Fiscal Council's opinion on the State Budget Law, the Social Insurance Budget Law for 2016 and the Fiscal Strategy for 2016-2018

On the evening of December 4th, 2015, the Fiscal Council (FC) received from the Ministry of Public Finance (MPF) the letter no. 420121, dated 4 December 2015, requesting, under art. 53, paragraph (2) of the Fiscal Responsibility Law (FRL) no. 69/2010 republished, the opinions on the draft Budget Law for 2016, the Report on the macroeconomic situation for 2016 and the projections for the years 2017-2019, the draft of the Social Insurance Budget Law for 2016 and the corresponding explanatory note, and also the Fiscal Strategy (FS) for 2016-2018, the explanatory note and the associated ceilings law of certain indicators specified in the fiscal framework for 2016.

Preamble

The draft budget for 2016 incorporates the impact of the revision of the Fiscal Code, as well as the wage increases in the public sector enacted in the second semester of 2015, jointly leading to an increase in the budget deficit to 2.8% under the national methodology (cash) and to 2.95% of GDP in accordance with the European Union (EU) methodology (ESA 2010) (from an estimated level of 1.2% of GDP for 2015 in both cash basis and in accordance with the European methodology). In the opinions elaborated during the current year, the Fiscal Council has repeatedly warned about the risk of a major fiscal slippage in the conditions of implementing the proposed amendments to the Fiscal Code. Even if the final version of the Fiscal Code approved by the Parliament has reduced the pressure in the short term (but leaving it unchanged in the medium term) by postponing some of the measures proposed for 2017 (reduction of the tax on dividends, however, was frontloaded in 2016 by Government Emergency Ordinance), the enactment of substantial wage increases in the public sector in the recent months has restored the slippage's dimension projected for 2016 to its initial level.

From the Fiscal Council's point of view, the construction of the draft budget for 2016 (and its medium-term projection) is **a textbook example for everything that the Fiscal Responsibility Law no. 69/2010 was designed to prevent – simultaneous enactment of tax cuts and increases in the expenditure, both having a permanent budgetary impact, likely to create the premises for lasting and very difficult to correct deviations from a balanced budget**, objective towards which Romania committed both by national legislation (the FRL) and through the signing of the European treaties.

Moreover, the current budget projection compromises the very idea of fiscal framework based on rules, given that **all the fiscal rules stated by the FRL are violated.** The explanatory note corresponding to the associated ceilings law of certain indicators specified in the fiscal framework for 2016 received by the Fiscal Council includes in the comprehensive list of articles of law from which is made a derogation both the art. 4 para. 1 point 3, which states the very principle of fiscal responsibility and the art. 6 which states the connection between the national legislation and the Treaty on the Functioning of the European Union in terms of the reference values for the budget deficit and the public debt. The explanatory note also provides a derogation from art. 7 and art. 14 of the FRL, which implies the abdication from the commitment to correct the deviation from the MTO, once occurred.

Furthermore, the Fiscal Council reiterates its concern regarding the following:

- **It is at least questionable, from the perspective of the cyclical position of the economy, the opportunity of tax cuts of this magnitude.** The European Commission (EC) assesses the cyclical position of the economy as being in balance in 2016 (negative gap of -0.04% of GDP) and estimates a demand surplus of 0.5% of potential GDP (given that the potential GDP's growth rate would accelerate gradually from 1.8% in 2014 to 3.1% in 2017).
  - At quasi-identical levels of projections for the economic growth in 2015 and 2016 and relatively similar in 2017 to those of the European Commission[1], the National Commission for Economic Forecasting (NCEF) assesses a substantially higher dynamics of the potential GDP, the cumulative deviation from the assessment of the European Commission for 2015-2017 being 1.2 pp of GDP, which will result to a significant demand deficit, according to the NCEF, both in 2016 and 2017. The Fiscal Council is skeptical about the NCEF's scenario of an rapidly acceleration of the potential GDP's dynamics, as there are no solid arguments to support this, especially given the weak investment developments in the economy in the recent years, particularly the continuous decrease and achievement of a minimum of the last 10 years for the public investment (expressed as a percentage of GDP) in 2015, the precarious condition of the infrastructure representing the main inhibitory factor for the long-term economic growth in Romania. Furthermore, the NCEF's optimistic assessment of the potential GDP growth brings MPF a direct benefit in terms of the structural deficit dimension and the need for fiscal consolidation in the medium term to restore the compliance with the MTO.
  - Romania risk falling back into the trap of pro-cyclical fiscal policies, pressing the accelerator in the expansion phase of the economic cycle and risking to be forced to implement structural adjustment measures in a inevitable next phase

