Romania

Fiscal Council

Fiscal Council's Opinions

2018

Fiscal Council
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I. Fiscal Council's Opinion on the Draft Budget Revision for 2018 and the Half-Year Report Regarding the Economic and Budgetary Situation

On August 6th 2018, the Fiscal Council received from the Ministry of Public Finance (MPF) by letter no. 465050/6.08.2018, the draft of the budget revision for 2018, the explanatory note and the draft Government Ordinance regarding the draft of the budget revision for 2018, the explanatory note and the Government Ordinance regarding the draft of the revised social security budget for 2018, as well as the half-year report regarding the economic and budgetary situation requesting, under article 53 paragraph (2) of the Fiscal Responsibility Law (no. 69/2010 republished, hereafter referred to as FRL) the Fiscal Council's opinion.

Compliance with the fiscal rules

None of the fiscal rules established by the FRL, except that for the deficit level expressed as percentage of GDP (even this is problematic, as will we detail below) is respected by the draft budget revision.

Compared to the initial budget, the draft budget revision increases both the total revenues and expenditures of the general consolidated budget (GCB) by 6.4 and 7.5 billion lei respectively, leading to a GCB deficit higher by 1.1 billion lei than the initial target.

The nominal increase of the budget deficit and the primary budget deficit implies non-compliance with the rule established by art 12 letter b) of the FRL which stipulates that *"the balance and the primary balance of the general consolidated budget, taking into account its components for the next budgetary year, shall not exceed the ceiling established by the fiscal framework of the Fiscal Strategy, approved by the Parliament",* the nominal ceilings related to the budget deficit and the primary budget deficit defined by the Law no. 269/2017 being *ex-ante* exceeded by 1.1 billion lei. Given the increase of 37.1 billion lei of nominal GDP projected for 2018, partly justified by the more favorable level of nominal GDP for the year 2017 compared to the one estimated at the time of the initial budgetary construction (higher by 16.2 billion lei), the level of the budgetary deficit expressed as a percentage of GDP, remains however at 2.97% of GDP, in line with the ceiling set for this parameter by Law no. 269/2017. Nevertheless, the Fiscal Council appreciate that the 5.5% real economic growth projection advanced by the National Commission for Prognosis and Strategies (NCPS) for 2018 is excessively optimistic given the annual growth of only 4% registered according to the preliminary data related to the first quarter of the current year and the dynamics recorded by the main economic indicators in the second quarter. Accepting the updated level of GDP deflator advanced by NCPS (4.3% compared to 2.1% in macroeconomic forecast which substantiate the initial budgetary construction), justified by the first quarter evolutions and observable trajectories of the consumer price index and the industrial production price index, the Fiscal Council estimates that is very probably that the real annual growth rate will be lower than the NCPS forecast by about 1.5-2 pp, which would imply a nominal GDP level of about 930 billion lei. The GDP position at such level would mean, *caeteris paribus,* a deficit level in GDP that would exceed (by about 0.05 pp) the ceiling of 2.97% of GDP for the budget deficit and would draw non-compliance also with the rule established by art. 12 letter a) of the FRL, according to which *"the balance of the general consolidated budget and the personnel expenditure of the general consolidated budget, expressed as a percentage of the gross domestic product, cannot exceed the annual ceilings set in the Fiscal Strategy's budgetary framework for the first 2 years covered by this"*.

Additional deviations from the rules established by the FRL occur due to revisions at the level of budget expenditure as follows:

- The programmed level in the budgetary revision of the personnel expenditures (86.2 billion lei, respectively 9.1% of GDP) exceeds the ceilings defined by the Law no. 269/2017 both in terms of nominal level (by 5.1 billion lei), as well as percentage of GDP (by 0.2 pp, despite the above-mentioned upward revision of the nominal GDP compared to the estimation used in the initial budgetary construction). The lack of compliance with the fiscal rules therefore occurs at the level of those established by Law no. 69/2010 by article 12 letter a) (for the level expressed as percentage of GDP) and letter c) (for the nominal level) and by article 17 paragraph 2, which prohibits increasing the personnel expenses during the budgetary revisions;

- The programmed level of the total GCB expenditures, excluding the financial assistance from the EU and other donors (293.3 billion lei), exceeds the corresponding ceiling defined by the Law no. 269/2017 by 7.3 billion lei. The lack of compliance with the fiscal rules occurs at the level of article 12 letter c) of the FRL and article 24, which prohibits the increase of the total GCB expenditures, net of financial assistance from the EU and other donors during the budgetary revisions, unless it is due to the supplementing of the interest expenses or those related to Romania's contribution to the EU budget. Given that the total expenditure increase is also due to the payment of Romania's contribution to EU budget (the "other transfers" component of the MPF budget is supplemented by about 765.5 million lei as a result of the revision of the amounts allocated to the payment of Romania's contribution to EU budget), the exceeding of the ceiling established by the Law no. 269/2017 appears as partially justified from the fiscal rules perspective (within the limit of that amount).

The draft Government Ordinance regarding the state budget revision for 2018 provides the corresponding derogations from the aforementioned fiscal rules and redefines the ceilings stipulated by the Law no. 269/2017 according to the levels proposed by the budget revision for the budgetary aggregates. The lack of coercion and the *de facto* inoperability of fiscal rules represent issues about which the Fiscal Council has repeatedly warned in recent years in the context of its opinions and reports. The Fiscal Council reports again the violation of the quasitotality of the fiscal rules, including the one regarding the nominal GCB deficit, except for the value expressed as percentage of GDP, which however occurs in the context of a most likely excessive upward revision of the nominal GDP estimated for the current year. The Fiscal Council once again notes the total lack of relevance of the “auxiliary” rules (regarding total expenditures and personnel expenditures), highlighted by the ease, frequency and dimensions of non-compliance with these, aspect which undermines the integrity and the coherence of the fiscal framework based on rules and prevents the achievement of at least two benefits envisaged by the legislator in the context of their statutes:

- if the “auxiliary” fiscal rules would have been fully operational, would have contributed to the coherence of the fiscal framework from the perspective of transparency and stability principles established by law, would have motivated the deciding authorities to fully include the relevant information in the initial budgetary construction (for example, the personnel expenses in the public sector should not be a “surprise” in the budget execution during the year, and should be relatively well determined since the beginning of the budgetary exercise) and would have led to an increased predictability of budgetary parameters, discouraging the adoption of *ad-hoc* measures.
- if the rule on the nominal ceiling of budgetary expenditures would have been operational, there would have existed a real-time mechanism to complying with structural balance benchmarks, to limiting deviations from them in the context of more favorable cyclical developments than anticipated, and finally, to more quickly eliminate the possible deviations from the budgetary balance in the event to obtained additional revenues having as a source, either improved payment compliance, either a more favorable evolution of the individual macroeconomics bases corresponding to the different types of budgetary revenues.

The updated coordinates of the budgetary revenues and expenditures

The budget revision draft supplements the estimated total revenues of GCB by 6.4 billion lei, the upward revision operated at the level of total revenues being determined by the massive increases of the estimated receipts from social security contributions and non-tax revenues which more offset the unfavorable developments at the level of fiscal and capital revenues.

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

- Tax revenues: -2.1 billion lei, out of which:
    - Personal income tax: +1.8 billion lei. The upward revision of the programmed level appears consistent with the 110.2% degree of achievement of the half-year program, given the better than expected development of the wage bill in the public and private sector.

- Other income taxes and capital gains: +0.5 billion lei. The upward revision of estimated revenues appears as the result of extrapolating the overperformance as compared to initial planning at the end of the first semester (119.9%, respectively + 0.22 billion lei).
- VAT: -2,1 billion lei. The downward revision appears to be insufficient in the context of registering a degree of achievement of only 92.6% for the first half-year program. This level of achievement already involves a deviation from the program whose nominal size is the same as the proposed level for revision for the whole year, which implies the assumption of a 100% achievement rate for the second half-year program. In its opinion on the 2018 budget, the Fiscal Council assessed as excessively optimistic the initial revenue program, anticipating lower revenues of at least 3 billion lei. Although the underperformance at the level of the first semester is to a certain extent the result of VAT reimbursements (in terms of VAT collected) above the historical average, the data on the day-to-day execution does not provide basis for changing the initial assessment if the level of VAT reimbursements related to the VAT collected would return in the second semester to the historical average. Therefore, the Fiscal Council express its reserves to the VAT revenue projection in the draft budget rectification and estimates that it is likely that it will register at the end of the year a lower level by about 1-1.5 billion lei compared to the updated MPF estimate.
- Excise tax: -0.9 billion lei. In this case, the downward revision of the estimates for the whole year appears to be of a small magnitude given that the achievement degree of the program at the end of the first semester (92.4%) already implies a deviation from the program of 1.1 billion lei. Given the day-to-day budget execution data, the Fiscal Council has reservations to the updated revenue forecast proposed by the MPF, considering a possible supplementary underachievement for the excise duties receipts of about 0.5 up to 1 billion lei for the whole year.
- Taxes on the use of the goods, the authorization of the use of the goods or the carrying out of activities: -1.1 billion lei. The downward revision is occasioned by the postponement of the auction for the rent of frequency bands for mobile operators.

- Social security contributions: +6.3 billion lei. Half-yearly execution indicates a 106.9% achievement degree compared to the planned outcome, respectively receipts higher by 3 billion lei, reflecting mostly a wage dynamic more alert than initial expectations in both the public and private sectors, but also higher incomes than anticipated from payments from legal entities for disabled people not included. The Fiscal Council appreciates the upward revision as justified given the day-to-day execution and the likely revenue trends in the second half of the year.

- Non-tax revenues: +2.9 billion lei. The first half-yearly execution reveals an achievement rate of 110.2% (over 1 billion lei). The extrapolation of performance at the end of the first semester and preliminary data for July (the month in which dividends are largely distributed by the state-owned companies) support the updated MPF estimate and consequently, the Fiscal Council considers the proposed updated level for this revenue aggregate to be feasible.

- Capital revenues: -0.96 billion lei. The downward adjustment reflects the failure to achieve the initial estimated revenues from the sale of heavy water - the estimation in the draft budget law for 2018 was already considered unrealistic by the Fiscal Council given the volume of world exports and Nuclearelectrica's S.A acquisitions.

Compared to initial execution, the draft revision maintains relatively unchanged the estimates of revenue from corporate income taxes and those relating to European fund inflows. The day-to-day budget execution does not give reason to question the feasibility of the annual estimate of income from corporate income tax. Not the same thing can be said regarding the amounts expected to be received from the EU: the half-yearly report on the execution of the budget reveals a program achievement of only 54.5% (-5.7 billion lei), the amounts attracted after the 6 months representing only 24.4% of the estimated annual total flows. The underperformance is still higher at the level of the structural and cohesion funds, where the half-yearly execution shows revenues of 1.5 billion lei, compared with the whole year estimate of 10.7 billion lei (actual entries representing 14% of the annual program). Although the possibility of achieving the planned annual level of structural and cohesion fund inputs cannot be excluded at this time, the Fiscal Council considers it unlikely to happen.

The budget expenditures are revised upward by 7.5 billion lei, the sources of this development are the following:

- Personnel expenses: +5.1 billion lei. The need for an upward revision appears to be necessary given the day-to-day budget execution, as since the first months of the year, the inadequacy of initial allocations was apparent. The size of the upward revision is due both to the initial sub-budgeting and to the impact of some wage increases decided upon after approval of the draft budget. In its opinion on the first budget revision of the 2017 consolidated general budget, which also agreed on a massive upward revision of this expenditure aggregate, the Fiscal Council drew attention to the apparent shortcomings of the budgetary planning process and the lack of constraint on fiscal rules, both likely to raise concerns about future pressures from this budget aggregate. Current developments just validate the concerns of the Fiscal Council;

- Goods and services: +0.9 billion lei. The revised level of the annual estimate for this category of expenditures reflects only slightly the surpass of the programmed level at the end of the first semester (spending exceeded the program by 10%) in the amount of 1.8 billion lei. The revised level of this expenditure category implies a nominal decrease of -0.4% compared to the year 2017. In the opinion of the Fiscal Council, the achievement of the programmed level will be difficult, as execution at the end of the first semester indicates an increase of 9.9% of this aggregate expenditure compared to the same period of the previous year;

- Social assistance: +1.8 billion lei. The upward revision operated validates the warning issued by the Fiscal Council in the context of approval of the annual budget law, when identifying a likely under-budgeting of this aggregate spending by about 1.5 billion lei. By extrapolating the day-to-day execution data (in this case, the social assistance expenses for July 2018, reflecting the increase in the pension point and of the social allowance for pensioners), the proposed revised annual allocation appears to be insufficient in relation to the expected annual expenditure, by about 1.3 billion lei. The amount proposed in the rectification proposal appears to be sufficient only to the extent that the recent decision to pay all the pension benefits before the 15th of each month (and which generated higher spending by 1.3 billion lei at the June level for supplementing the Romanian Post Office accounts in this respect) should be abandoned until the end of the year;

- Investment expenditures: -1.1 billion lei;

- Other transfers: +1 billion lei. The increase reflects mainly the need to increase the amounts for the payment of Romania's contribution to the EU budget by 765.5 million lei;

- Other expenses: +0.54 billion lei;
- Subsidies: -0.5 billion lei.

Conclusions

The budget revision draft records an upward revision of both total BGC revenues (+ 6.4 billion lei) and expenditures (+7.5 billion lei). The Fiscal Council has reservations regarding the proposed level of VAT and excise tax revenues, considering that the proposed downward revisions appear to be insufficient and considering the probability that the achieved revenues would be about 2 billion lei lower than the updated estimates. Regarding total expenditure, the Fiscal Council has reservations about the proposed levels for social assistance and goods and services spending. In the first case, maintaining the decision to pay pensions before the 15th of the month would require additional allocations of about 1.3 billion lei, while in the second case, the budget execution at the end of the first semester indicates additional expenditure of about 0.9 billion lei against the allocation – only a tight control of goods and services spending (unobservable so far) could still ensure framing in the proposed expenditure envelope. The above elements highlight significant risks of exceeding the deficit target and, implicitly, the 3% of GDP reference value for the budget deficit, in the absence of countervailing measures. These risks add to the extremely high probability that nominal GDP will register a significantly lower level than that advanced by NCPS, given the level of economic growth in the first quarter of the year and the recent dynamics of key macroeconomic indicators; the materialization of this eventuality would further contribute to registering a higher level of deficit, expressed as a percentage of GDP. In the opposite direction, a possible (but undesirable) non-realization of the planned absorption of the structural and cohesion funds would be made by reducing the co-financing costs that would be involved – a 75% achievement of the Structural and Cohesion Funds program, assuming constantly the ratio of the co-financing expenditures relative to the EU revenues would involve lower expenditures by 2 billion lei and would, ignoring the effects of the second round, lead to an equivalent decrease of the budget deficit.

The Fiscal Council therefore identifies significant short-term risks in avoiding to enter in the excessive deficit procedure, which is in addition to the already existing trend of weakening the public finances position under the conditions of a persistent and large deviation from the medium-term objective. An additional element undermining the resistance to adverse shocks of Romania's public finances is the tendency to modify the structure of general government expenditure in the favor of rigid expenditures (especially personnel and social assistance expenditure). Thus, the upward trend of the ratio: *rigid expenditure - total expenditure* (excluding EU fund inflows) and of the ratio: *rigid expenditure - tax revenue and social contributions* (see *Figure 3*) significantly complicates the adjustment in the event of adverse shocks (in this respect, the risk of tax increases in an adverse scenario is a major one), while being the reverse of capital expenditure reduction. It should be noted, in particular, that the share of public sector personnel expenditure in GDP and in total public spending (net of EU funds) is projected to reach maximum historical values in 2018, even surpassing the pre-crisis level, and highlights the already mentioned vulnerability of public finances in the event of an adverse macroeconomic shock. The massive reduction in investment spending in recent years to accommodate large-scale pressures at the level of rigid spending (such as wages and pensions) is not appropriate for an economy where infrastructure deficiency is systematically identified as a bottleneck to long-term economic growth.

The opinions and the recommendations above mentioned by the Fiscal Council 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 10th August 2018.

