Fiscal Council of Romania

Fiscal Council's Opinion on the Second Budget Revision for 2020

Summary

- The most acute moment of the current crisis, determined by health restrictions (shutdown effect, partial closure of economies), seems to have passed, and the process of economic recovery has begun in most national economies, including Romania.

- The war with COVID-19 is not over, it is one of attrition.

- The epidemic cycle conditions the speed of return, there may be local "closures".

- There will be persistent economic and social effects of the crisis; the effects depend heavily on rebuilding production chains, trade, support from central banks and governments. There are changes in the inclination towards consumption and the one for (productive) investments, with an increased risk aversion amid great uncertainties and structural changes, the expansion of the use of new technologies, including artificial intelligence.

- The extent of anti-crisis measures depends on parameters such as the existing fiscal and monetary space, the quality of issuing or not an international reserve currency, the degree of euroization/dollarization, the existence of back-up mechanisms (including repo and swap arrangements with the Fed and the ECB), the degree of economic robustness, institutional strength, etc.

- There is a trade-off between, on the one hand, the room for maneuver to deal with major crises, which requires one-off expenses and the structural deficit, on the other hand (Romania has the highest structural deficit in the EU). This explains the great audacity of other countries to go with budget deficits to and above 10% without worrying about inevitable macro corrections in the coming years.

- There is an essential difference between recording budget deficits of 8-9% of GDP mainly due to structural elements, based on tax cuts and increased permanent expenditures in recent years, as in the case of Romania and to record deficits of the same order mainly as a result of the

implementation of economic support programs to counter the economic and social effects of the COVID-19 pandemic, as is the case in many EU countries. The latter have room for maneuver to stimulate the economy and, in addition, have the advantage that these measures are one-off and will therefore no longer affect budget execution when the stimulus is withdrawn. Therefore, no corrective measures will be needed to return to a sustainable fiscal-budgetary policy trajectory.

- Romania's budgetary situation was and continues to be very tense, a fact also reflected by Romania's singular placement in the excessive deficit procedure (EDP) of the European Commission (EC) at the beginning of this year. Macroeconomic imbalances - the current account deficit (4.6% of GDP in 2019) and relatively large structural budget deficit (over 4% of GDP) - and the persistence of high budgetary pressures to increase permanent spending, call for a macroeconomic correction in the near future to maintain access to financial markets and the country rating.

- Large initial deficits (budget and current account) did not allow the National Bank of Romania (NBR) to be as aggressive in lowering the monetary policy rate as central banks in neighboring countries. This situation is also reflected in Romania's considerably higher financing costs on the financial markets, compared to those of other countries in the region - the Czech Republic, Hungary, Poland.

- A massive absorption of European resources from the multiannual financial framework and the European Recovery Plan will reduce the need for financing in the financial markets and support domestic aggregate demand and supply, thus allowing a smoother macroeconomic correction path.

- The absorption of European funds is a "battle for heavy water" in the coming years.

- The contraction of GDP, which is revised by NCSP, for 2020, at 3.8%, is in the immediate vicinity, slightly lower than the interval previously proposed by FC.

- FC estimates that the range of 4-6% for this year's GDP contraction remains valid.

- The essence of the second budget revision on the revenue side is a strong downward adjustment, in line with the deterioration of the macroeconomic framework taken into account when substantiating the budget construction.

- FC appreciates the prudent nature of the projection of fiscal revenues and social security contributions that can accommodate possible developments slightly below the expectations of the macroeconomic framework, or of non-fiscal revenues, compared to those considered in the preparation of the initial budget for 2020.

- The essence of the second budgetary amendment on the expenditure side is, in the opinion of the FC, an additional deterioration at the level of 2020 - discretionary increase of permanent expenditures and additional weaknesses in the budget construction - to which is added an increase of some one-off items. FC appreciates the Government's intention to increase investment expenditures, even under the conditions of significant deterioration of the resources mobilized to the general consolidated budget.

- Following the analysis of the data related to the second budget revision, FC notes a further deterioration of the public finance position of 0.6-0.8 pp of GDP in 2020, compared to its estimates from the first revision, as a result of increasing expenditures.

- Given the baseline scenario of FC, characterized by a decrease in real GDP between 4 and 6%, the budget deficit estimate for 2020 is between 8.6-9.4% of GDP. In this economic, health and electoral context, characterized by unusually large uncertainties, more unfavorable developments than those anticipated at this time cannot be ruled out.

- The starting point of the budget deficit for 2021 would be at least 7.5% of GDP, even admitting the expiration of temporary measures and the economic recovery forecasted by NCSP - economic growth of 4.9% for 2021. These perspectives of the public budget call for increased caution in the adoption of any fiscal policy measures and the early identification of a gradual and coherent fiscal consolidation strategy that minimizes the associated economic and social costs.

- The 14% increase of the pension point implies a budgetary effort of 3.6 billion lei in 2020 and, respectively, 10.92 billion lei in 2021. Such a measure, with an important impact on the budget construction for 2021, should be included in a medium-term fiscal-budgetary framework.

- FC considers that a rules-based approach to pension indexation (otherwise provided by law) would bring multiple benefits from the perspective of the stability of the pension system and anchoring participants' expectations, fiscal sustainability and budgetary programming.

- The increase in budget expenditures on pensions cannot ignore the situation of the GCB, whose primary and structural deficit is currently at very high levels, which requires the initiation of a correction process, the deviation from the 3% of GDP threshold set by the excessive deficit procedure being significant.

- Under the conditions of the new budgetary parameters, the size of the necessary public financing of Romania for 2020 is about 13% of GDP.

- FC appreciates the success so far in ensuring a large part of the financing needs of the Romanian state for 2020.

- Although the coverage of the financing needs for this year is largely ensured, its coverage in the medium term could be much more problematic. It is hard to believe that financial markets will tolerate high levels of the budget deficit for a long time, even if fiscal rules in the EU remain suspended until 2021. The ability to finance the budget deficit and refinance outstanding public debt that is a very "tough" constraint on fiscal policy.

- In this context, a correction leading in the medium term to much lower levels of the budget deficit and anchoring creditors' expectations towards a sustainable fiscal-budgetary policy trajectory is mandatory. The announcement of a credible multi-annual fiscal consolidation plan could provide the necessary respite for a gradual approach that would affect the economic recovery as little as possible.

- The ambitious target of joining the euro area (and, previously, of entering the Exchange Rate Mechanism - ERM2) is not compatible with structural budget deficits of more than 1% of GDP, not to mention more than 4% of GDP, with considerable external deficits, as was the situation in Romania at the beginning of 2020.

- FC reiterates that it is absolutely necessary to increase fiscal (budgetary) revenues in order to face future crises, in order to have a more robust public budget. It is false that these revenues cannot be increased given the experience of other states with similar economic and institutional structures in the EU. But it takes political will and overcoming resistance networks within the society.

Fiscal Council's Opinion on the Second Budget Revision for 2020

On August 13, 2020, the Ministry of Public Finance (MPF) sent to the Fiscal Council (FC), by address no. 474594/13.08.2020, a part of the documents related to the second budget revision for the current year[1], requesting, pursuant to art. 53, para. (2) of the Fiscal Responsibility Law (no. 69/2010, republished, hereinafter referred to as FRL), the opinion of the Fiscal Council on them. On 14 August 2020, the FC issued a preliminary opinion, taking into account both the very short time required to formulate the opinion and the partial information provided by the MPF. This preliminary opinion was sent to the MPF by address no. 52/14.08.2020, in the context in which, on the same day, the Government meeting for approving the budget revision took place.

In its preliminary opinion, FC considers that the fiscal-budgetary measures adopted by the Government, taking into account both their number and, especially, their volume, are particularly important for the analysis of the fiscal situation and, consequently, requested MPF - by address no. 53/18.08.2020 - the list of measures taken into account when elaborating the revision project, as well as their estimated budgetary impact. MPF sent these data to FC by address no. 9726/24.08.2020.

Subsequent to the Government meeting approving the second budget revision, two Government Emergency Ordinances (GEO) were published in the Official Journal of Romania (OJ): GEO no. 135 (regarding the revision of the state budget for 2020, the modification of some normative acts and the establishment of some budgetary measures) in OJ no. 751, Part I, of 18.08.2020 and GEO no. 136 (for the revision of the social security budget for 2020) in OJ no. 752, Part I, also from 18.08.2020. Given that there are some differences between the form originally sent to FC (on August 13) and the one approved (and published in the OJ on August 18), MPF completed and updated the set of available information by resending the address no. 474594 on 20.08.2020.

Based on the FC's decision to issue a preliminary opinion (containing only some considerations, as well as the assessment of the compliance of the revision proposal with the regulations established by the FRL[2]) on August 14, 2020, which took into account the very limited time for drafting an opinion as well as the lack of strictly necessary information (these being mentioned in the

[1] The report on the economic and budgetary situation for the first six months of 2020, the draft of the general consolidated budget revision for 2020, the substantiation note and the draft of the Government Emergency Ordinance on the revision of the state budget for 2020, amending normative acts and establishing budgetary measures, as well as the substantiation note and the draft of the Government Emergency Ordinance on the revision of the social security budget for 2020.

[2] Considering the fact that the figures of the second revision published in the OJ are very close to those sent to the FC, which were analyzed in the preliminary opinion, only minor changes occurring in some expenditure positions, the budget deficit forecast by the MPF remains unchanged at 8.6% of GDP, the assessments contained in the preliminary opinion of the FC on the compliance with fiscal rules change only marginally, the budget ceilings being adjusted accordingly.

preliminary opinion), this opinion complements the previous one by conducting an in-depth analysis of the second budget revision of 2020.

1. Considerations on the economic situation and the second budgetary revision for 2020

The Fiscal Council starts in its considerations from the special circumstances, determined by the pandemic caused by the SARS-CoV-2 virus as well as from its profound economic and social impact. This reality induces unprecedented uncertainties in recent history regarding the interconnected evolution of economies that are significantly dependent on the health situation.

It is noteworthy that the most acute moment of the current crisis, determined by the initial health restrictions (shutdown effect, partial closure of economies), seems to have passed, and the process of economic recovery, by reversing the closure measures, has begun in most economies, including Romania.

Although we are in the recovery phase, there will be persistent economic and social effects; the effects depend heavily on rebuilding production chains, international trade, support programs of central banks and governments. There are also significant changes in the inclination towards consumption and the one for (productive) investments, with a higher risk aversion amid great uncertainties and structural changes, the expansion of the use of new technologies, including artificial intelligence.

The economic downturn in Europe and other parts of the globe in the second quarter of this year, compared to the same period in 2019, speaks for itself of the COVID-19 shock: a 15% decline in GDP in the euro area, of 14 1% in the EU as a whole and of 31.7% in the US. It must be emphasized that the epidemic cycle conditions the speed of recovery, that there may be local "closures"; the war with COVID-19 is not over, it is one of wear and tear. It should also be noted that economies do not have a similar degree of robustness and shock absorption.