[1] The European Commission forecasts a economic growth of 3.5%, 4.1% and 3.6% during 2015-2017, while the NCEF indicates growth projections of 3.6%, 4.1% and 4.2 % during the same period.

of recession. There is a quasi-unanimity in the recent literature in identifying significantly higher levels of fiscal multipliers in the recession phase and low values during the expansion phase, which means that the benefits in terms of additional economic growth in the short term as a result of a pro-cyclical fiscal easing are outweighed by the costs that an inevitable fiscal consolidation could generate in the downward phase of the economic cycle, as otherwise the experience of Romania in the last 10 years fully demonstrates it.

- **The Fiscal Council is very reserved in regard to any positive implication that the new Fiscal Code, focused on reducing consumption taxation, has for the economic growth in the long term.** We believe that the most likely scenario is the one of a temporary plus of aggregate demand, unaccompanied by a similar impact on the long term potential growth – the reduction in the consumption taxation does not improve the domestic and external competitiveness of the domestic products. Also, the literature indicates that the effect of reducing consumption taxes on the long term economic growth is relatively modest[2].
- **The expected high budget deficits involves maintaining the medium term public debt expressed as a percentage of GDP on an upward trajectory,** despite that the use of Treasury's liquidity stock could partially accommodate the additional financing requirements. Even if the forecasted level of public debt stock (40.4% of GDP at the end of 2018) seems much lower than the reference value of 60% of GDP, the continuation of an upward trend, even moderate, of the dimension of the public debt as a share of GDP in the upward phase of the economic cycle, with an economic growth forecasted by the NCEF at levels above 4%, instead using such a period, as would be prudent, to reduce the indebtedness, **conceals the accumulation of vulnerabilities which would become apparent in a inevitable next phase of recession**. A relevant example in the sense of the rapid growth potential of the public debt in the context of adverse cyclical developments produced simultaneously with high structural deficits is Romania itself, which in 2008 recorded a public debt level of only 13.2% of GDP, in 2014 reaching a level of about 3 times higher (39.9% of GDP). Other examples of rapid growth of the public debt in the context of a prolonged recession are offered by Croatia (38.9% of GDP in 2008, 89.2% of GDP in 2015) and Finland (32.7% of GDP in 2008, 62.5% of GDP in 2014). The public debt, already relatively high for Romania's level of economic development, and the limited absorption capacity of the local financial markets (banks' exposure in Romania, the main funders of the public debt in the local market, as a percentage of total assets, is already the highest in Europe) are the essential constraints for which the budget deficits in the coming years should be small, beyond the

[2] Cournède B. et al. (2013) - "*Choosing fiscal consolidation instruments compatible with growth and equity*" **-** OECD Economics Department Working Papers, No. 07, OECD Publishing.

commitments made by Romania at the European level. Moreover, according to a recent study undertaken by the National Bank of Romania (NBR)[3], from a public debt level of 40-45% of GDP there is an adverse effect on the economic growth.

- **The idea that it would be sufficient to keep the budget deficit below 3% of GDP is incorrect.** A 3% deficit is not at all a "target", but rather a ceiling that is allowed only under cyclical effects of deep recession, which obviously is not at all the case now in Romania.
- **There is a major qualitative differences between having high structural/ effective deficits due to a path of fiscal adjustment less abrupt than necessary, as it is indeed the case for many EU countries, and achieving a high level of structural/effective deficit following a deliberate slip, in a flagrant contradiction with the principles and rules established both by national law and European treaties, as it is currently the case of Romania.** According to the European Commission projections, Romania would be among the few countries in the EU that would reverse the trend of fiscal consolidation, the magnitude of the increasing structural budgetary deficit in the period 2015-2017 being by far the highest in the EU. In addition, according to the same projections, Romania, along with Croatia and France are the only EU countries that would exceed even the 3% of GDP ceiling for the budget deficit in 2017. Such a situation would probably be penalized by the financial markets, especially in the occurrence of adverse shocks in international markets or even a predictable process of normalizing interest rates in major financial markets. Such a development would further narrow the operating space of the fiscal policy, through potential increase in the interest costs of the public debt. Currently Romania benefits of very low financing costs according to historical standards, the result of overlapping two factors – high liquidity and interest rates to historic lows in international markets and the correction of macroeconomic imbalances in Romania as a result of the adjustment efforts during the previous years.