10th August 2018 Chairman of the Fiscal Council,

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ANNEX I - Budget execution semester I 2018 vs. the half-year program	The half-year program 2018 with swap (mil. lei)	Budget execution semester I 2018 with swap (mil. lei)	Program swap semester I 2018	The half year program 2018 without swap (mil. lei)	Budget execution semester I 2018 without swap (mil. lei)	Sem. I 2018/ Sem. I 2017 without swap (%)	Differences from the half-year program 2018 without swap (mil. lei)	The achievement degree of the half-year program without swap (%)	Differences from the half-year program 2018 with swap (mil. lei)	The achievement degree of the half-year program with swap (%)
	1	2	3	4=1-3	5	6	7=5-4	8=5/4	9=2-1	10=2/1
TOTAL REVENUE	**137,063.8**	**132,043.9**	**323.3**	**136,740.5**	**131,720.6**	**13.2%**	**-5,019.9**	**96.3%**	**-5,019.9**	**96.3%**
Current revenue	124,055.0	125,179.9	323.3	123,731.6	124,856.5	12.9%	1,124.9	100.9%	1,124.9	100.9%
Tax revenue	70,804.2	67,951.6	118.8	70,685.4	67,832.8	0.4%	-2,852.6	96.0%	-2,852.6	96.0%
Taxes on profit, wages, income and capital gains	19,050.0	20,321.5	49.0	19,001.0	20,272.5	-10.8%	1,271.5	106.7%	1,271.5	106.7%
Corporate income tax	7,340.7	7,305.9	4.0	7,336.8	7,301.9	2.2%	-34.8	99.5%	-34.8	99.5%
Personal income tax	10,586.4	11,669.3	45.0	10,541.4	11,624.2	-21.1%	1,082.9	110.3%	1,082.9	110.2%
Other taxes on income, profit and capital gains	1,122.9	1,346.3		1,122.9	1,346.3	61.4%	223.5	119.9%	223.5	119.9%
Property tax	3,895.2	3,791.4		3,895.2	3,791.4	5.9%	-103.8	97.3%	-103.8	97.3%
Taxes on goods and services	46,740.3	42,940.9	50.8	46,689.6	42,890.2	6.2%	-3,799.4	91.9%	-3,799.4	91.9%
VAT	28,898.9	26,774.7	50.8	28,848.2	26,724.0	6.5%	-2,124.2	92.6%	-2,124.2	92.6%
Excises	14,209.6	13,132.3		14,209.6	13,132.3	9.9%	-1,077.3	92.4%	-1,077.3	92.4%
Other taxes on goods and services	2,040.8	1,835.1		2,040.8	1,835.1	9.0%	-205.7	89.9%	-205.7	89.9%
Taxes on using goods, authorizing the use of goods or on carrying activities	1,591.0	1,198.8		1,591.0	1,198.8	-26.8%	-392.1	75.4%	-392.1	75.4%
Tax on foreign trade and international transactions	544.1	510.2		544.1	510.2	6.7%	-33.9	93.8%	-33.9	93.8%
Other tax revenue	574.5	387.5	19.0	555.5	368.5	-12.8%	-187.0	66.3%	-187.0	67.4%
Social security contributions	43,800.6	46,811.8	204.5	43,596.0	46,607.3	38.0%	3,011.3	106.9%	3,011.3	106.9%
Nontax revenue	9,450.2	10,416.4		9,450.2	10,416.4	13.0%	966.2	110.2%	966.2	110.2%
Capital revenues	406.5	358.2		406.5	358.2	-9.6%	-48.3	88.1%	-48.3	88.1%
Grants	7.3	2.7		7.3	2.7		-4.6	37.5%	-4.6	37.5%

Amounts received from the EU in the account of payments made and prefinancing	89.8	97.1		89.8	97.1	2.9%	7.3	108.2%	7.3	108.2%
Amounts collected in the single account		-412.7		0.0	-412.7	70.4%	-412.7	-	-412.7	-
Other amounts received from the EU for operational Programmes funded under the convergence objective	0.0	8.1		0.0	8.1	-105.5%	8.1	-	8.1	-
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	12,505.2	6,810.6		12,505.2	6,810.6	19.8%	-5,694.7	54.5%	-5,694.7	54.5%
TOTAL EXPENDITURE	**157,654.1**	**147,009.2**	**323.3**	**157,330.8**	**146,685.9**	**19.6%**	**-10,644.9**	**93.2%**	**-10,644.9**	**93.2%**
Current expenditure	149,196.6	140,521.0	323.3	148,873.2	140,197.7	17.6%	-8,675.5	94.2%	-8,675.5	94.2%
Personnel	40,628.9	41,342.9		40,628.9	41,342.9	24.4%	714.0	101.8%	714.0	101.8%
Goods and services	17,484.5	19,281.5		17,484.5	19,281.5	9.9%	1,796.9	110.3%	1,796.9	110.3%
Interest	8,135.1	7,364.0		8,135.1	7,364.0	21.7%	-771.1	90.5%	-771.1	90.5%
Subsidies	4,219.3	3,737.9		4,219.3	3,737.9	4.1%	-481.5	88.6%	-481.5	88.6%
Total Transfers	78,538.3	68,659.3	323.3	78,215.0	68,336.0	16.5%	-9,879.0	87.4%	-9,879.0	87.4%
Transfers for public entities	1,212.5	779.2	323.3	889.1	455.9	304.5%	-433.2	51.3%	-433.2	64.3%
Other transfers	9,221.4	6,734.2		9,221.4	6,734.2	19.6%	-2,487.2	73.0%	-2,487.2	73.0%
Projects funded by external post accession grants	201.2	296.0		201.2	296.0	-37.4%	94.8	147.1%	94.8	147.1%
Social assistance	50,447.5	50,227.3		50,447.5	50,227.3	13.9%	-220.2	99.6%	-220.2	99.6%
Projects funded by external post accession grants 2014-2020	14,191.6	7,356.2		14,191.6	7,356.2	20.1%	-6,835.4	51.8%	-6,835.4	51.8%
Other expenditure	3,264.1	3,266.3		3,264.1	3,266.3	47.4%	2.3	100.1%	2.3	100.1%
Reserve funds	13.0	0.0		13.0	0.0	-	-13.0	0.0%	-13.0	0.0%
Expenditure funded from reimbursable funds	177.5	135.5		177.5	135.5	5.8%	-41.9	76.4%	-41.9	76.4%
Capital expenditures	8,457.6	7,013.3		8,457.6	7,013.3	72.0%	-1,444.3	82.9%	-1,444.3	82.9%
Payments made in previous years and recovered in the current year	0.0	-525.1		0.0	-525.1	-18.8%	-525.1	-	-525.1	-
EXCEDENT(+) / DEFICIT(-)	**-20,590.3**	**-14,965.3**		**-20,590.3**	**-14,965.3**	**137.7%**	**5,625.0**	**72.7%**	**5,625.0**	**72.7%**

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

ANNEX II	Initial Budget 2018	Swap program 2018	Initial Budget 2018	First Budget Revision (R1) 2018	Swap program R1	First Budget Revision 2018	R1 - Initial Budget 2018	R1 - Initial Budget 2018	Budget Execution Semester I 2018/ Budget Execution Semester I 2017	R1 2018/ Budget Execution 2017
			Without Swap			Without Swap	With Swap	Without Swap	With Swap	With Swap
	1	2	3=1-2	4	5	6=4-5	7=4-1	8=6-3	9	10
TOTAL REVENUE	**287,527.5**	**1,020.0**	**286,507.5**	**293,924.4**	**1,020.0**	**292,904.4**	**6,396.9**	**6,396.9**	**12.64%**	**16.70%**
Current revenue	257,274.0	1,020.0	256,254.0	264,397.2	1,020.0	263,377.2	7,123.1	7,123.1	12.34%	13.08%
Tax revenue	145,135.9	521.6	144,614.3	143,053.1	521.6	142,531.5	-2,082.8	-2,082.8	-0.06%	2.00%
Taxes on profit, wages, income and capital gains	38,598.9	298.0	38,300.9	40,838.8	298.0	40,540.8	2,239.9	2,239.9	-11.31%	-12.92%
Corporate income tax	15,020.3	148.0	14,872.3	15,012.8	148.0	14,864.8	-7.5	-7.5	1.29%	1.91%
Personal income tax	20,803.4	150.0	20,653.4	22,575.8	150.0	22,425.8	1,772.5	1,772.5	-21.51%	-25.10%
Other taxes on income, profit and capital gains	2,775.2		2,775.2	3,250.1		3,250.1	474.9	474.9	61.39%	60.47%
Property tax	5,824.4		5,824.4	5,728.0		5,728.0	-96.4	-96.4	5.94%	6.83%
Taxes on goods and services	98,666.8	184.0	98,482.8	94,677.3	184.0	94,493.3	-3,989.5	-3,989.5	5.88%	9.85%
VAT	61,308.2	184.0	61,124.2	59,184.0	184.0	59,000.0	-2,124.2	-2,124.2	5.87%	10.53%
Excises	30,218.5		30,218.5	29,323.4		29,323.4	-895.1	-895.1	9.93%	10.22%
Other taxes on goods and services	3,814.8		3,814.8	3,896.2		3,896.2	81.4	81.4	8.96%	25.53%
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	3,325.3		3,325.3	2,273.8		2,273.8	-1,051.5	-1,051.5	-26.77%	-22.58%
Taxes on foreign trade and international transactions (customs duty)	1,042.0		1,042.0	995.9		995.9	-46.1	-46.1	6.71%	6.71%
Other tax revenue	1,003.8	39.6	964.2	813.1	39.6	773.5	-190.7	-190.7	-16.83%	-5.17%
Social security contributions	91,811.8	498.4	91,313.4	98,083.5	498.4	97,585.1	6,271.7	6,271.7	36.80%	36.79%

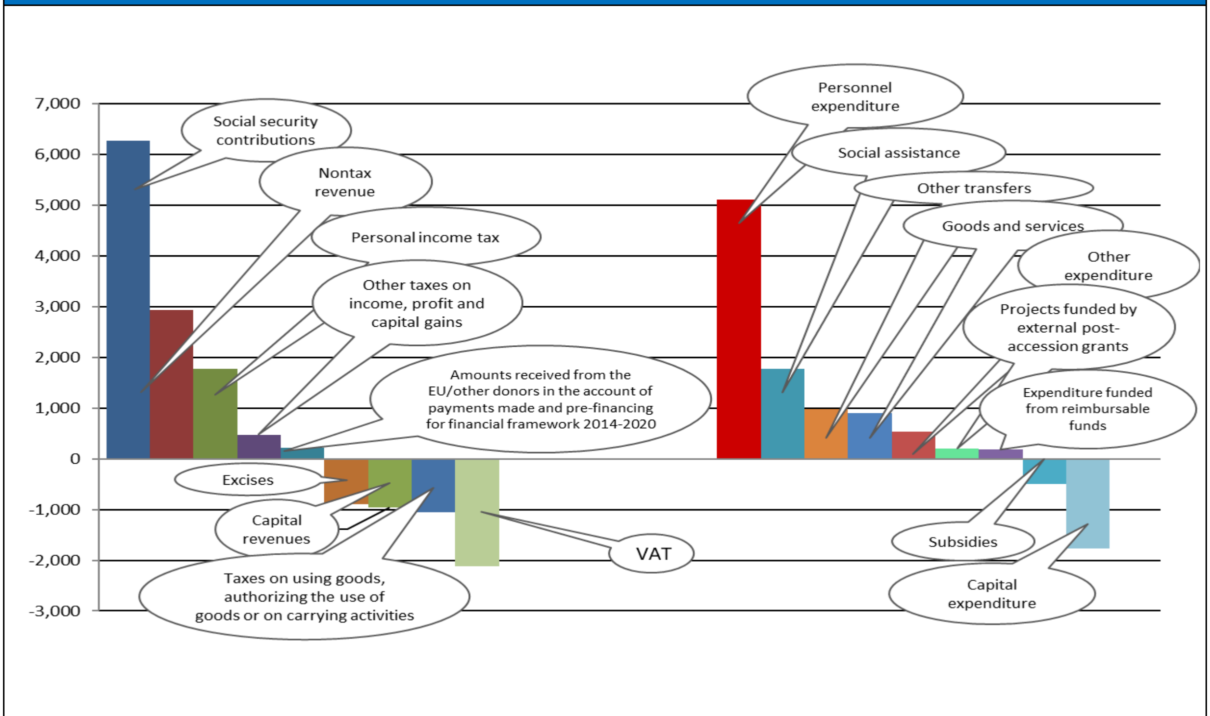
Nontax revenue	20,326.3		20,326.3	23,260.5		23,260.5	2,934.2	2,934.2	12.97%	6.34%
Capital revenue	1,843.6		1,843.6	885.2		885.2	-958.4	-958.4	-9.64%	6.60%
Grants	8.5		8.5	8.5		8.5	0.0	0.0	-	-4.43%
Amounts received from the EU for payments made and prefinancing	28,401.4		28,401.4	28,633.5		28,633.5	232.2	232.2	19.51%	65.38%
TOTAL EXPENDITURE	**314,487.1**	**1,020.0**	**313,467.1**	**321,990.9**	**1,020.0**	**320,970.9**	**7,503.8**	**7,503.8**	**19.01%**	**16.60%**
Current expenditure	293,509.0	850.0	292,659.0	302,775.1	850.0	301,925.1	9,266.2	9,266.2	17.01%	17.44%
Personnel	81,117.5		81,117.5	86,236.8		86,236.8	5,119.3	5,119.3	24.39%	23.88%
Goods and services	39,615.0		39,615.0	40,510.8		40,510.8	895.8	895.8	9.90%	-0.43%
Interest	12,096.8		12,096.8	12,094.2		12,094.2	-2.6	-2.6	21.72%	19.45%
Subsidies	7,210.3		7,210.3	6,719.0		6,719.0	-491.2	-491.2	4.14%	8.35%
Total transfers	152,868.5	850.0	152,018.5	156,412.4	850.0	155,562.4	3,543.8	3,543.8	15.31%	19.48%
Transfers between public administration entities	2,132.8	850.0	1,282.8	2,035.2	850.0	1,185.2	-97.6	-97.6	66.18%	52.62%
Other transfers	13,098.5		13,098.5	14,081.0		14,081.0	982.5	982.5	9.46%	15.90%
Projects funded by external post-accession grants	317.2		317.2	518.5		518.5	201.3	201.3	-37.42%	-40.32%
Social assistance	98,620.4		98,620.4	100,395.6		100,395.6	1,775.2	1,775.2	13.88%	8.45%
Projects funded by external post-accession grants 2014-2020	32,826.9		32,826.9	32,969.6		32,969.6	142.7	142.7	20.07%	75.74%
Other expenditure	5,872.6		5,872.6	6,412.4		6,412.4	539.8	539.8	47.42%	22.57%
Reserve funds	315.7		315.7	329.1		329.1	13.3	13.3	-	-
Expenditure funded from reimbursable funds	285.1		285.1	472.8		472.8	187.7	187.7	5.79%	70.45%
Capital expenditure	20,978.2	170.0	20,808.2	19,215.8	170.0	19,045.8	-1,762.4	-1,762.4	71.97%	-1.75%
EXCEDENT(+) / DEFICIT(-)	**-26,959.6**		**-26,959.6**	**-28,066.5**		**-28,066.5**	**-1,106.9**	**-1,106.9**	**137.73%**	**15.53%**

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

ANNEX III - EU FUNDS	Initial budget 2018 (million lei)		Budget execution semester I 2018 (million lei)		Influences (revision) (million lei)	First budget revision 2018 (million lei)	
	with agriculture and amounts according to art. 10 letter a) of GEO no.40/2015	without agriculture and amounts according to art. 10 letter a) of GEO no.40/2015	with agriculture and amounts according to art. 10 letter a) of GEO no.40/2015	without agriculture and amounts according to art. 10 letter a) of GEO no.40/2015		with agriculture and amounts according to art. 10 letter a) of GEO no.40/2015	without agriculture and amounts according to art. 10 letter a) of GEO no.40/2015
Revenue							
Post-accession funds	28,313.70	10,741.26	6,907.70	1,502.14	209.20	28,522.90	10,950.46
Expenditure							
EU expenditure + national co-financing + non-eligible expenditure	43,204.80	25,632.36	11,234.30	5,828.74	172.60	43,377.40	25,804.96

Source: Ministry of Public Finance

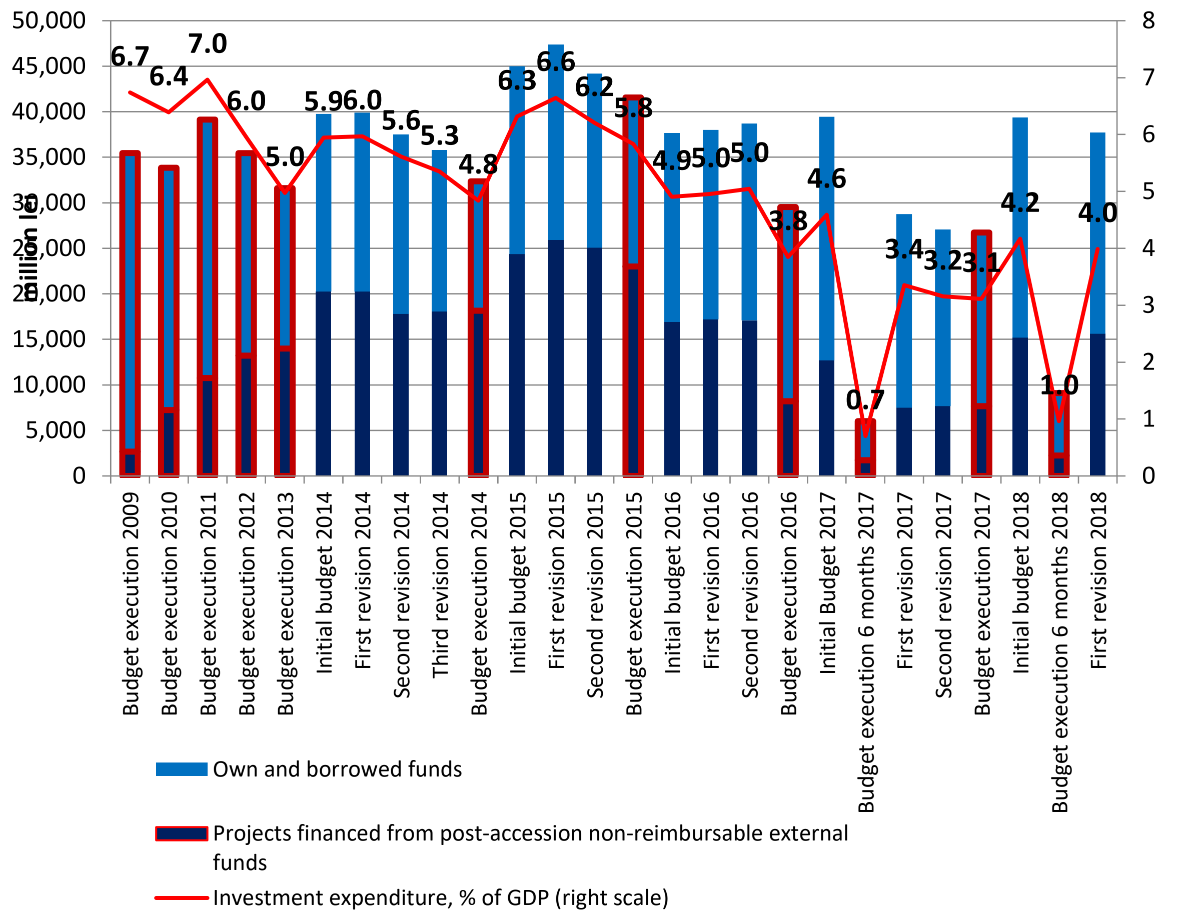
Figure 1: The main changes in expenditures and revenues after the budget revision (without the impact of swap schemes), million lei



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

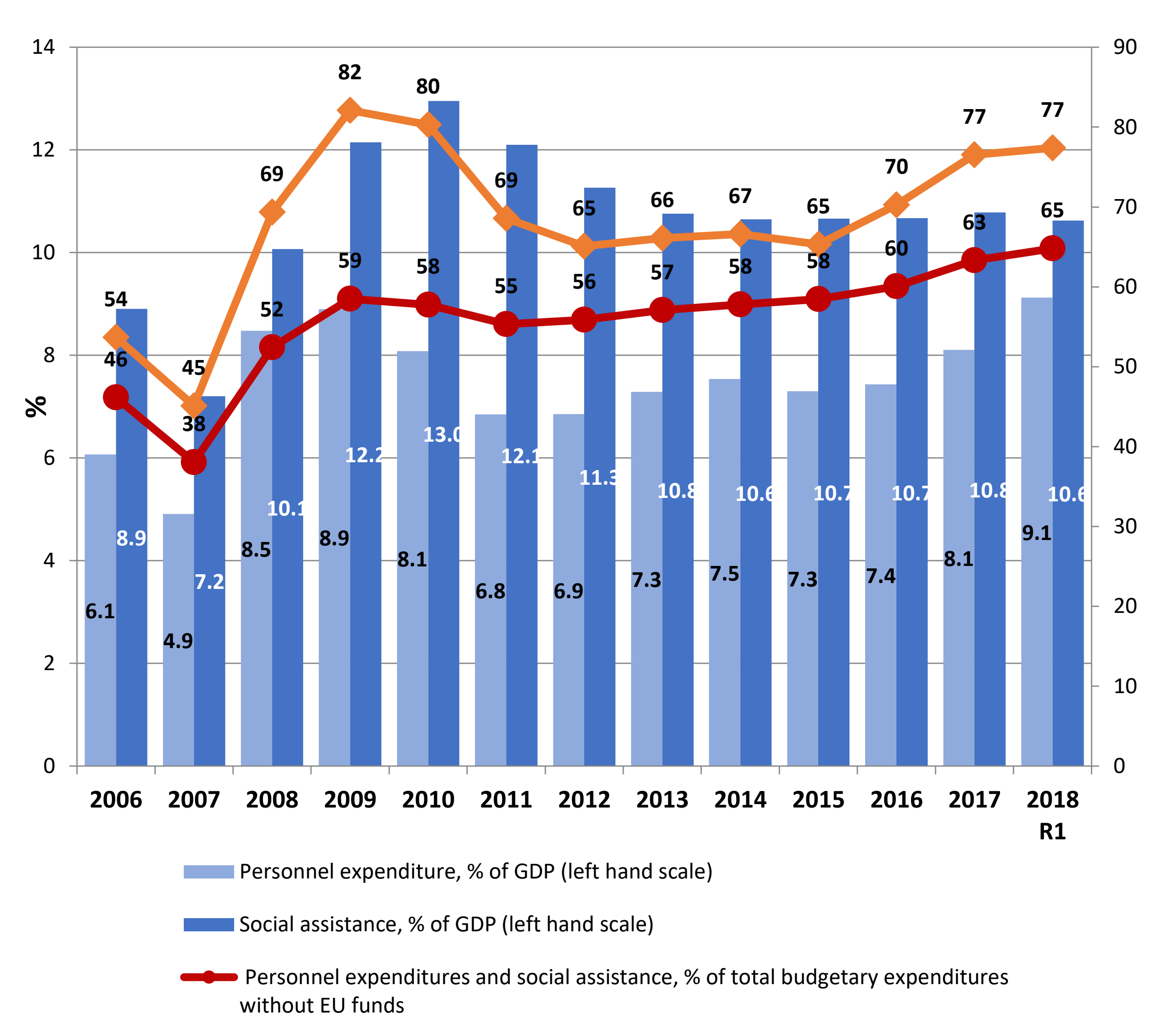
Figure 2: Evolution of the investment expenditure in the period 2009-2018

- planned vs. execution, million lei



Source: Ministry of Public Finance

Figure 3: Evolution of the personnel expenditure and social assistance in the period 2006-2018 (% of GDP, % of budgetary expenditure, % of budgetary revenue)



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

II. Fiscal Council's Opinion on the updated version of Draft Budget Revision for 2018

On September 3rd 2018, the Ministry of Public Finance (MPF) sent to the Fiscal Council, by letter no. 465366/3.09.2018, a new version of the draft general consolidated budget (GCB) revision for 2018, together with an updated version of the explanatory note and the draft Government Ordinance requesting, under article 53 paragraph (2) of the Fiscal Responsibility Law (no. 69/2010 republished, hereafter referred to as FRL) the Fiscal Council's opinion.

