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## FISCAL DISCIPLINE IN A MUSLIM COUNTRY – A CASE OF TURKEY

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**Summary:** The aim of the paper was to present the economic principles of Islam and the fulfilling of the fiscal discipline in the European Monetary Union (EMU) in Muslim Turkey. Achieving such a designated purpose, requires to make literature studies and analysis of statistical data on Public Finances in Turkey. The thesis is: the country with religious discipline should /not/ have a problem with complying the fiscal discipline according to the Maastricht Treaty and the Stability and Growth Pact. In 2006-2013 Turkey has fulfilled Maastricht public rule much better than the majority of EU countries. It seems that Turkey's religious rules have positive influence on fiscal discipline in their public sector.

**Keywords:** Islam and economics, fiscal discipline, fiscal rules in EMU, Maastricht rule, Stability and Growth Pact (SGP) rule.

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### 1. Introduction

For the last free decades, the notion of fiscal discipline has attracted an increasing attention of economists and become a subject of a very intensive theoretical and practical research. Regardless, however, of a great number of publications in the subject, there is still lack of a solid theory of the factors which are responsible for its increase. The reason for this lies in the complexity of the notion of fiscal discipline that manifests itself by the way it has been approached by the researchers. Fiscal discipline is not a definite one-dimension issue of research. In fact, it has been discussed from many angles and treated as a social, political and religious category of economics.

The financial crisis discovered the weak sides in the world economy and also the need of improving the methods in the implementation of the fiscal discipline. The European Union countries have their own fiscal rules according to The Maastricht Treaty and the Stability and Growth Pact. As the statistical data show the countries that fulfilled fiscal discipline before the crisis were able to keep it up during it [Euro-

pean Committee 2009]. On 22th May 2010 the head of European Central Bank Jean Claude Trichet said: “In the financial sector in general, not just in the banks, certain behavior has developed which is greatly at odds with the basic values of our democratic societies, [...]”. Then he added: “We need a change of values in the financial sector.” [*Fiscal discipline...* 2010]. His views were echoed by the Pope Benedict XVI during the conference in Vatican. “Politics needs to have primacy over finance, and morality needs to guide every activity”.

Discussing the reasons of the financial crisis from 2008, it is the fact that the basic one was the deficit of morality of financial deciders. On the other hand there is no evidence that if the world society is moral there will not be the economic crisis. But it seems possible that the morality can increase the financial discipline, including fiscal discipline. If we say “morality” we assume it is connected with religion. Different countries have different religions and the “quality” of the discipline they have implemented is different, too. There are some candidate countries and potential countries for the accession to the European Union. The most of them are Muslim countries. It seems to be interesting to make some research how fiscal discipline is fulfilled in one of them. Economic reforms in Turkey during the so called *Arab Spring* inspired the countries of the Middle East and North Africa, also because Turkey is Muslim, has a similar culture and tradition, and is located in the same part of the world. Turkey is still the undisputed economic pattern for the new Middle East democracy [Winiński 2012; Strachota 2013]. The paper is going to exam Turkey as the example of a Muslim country which has the majority of Muslim inhabitants. Muslims represent more than 90% of Turkish population [Ries 2001]. If religion rules are practiced by the majority of inhabitants we can assume that people who are responsible for fiscal policy in the above countries are religious, too. The question is: does the practice of Islam /religious discipline help fulfill fiscal rules or not? The thesis is: the country with religious discipline should (not) have a problem with complying fiscal discipline according to the Maastricht Treaty and the Stability and Growth Pact .

Research methods used in this article are the following: the method of analysis and critique of the literature, the method of analysis of statistical data on public finances in Turkey and the EU member states (time series analysis) and comparative analysis based on benchmark method (the reference values contained in the Maastricht rule and Stability and Growth Pact rule are the benchmark).

The first part of the paper will be about economic principles in Islam, the second will refer to fiscal rules in EU countries and the final part will present fulfilling fiscal discipline in Turkey.