Budgetary revenues and expenditures in 2016 budget draft

The budget's construction for next year aims at a 2.8% of GDP cash deficit, corresponding to a 2.95% of GDP deficit under the EU methodology (ESA 2010). According to the budget draft, the fiscal slippage from a cash deficit estimated for 2015 of 1.2% of GDP (according to the preliminary execution) to one of 2.8% of GDP occurs in a context where there is a reduction in budgetary revenues as a percentage of GDP of 1.3 pp, a direct consequence of the tax cuts legislated in the new Tax Code and other acts (a list of these together with their budgetary impact is included in Annex 2) simultaneously with an expansion of total expenditure by 0.3 pp

[3] The Financial Stability Report, 2015, the National Bank of Romania, p. 163.

of GDP, mainly due to public sector wage increases. The Fiscal Council's comments on the dynamics of the individual categories of revenues and expenditures refers to the corrected evolutions for the impact of compensation schemes (swaps with neutral impact on the budget deficit) to settle outstanding budgetary obligations implemented in 2015 and designed for 2016.

The decreasing of the budgetary revenues to GDP ratio (compared with the preliminary implementation of 2015) is located at the level of VAT aggregates (-1 pp of GDP) and taxes on income and salaries (0.2 pp of GDP). In the first case, the reduction is due to the impact of reducing the standard VAT rate from 24% to 20% starting from January 1st 2016, to which are added the rest of the annualized impact associated to the extending of the reduced VAT on food products, restaurant and catering services, and the impact of extending the VAT rate of 9% for the deliveries of potable water and for irrigation in agriculture. In the second case, the reduction of the income tax and wages revenues appears as a result of the 5% reduced tax on dividends to 5%, and the increased personal tax deduction.

The projection of revenues for 2016 include temporary influences from a new compensation scheme of outstanding obligations towards the budget (swap) with an symmetrical impact in budgetary revenues and expenditures of 850 million lei (in revenues the impact appears on VAT) as well as the tax amnesty legislated which is expected to generate additional revenue from the unpaid tax liabilities valued at 413.8 million lei (the annex shows their distribution by type of revenues).

At the level of budget expenditures increases as a percentage of GDP occur in the personnel expenditures (+0.3 pp, but the personnel expenditures from the 2015 preliminary execution - the comparison base – include about 4.1 billion lei temporary expenses following the favorable court sentences of some categories of employees in the public sector[4]), expenses with goods and services (0.2 pp of GDP, but largely determined by the value of corresponding cost-volume contracts concluded by the National Health Insurance House with counterpart on the budget revenues), capital expenditures (0.2 pp of GDP), and finally at the level of interest expenses (0.1 pp of GDP). In the opposite direction, evolves the expenditure on projects with grants from the EU (in both fiscal years 2007-2013 and 2014-2020) whose share in GDP falls by 0.6 pp.

The Fiscal Council does not have major reserves regarding the macroeconomic projection that underlies the draft budget, except those already made in terms of the potential GDP growth forecast. At the level of the revenue aggregates, however, the Fiscal Council's estimates indicate an overvaluation of VAT revenue in an amount of 3.2 billion lei, out of which about one third has as a source an assessment above that of the MPF of the first-round effect for 11

[4] Adjusting for these, the leap of the personnel expenditures to GDP ratio would be 0.9 pp.

months of reducing the standard VAT rate to 20% (the assessment method of the Fiscal Council, which indicates an impact of about 8 billion lei compared to 7 billion lei the MPF's assessment is provided in the Annex). The extrapolation of the estimated VAT revenues with the growth of nominal consumption for the current year, adjusted for the likely level of swap execution in 2015 as well as the favorable temporary impact (on the first months of 2015) determined by the significantly higher reimbursements of VAT incurred at the end of 2014, and adjusted with the impact of the discretionary measures for the rest of 2016, produce the remaining difference of about 2.2 billion lei. However, the Fiscal Council identifies differences in the opposite direction (the MPF's assessment appears to be more conservative than that of the Fiscal Council) on the level of revenues from corporate income tax - considering historical developments it is justified the use of an elasticity to the dynamics of nominal GDP of around 2, superior to the default one of 1 used by MPF, and therefore we identify possible additional revenues of about 962 million lei from profit tax, and in the revenues from the personal income tax - we identify a likely surplus of about 392 million lei. Overall, **FC identifies an overstatement of revenues of about 2 billion lei (0.3% of GDP)**.