Proposed changes to GCB revenues and expenditures compared to the initial version of the Draft Budget Revision notified to the Fiscal Council (August 6th, 2018)

The updated version of the draft budget revision supplements the estimated total revenues of GCB by 2.8 billion lei, out of which 0.6 billion lei come from a new chain compensation scheme for clearing arrears with symmetric impact on revenues and expenditures (so called swaps). Considering revenue categories are increased the VAT revenue (by 2.1 billion lei, this amount fully including the impact of the above mentioned compensation scheme) and the excise duties revenue (by 0.9 billion lei). As a result of the operated changes, the above mentioned aggregates return exactly to the level from the approved initial budget, despite the lack of objectives elements justifying such an evolution. An increase of lesser magnitude is operated to the level of non-tax revenues (+0.26 billion lei). Finally, the revenues from the tax on the use of goods, the authorization of goods or on the carrying out of activities are decreased by 0.5 billion lei, in the context of the increase of the estimated auto-tax refunds (registered as negative revenues).

The total expenditures of GCB are supplemented by an equivalent amount (2.8 billion lei), the increases being located at the level of goods and services expenses (0.6 billion lei), other transfers (0.14 billion lei), Government's contingency reserve fund (1 billion lei) and capital expenditure (1.06 billion lei, including here the total symmetric impact on expenditures of the above mentioned swap compensation scheme).

The budget deficit remains unchanged compared to the initial version of draft budget revision. From the perspective of fiscal rules, the draft budget revision updated coordinates imply the increase of the overrun's size of the GCB total expenditure ceiling (excluding the financial assistance from the EU and other donors), defined by the Law no. 269/2017 by 2.8 billion lei, up to the level of 10.1 billion lei.

In its Opinion on the first version of the draft budget revision, considering the six months budget execution, the Fiscal Council noted that the downward revisions operated at that time at the level of VAT and excise duties revenues appeared to be undersized, with total revenues likely to be lower by about 2 billion lei than the draft revision estimates (in particular by 1-1.5

billion lei in the case of VAT and 0.5-1 billion in the case of excise duties). The budgetary execution from July, available in the meantime, does not contain elements likely to cause the revision of the assessment from that time. These being said, the Fiscal Council considers as lacking foundation the increases proposed by the updated version of the draft budget revision at the level of VAT revenues (excluding the part which corresponds to the chain compensation scheme valued at 0.6 billion lei, 1.5 billion lei respectively) and excise duties revenues (0.9 billion lei). Therefore, the Fiscal Council increases by the above mentioned amounts its initial valuation on the likely revenue gap at the level of VAT and excise duties aggregates for the end of the year, considering that these are overestimated cumulatively by an amount ranging from 4 billion lei to 5 billion lei.

Also, regarding budgetary expenditures, the Fiscal Council considered, in the context of the Opinion regarding the initial proposal of GCB revision, that the size of goods and services expenses was probably under-budgeted by about 0.9 billion lei, and the size of social assistance expenses by about 1.3 billion lei (given that the decision to pay pensions before the 15^{th} of the month is maintained). The new revision proposal increases the expenditures on goods and services by 0.6 billion lei, however does not address the question of the likely insufficient size of the allocation corresponding to social assistance expenditures.

In conclusion, the Fiscal Council assesses upward the risks to the deficit target assumed in the draft budget revision, outlining, *ceteris paribus* (considering the preservation of the current fiscal framework), the prospect of exceeding it by about 6 billion lei (compared to the prospect of exceeding the deficit target in amount of about 4.2 billion lei evaluated in the context of the first version of draft revision).

The opinions and the recommendations above mentioned by the Fiscal Council 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 5^{th} September 2018.

5^{th} September 2018 Chairman of the Fiscal Council,

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ANNEX I	Initial Budget 2018	Swap program 2018	Initial budget 2018	First budget revision September (R1 sept) 2018	Swap program R1 September	First budget revision September (R1 sept) 2018	First budget revision August (R1 Aug) 2018	Swap program R1 August	First budget revision August (R1 Aug) 2018	R1 September 2018 - Initial budget 2018	R1 September 2018- Initial budget 2018	R1 Sept - R1 Aug	R1 Sept - R1 Aug
			Without swap			Without swap			Without swap	With swap	Without swap	With swap	Without swap
	1	2	3=1-2	4	5	6=4-5	7	8	9=7-8	10=6-1	11=6-3	12=4-7	13=6-9
TOTAL REVENUE	**287,527.5**	**1,020.0**	**286,507.5**	**296,753.6**	**1,620.0**	**295,133.6**	**293,924.4**	**1,020.0**	**292,904.4**	**9,226.1**	**8,626.1**	**2,829.1**	**2,229.1**
Current revenue	257,274.0	1,020.0	256,254.0	267,226.3	1,620.0	265,606.3	264,397.2	1,020.0	263,377.2	9,952.3	9,352.3	2,829.1	2,229.1
Tax revenue	145,135.9	521.6	144,614.3	145,663.7	1,121.6	144,542.1	143,053.1	521.6	142,531.5	527.8	-72.2	2,610.5	2,010.5
Taxes on profit, wages, income and capital gains	38,598.9	298.0	38,300.9	40,907.1	298.0	40,609.1	40,838.8	298.0	40,540.8	2,308.2	2,308.2	68.3	68.3
Corporate income tax	15,020.3	148.0	14,872.3	15,012.8	148.0	14,864.8	15,012.8	148.0	14,864.8	-7.5	-7.5	0.0	0.0
Personal income tax	20,803.4	150.0	20,653.4	22,575.8	150.0	22,425.8	22,575.8	150.0	22,425.8	1,772.5	1,772.5	0.0	0.0
Other taxes on income, profit and capital gains	2,775.2		2,775.2	3,318.4		3,318.4	3,250.1		3,250.1	543.2	543.2	68.3	68.3
Property tax	5,824.4		5,824.4	5,728.0		5,728.0	5,728.0		5,728.0	-96.4	-96.4	0.0	0.0
Taxes on goods and services	98,666.8	184.0	98,482.8	97,219.6	784.0	96,435.6	94,677.3	184.0	94,493.3	-1,447.2	-2,047.2	2,542.3	1,942.3
VAT	61,308.2	184.0	61,124.2	61,308.2	784.0	60,524.2	59,184.0	184.0	59,000.0	0.0	-600.0	2,124.2	1,524.2
Excises	30,218.5		30,218.5	30,218.5		30,218.5	29,323.4		29,323.4	0.0	0.0	895.1	895.1
Other taxes on goods and services	3,814.8		3,814.8	3,896.2		3,896.2	3,896.2		3,896.2	81.4	81.4	0.0	0.0
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	2,273.8		2,273.8	-1,528.5	-1,528.5	-477.0	-477.0
Taxes on foreign trade and international transactions (customs duty)	1,042.0		1,042.0	995.9		995.9	995.9		995.9	-46.1	-46.1	0.0	0.0
Other tax revenue	1,003.8	39.6	964.2	813.1	39.6	773.5	813.1	39.6	773.5	-190.7	-190.7	0.0	0.0
Social security contributions	91,811.8	498.4	91,313.4	98,042.1	498.4	97,543.7	98,083.5	498.4	97,585.1	6,230.3	6,230.3	-41.4	-41.4
Nontax revenue	20,326.3		20,326.3	23,520.5		23,520.5	23,260.5		23,260.5	3,194.2	3,194.2	260.0	260.0

Capital revenue	1,843.6		1,843.6	885.2		885.2	885.2		885.2	-958.4	-958.4	0.0	0.0
Grants	8.5		8.5	8.5		8.5	8.5		8.5	0.0	0.0	0.0	0.0
Amounts received from the EU for payments made and prefinancing	28,401.4		28,401.4	28,633.5		28,633.5	28,633.5		28,633.5	232.2	232.2	0.0	0.0
TOTAL EXPENDITURE	**314,487.1**	**1,020.0**	**313,467.1**	**324,820.1**	**1,620.0**	**323,200.1**	**321,990.9**	**1,020.0**	**320,970.9**	**10,332.9**	**9,732.9**	**2,829.2**	**2,229.2**
Current expenditure	293,509.0	850.0	292,659.0	304,540.3	850.0	303,690.3	302,775.1	850.0	301,925.1	11,031.4	11,031.4	1,765.2	1,765.2
Personnel	81,117.5		81,117.5	86,239.8		86,239.8	86,236.8		86,236.8	5,122.2	5,122.2	3.0	3.0
Goods and services	39,615.0		39,615.0	41,115.2		41,115.2	40,510.8		40,510.8	1,500.2	1,500.2	604.4	604.4
Interest	12,096.8		12,096.8	12,094.2		12,094.2	12,094.2		12,094.2	-2.6	-2.6	0.0	0.0
Subsidies	7,210.3		7,210.3	6,719.0		6,719.0	6,719.0		6,719.0	-491.2	-491.2	0.0	0.0
Total transfers	152,868.5	850.0	152,018.5	156,561.7	850.0	155,711.7	156,412.4	850.0	155,562.4	3,693.2	3,693.2	149.3	149.3
Transfers between public administration entities	2,132.8	850.0	1,282.8	2,035.2	850.0	1,185.2	2,035.2	850.0	1,185.2	-97.6	-97.6	0.0	0.0
Other transfers	13,098.5		13,098.5	14,220.1		14,220.1	14,081.0		14,081.0	1,121.6	1,121.6	139.1	139.1
Projects funded by external post-accession grants	317.2		317.2	518.5		518.5	518.5		518.5	201.3	201.3	0.0	0.0
Social assistance	98,620.4		98,620.4	100,397.5		100,397.5	100,395.6		100,395.6	1,777.1	1,777.1	1.9	1.9
Projects funded by external post-accession grants 2014-2020	32,826.9		32,826.9	32,969.6		32,969.6	32,969.6		32,969.6	142.7	142.7	0.0	0.0
Other expenditure	5,872.6		5,872.6	6,420.7		6,420.7	6,412.4		6,412.4	548.1	548.1	8.3	8.3
Reserve funds	315.7		315.7	1,337.6		1,337.6	329.1		329.1	1,021.9	1,021.9	1,008.6	1,008.6
Expenditure funded from reimbursable funds	285.1		285.1	472.8		472.8	472.8		472.8	187.7	187.7	0.0	0.0
Capital expenditure	20,978.2	170.0	20,808.2	20,279.7	770.0	19,509.7	19,215.8	170.0	19,045.8	-698.4	-1,298.4	1,063.9	463.9
EXCEDENT(+) / DEFICIT(-)	**-26,959.6**		**-26,959.6**	**-28,066.5**		**-28,066.5**	**-28,066.5**		**-28,066.5**	**-1,106.9**	**-1,106.9**	**0.0**	**0.0**

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

III. Fiscal Council's opinion on the draft law amending the Fiscal Responsibility Law no. 69/2010

On October 29th, 2018, the Fiscal Council (FC) received from the Ministry of Public Finance (MPF) the letter no. 466213/29.10.2018, requesting, the Fiscal Council's opinion on the draft law amending the Fiscal Responsibility Law (no. 69/2010 republished, hereafter referred to as FRL), considering the responsibilities of the Fiscal Council regarding the application of the provisions of this law.

The process of drafting a law amending the FRL aims at correcting the incomplete transposition of the provisions of the *Directive 2011/85/EC on the requirements related to the budgetary frameworks of the Member States* (hereafter referred to as the Directive) as identified by the European Commission following the information requested to the Romanian authorities in the context of the EU Pilot file 8829/16/ECFI, as well as avoiding an action for failure to fulfill the obligations as a Member State.

Brief description of the legislative proposal

The legislative proposal under the Fiscal Council's examination refers to several changes /additions to the provisions of the FRL, as follows:

- Introduction of a provision referring to the comparison of the national budgetary projections with the budgetary forecasts of the European Commission regarding the medium-term budgetary framework, presenting and justifying any differences between the two scenarios, according to art. 4 para. (1) of the Directive;
- Amending and complementing FRL with explicit provisions on the publication of the methodologies, assumptions and of the relevant parameters underpinning the macroeconomic and budgetary forecasts to ensure the full transposition of art. 4 para. (5) of the Directive;
- Complementing the FRL with an explicit provision regarding the consequences of non-compliance with the rule on expenditure growth limitation. Given the close correlation between this rule and the rule on compliance with the medium term objective, the proposed amendment envisages regulating unique consequences for breaches of those two rules, namely by applying in both cases the provisions of art. 14 of the FRL which refers to the correction mechanism. This will ensure the compatibility with the provisions of art. 6 par. (1) lit. (c) of the Directive;
- Complementing the FRL with an express provision regulating the procedures for assessing how changes in fiscal policies over the medium-term have a direct impact on public finances and how they will affect the long-term sustainability of public finances, in accordance with Art. 9 par. (2) (d) of the Directive.

Conclusions and recommendations

The Fiscal Council considers the proposed amendments to the FRL as appropriate, and also appreciates that they are contributing at reinforcing the regulations on the medium-term budgetary framework and as well at strengthening fiscal governance. Moreover, the proposed amendments of this legislative initiative regarding the publication of methodologies, assumptions and relevant parameters underpinning the macroeconomic and budgetary forecasts were mentioned over time as recommendations in the Fiscal Council's opinions and analysis.

Nevertheless, as the Fiscal Council reiterated on several occasions in recent years, the fundamental problem of the fiscal framework based on rules as defined by the FRL is the *de facto* inoperability of the fiscal rules and the ease of circumventing them, despite the fact that they are well structured and consistent with the European Treaties signed by Romania. In this context, the Fiscal Council advocates strengthening the rule-based fiscal framework and ensuring full compliance of the FRL provisions, which it considers promoting the sustainability of the public finances and also a balanced and sustainable economic growth.

The opinions and the recommendations above mentioned by the Fiscal Council 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 October 31st, 2018.

October 31st, 2018

Chairman of the Fiscal Council,

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IV. 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).

According to article 53, paragraph (4) of the FRL, the Government and the Parliament have the obligation to take into consideration the opinions and recommendations of the FC when drafting the Fiscal Strategy, the annual budget laws and in the case of elaborating and approving other measures determined by the application of this law. Considering the Government's intention to approve the aforementioned documents at the meeting scheduled for November 23rd 2018, at 11 o'clock, the FC did not dispose of sufficient time to analyze them and elaborate a complete opinion. Under these circumstances, FC decided to draw up a preliminary opinion that assesses the compliance of the draft budget revision with the fiscal rules stated by the FRL, while the detailed opinion will be finalized in the week of 26-29 November 2018. Once it is completed, FC will notify its opinion to MPF and will publish it on the institution's website (www.consiliulfiscal.ro).

Compliance with fiscal rules

In comparison to the budget approved at the first revision, the revenues of the general consolidated budget (GCB) are projected to increase by 245.9 million lei, while expenditures are also projected to increase by 382.3 million lei, leading to an estimated GCB deficit of 28,203.2 million Lei, which is 136.7 million lei above the updated nominal ceiling established by Law no. 269/2017 (Law on the approval of ceilings for certain indicators specified in the fiscal-budgetary framework for 2018).

The draft of the GEO regarding the second revision of the state budget records a series of derogations from the provisions stipulated at art. 12, letters a) - c), art. 17 para. (2), art. 24 and art. 26 para. (4) and (5) of the FRL, as well as from art. 2 para. (2), art. 3 para. (5) and (6) of Law no. 269/2017, thereby stating the non-compliance with fiscal rules, except for the rules concerning the GCB balance and personnel expenditures expressed as a percentage of GDP, the GCB primary balance in nominal terms and total expenditures of the GCB in nominal terms, excluding financial assistance from the European Union (EU) and other donors. Art. 12, letters a) - c), art. 17 para. (2), art. 24 and art. 26 para. (4) and para. (5) of the FRL stipulate the obligation to respect the ceilings, expressed as nominal values and as a percentage of GDP, set by the Fiscal Strategy and the law on budgetary ceilings for the GCB balance, the GCB primary balance, personnel expenditures and total expenditures, excluding financial assistance from the EU and other donors, allowing for total expenditure increases in the course of budget revisions only if they are related to the public debt service or the payment of Romania's contribution to the EU budget.