## **2. The economics principles in Islam**

### **2.1. The doctrine of Islam**

Islam is one of three world’s major monotheist religions. Judaism, Christianity and Islam were all born in the Middle East and are all linked to one another. Christianity

was born from the Jewish tradition and Islam developed from both Christianity and Judaism. All practicing Muslims accept belief in the "Six Articles of Faith" and are obliged to follow the "Five Pillars"<sup>1</sup>. The third **pillar – charity *zakat*** is particular as it relates to economics. *Zakat* is viewed as "compulsory charity"; it is an obligation for those who have received their wealth from God to respond to those members of the community in need. Islam encourages the sharing of wealth with others and helps people stand on their own and become productive members of the society. *Zakat* must be paid on different categories of property – gold, silver, money, livestock, agricultural produce and business commodities — and is payable each year after one year's possession. It requires an annual contribution of 2.5 percent of an individual's wealth and assets. Money given as *zakat* can only be used for certain specific things. According to the Islamic Law money from *zakat* should be used to support the poor and the needy, to free slaves and debtors [Quran 1986 (9:60)]. *Zakat* has been functioning as a form of social security among Muslims for fourteen hundred years<sup>2</sup>.

## 2.2. The Quran and economics?<sup>3</sup>

It covers various subjects. Most importantly, it talks about the unity of God and how to live according to His Will. Other issues include religious doctrine, creation, criminal and civil law, Judaism, Christianity, social values, morality, history, stories of past prophets, and science. The Quran calls the great human exemplars of the past prophets and mentions their great sacrifice in spreading the message of God, the most important of them being Noah, Abraham, Moses, and Jesus. It commands people that they should pray, fast, and take care of the needy. The Quran has much to say about the moral and legal duties of believers. It relates to economic principles, too. In verses 17:27 and 7:31 the Quran condemns wasteful expenditure<sup>4</sup> [Krawczyk 2013, p. 274] and avoiding *Israf* [Khan 2004]. It is connected to Islamic *Shariah* that generally refers to participation by investors in profits and loss of funds. (More information on the Islamic finance: [Adamek 2010]). Some Islamic economists recognize the prohibition of *Israf* or the sanction against wasteful expenditure/consumerism involving an unjustified attitude (the real needs and the costs of environmental, social or individual acquisition of material goods and services) [Golka 2004, p. 7] as an

<sup>1</sup> They are: Muslim profession of faith or shahada (1), ritual prayer or salah (2), obligatory charity or zakah (3), fasting or sawm (4), pilgrimage or hajj (5) [A'la Maududi 1990].

<sup>2</sup> In the contemporary Muslim world, it has been left up to an individual, except in some countries in which the state fulfills that role to some degree. Apart from *zakat*, the Quran emphasizes feeding the hungry, clothing the naked, helping those who are in need, and the more one helps, the more God helps the person, and the more one gives, the more God gives the person ([www.islamreligion.com/article/181/dated-on-08.06.2010](http://www.islamreligion.com/article/181/dated-on-08.06.2010)).

<sup>3</sup> Based on the translation of The Holy Quran by Bielawski and Sachiko Murata & William C. Chittick.

<sup>4</sup> "Excess" results from the evaluation-is not an economic category, but cultural and ethical. Someone has to have enough to someone else had excess.

