

Addendum to the Fiscal Council's Preliminary Opinion on the Second Supplementary Budget Draft for 2018

On the evening of November 21st 2018, the Fiscal Council (FC) received from the Ministry of Public Finance (MPF), by letter no. 466699/21.11.2018, the draft of the second budget revision of the general consolidated budget for 2018, the explanatory note and the draft of the Government Emergency Ordinance (GEO) regarding the second revision of the state budget for 2018, as well as the explanatory note and the draft GEO regarding the second revision of the social security budget for 2018, requesting the FC's opinion under article 53, paragraph (2) of the Fiscal Responsibility Law no. 69/2010 republished (FRL). Given the insufficient time for elaborating a complete opinion, taking into account that the Government intended to approve the aforementioned documents at the meeting scheduled for November 23rd 2018 (the draft of the second budget revision was eventually approved at that meeting), the Fiscal Council issued a preliminary opinion at that time. The present document constitutes an addendum that complements the above-mentioned preliminary opinion.

The updated coordinates of budgetary revenues and expenditures

In the opinion regarding the draft of the first budget revision, the FC assessed that the budget deficit target could be exceeded by about 6 billion lei, as a result of overestimating VAT and excise revenues coupled with the underestimation of social assistance expenditures. The draft of the second budget revision confirms the materialization of the aforementioned risk concerning VAT and excise revenues together with the identification of additional pressures on the level of expenditure with goods and services, interest and social assistance. However, the draft of the second budget revision complies with the budget deficit target (as a percentage of GDP) due to the inclusion of considerable extraordinary revenues: on one hand, receipts from the reserves of state-owned companies (basically the distribution of a supplementary dividend) and, on the other hand, recording as revenues the so-called "other EU funds" which derive from the fact that some projects, which were already implemented with non-EU financing, have been settled *ex-post* with European funds.

Specifically, the budget revision envisages the increase of total revenues by 246 million lei and of total expenditures by 382 million lei, the nominal deficit being higher than the one estimated in the context of the first budget revision by 136 million lei. The above figures include a reduction of 530 million lei in the sums associated with the chain compensation schemes for budget arrears (swap schemes with a symmetric impact on revenues and expenditures).

The main revisions to the revenue side of the budget are as follows:

- Tax revenues: -3.85 billion lei, out of which:
 - o Corporate income tax: +0.41 billion lei. Given the current budget execution, the upward revision seems plausible.
 - o Property taxes: -0.15 billion lei.

- VAT: -2.48 billion lei. The downward revision confirms the FC's reservations concerning the dynamics of this aggregate which were expressed in its opinions on the initial 2018 budget and on the first budget revision. However, the downward revision is slightly below FC's expectations, reflecting the favorable evolution of VAT revenues in September and October 2018.
 - Excise duties: -1.24 billion lei. The revised level confirms the objections raised by FC during the first budget revision.
 - Taxes on the use of goods, on authorizing the use of goods and on carrying activities: -0.34 billion lei.
- Social security contributions: +0.73 billion lei. The upward revision appears to be justified by the current budget execution.
 - Non-tax revenues: +2.4 billion lei. The upward revision largely reflects the extraordinary receipts from the reserves of state-owned companies (about 1.9 billion lei), the rest representing revenues that exceeded budget projections according to the execution for the first 10 months. It should be noted that the extraordinary receipts from the reserves of state-owned companies constitute supplementary dividends and, as such, they will not be treated as budget revenues in accordance with ESA 2010 rules because they represent a reduction in the company's own funds and do not qualify as an ordinary income distribution to shareholders. These receipts will be reflected in the reduction of the budget deficit financing needs, contributing to the explanation of the difference between the budget deficit and the changes in the stock of public debt. In fact, a similar statistical treatment was applied to the extraordinary revenues recorded in the previous year.
 - Amounts received from the EU and prefinancing for the 2014-2020 financial framework: -3.26 billion lei. The downward revision is due to a decrease of 4.7 billion lei (about 43%) in the sums estimated to be attracted from structural and cohesion funds whose final beneficiary is the state coupled with a decrease of 1.3 billion lei in the amounts transiting the consolidated budget that belong to the European Agricultural Fund for Rural Development, while a beneficial influence was exerted by the increase of 2.7 billion lei in the amounts intended for prefinancing the projects of the non-governmental sector in the case of the temporary unavailability of European funds, under art. 10 of GEO no. 40/2015, which transit the general consolidated budget. It should be noted that the first category, represented by structural and cohesion funds whose final beneficiary is the state, is the only one to be found in the budget execution according to ESA 2010 rules and in the investment expenditure aggregate reported by MPF.
 - Other EU funds: 4.17 billion lei. This newly introduced item corresponds to the government's intention to compensate *ex-post* from European funds the retrospective projects, originally completed from non-EU funds. In contrast with the regular revenues from EU funds that have a counterpart on budgetary spending and are neutral to the budgetary deficit in *cash* standards, the aforementioned amounts directly contribute to the deficit reduction. A similar episode, but of considerably smaller size, was recorded in 2014 (the respective amount was then 1.5 billion