- The first budget amendment has already recorded significant deviations of the mandatory ceilings stipulated in the Law no. 269/2017 and the non-observance of all the FRL's fiscal rules except for the one regarding the level expressed as a percentage of GDP for the GCB headline deficit, this rule being respected in the context of the upward revision operated at the level of the nominal GDP compared to the initial budget estimate. Thus, the following exceeding of the ceilings were registered: the GCB headline deficit (+1.1 billion lei), the GCB primary deficit (+1.1 billion lei), the GCB personnel expenses (both in nominal terms + 5.1 billion lei and as share in GDP by 0.2 percentage points), respectively the total GCB expenditure excluding the financial assistance from the EU and other donors (+10.1 billion lei). At the same time, there were violations of the rules prohibiting the increase in personnel spending and the total GCB expenditure (net of financial assistance from the EU and other donors) on the occasion of the budget rectifications, exclusively for servicing the public debt and, respectively, for paying the Romanian contribution to the EU budget.

- The changes introduced by the draft of the second supplementary budget increase the size of the non-compliance with the personnel spending ceiling by 110.35 million lei (respectively, the exceeding of the nominal ceiling of the GCB personnel expenses by 5,194 million lei and as a percentage of GDP by 0.2 pp compared to the initial provisions of the Law on Ceilings no. 269/2017, in the context of the increasing the GDP estimate by 41.700 million lei compared to the initial forecast). On the other hand, on the background of increasing the European funds revenues, the total expenditures net of the financial assistance from the EU and other donors are now lower by 529.8 million lei compared to the updated ceiling stipulated by Law no. 269/2017. The increase of the amounts from European funds occurs in the context of decreasing the revenue from "Amounts received from the EU in respect to payments made and pre-financing for the 2014-2020 financial framework" which has been offset by those relating to a newly introduced item "Other funds from the EU" in the amount of about 4.2 billion lei. These amounts are related to retrospective projects, originally funded from own budgetary funds that will be settled/compensated from European funds. On this aspect the Fiscal Council will comment in more detail in the complete opinion based on the analysis following the later clarifications transmitted by the MPF. Also, the primary deficit according to the proposal in the second supplementary budget draft is lower than the ceiling defined by the Law no. 269/2017 by 911.6 million lei, as the upward revision of interest expenses (+1.048.3 million lei compared to the first rectification, and +1.045.6 million lei compared to the initial budget) was only partially offset by the increase other expenses.

The lack of coercion and the *de facto* inoperability of fiscal rules are aspects on which the Fiscal Council has repeatedly drawn attention in recent years in the context of its opinions and reports.

The opinions and the recommendations above mentioned by the Fiscal Council 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 November 23rd, 2018.

November 23rd, 2018

Chairman of the Fiscal Council

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V. 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:
  - Corporate income tax: +0.41 billion lei. Given the current budget execution, the upward revision seems plausible.
  - 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

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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

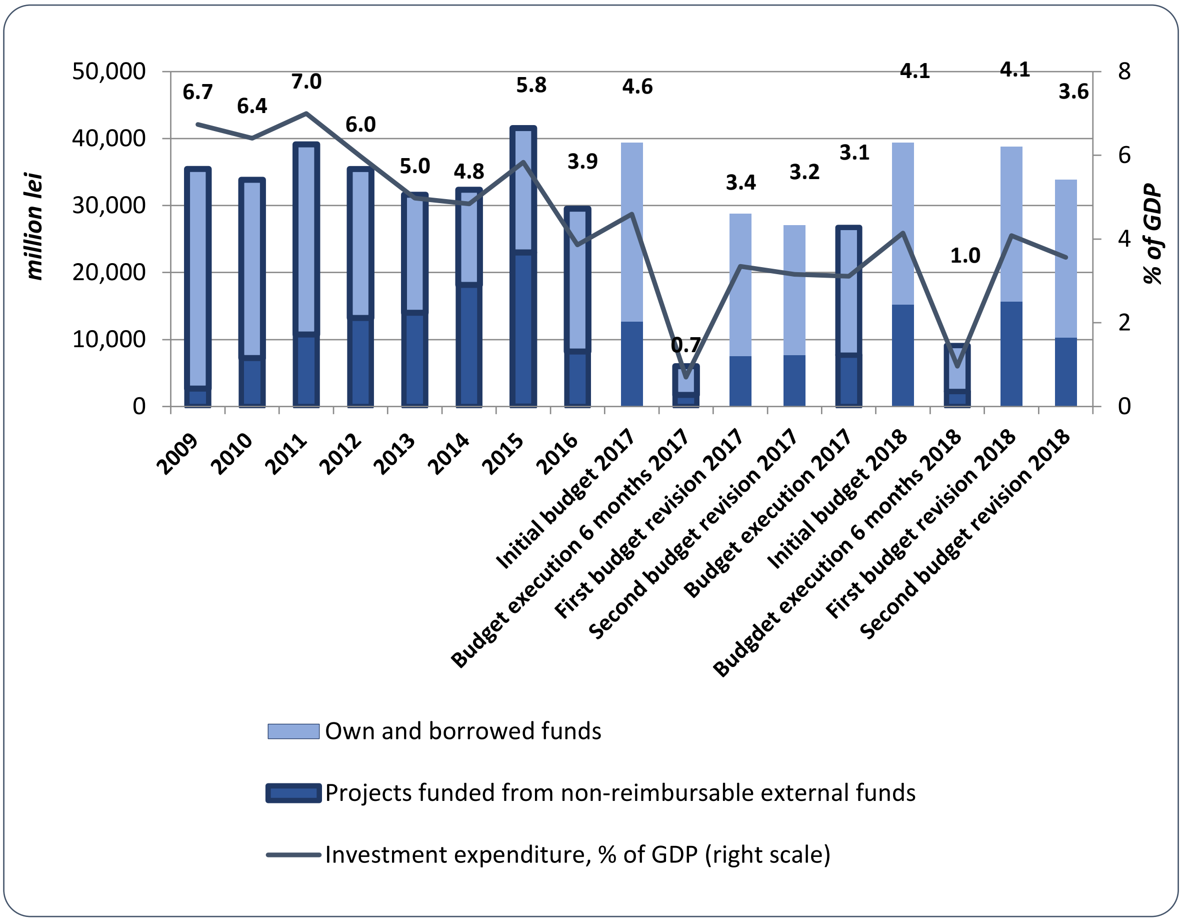
Amounts collected in the single account	0.0		0.0	0.0		0.0			0.0	0.0	0.0	0.0
Other EU funds	0.0		0.0	0.0		0.0	4,173.0		4,173.0	0.0	4,173.0	4,173.0
Amounts received from the EU/other donors in the account of payments made and prefinancing for the 2014-2020 financial framework	28,297.9		28,297.9	28,523.0		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

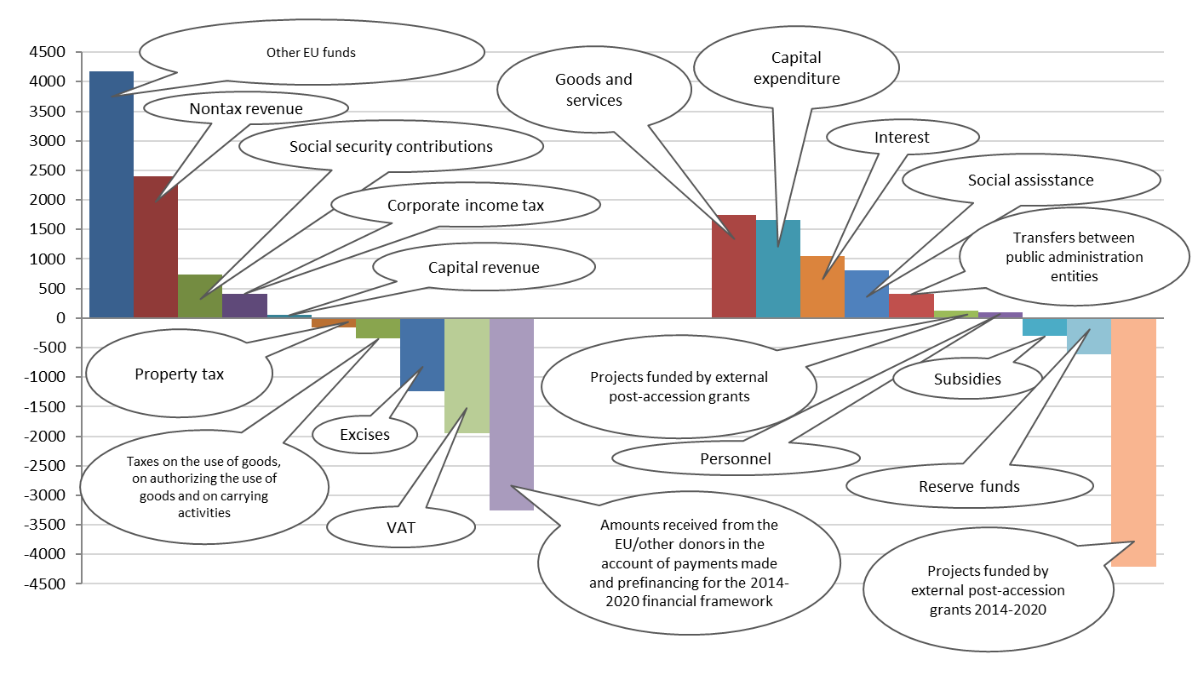
Source: Ministry of Public Finance, Fiscal Council's calculations

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



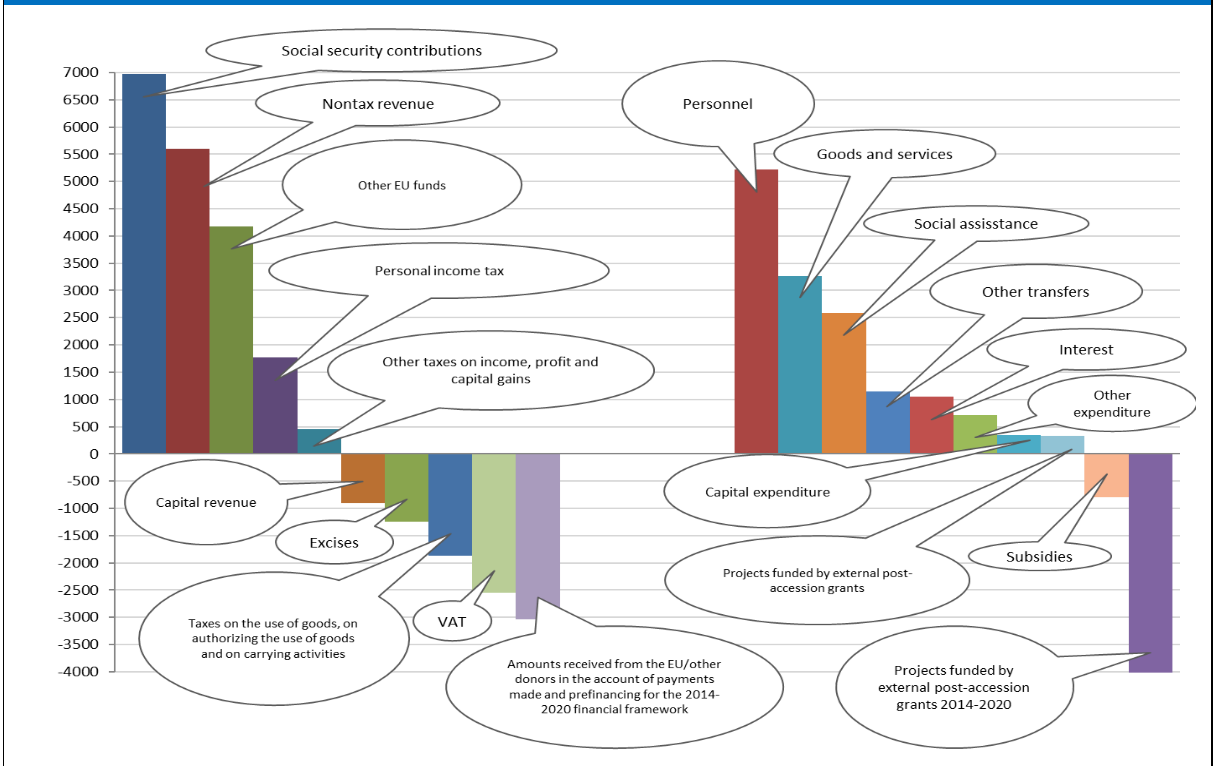
Source: Ministry of Public Finance, Fiscal Council's calculations

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

VI. Analysis of the economic and financial performance of Romania's state owned companies in 2017

A potential risk for the fiscal sustainability on the medium term is represented by the accumulation of losses and arrears in the sector of companies where the state is the major shareholder, because if these companies fail to streamline their activity, the Government will eventually be forced to intervene with public resources, which may lead to a deterioration of public finances, respectively increasing the budget deficit. The present report analyzes the economic and financial performance of Romanian state owned companies in 2017 on the basis of the annual financial statements submitted by all companies to the Ministry of Public Finance (MPF).

The analysis was made on 807 state companies, lesser compared to 916 companies in 2016, but the eliminated companies are mainly limited liability companies. However, the results of the study are expected to be comparable to those obtained in the previous years.

At the end of 2017[1], 1,795 companies reported in their annual financial statements that they belong to the SOEs' category. Following a rigorous analysis of their form of organization, the object of activity and the structure of capital holdings, it was noticed that many companies mistakenly registered their membership to the state-owned sector, the vast majority of them (over 600) claiming to be autonomous administrations. After correcting these errors, the final number of SOEs included in the analysis was 807, down from 916 companies in 2016. However, given that the eliminated entities are predominantly limited liability limited companies, the results of this study are expected to be comparable to those obtained in the previous years.

Also, in order for the results of the study to accurately reflect the economic and financial performance of Romanian state-owned companies, the sample of analyzed companies was adjusted in order to

At the same time, in order for the analysis to correctly reflect the economic and financial performance of the state-owned companies in Romania, two companies from the sample considered for 2017 were eliminated: Societatea de Administrare a Participaţiilor în Energie (SAPE) and Societatea Română de Televiziune (SRT). These entities significantly distort the profitability analysis of the state-owned companies as SAPE received 401.2 million euro from the Enel group[2] in April 2017, and SRT benefited from a substantial increase of the subsidy granted by the Romanian state (from

[1] According to data submitted by MPF on August 3, 2018, so that the analysis does not include those companies that had not yet transmitted until this date their financial statements for the year 2017.

[2] Following the February 2017 verdict of the International Court of Arbitration in Paris.

eliminate the effect of conjunctural factors.

95 million lei in 2016, to 946 million lei in 2017) due to the elimination of the radio-TV fee, but also for the purpose of repaying the historical debts of the public television. According to the approved budget for 2018 and the estimates for the 2019-2021, the increase of the subsidy granted to SRT was temporary and should stabilize at around 440 million lei. Thus, since the net profits obtained by the two companies are the result of conjunctural factors (without expressing an effective improvement of their profitability) that led to an artificial increase of the total net profit of state companies by almost 2.4 billion lei, justifies the elimination of these two companies from the 2017 analysis.

A similar situation was recorded in 2015 when Oltchim S.A. has achieved a profit on paper of more than 2.3 billion lei (representing almost 48% of the total profit of state-owned companies), as a result of the cancellation of a significant part of the debts. Also, in this case it was appropriate to exclude the profit recorded by Oltchim from the 2015 analysis.

The total revenues of state-owned companies increased by around 8.3%, while private firms reported higher revenues by about 7.9%. Positive developments were recorded in the case of turnover and gross added value, the state companies managing to maintain or even improve their contribution to the economic activity.

Amid strong economic growth in 2017, the total revenues[3] of the public companies included in the analysis increased by about 3.8 billion lei (+8.3%) from 46.6 billion lei in 2016 to 50.4 billion lei in 2017. This upward trend was supported by the increase of the total turnover of the companies in the analyzed sample by about 4 billion lei (+8.8%). A similar evolution was registered for the whole private sector companies, which registered an advance of 7.9% in the case of total revenues, respectively of 7.7% for the turnover. Positive trends were also noticed in the gross added value (+10.3% for state-owned companies, +7.4% for private companies). Thus, on the background of similar or even higher developments compared to the private sector, the state companies have slightly improved their contribution to the economic activity in Romania (3.68% of total revenues, respectively, 9.36% of total gross value added).

[3] Total revenue is represented by the indicator *production of the exercise*, calculated as the sum of the sold output, the stored output and the revenues from the production of fixed assets.

Labor productivity in state-owned companies exhibited an increasing trend during the period under review, and in 2017 it grew by 8.7% compared to the previous year. It should be noted that this positive trajectory was mainly achieved by reducing the number of employees in the public sector.

The number of employees in SOEs experienced a continuous decrease since 2011, reaching about 273 thousand persons at the end of 2017 (-8 thousand persons, representing a decrease of about 3% compared to the previous year), while the gross value added had a predominantly increasing trajectory over the same timeframe. In real terms[4], the gross value added appreciated by 5.5% compared to 2016, but its level remains 2.1% lower than the one recorded in 2008 (the maximum level of the considered period). Under these conditions, labor productivity in SOEs increased by 8.7% in 2017, reaching the peak value for the 2008-2017 period, and at the same time being almost 40% higher than in 2008, mainly due to the significant reduction of the number of employees (by about 117 thousand people).

Supported by Romania's high economic growth rate in 2017, the total net profit of state-owned companies maintained its upward trend, recording the peak of the post-crisis period.

In what concerns the profitability of SOEs, measured through the total net profit, it reached a value of 4.818 million lei in 2017 (+ 1.7 billion lei as compared to the previous year) which denotes the maximum level recorded during the post-crisis period. It is worth noting that this result was achieved after eliminating the net profits obtained by SAPE and SRT which would have added a surplus of almost 2.4 billion lei. Therefore, it can be appreciated that the aggregate profitability of SOEs experienced a significant improvement in 2017 (continuing the trend from recent years) and this evolution was favored by the fact that Romania recorded the highest economic growth rate in the post-crisis period.

The analysis carried throughout the period under review highlighted the fact that a small number of companies with substantial profits significantly influence the aggregate results of the public sector companies. In this context, in order to

The profitability of SOEs can be further analyzed by highlighting separately the top five companies in terms of net profit (Top 5 - presented in *Table 2*). Thus, the companies included in Top 5 have recorded significant profits over the last 6 years, increasing almost every year from 2,010 million lei in 2012 to 4,438 million lei in 2017 (+22.6% compared to the previous year). It is worth mentioning S.P.E.E.H. Hidroelectrica S.A., S.N.G.N. Romgaz S.A. and S.N.T.G.N. Transgaz S.A. Mediaș which had a continuous presence in the Top 5 during the last five years (2013-2017).

[4] The price index used for expressing the gross value added in real terms is the GDP deflator (2010 = 100).

highlight more accurately the evolution of the overall financial performance of state-owned companies, the present study will consider separately both the aggregate values and those obtained by excluding the five most profitable companies - Top 5.