The Fiscal Council has no major reserves regarding the sizing of the expenditure aggregates, but considers as possible oversized (in line, otherwise, with the practice of the past years) the expected level of interest expenses and identifies here a potential source of budgetary savings of about 500 million lei. However, a prudent level of interest expenditures appears to be justified given that recording a large budgetary slippage, cumulated with adverse external shocks, could have a negative impact on the funding costs of the state.

The expenses for the investments are planned to record a consistent growth in 2016 (+4 billion lei) compared with the preliminary execution for the current year, the increase being localized to an overwhelming extent in the category of capital expenditures (3 billion lei), with lower projected pluses in other investments type transfers (665 million lei). However, the budget executions in the past consistently recorded considerable deviations from the initially budgeted amounts or the subsequent budget amendments - meaning a lower capital expenditure allocation (see chart in appendix): the preliminary execution for 2015 indicates a historic low of the last 10 years in terms of the level of investment expenditure as a percentage of GDP (4.8%), despite some initial allocations that appeared as extremely generous. A similar development cannot be ruled out for 2016, while the apparent assumption in the budget projection of a relatively high absorption of structural funds under the new financial year 2014-2020 can be considered optimistic - historically, the initial estimates regarding the absorption never have been materialized to the projected levels.

The Fiscal Strategy for 2016-2018

As regards the Fiscal Strategy 2016-2018, the attention of the authorities once again appears as exclusively focused on the short term (next year), without paying the same consideration to the medium-term budgetary perspective. In almost all the fiscal strategies that the Fiscal Council has received over the years (starting with 2010), the practice of generating with an extremely high easiness fiscal consolidation over the medium term without a rigorous justification of the budgetary revenue and expenditure, could be observed. Similarly, the current strategy indicates an extremely modest deterioration of the structural deficit in 2017 (of 0.1% of GDP), although the second tranche of the tax cuts according to the new Fiscal Code will be implemented, followed by a structural adjustment of approximately 0.5 pp of GDP in 2018. At the end of the horizon of this strategy, the gap from the medium-term objective (MTO) remains substantial, with a necessary structural consolidation (as estimated by MPF) of about 1.4 pp of GDP.

Illustrative for the above mentioned idea is the surprising manner of maintaining relatively constant the level of the headline budget deficit in 2017. As in the previous two iterations of the fiscal strategy, there is an obvious mismatch between the expenditure related to programs financed by European funds and the EU funds revenues - the underestimation of the necessary co-financing spending for a certain amount of EU funds revenues generating, *ceteris paribus*, lower deficits. Thus, computing the needed co-financing spending as the difference between the aggregate amount of the costs of the projects financed by non-reimbursable funds for both financial exercises (before consolidation) and the expected inflows from post accession grants (also from both financial exercises), the level of co-financing spending is lower in 2017 than the implicit level from the budget projection for the year 2016 by about 2.4 billion lei, despite the fact that EU funds revenues are expected to be higher by about 800 million lei. We are very skeptical that this is a reasonable assumption, especially in the context of launching new investment projects financed by the allocations for the financial exercise 2014-2020 that would imply a higher volume of ineligible expenses at their debut. The extrapolation of the ratio co-financing spending - EU funds revenue for the years 2015 and 2016 indicates a gap of about 3 billion lei representing the underestimation of the co-financing spending for the 2017 budgetary projection.

A second discrepancy at the level of the budgetary projection for 2017 appears in relation to the expected size of the social assistance spending in the State Social Insurance Budget (SSIB). The correlation with the increase in the pension point disappears this year (as the data indicate its observance both before and after 2017): if the algorithm defined by law for the indexing of pensions (inflation plus half of the average real wage increase in 2015) would indicate an increase by about 4% (as the inflation rate is negative, and the real wage growth rate for the current year, according to NCP's projection indicates a level of around 8%) the projected increase of the SSIB's expenditure on social assistance is only 1.6 percent. The Fiscal Council considers that the expenditure size on this item is thus underestimated by about 1.2 billion lei (0.15% of GDP).

Added together, these two elements indicate a probable underestimation for the budgetary expenses (and thus of the budget deficit) in the amount of about 4.2 billion lei (0.5% of GDP) in the year 2017. If we add to this sum and the impact of overestimation for the budgetary revenue identified by Fiscal Council for 2016 (0.3% of GDP) will result budgetary deficits of 3.7% of GDP according to the European methodology (otherwise a level equal to that indicated by the most recent EC projection) and of 3.6% according to cash standards, as very credible values for 2017, rather than the values of 2.9% of GDP and, respectively 2.8% of GDP according to the Fiscal Strategy for 2016-2018.