lei). It should be noted that the recording of these revenues in the execution according to ESA 2010 will be made for the year in which the project for which EU funding is requested has been realized - a preliminary estimate indicates that only 1.4 billion lei would be reflected as revenue in the budget execution for 2018 according to ESA 2010 standards.

At the level of expenditures, the sources of the revised budget are:

- Goods and services spending: +1.75 billion lei. The cumulative successive increases made in the context of the budget amendments in the allocations for this expenditure aggregate amounted to 3.2 billion lei, confirming the concerns expressed by the FC regarding the difficulty of respecting the initial expenditure envelope, given the budgetary execution and historical developments. Even the newly planned level implies a strong deceleration in the annual growth rate in the last two months of the year, with the average monthly average expenditure being lower than the one recorded between November and December 2017.
- Subsidies: -0.3 billion lei.
- Interest spending: +1 billion lei.
- Social assistance: +0.8 billion lei. It should be noted that, given the current execution, the compliance with the updated envelope of this aggregate still implies that in December 2018 or January 2019, the practice of paying all pensions by the 15th of the month will be abandoned, the monthly flows indicating, in the opposite case, the exceeding of the budgeted amount by about 1 billion lei.
- Investment spending: -4.6 billion lei. The source of the decrease is the cut in the expenditures related to the investment projects financed from European funds by 5.3 billion lei, together with the increase of the capital spending (+1.1 billion lei) and the reduction of other transfers of the nature of investments (-315 million lei). However, it should be noted that the cut in investment spending does not contribute to the deficit reduction, as it reflects the decrease in the expected inflows from structural and cohesion funds whose final beneficiary is the state (-4.7 billion lei), as well as the reduction in the amounts related to the swap scheme by 0.53 billion lei, the savings from co-financing spending being offset by the higher allocations for capital expenditures.

Conclusions

During the current budgetary execution, much higher pressures than initially anticipated in budgetary expenditures, especially those of permanent nature (wages, social assistance and interest spending) aroused to the surface. These pressures have been partially accommodated from higher than anticipated revenues from personal income tax, social security contributions and dividends distributed by the state-owned companies, but keeping the cash deficit below 3% of GDP is only possible given that the second budget revision includes extraordinary revenues from the reserves of state-owned companies and the *ex-post* settlement of non-EU projects from European funds. Beyond the principle of public finances