important principle of Islamic economics<sup>5</sup> [Buiter 2009]. According to Khan we can find it as a principle of Islamic political economy<sup>6</sup>. The essence of the mechanism of Islamic economics is not an economic account but moral classification of an act [Krawczyk 2013]. Another Quran principle concerns Islamic social organization. It is the principle of *shura* or consultative decision making. The Quran advises Muslims to conduct their affairs through a process of mutual consultation [Quran 1986, 3:159]. The Quran also considers those as blessed who conduct their affairs through mutual consultation [Quran 1986, 42:38]. The contemporary discussions among Islamists, Western scholars of Islam and many Muslim intellectuals about the democracy form would take within an Islamic ethos, centers around the concept of *shura*. While there is little clarity on how an Islamic democracy or *shurocracy* would look like, there is a widespread agreement that *shura* or consultation is not just desirable but a necessary ingredient of Islamic governance [Khan 2004]. The former Ambassador of Oman to the United States – Sadek Sulaiman claims that *shura* is “a cardinal principle of governance in Islam”. “*Shura* governance is essentially democratic governance – liberating, uplifting, enabling, and conducive to progress” [Sulaiman 1999]. Next Quranic principle concerns the banking sector. There are only seven verses in the Quran that prohibit interest [Quran 1986, 2:275, 2:276, 2:278, 2:279, 3:130, 4:161, 30:39], there are 60 verses [Quran 1986, 9:34, 2:261, 2:265, 2:276, 2:280, 30:39, 34:39, 35:29, 57:11, 57:18, 64:17, 2:271, 2:245, 5:12, 57:11, 57:18, 64:17, 73:20, 2:273, 2:83, 19:31, 19:55, 9:91, 17:29, 2:3, 2:43, 2:110, 2:177, 2:195, 2:254, 2:267, 2:227, 5:55, 9:71, 13:22, 14:31, 21:73, 22:41, 22:78, 24:37, 24:55, 24:56, 27:3, 30:38, 31:4, 33:33, 47:38, 57:7, 57:10, 58:12, 58:13, 63:10, 64:16, 2:264, 2:266, 16:75, 4:38, 2:3, 3:180, 2:215] that stipulate, mandate, encourage charity, discuss its virtues and rewards, warn of punishment to those who eschew charity and also warn against hoarding. Islamic economists emphasize the significance of charity, welfare, redistribution of wealth and prevention of income inequalities and wealth disparities.

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<sup>5</sup> Willem Buiter (a very outstanding economist), proposes on his blog a very interesting application of *Israf* as a debt instrument connected to the economic growth in a given country. He treats it as financial innovations that replace debt-type instruments with true profit-, loss- and risk-sharing arrangements.

<sup>6</sup> While richer Muslim societies in the past and present are outstanding for their high consumption patterns, East Asian economies on the other hand are remarkable for high saving rates of 30-40 percent of GDP that they have maintained for nearly four decades. These saving rate play the major role in the miracle of East Asia [www.oecd.org/statistic (dated on 11th June 2010)].

<sup>7</sup> Accordingly to Sulaiman *shura* is essentially *parallel* to the democratic principle in Western political thought, as it has analogous aspects and about the same tendency or direction. It is rooted on *three basic precepts*: 1. All persons in any given society are equal in human and civil rights. 2. Public issues are best decided by the majority view. 3. The three other principles of *justice, equality* and *human dignity*, which constitute Islam’s moral core, and from which all Islamic conceptions of human and civil rights derive, are best realized, in personal as well as public life, under *shura* governance.

There is the mixture of religion and policy in Islam. Islam means for Muslims not only religion but also the state and culture [Waldenfels 1986]. The most of the believers of Islam follows the instructions of The Quran and are very strict and disciplined [Ries 2001]. However, the contact with the western culture makes Islamic law more liberal and democratic<sup>8</sup> [Szyzsko-Bohusz 1990].

### 3. Fiscal rules in EMU

#### 3.1. Maastricht's rules in EMU<sup>9</sup>

The Treaty [Article 121] requires a high degree of sustainable convergence for admitting a Member State to the monetary union. An achievement of such a requirement refers to so called *convergence criteria*. They take into consideration the degree of price stability, the sustainability of the government financial position, the fluctuations in the exchange rate, and the durability of convergence reflected in the convergence of long-term interest rates. Convergence criteria are still to be applied as a condition to join the euro-area to the countries currently members of the Union but not having adopted the euro (Denmark, Sweden, the United Kingdom, Czech, Poland, Hungary, Romania, Bulgaria,). They will also apply to the accession countries Iceland, Macedonia, Montenegro, Serbia and Turkey).

According to the Treaty "Member States shall avoid excessive government deficits" [Article 104]. Fulfilling the budgetary discipline is assessed on the basis of two criteria. First, whether the government deficit is below the reference value of 3% of GDP, or, if not, whether "the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value". According to the second criterion the government debt should not exceed the reference value of 60% of GDP. In case of a higher debt ratio, it should be on a decreasing trend and approach the reference value at a satisfactory pace.