Eliminating the influence of Top 5 companies, it can be noticed that the rest of SOEs recorded aggregate net losses during the period under review, with the only exception being the year 2017. However, comparing the overall net profit of SOEs excluding Top 5 (380 million lei) to the aggregate net profit of the Top 5 companies (4.438 million lei), it becomes clear that a small number of companies with substantial profits has a significant impact on the results of the analysis. In this context, in order to highlight more accurately the evolution of the financial performance of the whole SOE sector, the present analysis is conducted both at the aggregate level and by eliminating the influence of Top 5 companies.

The development of the main economic and financial indicators of the Romanian SOEs is presented in *Table 1*.

Table 1: The evolution of the main financial and economic indicators of Romanian companies from the non-financial sector											
		2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Number of companies	SOEs	718	774	791	1,048	1,006	1,151	1,155	1,143	916	807
	All companies, non-financial sector	663,860	602,190	613,080	644,379	630,066	657,500	643,644	647,872	677,843	692,966
	Share of SOEs in all companies	0.11%	0.13%	0.13%	0.16%	0.16%	0.18%	0.18%	0.18%	0.14%	0.12%
Total income, mil. lei	SOEs	56,660	50,756	55,022	58,511	49,853	51,208	44,487	48,578	46,586	50,432
	All companies, non-financial sector	977,619	845,396	920,600	1,056,190	1,072,777	1,101,386	1,113,445	1,186,900	1,269,290	1,369,313
	Share of SOEs in all companies	5.80%	6.00%	5.98%	5.54%	4.65%	4.65%	4.00%	4.09%	3.67%	3.68%
Gross value added, mil. lei	SOEs	21.744	20.454	22.881	24.202	22.339	25.131	25.220	26.687	26.143	28.845
	All companies, non-financial sector	203.875	189.633	195.849	196.151	197.392	233.734	255.957	260.530	286.190	308.113
	Share of SOEs in all companies	10.67%	10.79%	11.68%	12.34%	11.32%	10.75%	9.85%	10.24%	9.13%	9.36%
Gross value added in real terms, mil. lei (constant prices 2010)	SOEs	23,406	21,177	22,881	23,268	20,527	22,399	22,093	22,784	21,726	22,912
Employees, thousands of persons	SOEs	390	364	364	343	327	321	297	291	281	273
	All companies, non-financial sector	4,618	4,019	3,962	4,040	3,898	4,016	3,882	3,959	4,078	4,055
	Share of SOEs in all companies	8.44%	9.05%	9.19%	8.49%	8.40%	8.00%	7.64%	7.36%	6.89%	6.73%
Labor productivity mil. lei /1,000 employees (constant prices 2010)	SOEs	60,07	58,22	62,83	67,84	62,72	69,73	74,44	78,19	77,30	84,00
Net profit, mil. lei	SOEs	(1,996)	(3,443)	(2,900)	436	(1,425)	938	2,401	1,200	3,108	4,818
	SOEs, excluding Top 5	(4,210)	(4,573)	(4,508)	(2,926)	(3,436)	(1,787)	(1,323)	(2,034)	(513)	380
	Private companies	13,540	11,399	18,736	1,389	6,872	12,678	17,020	31,088	48,251	63,150
Arrears, mil. lei	SOEs	17,294	34,405	28,012	26,251	25,363	26,217	24,370	21,226	23,232	21,599
	Private companies	53,127	62,406	69,193	88,882	91,536	99,052	93,508	94,875	89,390	73,758
	Share of SOEs in all companies	24.56%	35.54%	28.82%	22.80%	21.70%	20.93%	20.67%	18.28%	20.63%	22.65%
Arrears, % of GDP	SOEs	3.21%	6.54%	5.29%	4.67%	4.26%	4.13%	3.64%	2.98%	3.03%	2.52%
Arrears, % of net turnover	SOEs	31.08%	68.90%	51.96%	45.62%	51.61%	52.10%	55.65%	44.60%	50.71%	43.32%

Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

Table 2: Top 5 SOEs with the largest net profits

Top 5 net profit in 2017

	Company name	Net profit (mil. lei)
1	S.N.G.N. ROMGAZ S.A.	1,854.75
2	S.P.E.E.H. HIDROELECTRICA S.A.	1,359.69
3	S.N.T.G.N. TRANSGAZ S.A. MEDIAŞ	582.06
4	COMPANIA NATIONALĂ AEROPORTURI BUCUREŞTI S.A.	337.55
5	S.N. NUCLEARELECTRICA S.A.	303.88
	Total	**4,437.93**

Top 5 net profit in 2016

	Company name	Net profit (mil. lei)
1	S.P.E.E.H. HIDROELECTRICA S.A.	1,227.67
2	S.N.G.N. ROMGAZ S.A.	1,024.58
3	S.N.T.G.N. TRANSGAZ S.A. MEDIAŞ	594.56
4	COMPANIA NATIONALĂ DE CĂI FERATE CFR S.A.	501.31
5	C.N.T.E.E. TRANSELECTRICA S.A.	272.36
	Total	**3,620.48**

Top 5 net profit in 2015

	Company name	Net profit (mil. lei)
1	S.N.G.N. ROMGAZ S.A.	1,194.29
2	S.P.E.E.H. HIDROELECTRICA S.A.	899.41
3	S.N.T.G.N. TRANSGAZ S.A. MEDIAŞ	488.73
4	C.N.A.D.N.R. S.A.	368.81
5	C.N.T.E.E. TRANSELECTRICA S.A.	360.05
	Total	**3,311.29**

Top 5 net profit in 2014

	Company name	Net profit (mil. lei)
1	S.N.G.N. ROMGAZ S.A.	1,409.88
2	S.P.E.E.H. HIDROELECTRICA S.A.	941.54
3	S.N.T.G.N. TRANSGAZ S.A. MEDIAŞ	502.52
4	SOCIETATEA UZINA MECANICĂ CUGIR S.A.	442.01
5	C.N.A.D.N.R. S.A.	428.61
	Total	**3,724.56**

Top 5 net profit in 2013

	Company name	Net profit (mil. lei)
1	S.N.G.N. ROMGAZ S.A.	995.55
2	S.P.E.E.H. HIDROELECTRICA S.A.	718.83
3	S.N. NUCLEARELECTRICA S.A.	423.39
4	S.N.T.G.N. TRANSGAZ S.A. MEDIAŞ	334.49
5	C.N.A.D.N.R. S.A.	253.19
	Total	**2,725.46**

Top 5 net profit in 2012

	Company name	Net profit (mil. lei)
1	S.N.G.N. ROMGAZ S.A.	1,244.05
2	S.N.T.G.N. TRANSGAZ S.A. MEDIAŞ	329.31
3	C.N.A.D.N.R. S.A.	174.14
4	COMPANIA NATIONALĂ DE CĂI FERATE CFR S.A.	144.65
5	COMPLEXUL ENERGETIC OLTENIA S.A.	118.33
	Total	**2,010.47**

Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

Although the share of the state-owned companies' arrears in total outstanding payments across the economy has been relatively stable in recent years, it remains well above the public sector's contribution to economic activity.

The evolution of arrears[5] accumulated by SOEs displays a general tendency to diminish their volume after reaching a peak of 34.4 billion lei in 2009. As for the share of SOEs' arrears in total outstanding payments across the economy, over the last 7 years it has been stabilized around 21%. On the other hand, this weight is well above the contribution made by SOEs to the economic activity in Romania (an average share of 4.3% of the total revenues and 10.4% of the total gross value added), indicating a chronic problem of arrears in the public sector.

The arrears of state-owned companies as a share of GDP and of the total net turnover exhibited a general downward trend since 2009, at the end of 2017 being recorded the lowest level of their share in GDP over the analyzed period.

A similar evolution is also found when analyzing the share of state-owned companies' arrears in GDP, respectively in total net turnover. After reaching the maximum levels of the analyzed period in 2009, the two indicators entered a general downward trend with slight discontinuities, the most important being manifested in 2016 when both weights recorded increasing values. However, the increase was only temporary and the decreasing trend resumed in 2017 when SOEs' arrears reached the lowest level of their share in GDP over the analyzed period. Thus, supported by the strong economic growth, 2017 saw a reduction in public sector arrears of over 1.6 billion lei to 21.6 billion lei, representing 2.5% of GDP and 43.3% of total net turnover. The downward evolution of SOEs' arrears was also driven by the measures[6] instituted through the two balance of payments agreements that were signed with international financial institutions (EC, IMF and WB).

In 2017, almost half of the arrears of state-owned companies were due to the general consolidated

Analyzing the structure of SOEs' arrears in 2017 (presented in *Figure 1*), it can be observed that most outstanding payments are due to the general consolidated budget, representing 10.6 billion lei (almost half of total arrears). Compared to the

[5] According to MPF, companies' arrears are delayed payments to banks, the state budget, the social security budget, suppliers and other creditors by more than 30 days against the contractual or legal terms, that generate payment obligations.

[6] Those measures aimed at framing the arrears within quarterly indicative targets and included budget transfers, placing SOEs into voluntary liquidation or insolvency and the conversion of arrears into shares.

budget and about 36% represented overdue payments to suppliers. The decrease of overdue payments by 1.6 billion lei, as compared to the previous year, was mostly driven by the reduction of arrears to the general consolidated budget, the changes observed in arrears to other categories of creditors being very small.

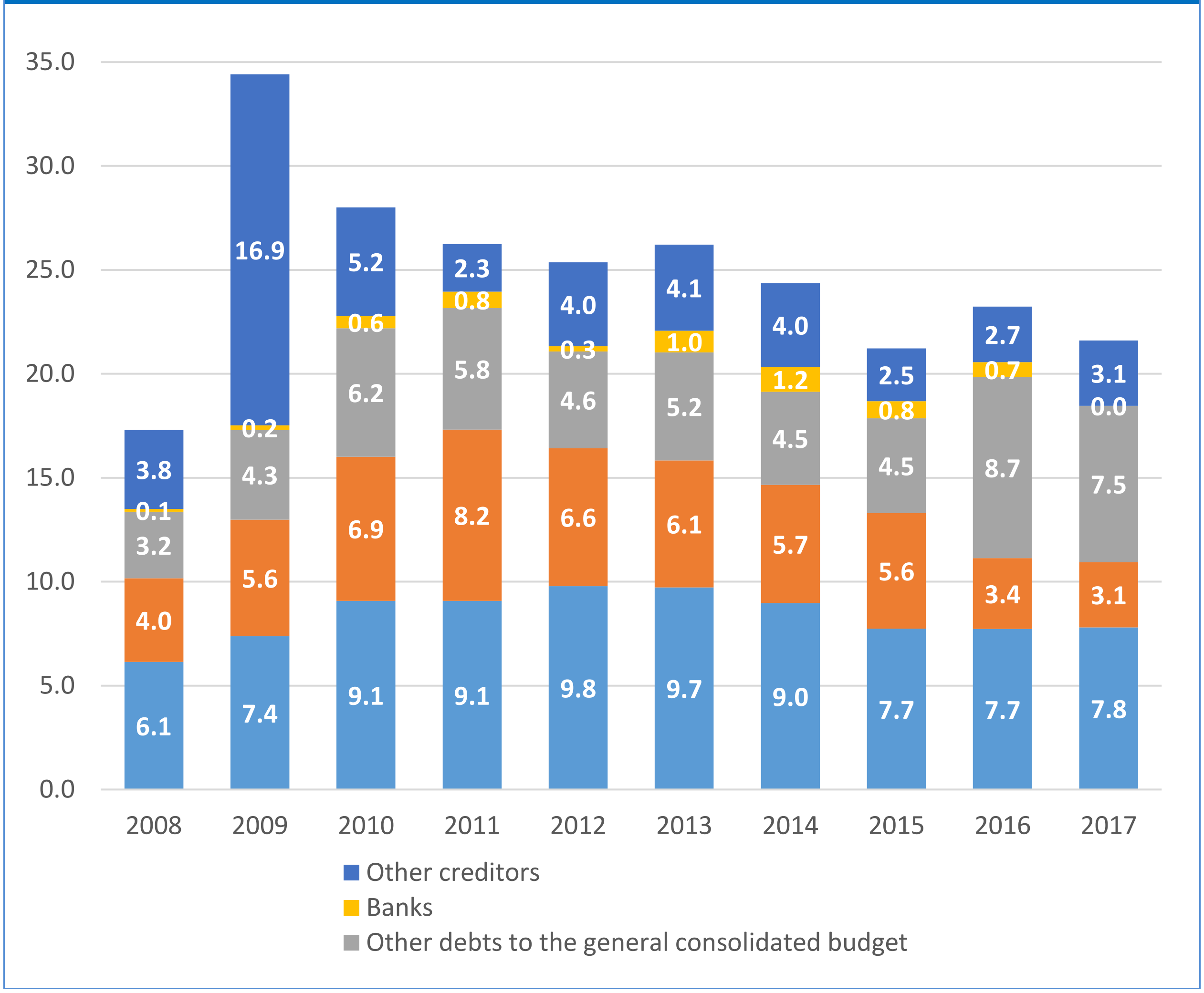
previous year, SOEs' arrears to the general consolidated budget decreased by about 1.5 billion lei, this decrease being manifested both in the case of outstanding payments to the social security budget (-0.3 billion lei) and in the case of overdue payments to the other budgets (-1.2 billion lei). Suppliers rank second in the hierarchy of SOEs' arrears, the amount due to them being 7.8 billion lei (representing about 36% of total arrears) which is slightly higher than in 2016.

In what concerns arrears to the banking sector and other creditors, since 2017 the F30 financial reporting form no longer provides information on overdue loan and interest payments, resulting in the unavailability of data on arrears to the banking sector. Thus, corroborating the elimination of this category (which recorded arrears of 0.7 billion lei in 2016) with a corresponding increase of overdue payments to other creditors[7] by almost 0.5 billion lei, it can be appreciated that no significant changes occurred within these categories of arrears.

Concluding the analysis of the structure of SOEs' arrears, it is worth noting that their reduction by over 1.6 billion lei, compared to 2016, was mostly driven by the decrease of arrears to the general consolidated budget, the changes observed in arrears to other categories of creditors being very small.

[7] Given the removal of a category of arrears from the financial reporting form, it is expected that its values will be aggregated in the category of overdue payments to other creditors.

Figure 1: Structure of arrears – SOEs (billion lei)



Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector
Note: Arrears to banks are computed as the sum of overdue loan and interest payments

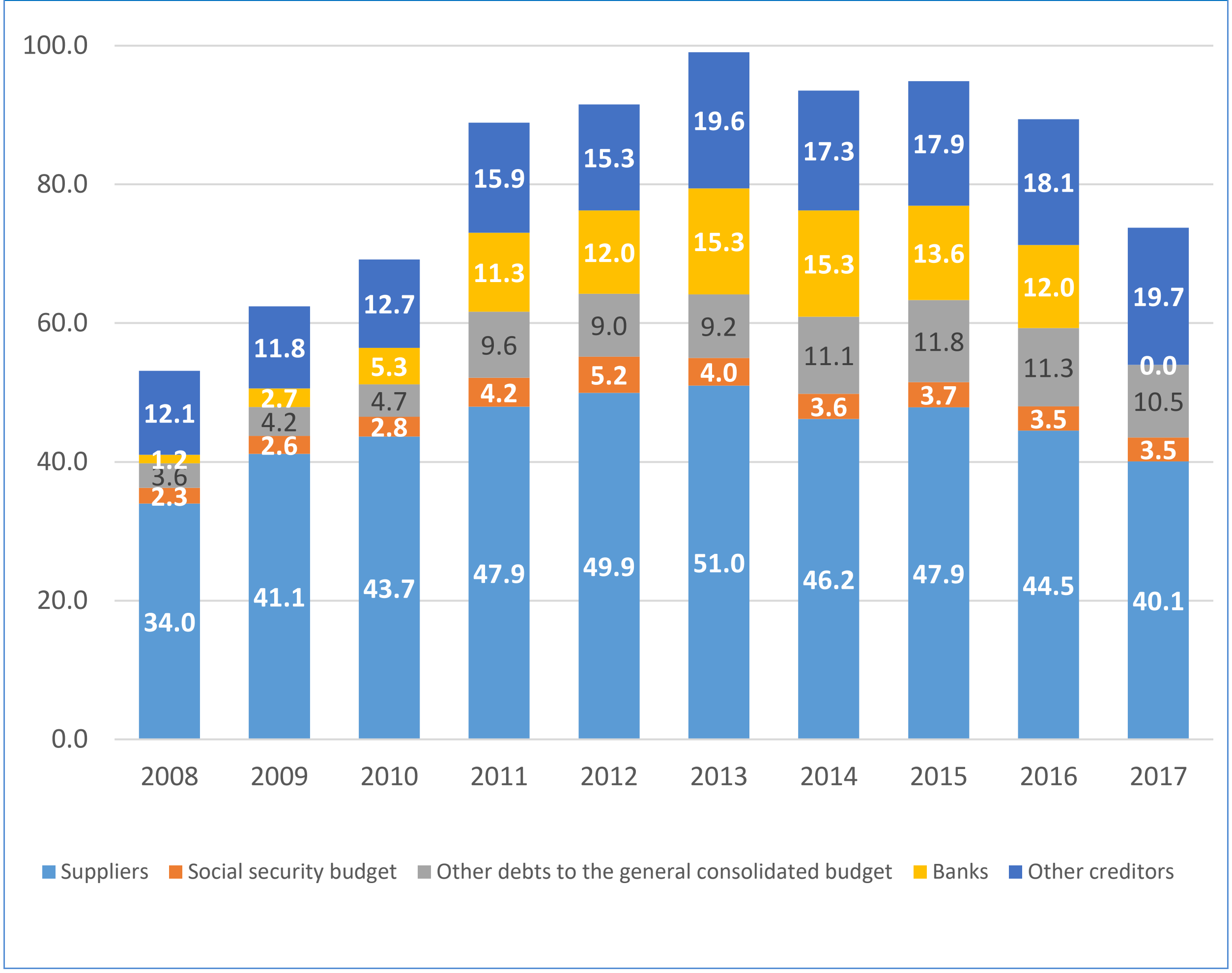
In the case of private companies, arrears to suppliers have the highest share (55% of total arrears), followed at a considerable distance by overdue payments to the general consolidated budget (19% of total arrears).

The analysis of the structure of private companies' arrears in 2017 (presented in *Figure 2*) shows that they have the highest volume of overdue payments to suppliers, amounting to 40.1 billion lei (almost 55% of total arrears), more than half of which were late payments for more than a year. As compared to 2016, the evolution was favorable, the arrears of private companies towards suppliers diminishing by 4.4 billion lei, the most significant decrease (-3.6 billion lei) being registered in the case of arrears with a duration longer than a year. The second place, at a considerable distance, belongs to arrears towards the general consolidated budget which amount to 14 billion lei (representing about 19% of total arrears). They also decreased by 0.9 billion lei in 2017, this evolution being determined by the reduction of arrears to the general consolidated budget (excluding the social security budget) by 0.8 billion lei.