sustainability that is put into question when permanent spending is financed from temporary revenue, there is also the question of how much of this extraordinary income will be recorded in the ESA 2010 execution. In the case of payments from the reserves of companies the ESA 2010 rules require that they are treated as a disinvestment and not as income and in the case of Romania, there is already a precedent of a similar statistical treatment in 2017. With regard to *ex-post* compensation from EU funds, the statistical treatment according to ESA 2010 is that of allocating these amounts as revenue in the years in which the projects in question occurred. According to the current estimates, only 1.4 out of the 4.1 billion lei corresponding to "other EU funds" in the *cash* execution would be recognized in the ESA 2010 execution of the current year. Together with the 1.9 billion lei of the non-tax revenues coming from the "extra-dividends", the gap between ESA 2010 deficit and the one according to the national methodology is increasing, *ceteris paribus*, by 4.6 billion lei. The FC considers that there is a very high risk that the ESA 2010 budget deficit - the relevant one from the perspective of European fiscal rules - will exceed the 3% of GDP threshold, even if the budget deficit according to the national methodology would fit in the planned parameters.

The opinions and the recommendations hereby stated were approved by the Chairman of the Fiscal Council, according to Art. 56, para (2) letter d) of the Law no. 69/2010 republished, after being approved by the Council members, through vote, on December 4th, 2018.

December 4th, 2018

Chairman of the Fiscal Council

IONUȚ DUMITRU

ANNEX 1	Initial budget 2018	Swap program 2018	Initial budget 2018 without swap	First budget revision (R1) 2018	Swap R1	R1 without swap	Second budget revision (R2) 2018	Swap R2	R2 without swap	R1- initial budget	R2- initial budget	R2-R1
										Without swap		
	1	2	3=1-2	4	5	6=4-5	7	8	9=7-8	10=6-3	11=9-3	12=9-6
TOTAL REVENUE	287,527.5	1,020.0	286,507.5	296,753.4	1,620.0	295,133.4	296,999.3	1,090.2	295,909.1	8,625.9	9,401.6	775.7
Current revenue	257,274.0	1,020.0	256,254.0	267,226.1	1,620.0	265,606.1	266,508.4	1,090.2	265,418.2	9,352.1	9,164.2	-187.9
Tax revenue	145,135.9	521.6	144,614.3	145,663.5	1,121.6	144,541.9	141,808.7	599.8	141,208.9	-72.4	-3,405.4	-3,333.1
Taxes on profit, wages, income and capital gains	38,598.9	298.0	38,300.9	40,907.0	298.0	40,609.0	41,232.7	298.0	40,934.7	2,308.1	2,633.8	325.7
Corporate income tax	15,020.3	148.0	14,872.3	15,012.8	148.0	14,864.8	15,422.8	148.0	15,274.8	-7.5	402.5	410.0
Personal income tax	20,803.4	150.0	20,653.4	22,575.8	150.0	22,425.8	22,575.9	150.0	22,425.9	1,772.5	1,772.5	0.0
Other taxes on income, profit and capital gains	2,775.2		2,775.2	3,318.4		3,318.4	3,234.1		3,234.1	543.1	458.8	-84.3
Property taxes	5,824.4		5,824.4	5,728.0		5,728.0	5,575.2		5,575.2	-96.4	-249.2	-152.8
Taxes on goods and services	98,666.8	184.0	98,482.8	97,219.5	784.0	96,435.5	93,213.1	254.2	92,958.9	-2,047.2	-5,523.9	-3,476.6
VAT	61,308.2	184.0	61,124.2	61,308.2	784.0	60,524.2	58,832.3	254.2	58,578.1	-600.0	-2,546.1	-1,946.1
Excises	30,218.5		30,218.5	30,218.5		30,218.5	28,979.2		28,979.2	0.0	-1,239.3	-1,239.3
Other taxes on goods and services	3,814.8		3,814.8	3,896.2		3,896.2	3,945.5		3,945.5	81.3	130.7	49.3
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	3,325.3		3,325.3	1,796.7		1,796.7	1,456.2		1,456.2	-1,528.6	-1,869.1	-340.5
Taxes on foreign trade and international transactions (custom duty)	1,042.0		1,042.0	995.9		995.9	1,045.9		1,045.9	-46.1	3.9	50.0
Other tax revenue	1,003.8	39.6	964.2	813.1	39.6	773.5	741.7	47.6	694.1	-190.7	-270.0	-79.4
Social security contributions	91,811.8	498.4	91,313.4	98,042.1	498.4	97,543.7	98,776.1	490.4	98,285.7	6,230.3	6,972.3	742.1
Nontax revenue	20,326.3		20,326.3	23,520.5		23,520.5	25,923.6		25,923.6	3,194.1	5,597.3	2,403.1
Capital revenue	1,843.6		1,843.6	885.2		885.2	936.7		936.7	-958.4	-906.9	51.5
Grants	8.5		8.5	8.5		8.5	8.5		8.5	0.0	0.0	0.0
Amounts received from the EU in the account of payments made and prefinancing	103.5		103.5	110.6		110.6	110.1		110.1	7.1	6.6	-0.5
Financial operations	0.0		0.0	0.0		0.0	0.0		0.0	0.0	0.0	0.0

