU's financial interests and the protection of the Euro against counterfeiting." In the first two areas, there is no specific EU legislation but candidate countries need to adapt their PIFC and external audit systems according to international standards (INTOSAI) and EU best practices (European Commission 2006b). Both systems are related to the entire public budget, especially central government revenue and expenditure as well as external funds. However, specific rules for the management and control of EU funds exist, which are subjects of other accession negotiation chapters (European Commission 2018c).

PIFC concept was developed by the European Commission with the aim of supporting candidate countries in reforming their public internal control systems (De Koning 2007). PIFC systems aim to give reasonable assurance that budgetary transactions in a country are implemented in accordance with the relevant legislation and the principles of sound financial management, transparency, efficiency, effectiveness, and economy (European Commission 2006b).

PIFC is founded on three pillars: managerial accountability through financial management and control systems, functionally independent internal audit and central harmonization unit(s) (CHU) for developing methodologies and standards relating to the first two pillars (European Commission 2006b).

Financial control can be regarded as one of the most important elements for effective implementation of the new public financial management system in Turkey as well. The adoption of the Law No. 5018 was the major step for founding a public internal control system in line with international standards. It provided a framework of responsibility and accountability for all relevant actors included in the management of public finances and established a decentralized system of financial management and control (European Commission 2004).

Turkey's level of alignment as regards the Financial Control Chapter is at a satisfactory level. The aim of the PIFC system and its three pillars are defined in Law No. 5018 in accordance with the EU requirement, which is to ensure effective, economic, and efficient utilization of public resources in conformity with policies and objectives of the Government, on the basis of accountability and fiscal transparency. In order to improve the implementation of the system, secondary and tertiary legislation have been put into effect and two central harmonization units, which are responsible for setting standards and methods in the fields of both financial management and control as well as internal audit were established. The Central Harmonization Unit (CHU) for Financial Management and Control, which is established under the Ministry of Treasury and Finance, prepares relevant legislation, ensures coordination, and provides guidance to public institutions in this field. The CHU for Internal Audit is the Internal Audit Co-ordination Board attached to the Ministry of Treasury and Finance and a department within the Ministry facilitates the activities of the Board and acts as its Secretariat. The duties of the Board are to coordinate and monitor the internal audit systems of public organizations, define and develop internal audit standards and procedures and provide guidance (SIGMA 2017b). In addition, internal auditors were appointed in public administrations.[2] In the field of financial management and

[2]As of 18 September 2018, 890 internal auditors are working in public administrations, however some of the administrations haven't appointed any internal auditors yet and 1188 of the internal auditor cadres are still empty (retrieved from the web page of Internal Audit Coordination Board).

control, strategy development units were established and financial services experts were recruited in public administrations.

Turkey's first PIFC Policy Paper was adopted in 2002 and needs to be updated. The updated Policy Paper should cover important issues such as the relationship between internal audit and inspection, link between internal audit of national budget and of EU funds, the precise definition of ex-ante financial control and the establishment of a permanent CHU for internal audit (European Commission 2018c).

Another area of Financial Control Chapter, which is relevant to the public financial management, is external audit. The external audit system in Turkey was reviewed with the Turkish Court of Accounts (TCA) Law No. 6085, which has been prepared in accordance with INTOSAI standards and principles and therefore complies EU requirements in this field.

The TCA's audit mandate is exhaustive and it is also authorized to audit EU and other international funds. According to the TCA Law, TCA is authorized, among other duties, for regularity audit (financial and compliance), performance audit, and also audit of performance indicators. TCA carries out its duties in accordance with generally accepted auditing standards (SIGMA 2017b).

After the screening meetings held in 2006, the level of compliance in Financial Control Chapter with regard to both legislation and institutional capacity has been considered adequate and the chapter was opened to accession negotiations on June 26, 2007 without any opening benchmarks.

In the most recent Regular Report for Turkey, the European Commission acknowledges that Turkey already has a good level of alignment in the area of financial control. On PIFC, it is stated that public administration of Turkey has a uniform management structure that combines managerial accountability and delegation of authority with results-oriented performance management system. Relevant legislation is mostly in line with the international standards and central harmonization units provide methodological guidance and supervise the implementation of the system. However, there is still work to be done, such as adopting the updated PIFC Policy Paper, establishing a formal monitoring and reporting framework on implementation, ensuring a systematic approach to risk management and quality assurance and improving the reporting on irregularities (European Commission 2018a). On external audit, it is indicated that the TCA Law is in line with international standards. The issues that need further improvement are stated as the need to increase the capacity of the TCA to audit local administrations, municipal companies, and associations, to develop an effective monitoring system to follow up implementation of audit recommendations, and also to increase the effectiveness of parliamentary follow-up mechanism for TCA's audit reports (European Commission 2018a).

13.5 Alignment in Taxation

The administration of revenues is another important area under public financial management. The European Commission published guidelines called 'Fiscal Blueprints' in 2007 to lay down criteria for tax administrations based on EU best practice. The blueprints were first published in 1999 with the aim of serving as an instrument for the candidate countries to develop their administrative capacity in adopting and implementing the Acquis for accession to the EU. They describe the main functions and systems of a tax administration and also provide a basis to design tax reforms (European Commission 2007b).

The European Union member states have the right to design their tax legislation according to their national priorities, while respecting the fundamental principles of nondiscrimination and respect for free movement in internal market. The European Union can propose an EU legislation on tax legislation where an EU-wide action is seen necessary for the proper functioning of the internal market (European Commission 2015).