The FC notes the unprecedented fiscal and monetary measures taken in the EU and internationally to combat the effects of the pandemic. The extent of these measures depends, from one economy to another, on parameters such as the fiscal space (the size of the pre-pandemic deficit and debt) and the existing monetary space (whether the zero-lower-bound was reached or not, zero or even negative nominal monetary policy rates), the quality of issuing or not an international reserve currency, the internal degree of euroization/dollarization, the existence of back-up mechanisms (including repo and swap arrangements with the Fed and the ECB), the degree of economic robustness and institutional strength, etc. From this point of view, Romania's budgetary situation has been and continues to be very tense, a fact reflected by Romania's unique placement in the excessive deficit procedure of the European Commission (EC) since the beginning of this year. This situation occurs despite the temporary suspension of the application of European fiscal rules.

The economic and financial situation of a country is reflected in the sovereign risk rating and is judged by the financial markets – since they are the ones that cover the need for financing and refinancing.

For Romania, the problem of macroeconomic imbalances - the current account deficit (4.6% of GDP in 2019) and the relatively large structural budget deficit (over 4% of GDP), as well as the persistence of high budgetary pressures to increase permanent expenditures, while fiscal and budgetary revenues are among the lowest in the EU (see Figure 5 in the Annex) - calls for a macroeconomic correction in the not too distant future to maintain access to financial markets and the country rating. This correction is also necessary given that Romania is under the incidence of the excessive deficit procedure and in the perspective of resuming the application of European fiscal rules in 2022.

The large initial deficits did not allow the NBR to be as aggressive with the reduction of the monetary policy rate as central banks from other neighboring economies. These initial deficits and permanent spending pressures on the budget explain why Romania is financed at considerably higher costs (in local and foreign markets) than the Czech Republic, Hungary, Poland, countries with which we compare most often and which are not in the euro area (see Figure no. 10 in the Annex).

The absorption of European resources from the multiannual financial framework and the European Recovery Plan, which together amount to approximately 80 billion euros (from which Romania's contribution to the EU budget and the European Recovery Plan must be deducted), will reduce the need for financing in the financial markets. They will support domestic aggregate demand and supply, thus allowing for a smoother macroeconomic correction path, compatible with promoting a short-term anti-cyclical fiscal policy.

FC reiterates the thesis that it is absolutely necessary to increase fiscal (budgetary) revenues in order to face future crises and to have a more robust public budget. It is false that these revenues cannot be increased given the experience of other states with similar economic and institutional structures in the EU. But it takes political will and overcoming resistance networks within the society.

The ambitious target of joining the euro area (and, previously, of entering the Exchange Rate Mechanism - ERM2) is not compatible with structural budget deficits of more than 1% of GDP, not to mention more than 4% of GDP, with considerable external deficits, as was the situation in Romania at the beginning of 2020.

2. *Macroeconomic framework considerations*

In the FC's opinion on the first budget revision in 2020, based on available data and information, both the scenario proposed by the National Commission for Strategy and Forecast (NCSP) - of an economic contraction for 2020 of 1.9% - and two alternative scenarios - considered by FC - one of a contraction between 4 and 6% as well as a risk scenario - of a real GDP contraction between 8 and 9% - were evaluated.

The unfavorable developments in the second quarter of the current year (reflected in the dynamics of more frequent sectoral data, such as industry, trade, etc.) which were anticipated and highlighted by the previous opinion of the Fiscal Council (on the first revision) are: (i) confirmed by new data, in the signal estimate of the National Institute of Statistics (INS) published on August 14, respectively a contraction of GDP of 10.5% in Q2 2020 (year on year), which is thus compatible with the FC estimates (the average scenario, from the previous opinion, which estimated a contraction of 4 to 6% of real GDP), (ii) validated by the new macroeconomic projection of the Government, published on 13 August by NCSP, which anticipates an economic contraction of 3.8% for the current year, significantly revising the previous figure of -1.9%, (iii) compatible with a recovery of the economy in the last two quarters of the year - compared to Q2 2020 -, the magnitude and speed of recovery depending on the evolution of the health situation in Romania and across the EU.

Revised macroeconomic coordinates - related to the summer forecast of NCSP 2020-2021 - thus confirm previous FC assessments. The contraction of GDP that is revised by NCSP, for 2020, at 3.8%, is in the immediate vicinity, but slightly below the lower threshold of the interval considered by FC in its baseline scenario.

Starting from the recently published internal macroeconomic data and considering the evolution of the external environment, **FC estimates that the range of 4-6% for this year's GDP contraction remains valid.**

FC also considers that the projection envisaged in the revision draft could present some risks of a more unfavorable development. We can corroborate this with the projection of a GDP deflator of 3.7% (thus determining a nominal GDP almost unchanged compared to 2019) which, given the latest developments in inflation, seems to present the risk of a slower evolution of prices and, consequently, of a lower dynamic of nominal GDP. **FC appreciates the higher degree of realism of the current projection on gross domestic product compared to the previous one.**

With regard to the labor market, FC considers that the current projection is more realistic compared to the previous one, but, similar to the GDP projection, it entails risks concerning a more unfavorable evolution. Thus, regarding the number of employees, the anticipated reduction by NCSP for 2020, respectively of 1.6% (or 1.7% according to the AMIGO methodology) was revised in the negative direction from 1.3% (or 1.6% according to the AMIGO methodology) in the first budget revision of the current year (from April). However, it continues to be relatively favorable both in relation to the latest available data and to the projections of other relevant institutions (e.g. the European Commission). Regarding the dynamics of earnings, the current projection of an increase of 3.9%/4.0% (gross/net) was revised downwards from 5.9%/6.0% (gross/net) in the previous NCSP projection, but at the same time emphasizes the risk of a possible more unfavorable development.

The unemployment rate considered by NCSP - 3.9% or 5.1% according to the AMIGO methodology - is revised upwards (from 3.4% or 4.4% according to AMIGO in the previous NCSP projection) but appears, based both on recent information and the projections of other institutions, as possibly underestimated. It should be emphasized again, that, in the opinion of the FC, the projections related to the labor market have a very significant fiscal-budgetary impact, the sensitivity of the deficit estimate being, thus, relatively high in relation to this input data. Overestimating the dynamics of the wage envelope in the economy (underestimating the reduction in the number of employees and overestimating earnings) is likely to lead to an overestimation of budget revenues, and a lower projected unemployment rate diminishes the forecast of unemployment benefits having a similar effect of underestimating the level of the deficit.

In conclusion, FC considers that in relation to the macroeconomic scenarios of the previous opinion (on the first budget revision), specifically the NCSP scenario of a 1.9% real GDP contraction - considered unlikely and the two alternative scenarios proposed by FC – estimating a real GDP contraction between 4-6% (baseline scenario) and, respectively, 8-9% (risk scenario), the current NCSP projection considerably aligns the macroeconomic forecast with the FC's baseline scenario.

The FC also considers that the baseline scenario, of a real GDP contraction between 4-6%, remains valid and continues to be, both based on recent information and forecast revisions operated by other institutions, the scenario with the highest probability of materialization. More unfavorable external developments - of the economies of the main trading partners or of the financial markets - and/or the manifestation of wider internal shocks (the evolution of the pandemic, or changes in legislation leading to further relaxation of fiscal policy) may lead to a deterioration of the public budget and of the macroeconomic indicators.

3. European funds - anchor of economic recovery

Following the negotiations at the European Council from July 2020[3], Romania was allocated 79.9 billion euros for the programming period 2021-2027, of which the funds related to the multiannual financial framework amount to 46.3 billion euros, and 33.5 billion euros are distributed through the Next Generation EU plan. Under the latter, 30.3 billion euros go to the Recovery Facility and

[3] https://www.consilium.europa.eu/en/press/press-releases/2020/07/21/european-council-conclusions-17-21-july-2020/

Resilience Mechanism (RRM) (13.7 billion euros in grants and 16.6 billion euros in loans[4]). However, access to this instrument is conditioned by the elaboration of a National Recovery and Resilience Plan (NRRP) which must contain the reform agenda and the public investment plan, and the deadline for submitting a first draft to the European Commission is extremely short (October 2020), while the negotiation process will take place until April 2021, with the issuance of the decision of its approval by the EC. A percentage of 70% of the value of grants must be contracted in 2021 and 2022, and the difference of 30%, by the end of 2023.

It must be said that the amounts mentioned above must be adjusted with the contribution to the EU budget, which can mean for Romania between 16-20 billion euros for the period 2021-2027. However, Romania could have a net benefit of many billions of euros annually starting in 2021.

Romania could benefit from funds to finance investments of almost 10 billion euros in 2021 and 2022 and another 4 billion euros in 2023 (to which would be added about 3 billion euros per year in the next 5 years from loans) only from the RRM instrument which aims to support the exit from the crisis, the recovery of the economy and the increase of the shock resistance capacity, relieving the pressures of the investment effort on the general consolidated budget. Priority areas for eligible investments concern major infrastructure projects (highways, railways), agriculture and environmental protection (land use planning, irrigation systems, combating soil erosion, afforestation, greening industrial platforms), public health (expansion/rehabilitation/ modernization of hospitals and endowment with medical equipment), research in the field of technological transfer, urban infrastructure, etc.

Investments in the above-mentioned areas should not face eligibility problems, responding not only to Romania's acute needs, but also being compatible with new requirements at European level on the Green Pact, modernization and increasing the resilience of economic systems.

The importance given by the European institutions to this plan is highlighted by the fact that **the NRRP will accompany, as an annex, the National Reform Plan** which is submitted for evaluation to the European Commission in April each year and, together with the Convergence Program, represent strategic documents that are the basis on which country-specific recommendations are made during the European Semester[5].

[4] At EU level, the Recovery and Resilience Mechanism is the main pillar of the New Generation EU plan, which has allocated 750 billion euros (of which 672.5 billion euros for RRM), intended for the recovery from the consequences of COVID-19 and being complementary to the EU's multiannual budget (1047 billion euros for the period 2021-2027), through their synergy aiming at the major reform of the EU, mainly through the Green Deal (including the Investment Plan-Just Transition Mechanism).

[5] Remarks by Commissioner Paolo Gentiloni at the press conference on the Recovery and Resilience Facility, Brussels, 28 May 2020.

The absorption of reimbursable and non-reimbursable European funds, with a direct and indirect favorable impact on fiscal consolidation, **is also an anchor of Romania's financial and economic standing (country rating)**, on which access to capital markets and coverage of financing needs depend, even at relatively high yields. In this sense, the elaboration of NRRP and its substantiation are of vital importance for Romania to enjoy a more favorable perception in the international financial environment. It should be emphasized, however, that Romania's financial standing depends essentially on fiscal/budgetary consolidation, which can be considerably helped by the absorption of European funds.

It should be noted that rating agencies[6] emphasize that the New Generation EU fund is a **factor supporting the rating of the beneficiary countries**, especially those in South-Eastern Europe, the assessments of the effects on sovereign risk will reflect the benefits of a more robust economy, the impact on public finances and economic growth, and how they can reduce the impact of the pandemic.