The European Commission assess the existence of an excessive deficit. It should also take into account whether the government deficit exceeds public investment, and consider all other relevant factors including the medium-term economic and budgetary position of the country. When a country is subject to a Council decision on the existence of an excessive deficit, it should aim at correcting its fiscal situation. If correction of the deficit is not implemented, sanctions may be applied to countries participating in the euro-area. One of the sanctions foreseen by the Treaty are non-interest bearing deposits and fines.

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<sup>8</sup> Sulaiman recalls that *shura* (Islamic democracy) was a part of Arabs life fourteen centuries ago, at a point in history when the rest of the world had but a faint idea about democracy.

<sup>9</sup> Based on: *Treaty of Maastricht* (Article 121 and 104) , [www.ec.europa.eu](http://www.ec.europa.eu) and M. Buti, G. Giudice, 2002, *Maastricht Fiscal Rules at Ten: An assessment*, European Commission, Brussels.

### 3.2. Stability and Growth Pact (SGP) rule in EMU<sup>10</sup>

The SGP is another fiscal rule compulsory in EMU. As mentioned above the Maastricht Treaty establishes the entry conditions for Member States to join the single currency and the aim of the SGP is making budgetary discipline a permanent feature of EMU<sup>11</sup>. The SGP consists of a preventive arm, Regulation (EC) No 1466/97 and a dissuasive arm, Regulation (EC) No 1467/97. The first one aims to strengthen the surveillance of budgetary positions and the surveillance and co-ordination of economic policies and the second one aims to accelerate and clarify the excessive deficit procedure of the Treaty. The Treaty strongly emphasized the punishment in case of failure to respect the criteria. The Pact prevents the occurrence of excessive deficits in order to avoid having to recur to such sanctions. It is stated in the Pact that the medium-term budgetary position must be of “close to balance or in surplus”: this would allow the full operation of automatic stabilizers in recessions without exceeding the 3% of GDP reference value for the deficit. SGP establishes the 3% of GDP deficit as a ceiling not as a target.

In 2005 SGP was reformed. More attention was given to the ceiling of structural deficit. Since that time not only general government deficit has to be below 3 % GDP but also structural deficit (cyclically adjusted budget-balance) has to be at least of 1% GDP. The rule of deficit “close to balance or in surplus“ was strengthened [European Commission 2001]. The situation of public finance was seen in the context of business cycle. In 2011 The Stability and Growth Pact (SGP) was reformed again. The reform of SGP in March 2005 was to strengthen the rule of the deficit. The changes in the record of the SGP in November 2011 put on an equal footing completing the deficit and the public debt criterion. The package of legislation to strengthen the economic governance in the EU and the euro area consists of 6 acts [Council Directive 2011; Regulation of the European Parliament and Council Regulation No 1173-77/2011].

## 4. Fulfilling the fiscal criteria of Maastricht Treaty in Turkey

Turkey has been a candidate country to the European Union since 1995. It is considered as a market-oriented state and as a leader of the Balkans region. It is estimated that Muslims make up 99,64% of the total Turkish population<sup>12</sup>. It means 74,983,021 Turkish are Muslims. The analyzed country is a founding member of the OECD (1961), and its GDP per capita was \$18,551 in 2012. Like many economies, the Turkish economy has been affected by the global financial crisis. The Finance Minister reported that Turkish budget deficit in the first half of 2009 was 13 times higher

<sup>10</sup> Based on: Regulation (EC) No1466/97, Regulation (EC) No1467/97 and [www.ec.europa.eu](http://www.ec.europa.eu).

<sup>11</sup> See: Glebocka-Zielińska, *Inauguration lecture at the University of Gdańsk*, Poland, 2003.