Since data on arrears to the banking sector is no longer available, due to changes in the F30 financial reporting form, the substantial reduction in the overall level of private companies' arrears raises serious questions as it could be the consequence of erroneous reporting.

In what concerns the unavailability of 2017 data on arrears to the banking sector, there appears to be a significant impact on the overall level of private companies' arrears. While overdue payments to the banking sector amounted to 12 billion lei in 2016, it is unclear if they have been taken over in 2017 to the category of arrears to other creditors which increased by only 1.6 billion lei compared to the previous year. Therefore, the aggregate level of private companies' arrears recorded a major decrease in 2017 compared to 2016 (-15.6 billion lei, corresponding to -17.5% in relative terms). This decrease could be the result of a substantial repayment of arrears to the banking sector (but since the other categories of arrears did not exhibit a similar behavior, the explanation does not seem plausible) or is the consequence of erroneously reporting the outstanding payments by a significant number of companies which completely eliminated arrears to the banking sector from their reports. Thus, considering that the analysis of private companies' arrears can lead to unrealistic conclusions, the present study mainly follows the evolution of SOEs' arrears, avoiding comparisons with the private sector and the analysis of the total volume of arrears in the Romanian economy.

Figure 2: Structure of arrears – Private companies (billion lei)



Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

Note: Arrears to banks are computed as the sum of overdue loan and interest payments

The arrears of the state-owned companies are concentrated in a small number of companies operating in mining sector, distribution of heat and chemical industry. Thus, the first 10 enterprises ranked in terms of volume of outstanding payments (Top

By proceeding to a more detailed analysis of the arrears of SOEs were identified the first 10 companies ranked in terms of outstanding payments (Top 10 – presented in *Table 3*). They have accumulated almost 74% of the total arrears of SOEs and belong predominantly to the mining sector, the distribution of heat sector and the chemical industry. Comparing Top 10 from the last three years, it is noted that seven companies were present every year in the ranking, which may indicate the chronicity of arrears for some companies and industrial sectors. During the 2015-2017 period, at a considerable distance from

10) have accumulated almost 74% of the total arrears of SOEs, and the outstanding payments of the company from the first place accounted for 25 of the total. Another worrying aspect is that many companies find themselves in Top 10 every year, indicating a chronicity of the issue of arrears in some sectors.

the rest of the ranking, Compania Națională a Huilei ranked in the first place every year, its outstanding payments accounting for 34% of the Top 10's total arrears, respectively 25% of the total outstanding payments of SOEs.

Concerning the Top of arrears to the general consolidated budget (also presented in *Table 3*), there is also a persistency, four companies being in the ranking in each of the last three years. Also, is maintained the prevalence of the companies within the mining and heat distribution sectors, but compared to the above presented Top 10, the affected industrial sectors are more diversified. On the other hand, in the case of arrears to the general consolidated budget the concentration degree is higher, with the first 10 companies accumulating more than 83% of the total arrears of SOEs to the general consolidated budget. At the same time, Compania Națională a Huilei (still ranking the first position in each of the three years) is characterized by a volume of arrears to the general consolidated budget accounting for almost 61% of the total of the Top 10 companies and almost 51% of the total of SOEs.

Table 3: Top 10 SOEs with the largest arrears

Top 10 arrears in Dec. 2017

	Company name	Arrears (mil.lei)
1	COMPANIA NAȚIONALĂ A HUILEI S.A. ÎN LICHIDARE	5,413.69
2	RADET BUCUREȘTI	3,655.64
3	ELECTROCENTRALE BUCUREȘTI S.A.	1,752.02
4	S.C. COMPLEXUL ENERGETIC HUNEDOARA S.A.	1,180.64
5	S.C. OLTCHIM S.A.	1,145.41
6	S.N.T.F.M. CFR MARFĂ S.A.	837.35
7	COMPANIA NAȚIONALĂ A METALELOR PREȚIOASE ȘI NEFEROASE REMIN S.A.	582.70
8	SOCIETATEA NAȚIONALĂ A CĂRBUNELUI S.A.	550.48
9	APATERM S.A.	410.90
10	C.E.T. GOVORA S.A.	391.73
	% din total	**73.71%**

Top 10 arrears in Dec. 2016

	Company name	Arrears (mil.lei)
1	COMPANIA NAȚIONALĂ A HUILEI S.A. ÎN LICHIDARE	5,413.69
2	RADET BUCUREȘTI	3,526.94
3	ELECTROCENTRALE BUCUREȘTI S.A.	1,426.22
4	S.C. OLTCHIM S.A.	1,180.49
5	S.C. COMPLEXUL ENERGETIC HUNEDOARA S.A.	1,048.55
6	REGIA AUTONOMĂ PENTRU ACTIVITĂȚI NUCLEARE R.A.	770.78
7	S.N.T.F.M. CFR MARFĂ S.A.	579.49
8	COMPANIA NAȚIONALĂ A METALELOR PREȚIOASE ȘI NEFEROASE REMIN S.A.	573.23
9	CENTRALA ELECTRICĂ DE TERMOFICARE IAȘI (C.E.T.) S.A.	560.98
10	SOCIETATEA NAȚIONALĂ A CĂRBUNELUI S.A.	550.47
	% din total	**67.28%**

Top 10 arrears in dec. 2015

	Company name	Arrears (mil.lei)
1	COMPANIA NAȚIONALĂ A HUILEI S.A. ÎN LICHIDARE	4,865.05
2	RADET BUCUREȘTI	3,407.85
3	S.C. OLTCHIM S.A.	1,224.82
4	S.C. COMPLEXUL ENERGETIC HUNEDOARA S.A.	662.83
5	COMPANIA NAȚIONALĂ A METALELOR PREȚIOASE ȘI NEFEROASE REMIN S.A.	572.35
6	SOCIETATEA ROMÂNĂ DE TELEVIZIUNE	559.39
7	CENTRALA ELECTRICĂ DE TERMOFICARE IAȘI (C.E.T.) S.A.	557.35
8	SOCIETATEA NAȚIONALĂ A CĂRBUNELUI S.A.	518.80
9	ELECTROCENTRALE BUCUREȘTI S.A.	498.46
10	S.N.T.F.C. CFR CĂLĂTORI S.A.	490.28
	% din total	**62.93%**

Top 10 arrears to the consolidated general budget in Dec. 2017

	Company name	Arrears (mil.lei)
1	COMPANIA NAȚIONALĂ A HUILEI S.A. ÎN LICHIDARE	5,403.95
2	ELECTROCENTRALE BUCUREȘTI S.A.	952.23
3	S.C. COMPLEXUL ENERGETIC HUNEDOARA S.A.	919.83
4	SOCIETATEA NAȚIONALĂ A CĂRBUNELUI S.A.	537.37
5	ROMAERO S.A.	281.95
6	S.C. ELECTROCENTRALE CONSTANȚA	216.37
7	REGIA AUTONOMĂ DE TRANSPORT PUBLIC IAȘI R.A.	181.66
8	AVERSA S.A.	162.18
9	SOCIETATEA NAȚIONALĂ "ÎMBUNĂTĂȚIRI FUNCIARE" S.A.	138.17
10	SOCIETATEA COMERCIALĂ DE REPARAȚII LOCOMOTIVE C.F.	115.92
	% din total	**83.56%**

Top 10 arrears to the consolidated general budget in Dec. 2016

	Company name	Arrears (mil.lei)
1	COMPANIA NAȚIONALĂ A HUILEI S.A. ÎN LICHIDARE	5,403.95
2	S.C. COMPLEXUL ENERGETIC HUNEDOARA S.A.	787.67
3	ELECTROCENTRALE BUCUREȘTI S.A.	735.70
4	SOCIETATEA NAȚIONALĂ A CĂRBUNELUI S.A.	537.35
5	REGIA AUTONOMĂ PENTRU ACTIVITĂȚI NUCLEARE R.A.	535.62
6	SOCIETATEA ROMÂNĂ DE TELEVIZIUNE	517.11
7	CENTRALA ELECTRICĂ DE TERMOFICARE IAȘI (C.E.T.) S.A	422.51
8	MOLDOMIN S.A.	260.41
9	ROMAERO S.A.	240.16
10	S.C. ELECTROCENTRALE CONSTANȚA	207.53
	% din total	**79.57%**

Top 10 arrears to the consolidated general budget in Dec. 2015

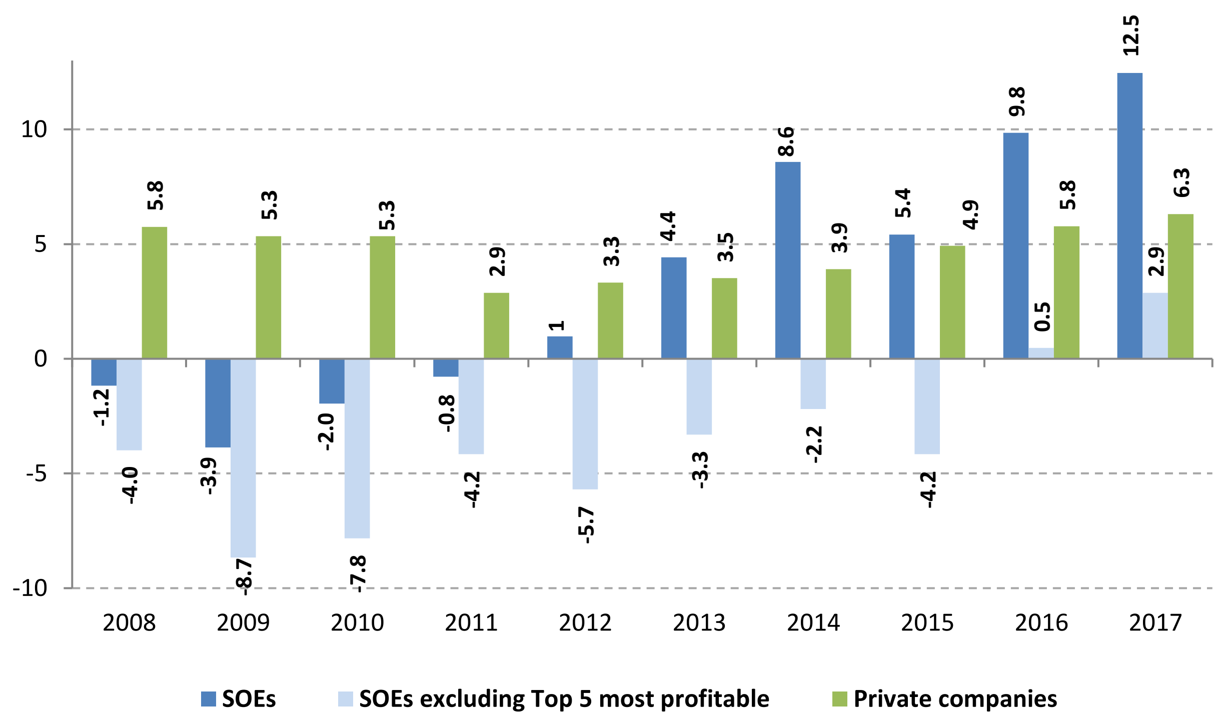
	Company name	Arrears (mil.lei)
1	COMPANIA NAȚIONALĂ A HUILEI S.A. ÎN LICHIDARE	4,851.92
2	S.C. COMPLEXUL ENERGETIC HUNEDOARA S.A.	531.69
3	SOCIETATEA NAȚIONALĂ A CĂRBUNELUI S.A.	505.68
4	SOCIETATEA ROMÂNĂ DE TELEVIZIUNE	459.49
5	CENTRALA ELECTRICĂ DE TERMOFICARE IAȘI (C.E.T.) S.A	41991
6	MOLDOMIN S.A.	261.41
7	SOCIETATEA NAȚIONALĂ A CĂILOR FERATE ROMÂNE R.A.	241.71
8	S.C. ELECTROCENTRALE CONSTANȚA	197.58
9	REGIA AUTONOMĂ PENTRU ACTIVITĂȚI NUCLEARE R.A.	174.39
10	AVERSA S.A.	160.93
	% din total	**77.20%**

Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

The operating margin of state-owned enterprises improved in 2017 compared to the year 2016, from 9.8% to 12.5%, being at the same time at a higher level than the one registered by the private sector. Excluding Top 5, the indicator had a value of 2.9%, recording a significant increase compared with the previous year when it was only 0.5%.

In 2017 continued the upward trend of the operating margin which measures the profitability of the core business activities by reporting earnings before interest and taxes to total revenues. The level of the indicator increased from 9.8% in 2016 to 12.5% in 2017, significantly exceeding the 6.3% value for the private companies. This evolution was determined by the faster pace of growth of operating result by about 37% compared to the growth rate of total revenues of about 8.2%. Excluding Top 5 most profitable state-owned enterprises (SOE), the indicator is reduced to 2.9%, but there is a significant increase from 0.5% in the year 2016 (the first positive value recorded since 2008). The gap registered when excluding the Top 5 SOEs is considerable suggesting their extremely high impact on the aggregate level. In addition, the top five companies manage to achieve very good results that offset the relatively low performance of the others, significantly improving the average of the entire state-owned sector.

Figure 3: Operating margin (%)



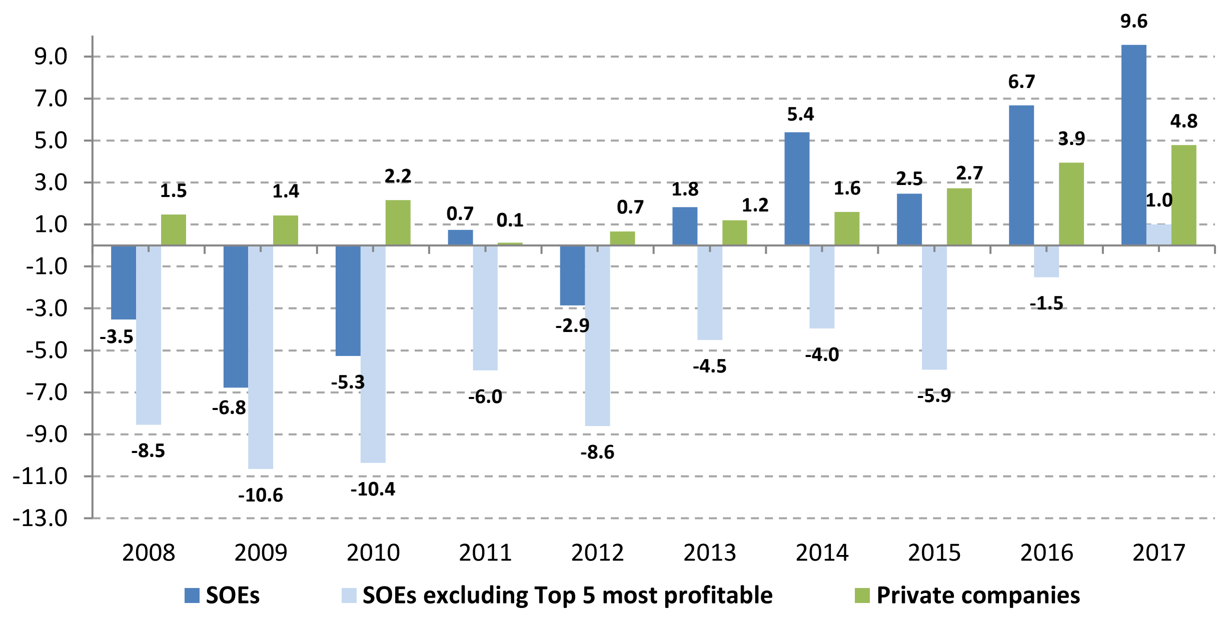
Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

*Note: Operating surplus (%) = Operating surplus/Total income * 100 (the operating surplus does not include the interest expenses and those related to income taxes).*

The profit margin of state-owned companies continued to be on an upward trend in 2017, reaching the level of 9.6% from 6.7% in 2016. The evolution of the indicator exceeded the performance of private companies, being in line with the overall positive dynamics of economic activity.

The improvement of the operational efficiency of SOEs (attested by the operating margin) is also visible at the level of the profit margin. The indicator increased significantly from 6.7% in 2016 to 9.6% in 2017 as a result of the faster growth of the net result (55%) compared to total revenues (8.2%). Moreover, SOEs' profit margin exceeded the one recorded by private companies (4.8%, also higher in comparison with 3.9% in 2016). Excluding the top five companies, the profit margin value is only 1%, but there is considerable improvement compared to 2016 (when it was -1.5%). It is also noteworthy that in 2017 this indicator recorded for the first time a value greater than 0 due to the net positive result. The differences between the operating margin and the profit margin are explained by the fact that the latter takes into account the financial and extraordinary results. Thus, due to the negative impact of interest expenses on the net income, the profit margin recorded lower values relative to the operating margin.

Figure 4: Profit margin (%)



Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

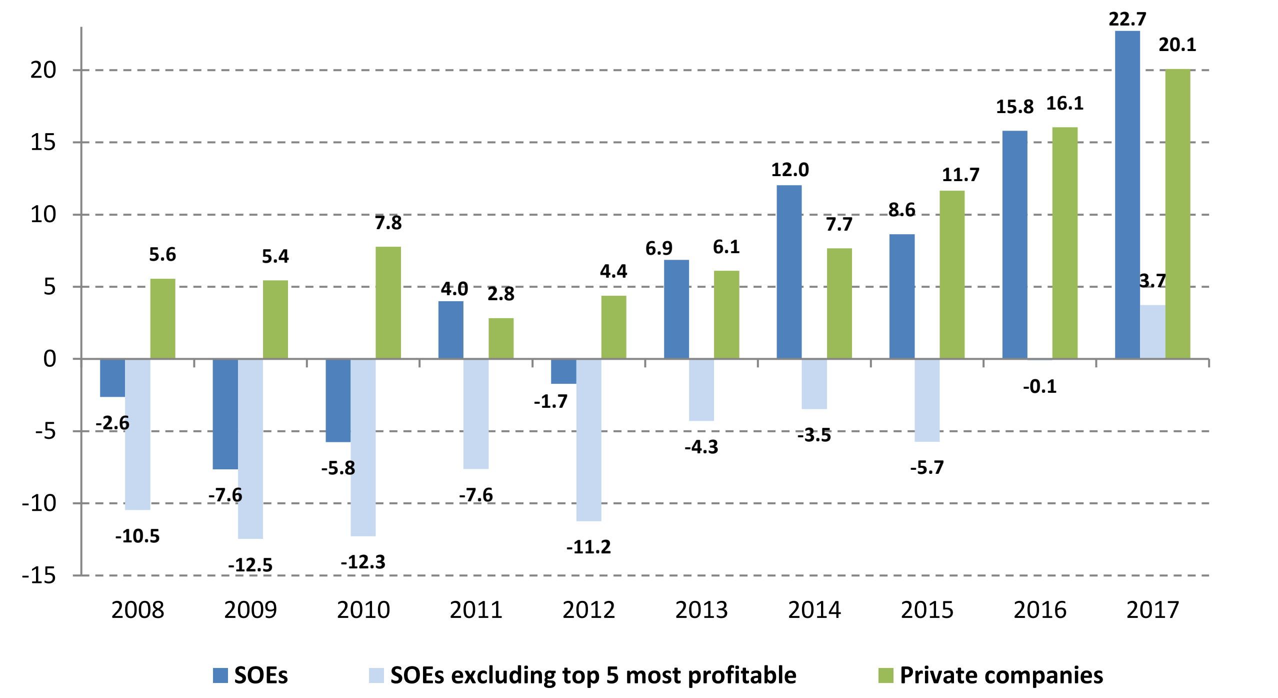
*Note: Profit margin (%) = Net result/Total income*100*

The indicator gross profit per 1,000 employees continued to increase in 2017 for state-owned companies mainly due to a sustainable increase of the gross profit. Excluding the top five companies, the gross profit per 1,000 employees register for the first time positive values and the results are significantly improved relative to 2016. Private companies have continued the upward trend from previous years and, for all the categories of companies included in the study, 2017 marks the maximum values of the indicator gross profit per 1,000 employees for the entire analyzed range.