FC estimates that the absorption of European funds allocated to Romania in the period 2021-2027, increased by over 70% compared to the pre-pandemic level through the Next Generation EU plan, is an anchor of economic recovery, by supporting potential GDP (which is affected by the effects of the current economic crisis) and by contributing to the financing of the current account deficit of the external balance of payments.

European funds can partially offset the constraining impact on aggregate demand and aggregate supply caused by the necessary fiscal/budgetary consolidation.

The absorption of European funds is a real "battle for heavy water", an exceptional opportunity for Romania to overcome such a difficult period.

4. Updated coordinates of budgetary revenues and expenditures related to the second budget revision

The second budget revision significantly increases the projection of the budget deficit for 2020 to 8.6% of GDP, respectively by 1.9 pp above the level considered by the budget revision operated in April. The causes of this development, as will be illustrated in detail below, are the deterioration of the macroeconomic framework compared to the previous one, additional weaknesses of the budget construction, as well as the implementation of new discretionary fiscal policy measures on the budget expenditure side.

[6] See the Fitch Ratings press release of July 23, 2020 https://www.fitchratings.com/research/sovereigns/eu-recovery-fund-is-step-towards-more-resilient-eurozone-23-07-2020

In its opinion on the first budget revision for 2020, the FC anticipated a likely level of the budget deficit for the current year of between 8.1% and 8.9% of GDP. This projection was based on the identification by the FC of some weaknesses in the budget construction (overestimation of revenues of about 0.3% of GDP and underestimation of expenditures of about 0.3-0.45% of GDP), as well as considering a scenario for the evolution of real GDP characterized by a decrease between 4 and 6%, a scenario that FC appreciated as more realistic compared to the NCSP projection at that time of a 1.9% decrease in real GDP. Given the revision of the real GDP forecast on which the budget construction is based at -3.8%, the previous projection of the FC for the budget deficit consistent with this would have been about 8% of GDP. The following will detail the elements that led to the level of 8.6% of GDP for the budget deficit, estimated by the MPF on the occasion of the second budget revision.

Compared to the parameters approved by the first budget revision operated in April this year, the second budget revision increases the total estimated revenues of GCB by 0.92 billion lei, while the total budget expenditures are increased by 19.42 billion lei, the budget deficit being thus increased by 18.5 billion lei. However, the second budget revision also includes a significant increase of around 1.1 billion in the swap compensation scheme of GCB arrears with a symmetrical impact on revenues and expenditures (and therefore neutral on the budget deficit), a more accurate illustration of the position of public finances requiring the exclusion of this element from the analysis. Thus, eliminating the impact of swap schemes, the budget revenues projected by the second revision decrease by about 0.18 billion lei, while the budget expenditures increase by 18.32 billion lei.

The revision of the revenue projection takes place under the conditions in which the significant decrease of budgetary revenues coming from the internal economy - tax, social security contributions and non-tax revenues -, respectively by 8.6 billion lei, is apparently compensated by the increase of the revenue aggregate "amounts received from the EU/other donors on account of payments made and pre-financing related to the financial framework 2014-2020" by about 8.47 billion lei. While the reduction of the revenue forecast from the domestic economy is a natural one, considering the decrease of the nominal GDP projection by about 2.2 pp, being consistent with the FC estimate according to which for each percentage point of its growth rate, budget revenues are lower by about 3.5 billion lei, in the case of increasing the amounts received from the EU, this does not reflect, for the most part, an improvement in the position of public finances for the reasons that will be presented below.

Thus, the essence of the second budgetary revision on the revenue side is a strong downward adjustment, in line with the deterioration of the macroeconomic framework taken into account when substantiating the budget construction.

It should be noted that among the measures adopted in the context of the exceptional situation generated by the COVID-19 pandemic was the possibility of postponing tax obligations by economic agents whose activity was severely affected, until October 25 this year, MPF estimating that the appeal to this facility leads to late collection compared to the initial planning of an amount of about 10 billion lei. In the projection of budget revenues related to the second budget revision, the MPF included a collection rate of these receivables of about 70%, a hypothesis that the FC considers reasonable. The distribution of these amounts by categories of budgetary revenues, which FC will take into account as such in assessing the projection of revenues for 2020 is as follows: corporate income tax 0.9 billion lei, personal income tax 0.4 billion. lei, VAT 2.9 billion lei, excise duties 0.2 billion lei, social security contributions 2.6 billion lei.

By revenue categories, revisions of previous estimates (net of the impact of swap compensation schemes) occur as follows:

- *Amounts received from the EU/other donors on account of payments made and pre-financing related to the financial framework 2014-2020*: +8.47 billion lei. An overwhelming proportion of this correction is attributable to the increase of European funds for agriculture (+2 billion lei), as well as the supplementation of amounts transiting the general consolidated budget for pre-financing non-governmental sector projects in case of temporary unavailability of European funds, based on art. 10 of GEO no. 40/2015 (+5.06 billion lei), while the European funds whose recipient is the state increase in planning only by 1.35 billion lei. The first two categories, which were not included in the cash budget execution before 2016, represent European funds whose recipient is the private sector and have a symmetrical impact on revenues and expenditures, they only transit the consolidated general budget and have no relevance in assessing the position of public finances *stricto sensu* - because, in a broad sense, the absorption of European funds as a whole, including the private sector, can contribute to increasing budget revenues. From the perspective of the ESA 2010 methodology, only the structural funds whose final beneficiary is the state are relevant, the amounts destined for agriculture and the pre-financings granted to the non-governmental sector not being included in the public administration sector. In conclusion, from the perspective of the GCB situation, the relevant supplementation related to this budgetary aggregate is 1.35 billion lei.
- *Tax revenues*: -6.8 billion lei, out of which:
    - *Corporate income tax*: -0.54 billion lei. FC estimates that the new forecast, corresponding to a level of revenues about 6% lower than in the previous year, taking into account that nominal GDP in 2020 is close to the one in 2019, it is reasonable given the up-to-date execution, the payment facilities introduced in 2020, as well as the deferred amounts that are expected to be recovered. However, the higher sensitivity of this aggregate to the evolution of the economy could generate additional risks, even if the estimate can be considered prudent.
    - *Personal income tax*: -0.3 billion lei. The revision of the projection takes place in the context of the change of the forecast regarding the evolution of the average number of employees in the economy from -1.3% to -1.6% and respectively of the average gross salary gain from +5.9% to +3.9%. FC appreciates as prudent the new

revenue forecast taking into account the more favorable day-to-day execution than that of other budgetary aggregates and waives the reservations previously expressed. Moreover, we appreciate that the new forecast may also accommodate slightly weaker developments in the relevant macroeconomic bases.

  - *Other taxes on income, profit and capital gains*: -0.5 billion lei. The revision is attributable to the negative change in the macroeconomic framework.
  - *VAT*: -5.36 billion lei. The reduction of the VAT revenue estimate takes into account the current budget execution and the updated macroeconomic framework, respectively the decrease of the forecasted increase of the expenditures with the final consumption of the population, excluding self-consumption and peasant market in nominal terms, from +2.7% to +0.5%. Under these conditions, the VAT revenues net of the impact of swap compensation schemes are expected to decrease by about 6.7% compared to the previous year. The decrease is explained by the acceleration of VAT refunds in order to inject liquidity into the economy (growth rate in the first 6 months of 2020 compared to the corresponding period of the previous year for refunded VAT of 32.1%, compared to a decrease of 4.1% for collected VAT), as well as the reduction of excise duties on energy products operated in 2020. The new estimate of VAT revenues suggests that the measure of timely repayment of VAT due by the state will not be reversed, an element that can be considered positive, especially in the current context. FC appreciates the new projection of VAT revenues as prudent.
  - *Excise duties*: +0.16 billion lei, as a result of a favorable impact on budget revenues, higher than anticipated, of the increase in excise duties on tobacco products. The good performance in the current context of this income category justifies the new estimate, despite a further downward revision of the related macroeconomic base, respectively the expenditure with the final consumption of the population, excluding self-consumption and peasant market in real terms, from -1% to -2.25%. Under these circumstances, the FC waives the reservations expressed on the occasion of the first budgetary revision regarding excise revenues.

- *Social security contributions*: -1.28 billion lei. Similar to personal income tax, social security contribution has as a relevant macroeconomic basis the gross wage bill across the economy, determined by the average number of employees and the average gross earnings. Considering the revision of their projections, previously described, as well as the up-to-date execution of social security contributions, the FC considers the forecast for this budget aggregate to be feasible.

- *Non-tax revenues*: -0.53 billion lei. The negative revision of the macroeconomic framework also has an impact on this budgetary aggregate, for example by reducing dividends distributed by state-owned companies as a result of decreasing their profitability. However, the new forecasted level, only 1% below that of 2019, seems optimistic considering the execution related to the first 7 months of 2020, which reveals lower revenues by about 12% compared to the previous year.

Summarizing, on the side of budget revenues, FC has no major reservations regarding the levels projected by the second budget revision. However, uncertainties persist about the evolution of GDP and the degree of recovery of amounts deferred for payment by economic operators, and more unfavorable developments cannot be ruled out compared to current forecasts, which could subsequently influence budget revenues. However, the FC appreciates the more prudent nature of the projection of tax revenues and social security contributions, which has the potential to accommodate possible developments slightly below expectations of the macroeconomic framework or non-tax revenues.

Although FC has no major reservations on the revenue forecast for the current budget construction, it should be noted the severe impact on the position of public finances generated by the decrease in revenue projection from the domestic economy by about 31.5 billion lei compared to those considered when drawing up the initial budget for 2020.

Budget expenditures, net of the impact of swap compensation schemes, are increased on the occasion of the second budget revision by about 18.3 billion lei, both as a result of some structural components and as a result of extraordinary components (one-off) intended to combat the economic and public health effects of the COVID-19 pandemic, but also on the basis of supplementing the aggregate "Projects financed from non-reimbursable external post-accession grants 2014-2020". As shown in the discussion on budget revenues, most of the supplementation of the expenditure position related to European funds (amounting to about 7.06 billion lei) does not represent a change in the position of public finances or investment capacity of the state, being related to funds destined for the private sector that only transit the GCB.

There are two aspects to be reiterated regarding European funds: the public sector uses considerable amounts, which are found in the part of public investments and which were in the period 2010-2019 on average about 1.8% of GDP; all European funds, used in the public and private sectors, potentially increase GDP and help economic development as a whole.

The essence of the second budgetary revision on the expenditure side is, in the FC's view, a further deterioration in 2020, mainly a discretionary increase in permanent expenditures and additional weaknesses in the budget construction, to which is added an increase in one-off elements.

By categories of expenditures, revisions of previous estimates (net of the impact of swap compensation schemes) are as follows:

- *Personnel expenses*: +1.17 billion lei. In the list of fiscal policy measures submitted to FC by the MPF, the explanation for this supplement is represented by additional salary increases granted for staff in health units and the payment of the risk incentive. Another discretionary measure that influences this budgetary aggregate is the postponement of the advance of salary increases in education, whose budgetary impact, indirectly determined from the substantiation note accompanying the budgetary revision, would have been about 0.8 billion lei in 2020. In view of the 7-month budget execution and the elements described above, the FC considers it feasible to meet the new level proposed for personnel expenses.