Conclusions

The draft budget for the year 2016 is characterized by a deliberate and large deviation from all fiscal rules imposed by both national legislation and the European treaties signed by Romania and induce a significant vulnerability for the position of the public finances, thus substantially complicating their managing in the event of manifestation of the adverse shocks. The Fiscal Council does not support at all such an approach of the fiscal policy, the adopted measures having a permanent impact on the budget deficit, generating a budgetary slippage whose subsequent correction by fiscal consolidation measures, as shown in the economic theory, according to empirical estimates at international level and the Romanian experience itself in the past 10 years, is likely to generate economic and social costs that exceed the short-term positive effects of the fiscal loosening.

The Fiscal Council's assessments indicate a high probability of the occurrence of a negative gap in the budgetary revenue in 2016 (0.3% of GDP), having as a likely source the overvaluation of the VAT revenue. At the level of the year 2017, the lack of correlation between the size of the necessary co-financing and the expected European funds revenues, plus that between the growth rate of the social assistance expenditure and the pension point involves, in addition, a probable underestimation of budgetary expenditure by about 0.5% of GDP. Under these circumstances, the risk of exceeding the reference level of 3% of GDP, and reentry into the excessive deficit procedure appears as significant in 2016, and even more in 2017, as the current draft budget is providing only minimal safety margins in this regard, most likely located at the expenses of investment nature, as usual. Budgetary deficits of 3.3% of GDP, respectively 3.7% of GDP in the first two years covered by the Fiscal Strategy 2016-2018 appear as plausible in a no policy change scenario.

The imminent budgetary slippage in the coming years is generated by a mix of aggressive tax cuts, particularly taxes on consumption, combined with large increases in the budgetary expenditure, in particular those related to public sector wages. The current estimates for the budgetary revenue indicate that Romania will have, beginning in 2016, by far the lowest share of revenues in GDP compared to the EU, which will greatly complicate the construction of the budget over the medium-term. Symptomatic in the sense of sacrificing the long-term objectives for the purposes of a short-term fiscal space is the decision of reducing at just 0.1 pp the increase of the social contributions transferred to the second pension pillar (to a level of 5.1%), even if in 2016 it would have been required by law to mark the achievement of the target level of 6%, ensuring the recovery of the 2009' freeze of these transfers' increase; but if the decision of postponement in 2009 was taken in the context of a massive economic shrinking, the present decision occurs in a favorable economic conjuncture.

Under these circumstances, the Fiscal Council recommends that the Government should accelerate the structural reform measures impacting revenue collection rate and the efficiency of public spending. In this regard, the Fiscal Council considers that recovering the delays and speeding up the implementation of the World Bank's program signed in 2013 by Romania regarding the modernization of the revenue administrative system shall be an immediate priority. Within this project, the IT infrastructure and computerization of the tax collection process would greatly ease the bureaucratic effort to pay taxes and increase the voluntary compliance. Also, the rapid operationalization of the process of public investment prioritization and a real reform of the public administration, designed to implement the performance management in the functioning of the State at various levels, could generate significant efficiency gains regarding budgetary spending.

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to article 56, paragraph (2), letter d) of Law no. 69/2010 republished, after being approved by the Council members through vote, on the 9th of December, 2015.

9th of December, 2015 **Chairman of the Fiscal Council**

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Annexes

Annex 1: Fiscal policy measures – Revenue	Budgetary impact	Revenue item - million lei
Fiscal policy measures*:	**-10,680.1**	
Increase of the personal deductions granted according to the number of dependent persons, between 300 lei/month and 800 lei/month, for a gross monthly income up to 1,500 lei/month.	-539.8	Personal income tax
Increase of the lump expenditure share from 25% to 40% for revenue from transferring the right of use, inclusive for net revenue from lease.	-111.8	Personal income tax
Investment revenue - review of this chapter as it was proposed in the project of the Fiscal Code revision.	-230.3	Personal income tax
Reduction of the personal income tax for dividends revenue to 5%.	-1357.2	Personal income tax
Increase of the monthly tax free threshold for calculation the taxable revenue from pensions of 1,050 lei per month, starting with rights for January 2016.	-137.8	Personal income tax
Changing the microenterprises income tax rate according to the number of employees and increase of the ceiling to 100,000 euro.	-300.0	Other corporate taxes on profits, income and capital gains
Extending the eligible assets to apply the reinvested profit tax exemption scheme.	-56.0	Profit tax
Reviewing the dividend income received from the Romanian legal persons by non taxation dividends received by a Romanian legal person.	-57.0	Profit tax
Income tax from dividends obtained in Romania by non-residents – changing the rate to 5%.	-110.7	Other taxes on income, profits and capital gains
Extending the application scope of the reduced VAT rate of 9% for delivery of potable water and irrigation water for agriculture.	-233.8	Value added tax
Reduction of the standard VAT rate from 24% to 20%**.	-8,046.46	Value added tax
Changing the excise duty on alcoholic beverages.	-312.5	Excises
Exclusion from the excise duty sphere of other excisable products.	-71.8	Excises
Increase of excise from 412.02 lei/1000 cigarettes to 430.71 lei/1,000 cigarettes.	455.7	Excises