Gross profit per 1,000 employees is an indicator that measures the average profit generated by every 1,000 employees, assessing the company's effectiveness in using its own employees to maximize profits. For SOEs, the indicator continued to increase in 2017, reaching the level of 22.7 from 15.8 in 2016. This result is driven by the sustainable growth of the gross profit (by about 40%) doubled by the decrease of about 3% in the number of employees. At the same time, in 2017, the indicator level was about 2.6 pp above the level recorded by private sector companies.

However, the aggregate evolution of SOEs is influenced by the top five most profitable companies: in 2017 they registered a gross profit of 5,244 million lei, while the remaining SOEs recorded a gross profit of only 955 million lei. Therefore, the gap between the top five companies and the other SOEs is considerable (although they have not experienced losses as in previous years), significantly influencing the overall results. Nevertheless, even when the top five companies are excluded, there is a notable improvement of the indicator: 3.7 million lei in 2017 compared to -0.1 million lei in 2016. Positive developments are also registered by private companies: their gross profit per 1,000 employees increased from 16.1 million lei in 2016 to 20.1 million lei in 2017. It is important to note that, for all the categories of companies included in the study, 2017 marks the maximum values of the indicator for the entire analyzed range.

Figure 5: Gross profit per 1,000 employees (million lei)



Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

The return on equity generated by state-owned companies increased in 2017 compared to 2016, but continues to be lower than the one obtained by private firms: 3.9% against 9.6%. Thus, the ability of state-owned companies to generate value for their shareholders is rather poor.

The return on equity (ROE) and the return on assets (ROA) are some of the most relevant indicators of a company's profitability:

- ROE measures the efficiency of equity (how many lei of profit brings a leu invested in equity by the shareholders);
- ROA measures the efficiency of assets (how many lei yields a leu invested in the company's assets).

In 2017, SOEs recorded an improvement in both rates of return, mainly driven by the net profit growth of nearly 55%. Thus, ROE reached the level of 3.9% while ROA increased to 2.8%, both representing the maximum values recorded by SOEs since 2008.

The return on assets exhibited a similar evolution: for state-owned companies rose from 1.8% in 2016 to 2.8% in 2017. During the same period, the return on assets of private firms experienced a much lower

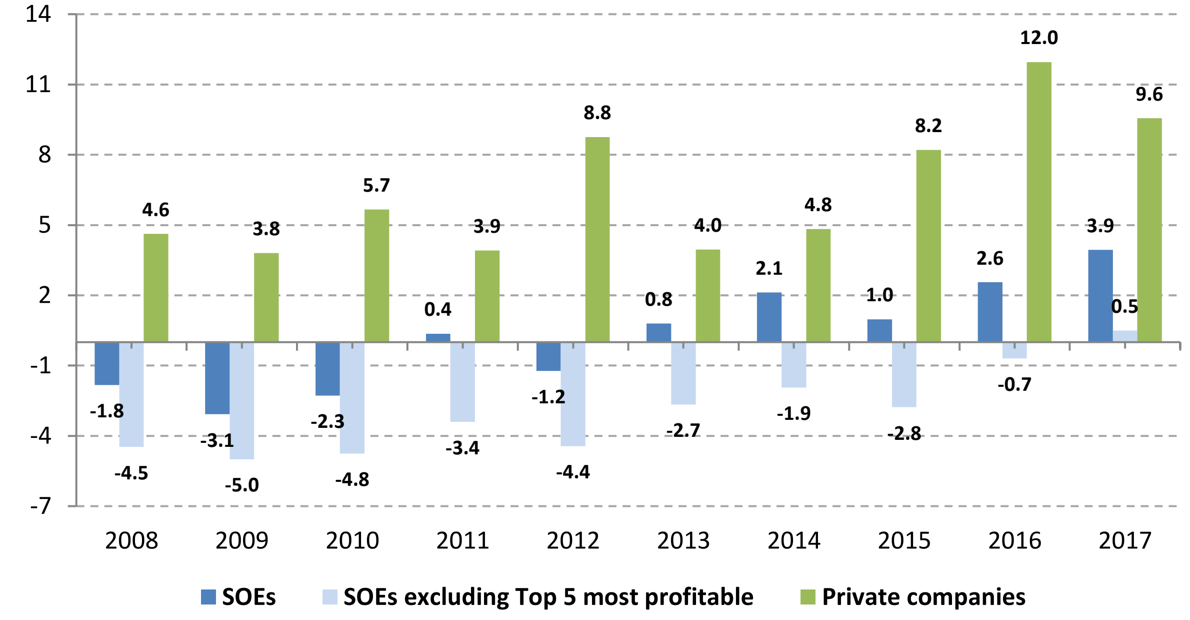
On the other hand, it should be noted that, despite these positive developments, the profitability of SOEs remains significantly lower than the profitability of private firms.

Excluding the influence of top five most profitable companies, is remarkable again a clear improvement of both rates of return, ROE reaching the value of 0.5% and ROA of 0.3%. It is important to note that 2017 is the first year of the analyzed range in which the values of these two indicators are positive. Regarding the private companies,

amplitude increase, from 3.9% to 4.1%.

ROA registered a slightly increase sustained by the net profits growth of about 30%, and ROE recorded a decline driven by the slower pace of growth of the net profit as compared to equity. Thus, ROE decreased to 9.6% from 12% in 2016, and ROA increased to 4.1% from 3.9% in 2016.

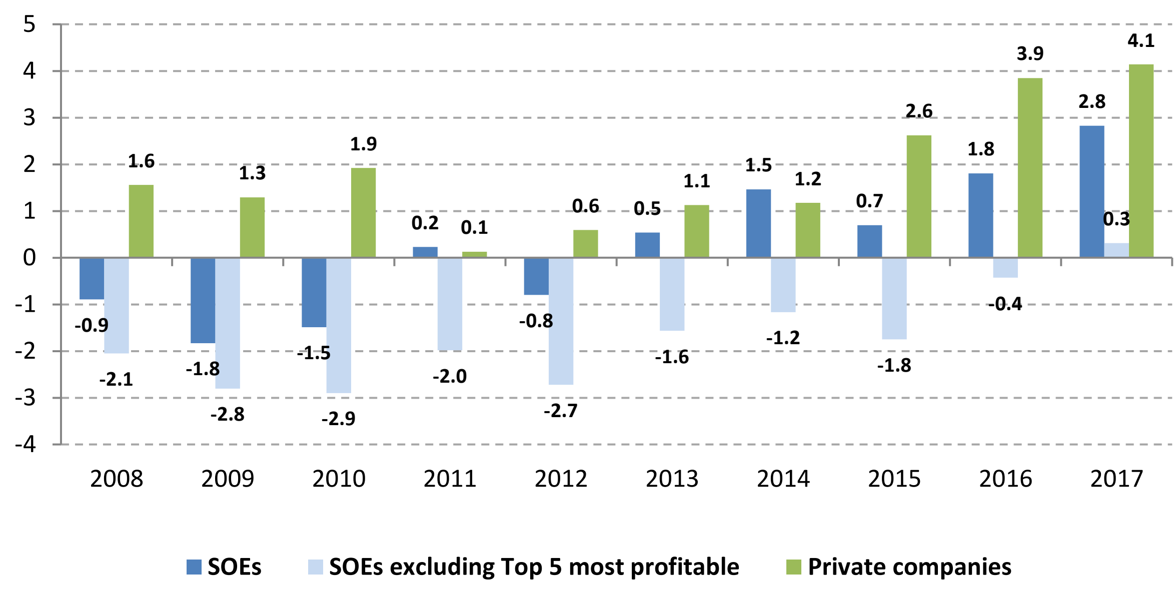
Figure 6: ROE (%)



Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

*Note: ROE (%) = Net Profit/Equity*100*

Figure 7: ROA (%)



Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

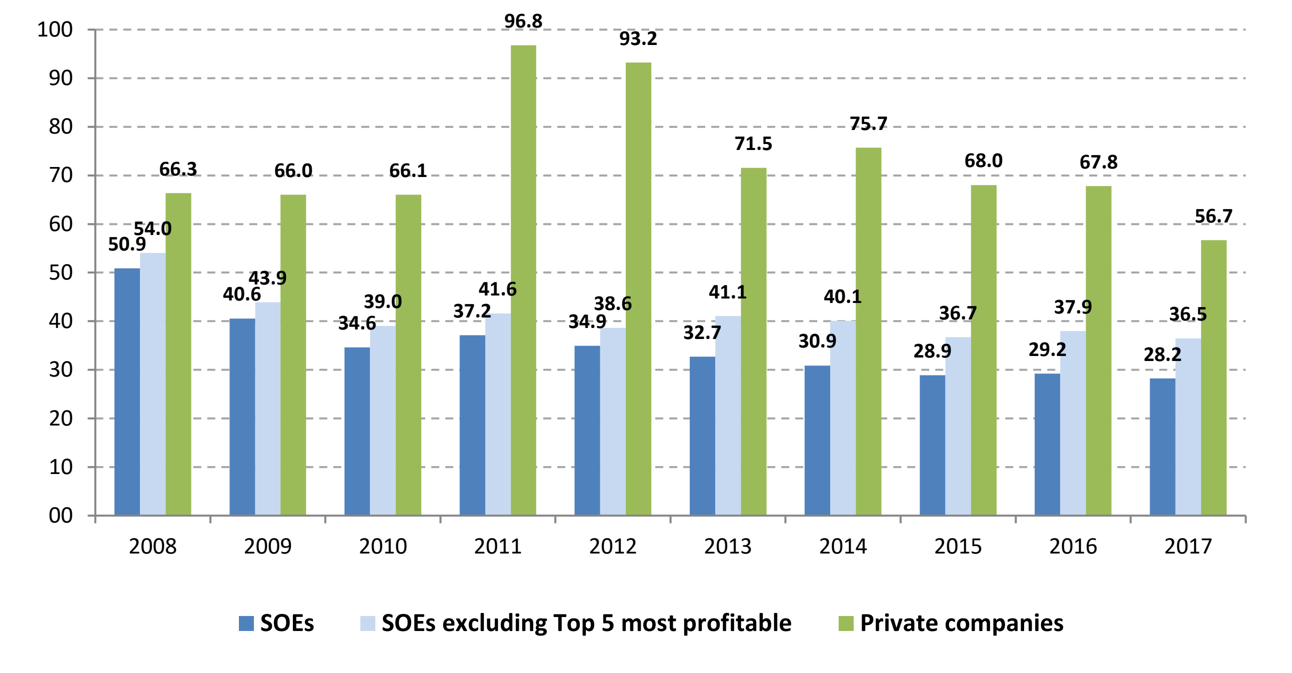
*Note: ROA (%) = Net income/Total assets*100*

The ability of state-owned companies to cover their debt has not changed significantly since 2016, but indebtedness is distributed unevenly among them, with some companies having very small amounts of debt, while others are heavily indebted. Overall, also in 2017, the share of debt in total assets of state-owned companies remained well below the level recorded by the private ones.

Concerning the indebtedness of SOEs, reflected by the ability to cover their debt with their assets, it suffered a slight decline from 29.2% in 2016 to 28.2% in 2017. This result is explained by the fact that the total assets of SOEs remained relatively stable, with the change being below 1%, while total debts decreased by about 4.5%. The result is also influenced by the uneven distribution of debt across SOEs which include large firms with very low levels of indebtedness. For private firms, the indicator reflects a significantly higher indebtedness compared to that of SOEs, with the level of 56.7%. It is also noted that this level is lower than the one registered in 2016 (67.8%). Excluding the top five SOEs, the solvency ratio is 36.5%, which in turn is very close to the level recorded in 2016 (37.9%).

In conclusion, the indebtedness analysis at the level of the state-owned companies highlights the stability of the indicator, without major changes compared to 2016, while at the level of the private companies it has evolved favorably.

Figure 8: Indebtedness (%)



Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

Note: Indebtedness *(%) = Total debt/Total assets * 100*

In 2017, the interest coverage ratio of state-owned companies registered a significantly increase compared to 2016, reaching the level of 26 from 17.6. However, this indicator should be interpreted with caution because its values are largely influenced by the top five companies in terms of profitability. Excluding Top 5 companies, the value of the indicator is 2.4, increasing compared to the previous year.

For private firms continued the upward trend in terms of the ability to repay interest expenses. Although the pace of growth was moderate, it is

The interest coverage ratio is a solvency indicator that measures a company's ability to pay interest on the accumulated debt. In essence, this indicator shows how many times a company could pay the interest owed with its available earnings. Thus, it is calculated by dividing the earnings before interest and taxes (EBIT) to the amount of interest due over a one-year period. An interest coverage ratio below 1 indicates that the company does not generate sufficient revenues to cover interest expenses and will have to use its reserves for this purpose.

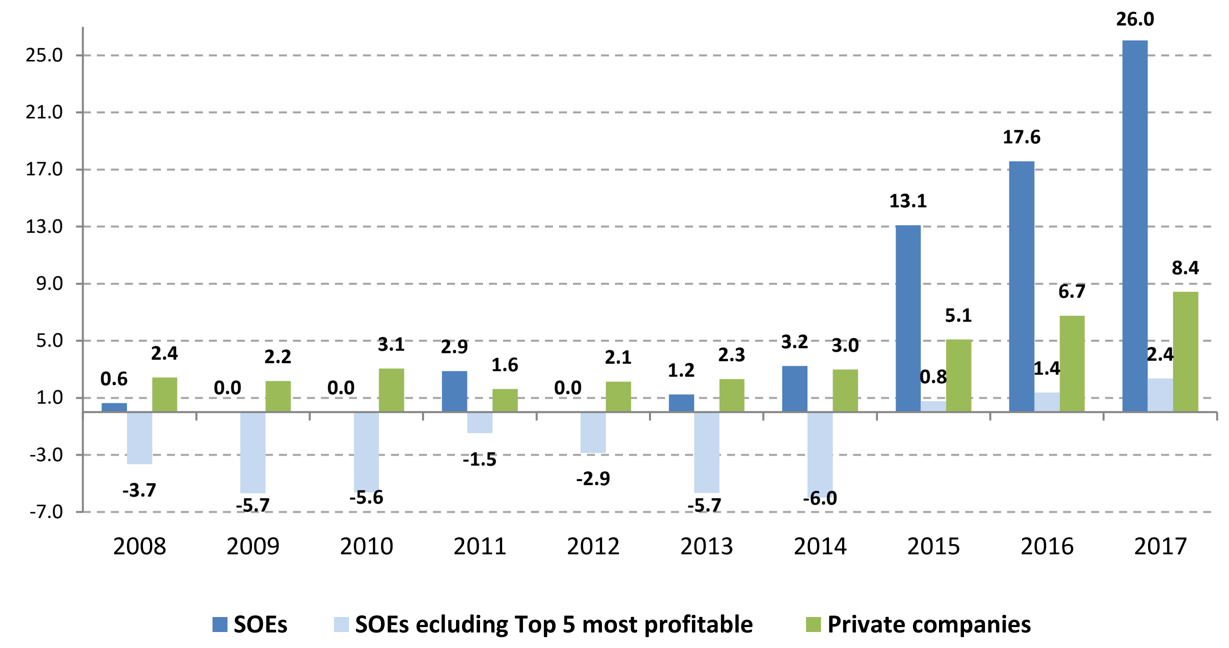
After a considerable increase between 2014 and 2015 (from 3.2 to 13.1), the interest coverage ratio of SOEs continued to grow also in 2017, reaching the value of 26 from 17.6 in 2016. This evolution should be interpreted with caution because the indicator is strongly influenced by the top five companies in terms of profitability. Thus, on one hand, they recorded large operating profits and, on the other hand, they reported low interest expenses or even equal to 0 in the case of S.N.T.G.N. Transgaz S.A. Consequently, their interest

expected that the trend will be sustainable, being supported by significant increases in the operating and net results.

coverage ratios are very high (reaching a maximum of 682,958.34 in the case of S.N.G.N. Romgaz S.A.) and the important weight of the top five companies, relative to all SOEs, influences significantly the results of the indicator for the entire category.

Excluding the top five companies, the interest coverage ratio for the remaining SOEs has a smaller value of just 2.4, also higher in comparison with 2016. It should be noted that during the analyzed period the value of this indicator is for the second consecutive year above the critical threshold of 1, continuing the favorable trend from 2015 when it returned to positive values. This increase could indicate a notable improvement in the solvency of SOEs. Private firms continued the upward trend in terms of the ability to repay interest expenses, with the indicator rising from 6.7 in 2016 to 8.4 in 2017. It is expected that this increase to be sustainable, being supported by significant increases in the operating and net results from the last three years.