- *Reserve funds*: +2.16 billion lei. As with the first revision, the additional amounts are most likely to address the fight against the effects of the COVID-19 pandemic. The amounts will then be distributed by budget category according to actual needs. The category most susceptible to allocations from the reserve fund for this purpose is "goods and services".

- *Goods and services*: +3.08 billion lei. Under the new conditions, the budget envelope (net of the impact of the swap compensation scheme in the amount of +0.5 billion lei, decided on the second revision) is placed at a level of 54.6 billion lei, respectively by about 3.4% above the nominal level of 2019. In the first 7 months of 2020, this category of expenditures grew at a rate of about 15% compared to the same period last year. In this context, even in spite of the increase decided on the second revision, most likely this budgetary aggregate is under-dimensioned by about 0.3-0.5% of GDP, part of this additional need being able to be covered by allocations from the reserve fund.

- *Interest expenses*: +1.72 billion lei. The explanations for this increase in the substantiation note accompanying the second revision relate to the increase in financing requirements, borrowing costs and the depreciation of the national currency. The increase is a relevant one and amplifies the GCB imbalance under the current conditions and is edifying for the negative consequences on the maneuvering space of the fiscal-budgetary policy in the context of deepening budgetary imbalances.

- *Subsidies*: +0.7 billion lei.

- *Other transfers*: +1.02 billion lei, out of which +0.5 billion lei to supplement Romania's contribution to the EU budget, an expense that is normally included in the draft budget.

- *Other expenses*: -0.9 billion lei. According to the clarifications received from the MPF, the decrease is localized at the level of allowances granted to parents for the supervision of children during the period of temporary closure of schools (Law no. 19/2020).

- *Social assistance*: - 1.06 billion lei. The main sources of the review are:

    - -6.8 billion lei to the social security budget, representing the negative difference between the 40% pension point increase starting September 1, included in the initial budget, and the 14% recently decided.

- +3 billion lei to the unemployment budget, representing measures granted to support employees and employers in the context of the epidemiological situation, of which the most important is the settlement of part of the salary, representing 41.5% of the corresponding gross base salary, but not more than 41.5% of the average gross earnings per economy, for employees who were technically unemployed and returned to work.
- +1.55 billion lei to the state budget for supplementing funds for the payment of social assistance rights (mainly the state allowance for children, which increased by 20% from August 1, with a budgetary impact of about 0.4 billion lei at the level of 2020, the monthly allowance for raising children, rights granted to persons with disabilities) and the implementation of approved measures to combat the COVID-19 pandemic.
- +0.3 billion lei additional amounts necessary for the payment of military pensions by the Ministry of Internal Affairs.
- +0.8 billion lei at the Single National Health Insurance Fund level for increasing the funds necessary for the payment of medical leave.

FC has no reservations about the proposed levels for the aggregate concerning social assistance expenditures.

- *Capital expenditures*: +3.34 billion lei, out of which the supplementation of the amounts related to the National Local Development Program (NLDP) represents 1.1 billion lei.

- *Projects financed from non-reimbursable external funds related to the financial framework 2014-2020*: +8.55 billion lei, out of which 7.06 billion lei for increasing the EU funds allocated for agriculture, as well as those transiting the GCB for pre-financing non-governmental sector projects in case of temporary unavailability of European funds - irrelevant elements in assessing the position of public finances *stricto sensu* - while projects from European funds to whom the final beneficiary is the state increase in planning by only 1.5 billion. lei.

Total public investment expenditures, from internal and external sources, increase in planning by 5.7 billion lei, having as sources the supplementation related to the above capital expenditures and those from European funds by 2.4 billion lei, leading to a projected growth rate in nominal terms of about 30%. <u>FC appreciates the Government's intention to increase investment expenditures, even under the conditions of significant deterioration of the resources mobilized to the general consolidated budget. The materialization of investment expenditures at the budgeted level can provide an impetus to economic activity during an extremely difficult period</u>. However, despite the increase in 7-months investment expenditures by about 29% compared to the corresponding period of the previous year, they are executed in proportion of only 35.6% of the annual program, which involves risks from the perspective of achieving the planned level, especially in terms of investments financed by European funds. In fact, the high volatility of the quarterly execution of investment expenditures, which were significantly higher in the last quarter, but also sizeable deviations in a negative sense from the target level were the usual situation in recent years.

FC advocates for the improvement of the budget programming process through a more balanced quarterly distribution of public investment expenditures, even if the precautionary principle could partially justify the postponement of expenditures until the budget revenue projection is characterized by a lower degree of uncertainty.

Summarizing, on the side of budget expenditures, from the perspective of the levels proposed in the second budget revision, FC has reservations only concerning the expenditures on goods and services, but the amounts from the reserve fund and a non-realization of investment expenditures compared to the ambitious levels proposed currently (undesirable) could be sources of compensation.

The FC notes an adequate budgeting of the programmed budget expenditures. On the other hand, their increase amplifies the budgetary imbalance over the one anticipated at the first budgetary revision. Thus, new increases in permanent expenditures (salaries, allowances), investment expenditures, the disclosure of additional weaknesses in the budget construction (additional allocations required for interest expenses, goods and services, for various social assistance rights), but also the implementation of new one-off measures to support economic agents affected by the pandemic has led to higher budget expenditures by about 0.9 pp of GDP[7]. Most of these allocations are structural, not attributable to one-off measures, and take place in the context of the revised increase in the pension point, starting September 1, from a 40% increase to a 14% increase.

Under these conditions, the level projected by the second revision for the budget deficit appears to be consistent with the materialization of the updated macroeconomic framework underlying the second budget revision - a decline in real GDP of 3.8% in 2020.

Following the analysis of the data related to the second budget revision, the FC notes a further deterioration of the public finance position of about 0.6-0.8 pp of GDP in 2020 compared to its estimates from the first revision (in this case 8%, accepting the new projection of real GDP of -3.8%), as a result of increases in expenditures.

However, the FC operates with a baseline scenario characterized by a decrease in real GDP between 4 and 6%, which corresponds to a projection of a budget deficit between 8.6-9.4% of GDP for 2020.

[7] The figures for the second budget revision are presented in the Annex.

Moreover, in this economic, health and electoral context, characterized by unusually large uncertainties, more unfavorable developments than those anticipated at this time cannot be ruled out.

It should also be noted the essential difference between recording budget deficits of 8-9% of GDP mainly due to structural elements, based on tax cuts and increased permanent spending in recent years, as in the case of Romania and to record deficits of the same order mainly as a result of the implementation of economic support programs to counter the economic and social effects of the COVID-19 pandemic, as is the case of many EU countries. Thus, the latter have had room for maneuver to stimulate the economy and, in addition, have the advantage that these measures are one-off and will therefore no longer affect budget implementation when the stimulus is withdrawn. In other words, no structural measures will be needed to return to a sustainable fiscal-budgetary policy trajectory at that time. Romania was hit by the health and economic crisis with the highest structural deficit in the EU, and the fiscal space it had to implement fiscal stimuli was extremely limited.

FC notes the adoption of new fiscal-budgetary measures that lead to the deterioration of the position of public finances, which complicates the inevitable budgetary consolidation process in the coming years. At the same time, FC notes the persistence of risks for a wider deterioration of the structural fiscal position on the side of permanent expenditures (personnel, social assistance), a possible materialization of such risks being likely to further complicate the public budget situation.

Illustrative for the considerations set out above are Romania's fiscal-budgetary prospects for 2021. **Even if the one-off measures implemented by Romania to support the economy (in the amount of about 1.5-2% of GDP, possibly higher) will expire and will no longer affect budget execution, the high level of the structural deficit and the measures already taken (i.e. the increase in pensions and child allowances in the recently decided amount) make the starting point of the budget deficit for next year at least 7.5% of GDP, even admitting the economic recovery forecast by NCSP - economic growth of 4.9% for 2021.**

These public budget perspectives call for increased caution in the adoption of any fiscal-budgetary policy measures and the early identification of a gradual and coherent budgetary consolidation strategy that minimizes the associated economic and social costs.

The problem of increasing permanent expenditures on social assistance

The FC has addressed several times in its previous opinions the issue of applying the new pension law from the perspective of its budgetary impact. In its version prior to the second revision, the law provided for a 40% increase in the pension point from September 1, 2020, which would have led to an increase in the share of GDP of the "social assistance" aggregate by more than 2 pp in 2021.

Although the pension increase is obviously a valid objective, the FC warned about the incompatibility of such an increase with the desire to ensure fiscal/budgetary discipline, respectively reducing the budget deficit below 3% of GDP and then to the level described by the long-term objective, the creation of macroeconomic premises for joining the euro area; the significant deterioration of the public finance position, especially in the medium term; the destabilizing effect on the domestic economy; etc. and considered it necessary to reconsider the timetable for the application of the new pension law.

The government decided on the occasion of the second budget revision a 14% increase of the pension point, which implies an important budgetary effort, of 3.6 billion lei in 2020 and 10.92 billion lei in 2021, respectively. This measure leads to maintaining the share of pension expenditures in GDP in 2021 at the level of the current year, admitting the NCSP forecast for the next year's economic growth and without any subsequent increases.

Compared to the previous version of the law, this decision implies lower budget expenditures by 6.8 billion lei in 2020 and 20.3 billion lei in 2021, which limits the sharp deterioration of the budget deficit. More specifically, if the pension point had been increased by 40%, pension expenditures as a share of GDP would have been higher by 0.6% of GDP in 2020 and by 1.8% of GDP in 2021. compared to the current situation described by a 14% increase in the pension point.

Although the reduction of pressures on the fiscal outlook is obscured in 2020 by the shorter implementation period, as well as by other adopted measures, the measure therefore contributes to the prospect of lower fiscal-budgetary imbalances in 2021 compared to the situation in which the 40% pension point increase would have been maintained.

In connection with the recent decision concerning the increase of the pension point, FC makes the following assessments:

- The reconsideration of the implementation schedule was necessary from the perspective of the sustainability of public finances and the reduction of pressures on the sovereign rating.
- **Normally, such a measure that has a significant impact on the budget construction for 2021 should be included in a medium-term budgetary fiscal framework**. Both the timing of this decision (two weeks before implementation) and the discretionary approach to the percentage increase highlight the ad-hoc nature of fiscal policy decisions and poor budget planning.
- **The FC considers that a rules-based approach to pension indexation (otherwise provided by law) would bring multiple benefits from the perspective of the stability of the pension**

system and anchoring participants' expectations, fiscal sustainability and budgetary programming.