The European Commission clearly stated in its Communication on Tax Policy of the EU that the member states do not need to fully harmonize their tax systems, but they should respect EU rules. As a result, member states may choose their tax systems according to their own preferences. Within this framework, the main priority for EU tax policy would be to address the concerns of individuals and businesses functioning in internal EU market by focusing on the removing tax obstacles to cross-border economic activities and in the meantime preventing harmful tax competition and endorsing cooperation between member states' tax administrations to fight fraud (European Commission 2001).

EU legislation in indirect taxes consist of harmonization of national laws in the fields of Value Added Tax (VAT) and excise duties, since different tax rules in goods and services can harm competition between businesses and make it hard to sell and buy products across borders (European Commission 2015). VAT legislation lays down the scope, key definitions, and principles. Tobacco products, alcoholic beverages, and energy products are subject to excise duties according to EU legislation, which establishes the structure of the tax and minimum rates (European Commission 2007a).

Legislation in direct taxation area, however, regulates approximation of legislation of the member states in order to improve the functioning of the internal market and prevent intra-Community tax evasion and tax avoidance (European Commission 2015). The *Acquis* on direct taxation focus on eliminating distortions for cross-border economic activities within the internal market and therefore covers effective taxation of income from savings and corporate taxes. Member States also need to complying with the principles set by the Code of Conduct for Business Taxation, with the aim of eliminating harmful tax practices. Administrative cooperation between Member States is also necessary. Member States are expected to increase their implementation capacities and connection to EU's computerized tax systems (European Commission 2007a).

The need for the approximation of Turkey's tax legislation and administrative procedures with the EU started even before the accession negotiations, with the Customs Union established between Turkey and EU by the Decision No. 1/95 of Turkey-EU Association Council. The Articles 49–51 of this Decision cover provisions on direct and indirect taxation, mainly aiming at preventing discriminatory taxation against each other (EC-Turkey Association Council 1995).

Chapter 16: Taxation was opened to negotiations on June 26, 2009, after meeting the opening benchmark. Turkey is gradually taking steps to harmonize with EU legislation and improving the institutional capacity of tax administration; including transition to electronic transactions. However, bearing in mind that taxation is an important tool in national policymaking, it is assumed that full alignment will only take place by the time of full membership.

Turkey's alignment is seen moderate in the field of taxation, as stated in the most recent Regular Report for Turkey. The areas of progress are stated as the elimination of discriminatory excise duties on alcoholic beverages and tobacco in accordance with the Action Plan, the ratification of the Convention on administrative assistance in tax matters and the plans for an integrated public finance management information system. The issues which were criticized by the European Commission (2018a) are the remaining differences on exemptions, structure, special schemes, and reduced rates in VAT legislation, the range of excisable energy products and the deficits in tax regimes that could be potentially harmful.

13.6 Support of EU Funds in Alignment Process

The European Union provides financial assistance to candidate and potential candidate countries in order to support them in adopting and implementing the reforms required for membership, using the Instrument for Pre-accession Assistance (IPA). One of the objectives of IPA is to strengthen the public administration and good governance at all levels. The reforms in public administration reform, including the improvement of economic governance and public financial management are supported under the 'democracy and governance' priority sector of IPA II (2014–2018) period (European Parliament and the Council 2014).

The projects funded by IPA that aim alignment in the field of public financial management as well as the Financial Control and Taxation Chapters support both legislative alignment and capacity building in Turkey's core administrations. These projects also help to raise awareness about EU accession process.

13.7 Conclusion

European Union accession process has been a driving force behind some of the fundamental reforms in Turkey. The reforms in the area of PFMC can be considered as one of the most important reforms in this regard, which affected the whole public administration. As a result of these reforms and commitment in maintaining fiscal discipline, sustainability of public finances was achieved to a great extent.

The public financial management and control reform, which was headed by the Law No. 5018, incorporated many new concepts to public administrations, together with a change in management culture dating back to 1920s. After the enactment of the Law, relevant implementing legislation have been published, new units were founded such as strategy development units, internal audit units, and central harmonization units, and appointments have been made for the new functions in these units. Moreover, several trainings were organized for relevant civil servants, some of which were funded under EU projects.

Considering the overall impact of this transformation and the size of Turkish public administration, it is reasonable to argue that might take time until the new system is fully adopted and implemented. In this regard, in order to improve the implementation of the new system, it is important to continue activities for the civil servants in both central government and local administrations such as organizing regular trainings, raising awareness of top managers, recruiting adequate number of staff in financial management and control units and finally establishing a robust monitoring and evaluation mechanism.

Although the foundations of this new system are based on the EU requirements under various areas, there are still some elements to be improved for full alignment with the EU. It could be observed from the assessment reports that the general legislative and institutional framework of Turkey's public financial management and control systems as well as its subfields which are studied under different negotiation chapters are aligned with the EU *Acquis* to a large extent. The only remaining factors are related to increasing the institutional capacity of relevant public administrations in order to improve the implementation and monitoring of the system. On the other hand, continuing to implement structural reforms while maintaining the fiscal discipline is of critical importance for both EU alignment and for maintaining the stability of Turkish economy.

Consequently, regardless of the current slowdown in accession negotiations, the efforts for full alignment should be continued in all areas where they would help rise the living standards of Turkish citizens, increase Turkey's credibility in international platforms and improve the business and investment environment.

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