<sup>12</sup> According to Turkish Statistical Institute (TurkStat): The Results of Address Based Population Registration System, 2012, dated on 6.06.2012.

than a year before [*Economy of Turkey* 2010]. Even though Turkey did not reach the deficit level of 3% GDP in 2009, the performing Maastricht deficit criteria in Turkey in 2006–2008 was much better than in the majority of EU countries. The general government deficit and debt in the euro area, EU 27 and Turkey in 2006–2009 are presented in the table below.

**Table 1.** Government deficit/surplus and debt in the euro area. EU 27 and Turkey 2006-2009 (% GDP)

	2006	2007	2008	2009
<b>Euro area (EU16)/ Turkey</b>				
Government deficit(-)/surplus(+)	-1,3/-0,6	-0,6/-1,6	-2,0/-1,8	-6,3/-5,5
Government debt	68,3/56	66,0/52,8	69,4/52,6	78,7/52,5
<b>EU27/Turkey</b>				
Government deficit (-)/surplus(+)	-1,4/-0,6	-0,8/-1,6	-2,3/-1,8	-6,8/-5,5
Government debt	61,4/46,1	58,8/39,4	61,6/39,5	73,6/47,3

Source: Eurostat, *News release euro indicators*, 55/2010, 22 April 2010; European Commission, Candidate and pre-accession countries economic quarterly, April 2010.

Fifteen Member States had government deficits higher than Turkey in 2009. Slovenia had the similar level of deficit as Turkey in 2006-2009. That time the average deficit in Turkey was -2.3% GDP and in Slovenia it was 2.12% GDP. Even though Turkey did not comply with Maastricht deficit criteria in 2009, it should be emphasized that the deficit and debt performance in 2006–2008 was much below Maastricht fiscal ceilings of 3% GDP deficit and 60% GDP debt. More than thirteen EU countries had higher public debt in 2009 than Turkey, including Spain (53.2% GDP) and Poland (51% GDP). The fiscal adjustment of Turkey was recommended by the European Commission. Maastricht deficit criteria in Turkey in 2010-2013 was much better than in the majority of EU countries. The general government deficit and debt in the euro area, EU 28 and Turkey in 2010-2013 are presented in the table below.

**Table 2.** Government deficit/surplus and debt in the euro area. EU 28 and Turkey (% GDP)

	2010	2011	2012	2013
<b>Euro area (EU18)/ Turkey</b>				
Government deficit(-)/surplus(+)	-6,2/-2,9	-4,1/-0,8	-3,7/-1,5	-3,0/-1,6
Government debt	68,3/42,3	66,0/39,1	69,4/36,2	78,7/36,3
<b>EU28/Turkey</b>				
Government deficit(-)/surplus(+)	-6,5/-2,9	-4,4/-0,8	-3,9/-1,5	-3,3/-1,6
Government debt	61,4/42,3	58,8/39,1	61,6/36,2	73,6/36,3

Source: Eurostat, *News release euro indicators*, 64/2014, 23 April 2014; European Commission, Candidate and pre-accession countries economic quarterly, April 2014;

Nineteen Member States had government deficits higher than Turkey in 2013. Austria, Bulgaria and the Czech Republic with a deficit of 1.5% of GDP were almost on the same level of deficit as Turkey, where the indicator deficit was 1.6% GDP in 2013. Turkey complied with Maastricht deficit and debt criteria in 2013. It should be emphasized that the deficit and debt performance in 2010-2013 was much below Maastricht fiscal ceilings of 3 % GDP deficit and 60 % GDP debt. 27 EU countries had higher public debt in 2013 than Turkey, including Romania (38,6% GDP) and Sweden (40,6% GDP). Only Luxembourg has lower government debt than Turkey (23.1% GDP).