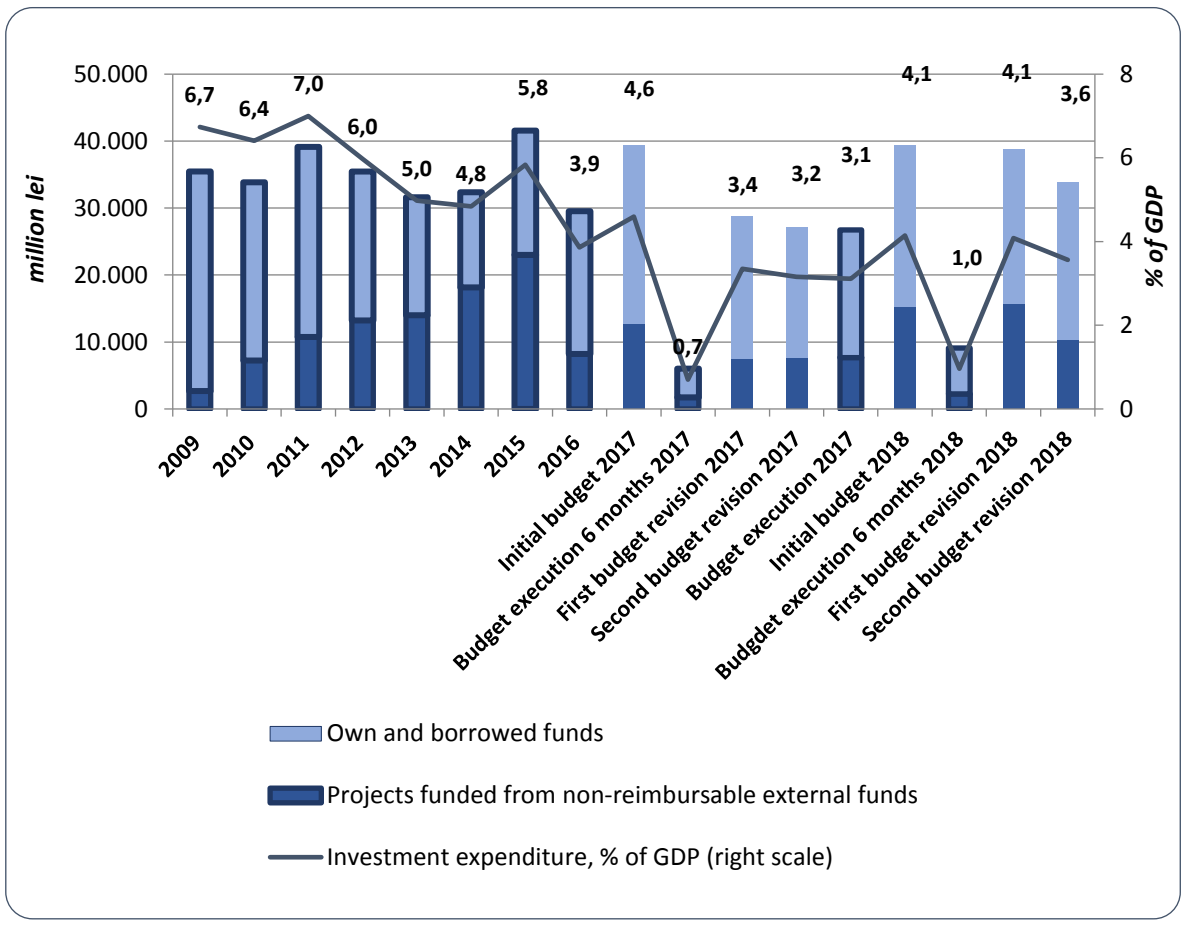
Amounts collected in the single account	0.0		0.0	0.0		0.0			0.0	0.0	0.0	0.0
Other EU funds	0.0		0.0	0.0		0.0	4,173.0		4,173.0	0.0	4,173.0	4,173.0
Amounts received from the EU/other donors in the account of payments made and prefinancing for the 2014-2020 financial framework	28,297.9		28,297.9	28,523.0		28,523.0	25,262.6		25,262.6	225.2	-3,035.2	-3,260.4
TOTAL EXPENDITURE	314,487.1	1,020.0	313,467.1	324,820.2	1,620.0	323,200.2	325,202.4	1,090.2	324,112.2	9,733.1	10,645.1	912.0
Current expenditure	293,509.0	850.0	292,659.0	304,545.5	850.0	303,695.5	303,803.3	850.0	302,953.3	11,036.5	10,294.4	-742.1
Personnel	81,117.5		81,117.5	86,239.6		86,239.6	86,343.4		86,343.4	5,122.1	5,225.8	103.7
Goods and services	39,615.0		39,615.0	41,123.6		41,123.6	42,875.7		42,875.7	1,508.6	3,260.7	1,752.1
Interest	12,096.8		12,096.8	12,094.2		12,094.2	13,142.4		13,142.4	-2.7	1,045.5	1,048.2
Subsidies	7,210.3		7,210.3	6,719.1		6,719.1	6,414.1		6,414.1	-491.2	-796.1	-304.9
Total transfers	152,868.5	850.0	152,018.5	156,561.7	850.0	155,711.7	153,884.0	850.0	153,034.0	3,693.2	1,015.5	-2,677.7