Performing early payments in the monthly basis for pension contributions which represent 35% of the average gross salary in force in the year for which early payments are established, in the case of individuals who earn income from independent activities.	-161.8	Social security contributions
Eliminating the exemption which states that individuals who earn income from independent activities don't owe pension contributions if they also earn salary income.	200.4	Social security contributions
Increase of the ceiling used for health contribution calculation for pension revenues from 740 lei (in the present) to the value of the index pension point annually settled.	-144.5	Social security contributions
The increase of salaries of the personnel from the public sector by 10% in 2015, of the National Commission for Prognosis staff by 25%, doubling salaries of the personnel from National Sanitary Veterinary and Food Safety Authority and increase salaries of the social assistance personnel by 25% from 1st December 2015.	1,305.2	Total impact on revenue, of which:
	270.2	Personal income
	1,035.0	Social security contributions
Elimination of the mandatory payment of the pension contribution for employers in the case of employees from the police, army and special services in the context of the return to the service pension system which exists before 2010.	-936.0	Social security contributions
Fiscal amnesty GEO 44/2015.	413.8	Total impact on revenue, of which:
	52.6	Profit tax
	86.9	Personal income tax
	190.8	VAT
	81.1	Excise

Source: Ministry of Public Finance

* Only the measures with a budgetary impact of more than 50 million are displayed.

** In the case of the reduction in the standard VAT rate by 4 pp the estimation of the Fiscal Council significantly differs from that of the MPF (loss of fiscal revenue is estimated by the Fiscal Council to be higher by about 1.15 billion lei compared to the MPF projection).

Annex 2: Fiscal policy measures – Expenditure	Budgetary impact	- million lei Expenditure item
Fiscal policy measures:	**9,263.0**	
Doubling the child benefits starting from July 1st, 2015.	Impact 2016: 900 Annualized impact: 1,800	Social assistance
The increase allowances for war veterans and persons ethnically and politically persecuted.	600	Social assistance
Establishing pension service for clerks, seafarers, diplomatic and consular personnel, civil servants MPs.	300	Social assistance
The increase in salaries of employees in the health sector by 25% from October 1st, 2015.	Impact 2016: 1,500 Annualized impact: 1800	Personnel expenditure
The increase in salaries of employees in the education sector by 15% from December 1st, 2015.	1700	Personnel expenditure
The increase in salaries of employees in the local authorities from August 1st, 2015.	Impact 2016: 867 Annualized impact: 1,300	Personnel expenditure
Updating food ratio and equipment for militaries and policemen.	Impact 2016: 750 Annualized impact: 1,000	Personnel expenditure
The increase by 10% in salaries of employees in the administration, research, culture, diplomacy, justice, army sector from December 1st, 2015.	2,733.40	Personnel expenditure
The increase in social assistance salaries by 25%.	556.235	Personnel expenditure
The increase in salaries of employees of the National Commission for Prognosis by 25%.	41.3	Personnel expenditure
Personnel remuneration of employees from the National Sanitary Veterinary and Food Safety Authority similar to those from Ministry of European Funds (doubling wages).	250.8	Personnel expenditure
Elimination of the mandatory payment of the pension contribution for employers in the case of employees from the police, army and special services in the context of the return to the service pension system which exists before 2010.	-936.0	Personnel expenditure