## 5. Conclusions

This paper answers the question: Does practice of Islam/religious discipline help to fulfill the fiscal rules or not? The thesis was that the countries with religious discipline should (not) have a problem with complying the fiscal rules/fiscal discipline according to the Maastricht Treaty and Stability and Growth Pact. To realize the aim of the paper and to verify the thesis, firstly the economic principles of Islam was introduced. Then the fiscal rules in EMU were presented. Finally the performing of government deficit and debt in Turkey was analyzed, having referred it to the fiscal rules in EMU. It can be stated that Islamic discipline has an influence on the fulfillment of fiscal criteria of the Maastricht Treaty in Turkey. The candidate countries are not yet obliged to run the fiscal policy according to the Maastricht convergence criteria. Firstly they should comply Copenhagen criteria as they are candidate countries of the EU. In spite of the above, Turkey has fulfilled Maastricht public rule much better than the majority of EU countries. In 2010-2013 the average public debt in Turkey was 38,4% GDP. Turkey achieved the deficit level of 3 % GDP which was recommended by the EU. Only ten EU countries fulfilled it in 2013. Turkey had a better deficit situation than nineteen EU Member States. The average deficit in 2006-2009 was 2.05% of GDP and in 2010-2013 the relation of government deficit to GDP was from 2,9 % to 1,6 %. Turkey's deficit indicator compared to the deficit of EU countries is one of the lowest together with Luxembourg.

Turkey has a better fiscal situation of public finance sector than the majority of EU countries. Turkey as a Muslim country has fulfilled deficit and debt fiscal criteria of the Maastricht Treaty. Turkey despite the impact of the so-called Arab Spring still remains a model of sustainable public finances for the new democracies of the Middle Eastern countries, but it should not be a role model with regard to democracy as a former U.S. ambassador to Turkey, Osman Faruk Logoglu stated [Winiecki 2012]. The rule of SGP was not examined because of the lack of the data. It seems that Turkey's religious rules have a positive influence on fiscal discipline in their public sector. Moral and economic Islamic rules exist not only in a written form, but they are practiced and are implemented into everyday's life. Muslims believe that only by good behavior they can attract people. The efforts to follow moral Islamic rules

are called *dzihad*. Maybe EU policymakers should make more efforts to be moral and they should perform *dzihad* in every decision concerning public money. Governments should also make efforts at applying some Islamic economic rules [Buiter 2009]. The rule of avoiding waste expenditure (*isfar*) can help balance the public budget. Sanctions for wasteful expenditure can be a good solution to discipline policymakers, and they can also teach responsibility for public money and solidarity. *Zakhat* (giving 2.5% of one's income for the poorest people) is a good solution in the richest EU countries. It can limit social spending in the long term. *Zakhat* should not be compulsory. Only countries that can afford it should pay it. Another Islamic economic rule can be very useful, too. It is the principle of *shariah*, which refers to the "Islamic Investment Fund". If the fund earns huge profits, the return in their subscription will increase to that proportion. However, in case the fund suffers loss, they will have to share it too. If the loss is caused by the negligence or mismanagement, the management is liable to compensate it. The participation of subscribers in profits and loss can help limit the public debt.

In the 21<sup>st</sup> century many countries have not only a problem with an excessive deficit and public debt, but also with a deficit of morality. Maybe policy makers should consider the application of some moral and economic Islamic rules to improve public finance in EMU. Further conclusion requires further study, research and successful cooperation of scholars from different areas of science.

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## DYSCYPLINA FISKALNA W KRAJU MUZUŁMAŃSKIM – PRZYKŁAD TURCJI

**Streszczenie:** Celem pracy było przedstawienie zasad ekonomicznych islamu i wypełniania dyscypliny fiskalnej Unii Gospodarczo-Walutowej (UGW) w muzułmańskiej Turcji. Osiągnięcie tak wyznaczonego celu wymagało studiów literaturowych oraz analizy danych statystycznych dotyczących finansów publicznych w Turcji. Postawiono tezę: kraj z dyscypliną religijną nie powinien/powinien mieć problemu/problem z przestrzeganiem dyscypliny fiskalnej zgodnie z Traktatem z Maastricht oraz Paktem Stabilności i Wzrostu. W latach 2006-2013 Turcja spełniała reguły Maastricht znacznie lepiej niż większość krajów UE. Wydaje się, że zasady religijne Turcji mają pozytywny wpływ na ich dyscyplinę fiskalną w sektorze publicznym.

**Słowa kluczowe:** islam i ekonomia, dyscyplina fiskalna, reguły fiskalne UGW.