Transfers between public administration entities	2,132.8	850.0	1,282.8	2,035.2	850.0	1,185.2	2,438.3	850.0	1,588.3	-97.6	305.5	403.1
Other transfers	13,098.5		13,098.5	14,220.0		14,220.0	14,244.9		14,244.9	1,121.5	1,146.4	24.9
Projects funded by external post-accession grants	317.2		317.2	518.5		518.5	648.0		648.0	201.3	330.7	129.5
Social assistance	98,620.4		98,620.4	100,397.5		100,397.5	101,207.6		101,207.6	1,777.1	2,587.1	810.1
Projects funded by external post-accession grants 2014-2020	32,826.9		32,826.9	32,969.7		32,969.7	28,767.5		28,767.5	142.7	-4,059.4	-4,202.1
Other expenditure	5,872.6		5,872.6	6,420.8		6,420.8	6,577.7		6,577.7	548.2	705.1	156.9
Reserve funds	315.7		315.7	1,334.5		1,334.5	719.6		719.6	1,018.8	403.9	-614.9
Expenditure Funded from reimbursable funds	285.1		285.1	472.8		472.8	424.2		424.2	187.7	139.1	-48.6
Capital expenditure	20,978.2	170.0	20,808.2	20,274.7	770.0	19,504.7	21,399.1	240.2	21,158.9	-1,303.5	350.7	1,654.2
Financial operations	0.0		0.0	0.0		0.0	0.0		0.0	0.0	0.0	0.0
Payments made in previous years and recovered in the current year	0.0		0.0	0.0		0.0	0.0		0.0	0.0	0.0	0.0
SURPLUS (+) / DEFICIT(-)	-26,959.6	0.0	-26,959.6	-28,066.8	0.0	-28,066.8	-28,203.1	0.0	-28,203.1	-1,107.2	-1,243.5	-136.3