- **The increase in budget expenditures on pensions cannot ignore the situation of the GCB, whose primary and structural deficit is currently at very high levels, which obviously requires the initiation of a correction process, the deviation from the 3% of GDP threshold of the excessive deficit procedure being significant. In such a context, the implementation of measures to increase permanent expenditures will subsequently involve the adoption of additional corrective measures of an equivalent size.**

Another discretionary measure affecting the "social assistance" aggregate adopted on the occasion of the second budget revision was the increase of child allowances by 20% from August 1, followed by successive increases until July 1, 2022, when they will double compared to 2019. This measure involves higher annual expenditures by about 7 billion lei starting July 1, 2022, the budgetary impact for 2020 being about 0.4 billion lei, and for 2021 of about 3 billion lei. The arguments put forward by the FC regarding the increase in permanent pension expenditures are also valid in this case.

In addition to the above, FC also notes the risks to the GCB's position arising from a possible change in the decision on the percentage increase in permanent expenses included in the "social assistance" aggregate analyzed above[8].

The FC reiterates the importance of taking into account the extremely complicated situation of the GCB, as well as the fact that any further increases in permanent expenditures will involve equivalent corrective measures during the fiscal consolidation period.

The problem of financing the budget deficit and refinancing public debt

On the occasion of its opinion on the first budgetary revision for 2020, FC noted the sharp increase in Romania's financing needs from about 8.6% of GDP in 2019 to levels between 11% and 14.3% amid the abrupt deepening of the budget deficit. The FC also pointed out the major challenges involved in identifying sources of funding in such an amount.

Under the new budgetary parameters, the size of Romania's public financing needs in 2020 is about 13% of GDP.

The FC appreciates the success in ensuring the large-scale financing of the budget deficit and the refinancing of public debt for 2020 in this extremely complicated context. The maintenance of the sovereign rating by the main rating agencies, the monetary policy measures of the NBR and of the most important central banks globally, as well as the actions taken by the European Commission, also contributed to this result. We can mention in this sense the SURE program through which Romania benefits from financing in the amount of 4 billion euros in advantageous

[8] For example, for doubling the allocations starting with January 2020, the budgetary impact would be about 6.5 billion lei.

conditions on account of the labor market support measures adopted by Romania after the outbreak of the COVID-19 pandemic.

Financing costs in national currency have returned to pre-pandemic levels, while the costs of recent issues in international markets have been rising compared to previous years, but within reasonable limits in absolute levels. **However, the costs are considerably higher than in other countries from the region (Czech Republic, Hungary, Poland) due to structural imbalances (see Figure 10 in the Annex).**

As a positive element we can appreciate the recent issues of government securities for the population, some of which were made through the stock exchange that proved to be a success. Although they still have a small share in total attracted amounts, regular issues and ease of access to government securities can lead to a more substantial contribution of the population to cover the need for funding.

Although the coverage of the financing needs for this year is largely ensured, it will be much more problematic to cover it in the medium term. It is hard to believe that financial markets will tolerate high levels of the budget deficit for a long time, even if fiscal rules in the EU will remain suspended in 2021. The ability to finance the budget deficit and refinance outstanding public debt is a very "tough" constraint on fiscal policy.

In this context, a correction leading in the medium term to much lower levels of the budget deficit and anchoring creditors' expectations towards a sustainable fiscal-budgetary policy trajectory is mandatory. The announcement of a credible multi-annual fiscal consolidation plan could provide the necessary respite for a gradual approach that would affect the economic recovery as little as possible.

5. Conclusions

- The most acute moment of the current crisis, determined by health restrictions (shutdown effect, partial closure of economies), seems to have passed, and the process of economic recovery has begun in most national economies, including Romania.

- There will be persistent effects of the crisis on the economic and social levels; the effects depend heavily on rebuilding production chains, trade, support from central banks and governments. There are changes in the inclination towards consumption and the one for (productive) investments, with an increased risk aversion amid great uncertainties and structural changes, the expansion of the use of new technologies, including artificial intelligence.

- The epidemic cycle conditions the speed of return, there may be local "closures".

- The war with COVID-19 is not over, it is one of attrition.

- There is a major trade-off between, on the one hand, the room for maneuver to deal with major crises, which requires one-off expenses and the structural deficit, on the other hand (Romania has the highest structural deficit in the EU). This explains the great audacity of other countries to go with deficits to and above 10% without worrying about inevitable macro corrections in the coming years.

- Romania's budgetary situation was and continues to be very tense, a fact reflected by Romania's unique placement in the European Commission's excessive deficit procedure earlier this year. Macroeconomic imbalances - the current account deficit (4.6% of GDP in 2019) and relatively large structural budget deficit (over 4% of GDP) - and the persistence of high budgetary pressures to increase permanent spending, call for a macroeconomic correction in the near future to maintain access to financial markets and the country rating.

- This situation is also reflected in Romania's considerably higher financing costs on the financial markets, compared to those of other countries in the region - the Czech Republic, Hungary, Poland.

- A massive absorption of European resources from the Multiannual Financial Framework and the European Recovery Plan will reduce the need for financing in the financial markets and support domestic aggregate demand and supply, thus allowing a smoother macroeconomic correction path. The absorption of European funds is a "battle for heavy water" in the years to come.

- The contraction of GDP, which is revised by NCSP, for 2020, at 3.8%, is in the immediate vicinity of the lower threshold of the FC baseline scenario.

- FC estimates that the range of 4-6% for this year's GDP contraction remains valid.

- The essence of the second budget revision on the revenue side is a strong downward adjustment, in line with the deterioration of the macroeconomic framework taken into account when substantiating the budget construction.

- FC appreciates the prudent nature of the projection of fiscal revenues and social security contributions which has the potential to accommodate possible developments slightly below expectations of the macroeconomic framework or of the non-tax revenues compared to those envisaged in the preparation of the initial budget for 2020.

- The essence of the second budget rectification on the expenditure side is, in the FC's view, an additional deterioration in 2020, mainly the discretionary increase of permanent expenditures and additional weaknesses in the budget construction, to which is added an increase of one-off elements.

- Following the analysis of the data related to the second budget revision, FC notes a further deterioration of the public finance position of 0.6-0.8 pp of GDP in 2020 compared to its estimates from the first revision, as a result of increasing expenditures.

- Given the baseline scenario of FC, characterized by a decrease in real GDP between 4 and 6%, the budget deficit estimate for 2020 is between 8.6-9.4% of GDP. In this economic, health and electoral context, characterized by unusually large uncertainties, more unfavorable developments than those anticipated at this time cannot be ruled out.

- The starting point of the budget deficit for 2021 would be at least 7.5% of GDP, even admitting the economic recovery forecasted by NCSP - economic growth of 4.9% for 2021. These perspectives of the public budget call for increased caution in the adoption of any fiscal-budgetary policy measures and the early identification of a gradual and coherent budgetary consolidation strategy that minimizes the associated economic and social costs.

- The 14% increase of the pension point implies a budget effort of 3.6 billion lei in 2020 and, respectively, 10.92 billion lei in 2021. Such a measure, with an important impact on the budget construction for 2021, should be included in a medium-term fiscal-budgetary framework.

- FC considers that a rules-based approach to pension indexation (otherwise provided by law) would bring multiple benefits from the perspective of the stability of the pension system and anchoring participants' expectations, fiscal sustainability and budgetary programming.

- The increase in budget expenditures on pensions cannot ignore the situation of the GCB, whose primary and structural deficit is currently at very high levels, which calls for the initiation of a correction process, the deviation from the 3% of GDP threshold set by the procedure of excessive deficit being significant.

- Under the conditions of the new budgetary parameters, the size of Romania's public financing need for 2020 is about 13% of GDP.

- FC appreciates the success in largely ensuring the financing of the budget deficit and the refinancing of the public debt for 2020.

- Although the coverage of the financing needs for this year is largely ensured, its coverage in the medium term could be much more problematic. It is hard to believe that financial markets will tolerate high levels of the budget deficit for a long time, even if fiscal rules in the EU remain suspended in 2021. The ability to finance the budget deficit and refinance outstanding public debt is a very "tough" constraint on fiscal policy.

- In this context, a correction leading in the medium term to much lower levels of the budget deficit and anchoring creditors' expectations towards a sustainable fiscal-budgetary policy trajectory is mandatory. The announcement of a credible multi-annual fiscal consolidation plan could provide the necessary respite for a gradual approach that would affect the economic recovery as little as possible.

- The ambitious target of joining the euro area (and, previously, of entering the Exchange Rate Mechanism - ERM2) is not compatible with structural budget deficits of more than 1% of GDP, not to mention more than 4% of GDP, with considerable external deficits, as was the situation in Romania at the beginning of 2020.

- FC reiterates that it is absolutely necessary to increase fiscal (budgetary) revenues in order to face future crises, in order to have a more robust public budget. It is false that these revenues cannot be increased given the experience of other states with similar economic and institutional structures in the EU. But it takes political will and overcoming resistance networks within the society.

The opinions and recommendations formulated above by the Fiscal Council were approved by the Chairman of the Fiscal Council, according to the provisions of art. 56, para (2), letter d) of Law no. 69/2010 republished, following their approval by the Council members, through vote, in the meeting of August 31, 2020.