Figure 9: Interest coverage ratio



Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

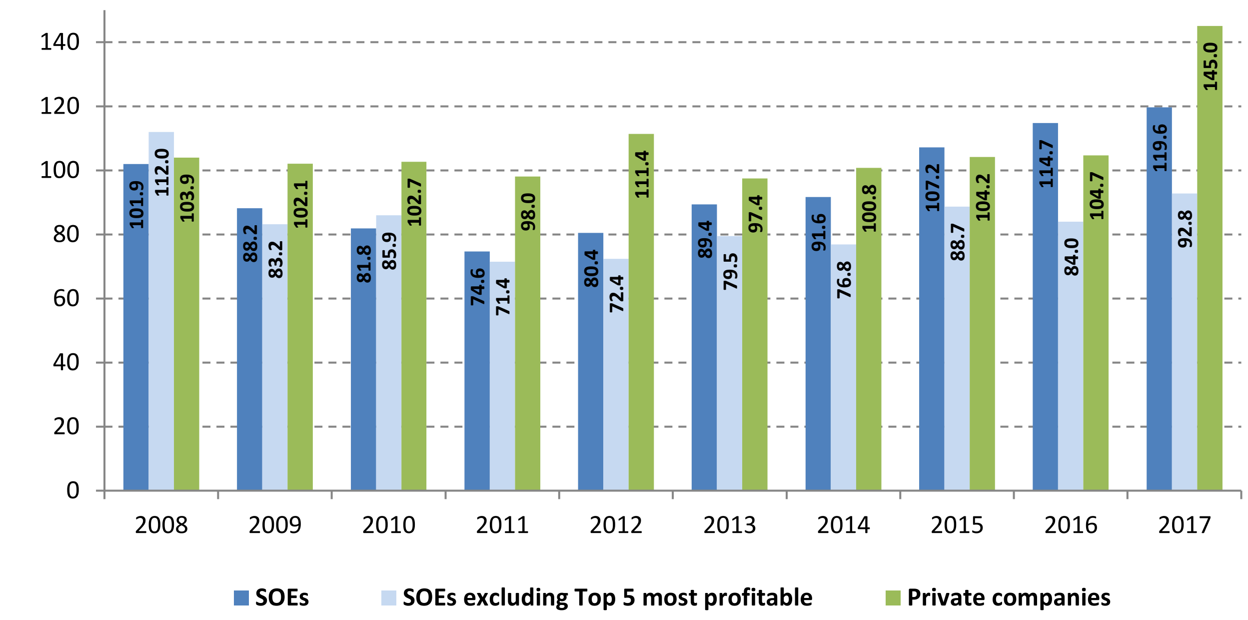
Note: Interest coverage ratio = (Profit or current loss + Financial profit or loss + Adjustments for provisions - Other income + Other expenses + Interest expenses – Interest incomes)/Interest expenses

In 2017, the liquidity ratio of state-owned enterprises (119.6%) continued to evolve on an upward trend, but was below the level registered by the private sector companies (145%). Excluding the top five state-owned companies in terms of profitability, the liquidity ratio increased from 84% to 92.8%, but continues to be below the recommended threshold.

The current liquidity ratio is an indicator that measures a company's ability to pay its short-term liabilities with current assets. The higher the ratio, the greater the ability of the company to pay its short-term liabilities, while a ratio below 1 may indicate that the company is unable to pay its outstanding debt. On the other hand, a high value of the indicator (greater than 3) does not necessarily imply that the company is in a state of exceptional liquidity. Depending on how the company's assets are allocated, a high current liquidity may suggest that the company does not use its assets in an efficient manner, or it doesn't attract funding.

In the year 2017, the liquidity ratio of SOEs continued to evolve on an upward trend, reaching the value of 119.6%. This level is below the liquidity ratio recorded by private firms which increased from 104.7% in 2016 to 145% in 2017. Thus, both categories of companies exhibited liquidity ratios that can be considered adequate. Excluding the top five SOEs, there is significant improvement of the liquidity from 84% to 92.8%, but this value remains well below the aggregate level and the recommended threshold of 100%.

Figure 10: Liquidity ratio (%)



Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

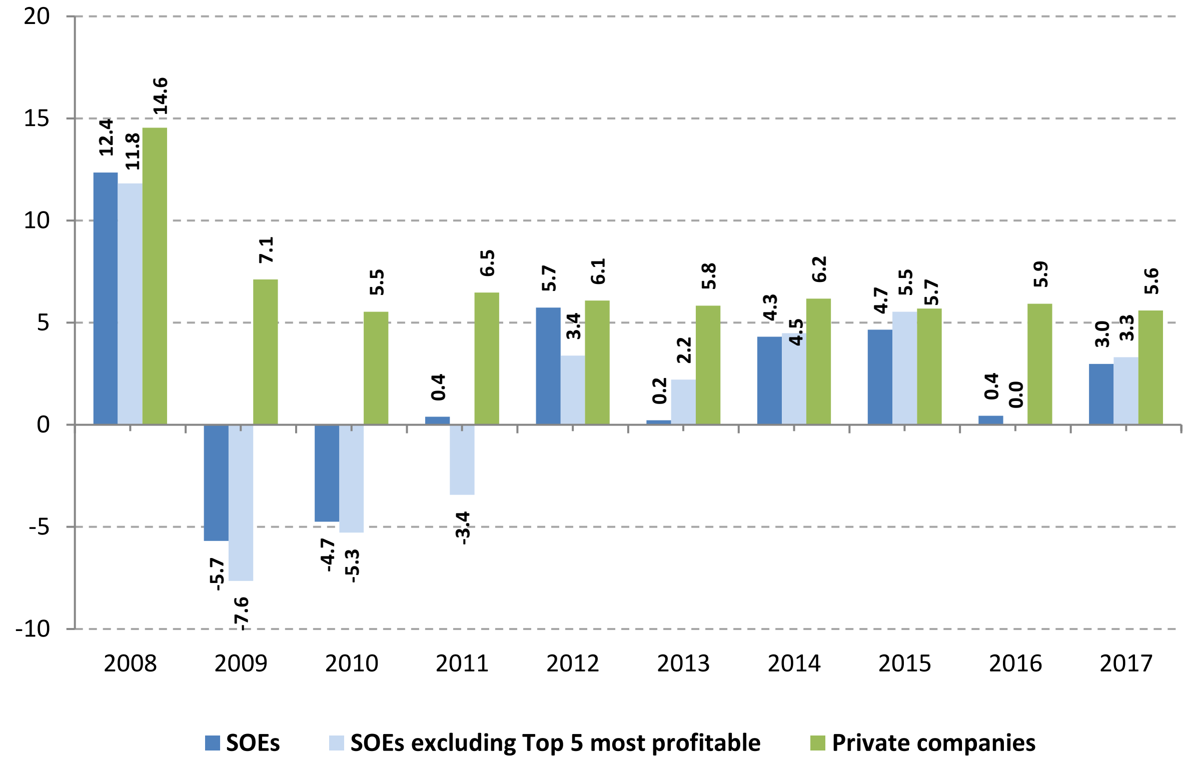
*Note: Liquidity ratio (%) = Current assets/Short term debts *100*

In 2017 the new investment ratio for state-owned companies registered a considerable increase both at the aggregate level and excluding Top five companies. On the other hand, the indicator recorded a slight decrease for private companies, but continued to remain around 6%.

After 2016, when the new investments in state-owned companies registered a drastic decrease by almost 91.5% compared to previous year, reaching 0.4%, in the year 2017 its level increased significantly reaching 3%.

Excluding the top five SOEs, the increase is even more pronounced, the new investment ratio reaching 3.3% from a value almost close to 0. Thus, the results confirm that this indicator exhibits a high volatility in the case of SOEs, with sudden evolutions from one period to the next. On the other hand, in the case of private firms the ratio of new investments has recorded an insignificant decrease from 5.9% to 5.6%, thus, remaining around 6% for the entire 2010-2017 interval. At the same time, it should be noted that, for all the companies included in the analysis, the ratio of new investments is still considerably lower than its pre-crisis levels.

Figure 11: New investments (% of total assets)



Source: MPF, based on the annual financial reports submitted by economic agents from the non-financial sector

Note: New investments are calculated as the change in non-financial assets + amortization and depreciation expenses.

With the entry into force of the Emergency Ordinance no. 109/2011 regarding the corporate governance of public enterprises, there has been a visible progress in increasing the transparency and monitoring of the activity of state-owned companies.

The improvement of SOEs' performance in the period 2015-2017 was also supported by the legislative reforms embodied by the enforcement of the Emergency Ordinance no. 109/2011 regarding corporate governance of public enterprises. This represented a major step in the implementation of the best corporate governance practices and aimed at depoliticizing and professionalizing the management of SOEs, both regarding the selection, appointment and functioning of the Board of Directors and managers, and in terms of increasing the transparency and providing information in order to increase the public companies' accountability.

Despite the recommendations of the international financial institutions to consolidate the progress and bring the financial performance of

In the year 2016, new regulations were formally introduced to promote corporate governance: Law no. 111/2016 with the associated implementing rules (Government Decision no. 722/2016), the establishment of a specialized department within the Ministry of Public Finance for overseeing the implementation of the

state-owned enterprises to a level comparable to that of the private sector, the latest amendments made in 2017 to the Law no. 111/2016 on approving Emergency Ordinance no. 109/2011 regarding the Corporate Governance of Public Enterprises have severely limited the scope of the principles of good corporate governance practices in state-owned companies by restricting the number of state corporations subject to this corporate governance law.

provisions of GEO no. 109/2011, monitoring the activity of public enterprises with the obligation to report some performance indicators on the basis of which MFP draws up an annual report on the activity of public enterprises, and so on. Among the performance indicators related to corporate governance, are included: developing executive management evaluation models, implementing the evaluation process and remuneration policies of the CEO; implementing the code of ethics, the corporate governance code, and ensuring transparency regarding public information; setting, reviewing and pursuing the performance indicators at the level of the public enterprise. The report also shows that those SOEs that implemented the corporate governance system and have selected professional administrators, performed better in terms of optimizing their financial and operational efficiency.

Nevertheless, and despite the recommendations of the international financial institutions aiming to consolidate the progress made with the purpose of aligning the financial performance of the SOEs to a level comparable to that of the private sector's companies, following the publication of the Law no. 111/2016 approving the Emergency Ordinance no. 109/2011[8], a number of legislative changes were introduced that led to the *de facto* non-application of the initial provisions aimed at strengthening corporate governance for SOEs. Thus, according to the legislative proposal that was approved by the Chamber of Deputies in December 2017, there were exempted from the applicability of the provisions of GEO no. 109/2011 dozens of companies and institutions[9], most of them in the field of defense sector, energy sector, chemical industry, road infrastructure, etc. Practically, at the entry into force of the law thus amended, the provisions of GEO no. 109/2011 on corporate governance no longer

[8] Legislation regarding promoting corporate governance has been amended several times between 2016-2018 through a series of Orders of the Minister of Public Finance. Thus, OMPF no. 41/2014 was repealed by OMPF no. 2873/2016 with application from May 2018, and this was also modified by OMPF no. 768/2017, while Order no. 2874/2016 was amended by Order no. 3233/2017, and, subsequently, in 2018 being abrogated by Order no. 1952/2018 regarding the regulation of the procedure for monitoring the implementation of the provisions of GEO no. 109/2011 on the Corporate Governance of Public Enterprises.

[9] Among them are: Fabrica de Arme Cugir S.A., C.N. Poșta Română S.A. and the companies owned by it, Societatea Complexul Energetic Oltenia S.A., R.A., Tehnologii pentru Energia Nucleară, Hidroelectrica S.A. and the companies owned by it, S.N. ROMGAZ S.A. and so on. For the complete list of companies exempted from the applicability of the provisions of GEO no. 109/2011 – see http://www.cdep.ro/comisii/economica/pdf/2017/rp226.pdf.

apply to most SOEs. In February 2018 the Law no. 111/2016 was appealed to the Constitutional Court of Romania, which admitted the objection of unconstitutionality of the Law, regarding the amendment of Article 1 paragraph (3) of GEO no. 109/2011, as a series of legislative and procedural technical norms were violated, among which the most important ones are the exclusion of 100 state-owned companies from the scope of the law, as well as the possibility of modification and completing the law by Government decrees, which are acts of inferior legal power, and breach of the principle of bicameralism (see CCR Decision no. 62/ 13.02.2018[10]).

However, the final form of Law no. 111/2016 adopted by the Senate and applicable since June 4, 2018 remained practically unchanged[11] compared to the December 2017 version, regarding the list of public enterprises exempted from the applicability of GEO no. 109/2011 (even the list was supplemented with RA Rasirom and CN Romtehnica SA). Subsequently, GEO no. 73/07.07.2018 granted the right to ensure the executive management of the company to the private investor, even a minority shareholder, who has the financial and technical capacity necessary to develop its activity.

It is worth noting the large differences between the reports on the activity of the state-owned companies elaborated by the MPF specialized department, respectively, the *Report for the year 2017 regarding the activity of the public enterprises under the authority or in the administration of MPF, acting as a shareholder behalf the state,* compared to the *Public Enterprises Activity Report in 2016*[12], both as the number of state-owned enterprises monitored and regarding monitoring the corporate governance performance indicators specified in the law. This can be seen as diminishing the commitment to apply the corporate governance principles based on professionalism, integrity, transparency and accountability, that

The impact of state companies on the budget balance in European standards ESA10 was positive in 2013-2017, the contribution of the companies consolidated in central government sector (the first 20 companies) and local sector being between 0.5% of

[10] See https://lege5.ro/Gratuit/gi3tqnrvgayq/decizia-nr-62-2018-referitoare-la-admiterea-obiectiei-de-neconstitutionalitate-a-legii-pentru-modificarea-art-1-alin-3-din-ordonanta-de-urgenta-a-guvernului-nr-109-2011-privind-guvernanta-corporativa-

[11] From the form adopted in December 2017, was removed the generic terminology "water and transport companies" for the companies that could be exempted from the provisions of GEO no. 109/2011.

[12] The Reports for 2017 and 2016 are published on the MPF website http://www.mfinante.ro/pagina.html?categoriebunuri=rapoarte-generale-periodice&pagina=domenii&menu=Guvernanta

GDP in 2014 and 0.25% of GDP in 2017.

could enhance the growth of the state-owned companies' value on medium and long-term.

Regarding the state-owned companies consolidated in the local government, their contribution was of small amplitude, with values alternating from negative (2014 and 2016) to positive (2015 and 2017).

The impact of state companies on the budget balance in European standards based on commitments (ESA10) may be an additional pressure on the budget deficit targets undertaken by the government in accordance with the Maastricht criteria (below 3% of GDP in ESA10 terms) and the Fiscal Compact (structural deficit below 1% of GDP). The impact on the budget deficit in ESA10 standards could manifest (i) by the issuance of state guarantees (also subject to EU rules on state aid) and especially (ii) by the reclassification of the state enterprises within the public administration.

Table 4: Contribution of state companies included in the public sector to the consolidated budget balance (million lei), ESA10 standards				
	2014	2015	2016	2017
1. Total companies at central level	**3,498.40**	**1,344.76**	**1,428.52**	**2,019.30**
C.N. de Căi Ferate CFR S.A.	501.80	424.50	524.40	1,553.00
C.N. de Autostrăzi şi Drumuri Naţionale	2,244.20	341.00	463.60	253.00
S.N.T.F.C. CFR Călători S.A.	473.00	308.00	-4.80	-12.80
COMPANIA NAȚIONALĂ DE INVESTIŢII S.A.	85.30	229.90	-13.90	68.40
S.N. RADIOCOMUNICAŢII S.A.	102.40	72.00	63.24	117.00
SOCIETATEA DE ADMINISTRARE A PARTICIPAȚIILOR ÎN ENERGIE S.A.	-1.70	68.09	29.30	4.30
SOCIETATEA ROMÂNĂ DE TELEVIZIUNE	-5.00	51.29	50.97	50.97
SOCIETATEA ROMÂNĂ DE RADIODIFUZIUNE	15.20	25.90	25.13	25.13
S.N. Aeroportul Internațional Mihail Kogălniceanu	3.20	1.00	-0.40	2.20
C.N. Administrația Canalelor Navigabile Constanţa S.A.	-19.00	-33.80	83.70	-24.40
Administrația fluvială Dunărea de Jos Galați	2.40	17.99	18.74	-16.90
Fondul Proprietatea	0.00	0.00	0.00	0.00
Institutul Național de Cercetare-Dezvoltare pentru Chimie și Petrochimie	-1.10	-8.20	-1.70	-1.00
S.N. ÎNCHIDERI MINE VALEA JIULUI S.A.	11.20	10.70	10.44	7.00
S.C. ELECTROCENTRALE GRUP S.A.	11.20	-9.90	-0.10	0.90
R.A. TEHNOLOGII PENTRU ENERGIE NUCLEARĂ	0.60	-1.10	1.30	1.30
S.C. CONVERSIM S.A.	61.00	-2.20	-1.50	-2.20
S.N. CFR R.A	-0.60	-42.60	-0.20	0.00
C.N. Administraţia Canalelor Navigabile Constanța S.A.	-19.00	-33.80	83.70	-24.40
SCTMB Metrorex SA	33.30	-74.00	96.60	17.80
2. Total companies at local level	**-60.87**	**10.80**	**-81.40**	**33.80**
Local airports	-19.10	13.10	-53.30	45.30
Heating stations with local subordination	-58.80	-36.40	-28.00	-21.20
Other local units	17.03	34.10	-0.10	9.70
3. Total SOEs	**3,437.53**	**1,355.56**	**1,347.12**	**2,053.10**
% of GDP	**0.51**	**0.19**	**0.18**	**0.24**

Source: NIS

Following the analysis of the main economic and financial indicators of state and private companies in the non-financial sector, it can be concluded that the high rate of economic growth in Romania in 2017 favored positive developments not only in the public sector but in the whole economy. Overall, the companies included in the study had significant increases in total revenue, operating result and net result, also reflected in labor productivity growth and improved return on equity and assets indicators. However, the profitability gap between state-owned companies and private sector firms remained significant, reflecting the lower capacity for efficiently using resources in the case of state companies. The results of the main risk indicators did not highlight pressing issues concerning the financial "health" of the public sector companies, as the evolution of liquidity and solvency indicators were favorable, respecting the values recommended in the literature. Regarding the rate of new investments, it is to be noted the remarkable upswing recorded by the state companies, but the indicator continues to be characterized by high volatility, specific to the entire analyzed period. On the other hand, the rate of new investments for the private companies was relatively stable in recent years and constantly at a higher level compared to the state companies.

However, as highlighted in the previous analyzes, the financial performance is not evenly distributed within the state companies, as there are some highly profitable companies influencing favorable the entire sector, but also many companies with problems, both in terms of arrears, and profitability. Thus, eliminating the impact of the best five companies in terms of net profit, there is a significantly reduced level for most of the analyzed indicators, nevertheless the developments of the recent years show a trend of improvement, which in 2017 resulted in the transition of the aggregate net profit in the positive territory. However, in order to achieve sound financial performance, we appreciate the need for additional efforts to increase the efficiency of most state-owned companies.

Regarding the financial discipline of state companies, following a slight deterioration during 2016, in 2017 the arrears continued the decreasing trend, reaching the minimum level for their share in GDP in the period under review. However, it should be noted that the share of arrears of state-owned companies in total arrears remains significantly higher than the contribution of these companies to the economic activity.

In the post-crisis period, the improvement of the economic and financial performance of SOEs was also supported by the legislative reforms materialized through the enactment of the Government Emergency Ordinance no. 109/2011 on Corporate Governance of Public Enterprises. However, the implementation in 2018 of the amendments made during the 2016-2017 period, which allowed a significant number of companies and institutions to be exempted from applying GEO no. 109/2011 represents a significant weakening, *de facto* abolishing the functionality of the good corporate governance practices in most state-owned enterprises. Thus, by diminishing the commitment to corporate governance principles based on professionalism, integrity, transparency and accountability that can ensure the growth of the value of state corporations on medium and long-term, there is a risk that the progress made in recent years will be reversed in the near future.