Source: Ministry of Public Finance, Fiscal Council's calculations

ANNEX II - EU Funds	Initial budget 2018 (mil. lei)			First budget revision 2018 (mil. lei)			Second budget revision 2018 (mil. lei)		
	Structural	Agriculture	Amounts according to art. 10 letter a) of GEO no. 40/2015	Structural	Agriculture	Amounts according to art. 10 letter a) of GEO no. 40/2015	Structural	Agriculture	Amounts according to art. 10 letter a) of GEO no. 40/2015
EU funds inflows	10,741.3	17,272.4	300.0	10,960.6	17,272.4	300.0	6,279.4	15,983.0	3,000.0
EU funds expenditure	18,886.9	17,272.4	300.0	18,875.4	17,272.4	300.0	13,464.0	15,983.0	3,000.0
National co-financing and ineligible expenses	6,745.5	0.0	0.0	6,514.8	0.0	0.0	5,784.6	0.0	0.0

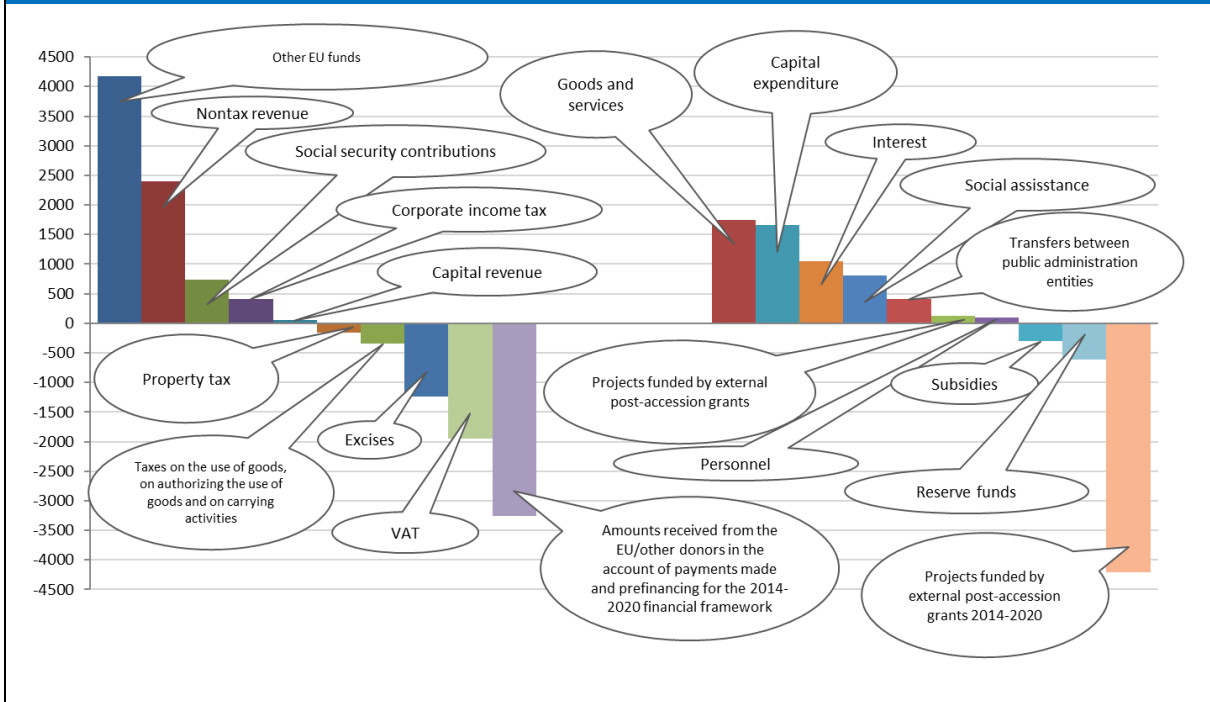
Source: Ministry of Public Finance, Fiscal Council's calculations