31st August 2020 — Chairman of the Fiscal Council

Professor Daniel Dăianu

Annex I - Budgetary revision vs. initial budget

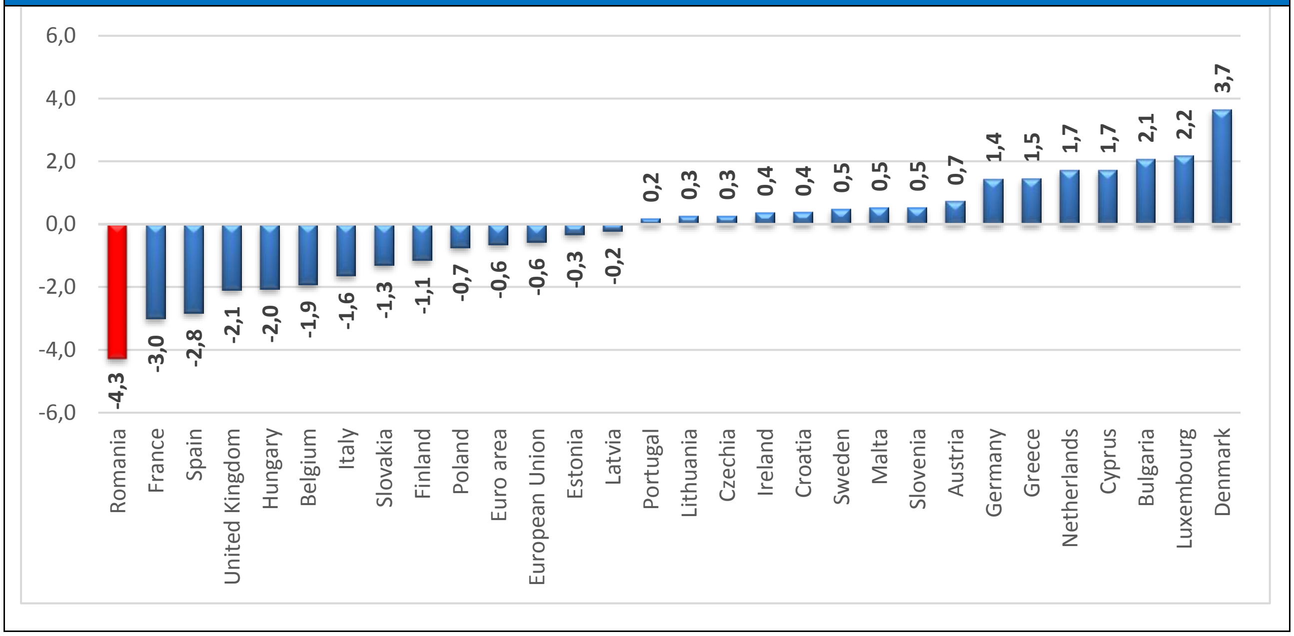
ANNEX I	Initial budget 2020	Swap program 2020	Initial budget 2020 without swap	First budget revision (R1) 2020	Swap R1	R1 without swap	Second budget revision (R2)	Swap R2	R2 without swap	R1 - initial budget (Without swap)	R2 - initial budget (Without swap)	R2 - R1 (Without swap)
	1	2	3=1-2	4	5	6=4-5	7	8	9=7-8	10=6-3	11=9-3	12=9-6
Total revenue	**360,148.5**	**850.0**	**359,298.5**	**341,096.0**	**850.0**	**340,246.0**	**342,016.1**	**1,951.4**	**340,064.7**	**-19,052.5**	**-19,233.8**	**-181.3**
Current revenue	329,820.7	850.0	328,970.7	306,899.5	850.0	306,049.5	299,395.6	1,951.4	297,444.2	-22,921.2	-31,526.4	-8,605.3
Tax revenue	177,017.6	850.0	176,167.6	163,906.3	850.0	163,056.3	158,203.1	1,951.4	156,251.7	-13,111.3	-19,915.9	-6,804.6
Taxes on profit, wages, income and capital gains	49,883.7	0.0	49,883.7	45,784.1	0.0	45,784.1	44,431.2	0.0	44,431.2	-4,099.6	-5,452.4	-1,352.8
Corporate income tax	19,471.8	0.0	19,471.8	17,191.9	0.0	17,191.9	16,656.3	0.0	16,656.3	-2,279.9	-2,815.5	-535.7
Personal income tax	26,315.2	0.0	26,315.2	24,765.4	0.0	24,765.4	24,463.4	0.0	24,463.4	-1,549.8	-1,851.8	-302.0
Other taxes on income, profit and capital gains	4,096.7	0.0	4,096.7	3,826.7	0.0	3,826.7	3,311.6	0.0	3,311.6	-269.9	-785.1	-515.2
Property tax	7,105.7	0.0	7,105.7	6,512.9	0.0	6,512.9	6,267.1	0.0	6,267.1	-592.8	-838.6	-245.7
Taxes on goods and services	117,974.8	850.0	117,124.8	109,693.5	850.0	108,843.5	105,504.1	1,951.4	103,552.7	-8,281.3	-13,572.0	-5,290.8
VAT	72,720.5	850.0	71,870.5	67,122.4	850.0	66,272.4	62,868.0	1,951.4	60,916.6	-5,598.1	-10,953.9	-5,355.8
Excise duties	33,658.1	0.0	33,658.1	30,969.2	0.0	30,969.2	31,129.2	0.0	31,129.2	-2,688.9	-2,528.9	160.0
Other taxes on goods and services	4,903.1	0.0	4,903.1	4,714.2	0.0	4,714.2	4,865.4	0.0	4,865.4	-188.9	-37.7	151.2
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	6,693.1	0.0	6,693.1	6,887.7	0.0	6,887.7	6,641.6	0.0	6,641.6	194.6	-51.5	-246.2
Taxes on foreign trade and international transactions (custom duty)	1,253.9	0.0	1,253.9	1,125.9	0.0	1,125.9	1,125.9	0.0	1,125.9	-128.1	-128.1	0.0
Other tax revenue	799.5	0.0	799.5	790.0	0.0	790.0	874.7	0.0	874.7	-9.5	75.2	84.7
Social security contributions	124,026.8	0.0	124,026.8	115,664.5	0.0	115,664.5	114,389.1	0.0	114,389.1	-8,362.3	-9,637.7	-1,275.5
Non-tax revenue	28,776.3	0.0	28,776.3	27,328.7	0.0	27,328.7	26,803.5	0.0	26,803.5	-1,447.6	-1,972.8	-525.2
Capital revenue	1,000.8	0.0	1,000.8	995.6	0.0	995.6	951.9	0.0	951.9	-5.1	-48.8	-43.7
Grants	8.5	0.0	8.5	8.5	0.0	8.5	8.7	0.0	8.7	0.0	0.2	0.2
Amounts received from the EU in the account of payments made and prefinancing	7.7	0.0	7.7	7.7	0.0	7.7	7.7	0.0	7.7	0.0	0.0	0.0
Financial operations	0.0	0.0	0.0	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	0.0	0.0	0.0	0.0
Other amounts received from the EU	0.0	0.0	0.0	3,920.4	0.0	3,920.4	3,920.4	0.0	3,920.4	3,920.4	3,920.4	0.0

Amounts received from the EU/other donors in the account of payments made and prefinancing for the 2014-2020 financial framework	29,310.9	0.0	29,310.9	29,264.2	0.0	29,264.2	37,731.6	0.0	37,731.6	-46.7	8,420.8	8,467.5
Total expenditure	**400,694.5**	**850.0**	**399,844.5**	**413,596.7**	**850.0**	**412,746.7**	**433,012.8**	**1,951.4**	**431,061.4**	**12,902.2**	**31,216.9**	**18,314.7**
Current expenditure	373,441.7	850.0	372,591.7	385,346.9	850.0	384,496.9	401,424.8	1,350.0	400,074.8	11,905.2	27,483.1	15,578.0
Personnel	109,160.4	0.0	109,160.4	109,736.9	0.0	109,736.9	110,911.6	0.0	110,911.6	576.5	1,751.2	1,174.7
Goods and services	51,046.4	0.0	51,046.4	51,516.6	0.0	51,516.6	55,093.8	500.0	54,593.8	470.2	3,547.4	3,077.2
Interest	13,950.6	0.0	13,950.6	13,998.8	0.0	13,998.8	15,716.9	0.0	15,716.9	48.2	1,766.3	1,718.1
Subsidies	7,398.8	0.0	7,398.8	7,431.2	0.0	7,431.2	8,125.2	0.0	8,125.2	32.4	726.4	694.0
Total transfers	190,364.5	850.0	189,514.5	198,703.5	850.0	197,853.5	208,135.8	850.0	207,285.8	8,339.1	17,771.3	9,432.3
Transfers between public administration entities	2,169.7	850.0	1,319.7	2,100.8	850.0	1,250.8	2,702.7	850.0	1,852.7	-68.8	533.0	601.8
Other transfers	17,090.5	0.0	17,090.5	17,417.3	0.0	17,417.3	18,437.9	0.0	18,437.9	326.8	1,347.4	1,020.6
Projects funded by external post-accession grants	199.3	0.0	199.3	341.0	0.0	341.0	391.3	0.0	391.3	141.7	192.0	50.3
Social assistance	131,220.5	0.0	131,220.5	138,005.8	0.0	138,005.8	136,944.9	0.0	136,944.9	6,785.3	5,724.4	-1,060.9
Projects funded by external post-accession grants 2014-2020	32,958.6	0.0	32,958.6	32,735.7	0.0	32,735.7	41,280.5	0.0	41,280.5	-222.8	8,321.9	8,544.8
Other expenditure	6,725.9	0.0	6,725.9	8,102.8	0.0	8,102.8	8,378.5	0.0	8,378.5	1,376.9	1,652.6	275.7
Reserve funds	951.2	0.0	951.2	3,153.1	0.0	3,153.1	2,288.7	0.0	2,288.7	2,201.9	1,337.5	-864.4
Expenditure funded from reimbursable funds	569.8	0.0	569.8	806.8	0.0	806.8	1,152.8	0.0	1,152.8	237.0	583.0	346.0
Capital expenditure	27,252.8	0.0	27,252.8	28,249.8	0.0	28,249.8	31,588.0	0.0	31,588.0	997.0	4,335.2	3,338.2
Financial operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	601.4	-601.4	0.0	-601.4	-601.4
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	0.0	0.0	0.0
EXCEDENT(+) /DEFICIT(-)	**-40,546.0**	**0.0**	**-40,546.0**	**-72,500.7**	**0.0**	**-72,500.7**	**-90,996.8**	**0.0**	**-90,996.8**	**-31,954.7**	**-50,450.7**	**-18,496.0**

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

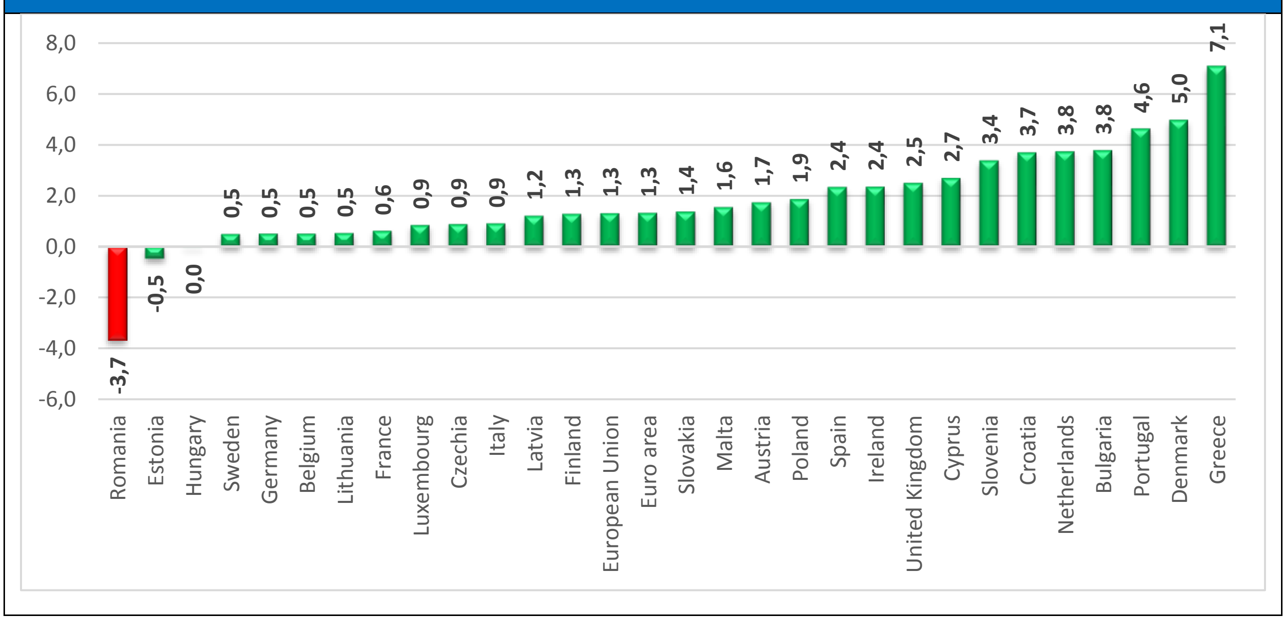
Annex II

Figure 1: Budget Balance in EU countries in 2019 (% of GDP, ESA 2010)