Source: Ministry of Public Finance

Annex 3: Methodology for calculating the budget impact of reducing the standard VAT rate by 4 pp starting from January 1st, 2016
1. The starting point for estimating the revenue loss involved by the reduction of the standard VAT rate by 4 pp starting with January 1st was the Fiscal Council projection regarding the collected VAT for 2015, without swap, which is higher than that of MPF from the Second Supplementary Budget Draft by 500 million lei.
2. The estimation of revenue loss is based on the computation of collected VAT for products affected by the reduction of the standard rate, which was achieved by removal from the basis of the goods and services that currently benefit of a reduced rate. It should also be taken into account that the reduction of VAT to 9% for food products and restaurant services was implemented starting from June 1st 2015, and receipts over the first 6 months of 2015 according to cash methodology incorporated a rate of 24% for these products and services.
3. Thus, in order to eliminate from the base the VAT receipts from food and restaurant services, it was proceeded as following: there were determined theoretical receipts from VAT without reducing VAT on food from 1st June and then were deducted theoretical receipts from VAT if the rate of 24% wouldn't maintained.
4. The impact of the measure in 2015 was determined by dividing the basis determined in the previous paragraph by 24 (to find the receipts for a VAT point) and then the result was multiplied by 4 and then by 11/12 (VAT reduction from 1st January affects only 11-month cash execution).
5. The result based on the methodology described in the previous paragraph was extrapolated with the projected growth of the nominal consumption for 2016.

	No.	
Collected VAT without swap projected by the FC for 2015	1	56,107
The impact of reduced VAT on food products in 2015	2	2,779
Collected VAT for 2015 without reduced VAT for food products and restaurant services	3	58,886
Collected VAT from food products without the measure of reduced VAT of 9% (with VAT of 24%)	4=(2*2)/15*24	8,893.00
Collected VAT from bread and bread products	5	400.00
Collected VAT from products and services with a rate of 24% (total goods and services excluding food)	6=3-4-5	49,593.00
Impact of reducing VAT to 20% in 2015	7=(6/24*4)*11/12	7,576.71
Nominal growth of household's final consumption expenditure excluding self-consumption for 2016	8	6.20%
Impact of reducing VAT to 20% in 2016	9=7+(1+8)	8,046.46

Annex 4	Preliminary execution for 2015 according to MPF	Swap R2 2015	Preliminary execution for 2015 according to MPF (without swap)	The draft budget 2016	The planned swap for 2016	The draft budget for 2016 (without swap)	The draft budget for 2016-Preliminary execution 2015	The draft budget for 2016-Preliminary execution 2015 without swap	The draft budget for 2016/ Preliminary execution 2015	The draft budget for 2016/ Preliminary execution 2015 without swap	Preliminary execution for 2015	The draft budget 2016	The draft budget for 2016-Preliminary execution 2015
											without swap, % GDP		
	1	2	3=1-2	4	5	6=4-5	7=4-1	8=6-3	9=4/1	10=6/3	11	12	13=12-11
TOTAL REVENUE	**227,825.7**	**1,538.7**	**226,287.0**	**231,125.5**	**850.0**	**230,275.5**	**3,299.8**	**3,988.5**	**1.4%**	**1.8%**	**32.1%**	**30.8%**	**-1.3%**
Current revenue	212,881.2	1,538.7	211,342.5	217,018.1	850.0	216,168.1	4,137.0	4,825.7	1.9%	2.3%	30.0%	29.0%	-1.0%
Tax revenue	137,524.2	1,538.7	135,985.5	136,123.0	850.0	135,273.0	-1,401.2	-712.5	-1.0%	-0.5%	19.3%	18.1%	-1.2%
Corporate income tax	41,402.1		41,402.1	41,759.6		41,759.6	357.5	357.5	0.9%	0.9%	5.9%	5.6%	-0.3%
Profit	13,725.5		13,725.5	14,384.9		14,384.9	659.4	659.4	4.8%	4.8%	1.9%	1.9%	0.0%
Wages and income tax	26,118.8		26,118.8	26,206.9		26,206.9	88.1	88.1	0.3%	0.3%	3.7%	3.5%	-0.2%
Other taxes on income, profit and capital gains	1,557.8		1,557.8	1,167.8		1,167.8	-390.0	-390.0	-25.0%	-25.0%	0.2%	0.2%	-0.1%
Property tax	5,774.8		5,774.8	5,980.1		5,980.1	205.3	205.3	3.6%	3.6%	0.8%	0.8%	0.0%
Taxes on goods and services	89,132.4	1,392.7	87,739.7	87,137.6	850.0	86,287.6	-1,994.8	-1,452.1	-2.2%	-1.7%	12.5%	11.6%	-0.9%
VAT	57,000.7	1,392.7	55,608.0	52,342.3	850.0	51,492.3	-4,658.4	-4,115,.7	-8.2%	-7.4%	7.9%	6.9%	-1.0%
Excises	26,042.2		26,042.2	27,382.3		27,382.3	1,340.1	1,340.1	5.1%	5.1%	3.7%	3.7%	0.0%
Other taxes on goods and services	2,764.5		2,764.5	3,958.6		3,958.6	1,194.1	1,194.1	43.2%	43.2%	0.4%	0.5%	0.1%
Taxes on using goods, authorizing the use of goods or on carrying activities	3,325.0		3,325.0	3,454.5		3,454.5	129.5	129.5	3.9%	3.9%	0.5%	0.5%	0.0%
Tax on foreign trade and international transactions	773.0		773.0	836.7		836.7	63.7	63.7	8.2%	8.2%	0.1%	0.1%	0.0%
Other tax revenue	441.9		441.9	409.0		409.0	-32.9	-32.9	-7.5%	-7.5%	0.1%	0.1%	0.0%
Social security contributions	56,996.7	146.0	56,850.7	61,748.8		61,748.8	4,752.1	4,898.1	8.3%	8.6%	8.1%	8.3%	0.2%
Non-tax revenue	18,360.3		18,360.3	19,146.4		19,146.4	786.1	786.1	4.3%	4.3%	2.6%	2.6%	0.0%
Capital revenue	912.5		912.5	951.7		951.7	39.2	39.2	4.3%	4.3%	0.1%	0.1%	0.0%
Grant	5.2		5.2	20.6		20.6	15.4	15.4	295.9%	295.9%	0.0%	0.0%	0.0%
Amounts received from the EU in the account of payments made and prefinancing	13,599.6		13,599.6	336.9		336.9	-13,262.7	-13,262.7	-97.5%	-97.5%	1.9%	0.0%	-1.9%