**Figure 1: Evolution of the investment expenditure in cash terms in the period 2009-2018
- planned vs. execution, million lei**



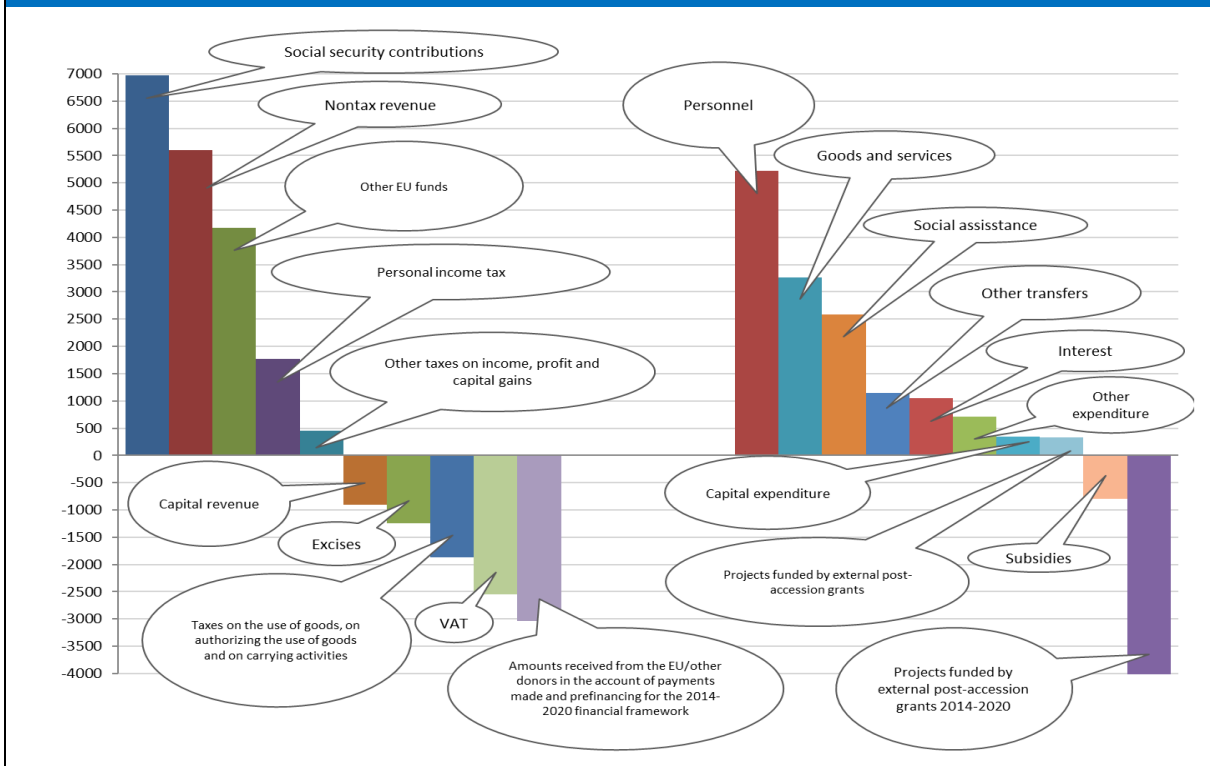
Source: Ministry of Public Finance, Fiscal Council's calculations

Figure 2: The main changes in expenditures and revenues compared to the first budget revision 2018 (without swap), mil. lei



Source: Ministry of Public Finance, Fiscal Council's calculations

Figure 3: The main changes in expenditures and revenues compared to the initial budget 2018 (without swap), mil. lei



Source: Ministry of Public Finance, Fiscal Council's calculations