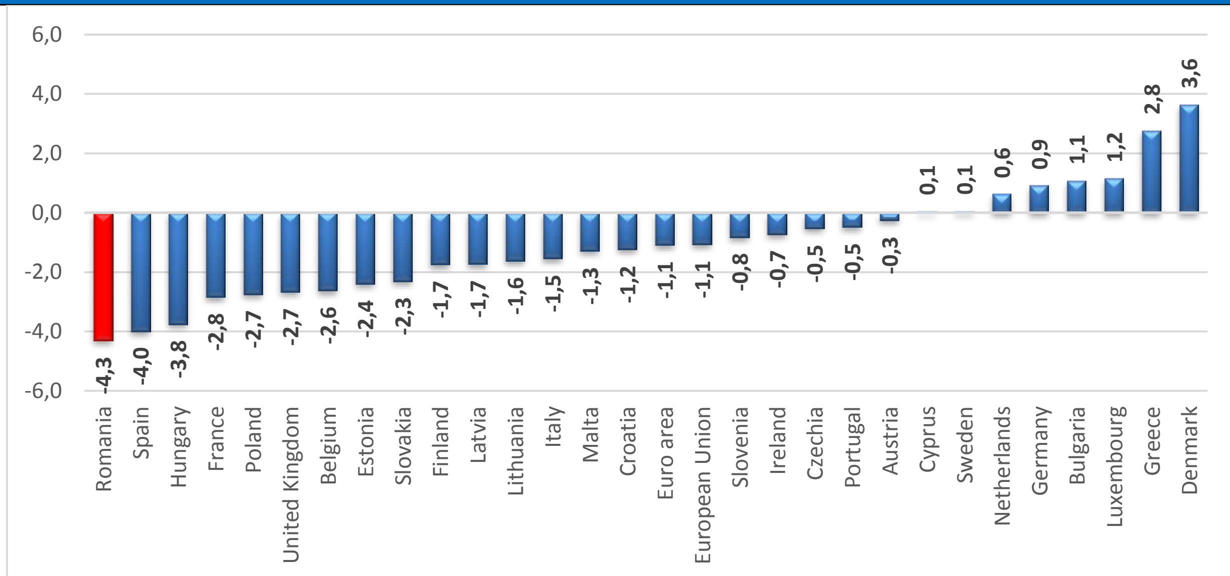
Source: AMECO, Ministry of Public Finance

Figure 2: Budget Balance difference 2019-2015 in EU countries (pp of GDP, ESA 2010)



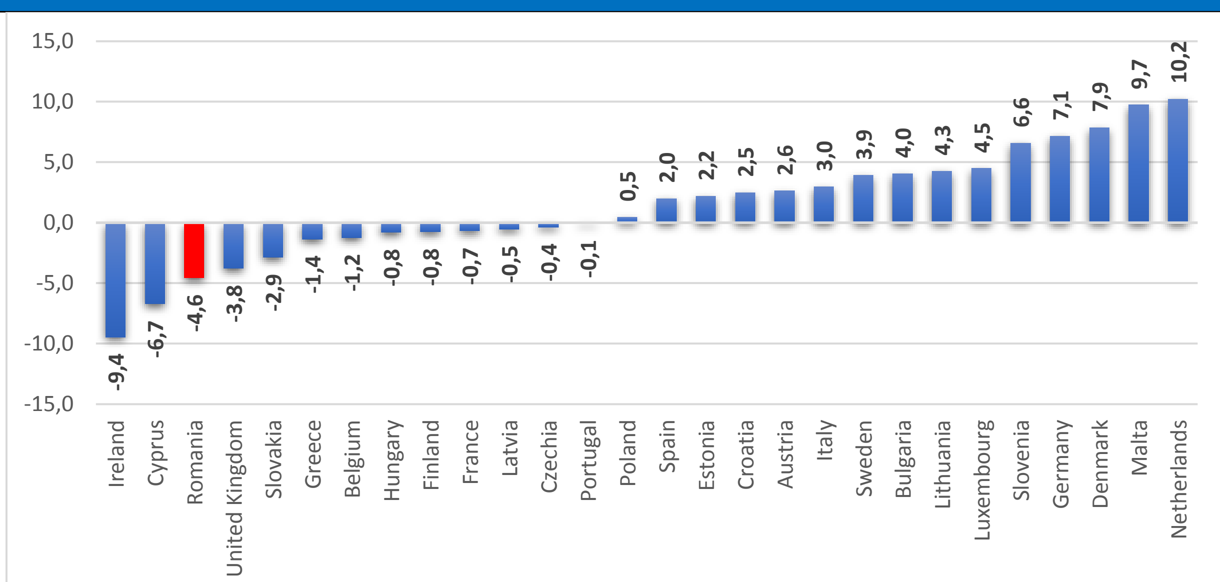
Source: Ameco, Ministry of Public Finance, Fiscal Council's calculations

Figure 3: Structural Budget Balance in EU countries in 2019 (% of potential GDP)



Source: AMECO, Ministry of Public Finance

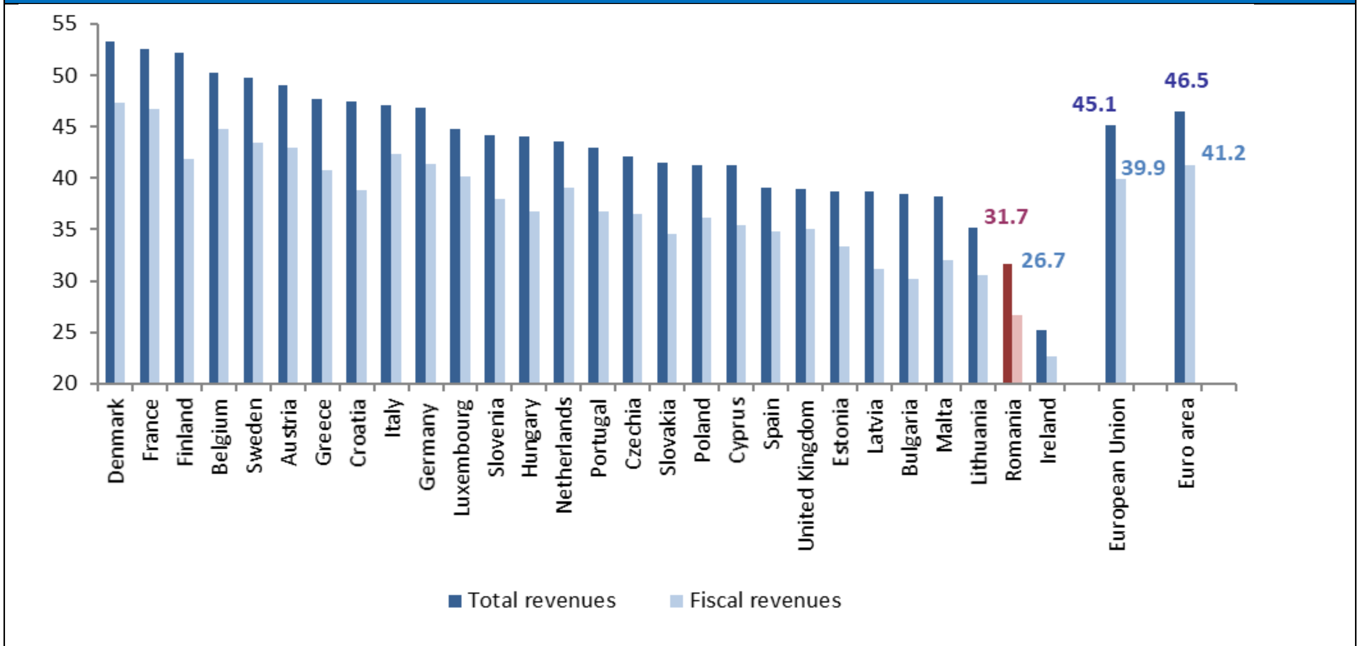
Figure 4: Current Account Balance in EU countries in 2019 (% of GDP)



Source: Eurostat

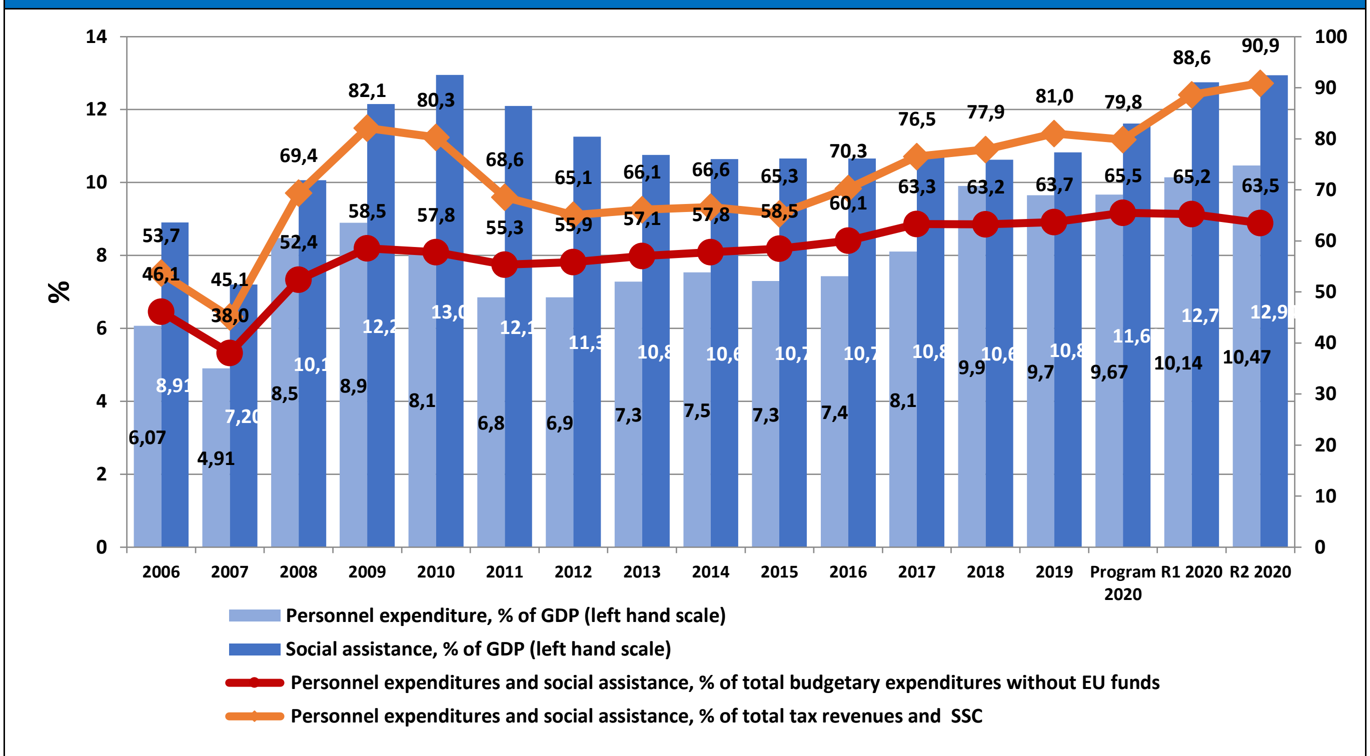
Annex III

Figure 5: Total revenues and fiscal revenues in 2019 (% of GDP, ESA 2010)



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

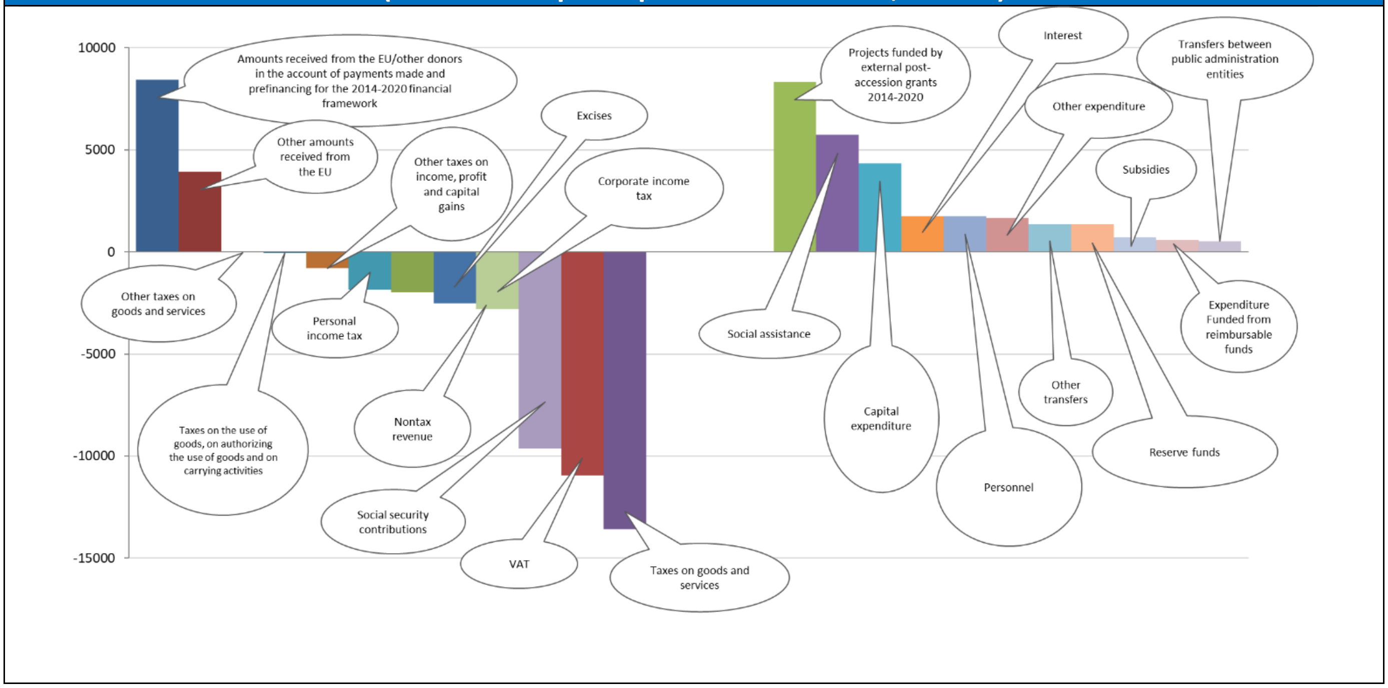
Figure 6: Personnel and Social Assistance expenditure evolution between 2006-2020



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

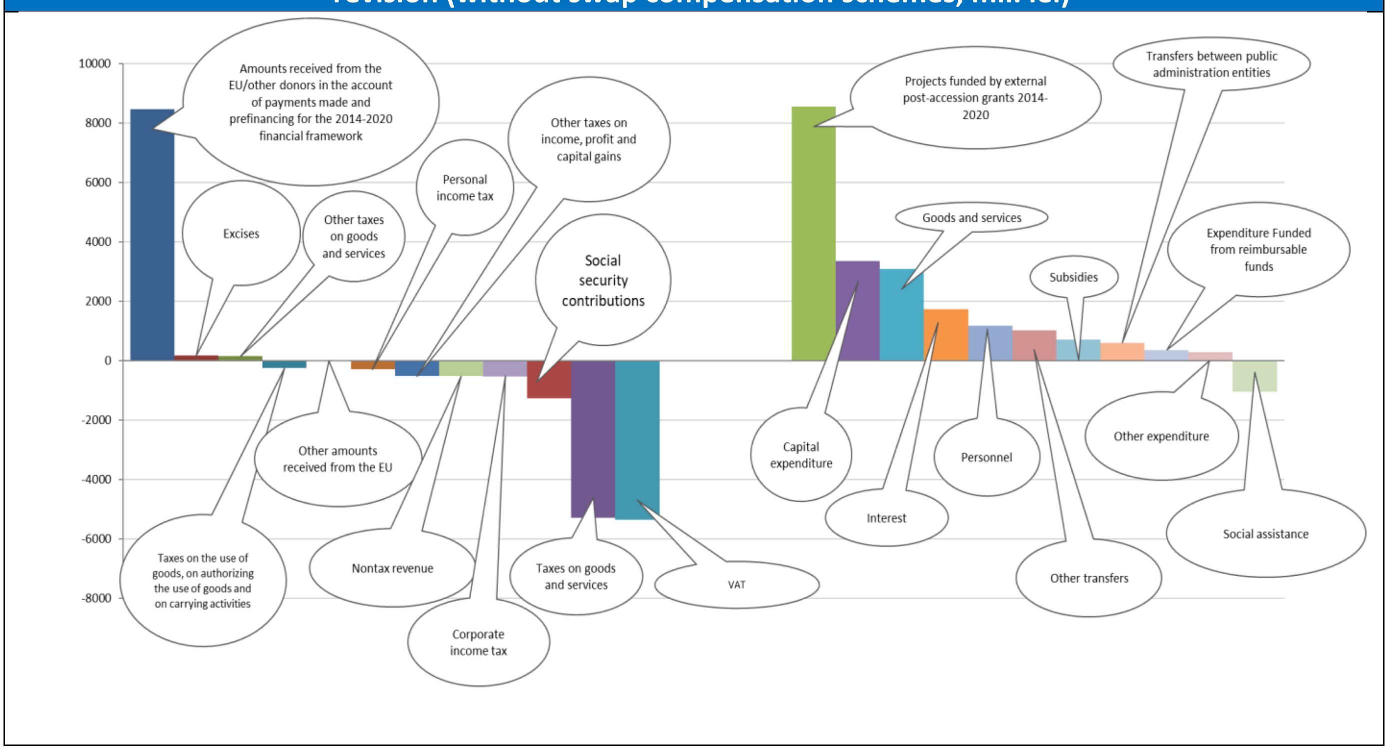
Annex IV

Figure 7: Main changes in budgetary expenditures and revenues compared to the initial 2020 budget (without swap compensation schemes, mil. lei)



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

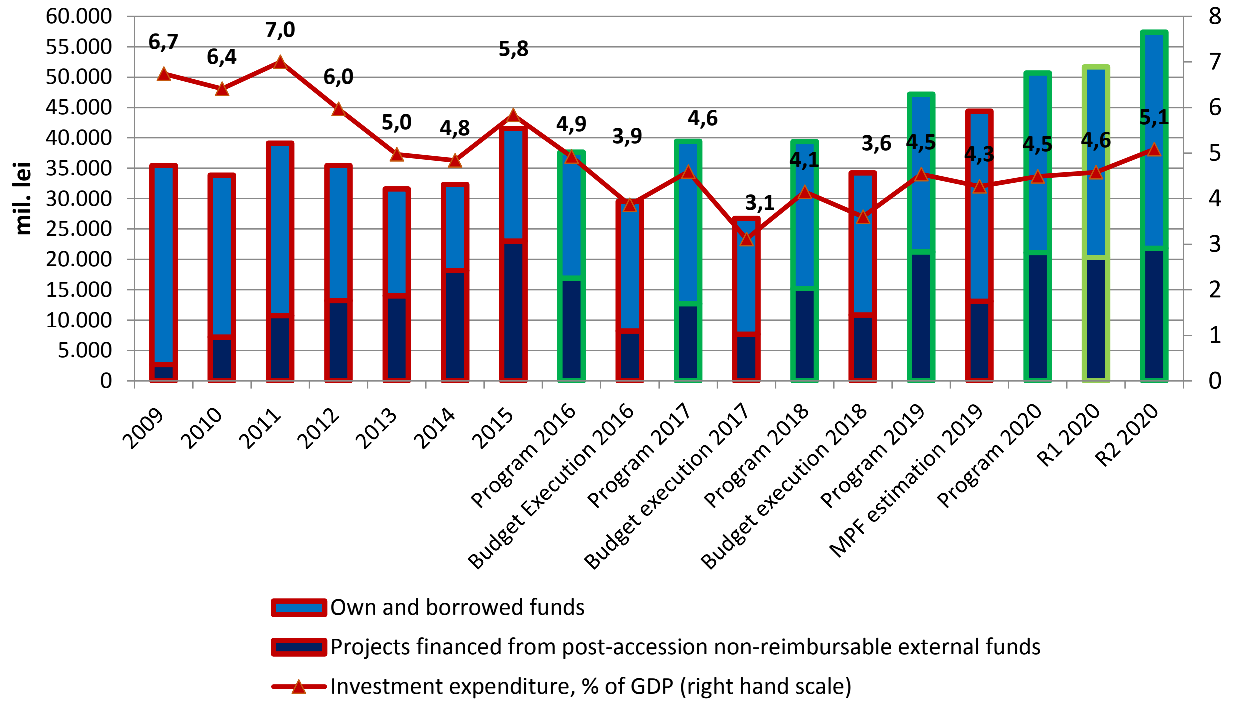
Figure 8: Main changes in budgetary expenditures and revenues compared to the first 2020 budget revision (without swap compensation schemes, mil. lei)



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

Annex V

Figure 9: The evolution of public investment expenditures between 2009-2020 – planned level vs. realized (mil. lei)



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

ANNEX V - EU Funds	Initial budget 2020 (mil. lei)			First budget revision 2020 (mil. lei)			Second budget revision 2020 (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	16,557.0	12,753.9	72.4	16,552.4	12,761.8	167.5	17,904.9	19,826.8	5,228.5
Eu funds expenditure	25,893.3	12,753.9	72.4	24,674.6	12,761.8	167.5	26,511.0	19,826.8	5,228.5
National cofinancing and ineligible expenses	9,336.3	0.0	0.0	8,122.2	0.0	0.0	8,606.1	0.0	0.0

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

Annex VI

Figure 10: Average yields for 5-year bonds issued in local currency