Annex 4	Preliminary execution for 2015 according to MPF	Swap R2 2015	Preliminary execution for 2015 according to MPF (without swap)	The draft budget 2016	The planned swap for 2016	The draft budget for 2016 (without swap)	The draft budget for 2016-Preliminary execution 2015	The draft budget for 2016-Preliminary execution 2015 without swap	The draft budget for 2016/ Preliminary execution 2015	The draft budget for 2016/ Preliminary execution 2015 without swap	Preliminary execution for 2015 without swap, % GDP	The draft budget 2016 without swap, % GDP	The draft budget for 2016-Preliminary execution 2015 without swap, % GDP
	1	2	3=1-2	4	5	6=4-5	7=4-1	8=6-3	9=4/1	10=6/3	11	12	13=12-11
Amounts collected in the single account (State budget)	150.2		150.2	0.0		0.0	-150.2	-150.2	0.0%	0.0%	0.0%	0.0%	0.0%
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	416.3		416.3	12,798.1		12,798.1	12,381.8	12,381.8			0.1%	1.7%	1.7%
TOTAL EXPENDITURE	**236,178.3**	**1,538.7**	**234,639.6**	**252,030.9**	**850.0**	**251,180.9**	**15,852.7**	**16,541.4**	**6.7%**	**7.0%**	**33.3%**	**33.6%**	**0.3%**
Current expenditure	220,297.0	996.0	219,301.0	232,830.4	850.0	231,980.4	12,533.4	12,679.4	5.7%	5.8%	31.1%	31.1%	-0.1%
Personnel	51,836.0	146.0	51,690.0	57,253.0		57,253.0	5,417.0	5,563.0	10.5%	10.8%	7.3%	7.7%	0.3%
Goods and services	39,388.6		39,388.6	43,114.4		43,114.4	3,725.8	3,725.8	9.5%	9.5%	5.6%	5.8%	0.2%
Interest	9,741.4		9,741.4	11,084.0		11,084.0	1,342.6	1,342.6	13.8%	13.8%	1.4%	1.5%	0.1%
Subsidies	6,294.8		6,294.8	6,451.0		6,451.0	156.2	156.2	2.5%	2.5%	0.9%	0.9%	0.0%
Total Transfers	112,666.6	850.0	111,816.6	114,295.1	850.0	113,445.1	1,628.6	1,628.6	1.4%	1.5%	15.9%	15.2%	-0.7%
Transfers for public entities	1,138.0	850.0	288.0	1,966.8	850.0	1,116.8	828.8	828.8	72.8%	287.8%	0.0%	0.1%	0.1%
Other transfers	11,063.7		11,063.7	12,370.9		12,370.9	1,307.2	1,307.2	11.8%	11.8%	1.6%	1.7%	0.1%
Projects funded by external post-accession grants	20,058.4		20,058.4	4,610.7		4,610.7	-15,447.7	-15,447.7	-77.0%	-77.0%	2.8%	0.6%	-2.2%
Social assistance	75,849.2		75,849.2	79,372.9		79,372.9	3,523.7	3,523.7	4.6%	4.6%	10.8%	10.6%	-0.1%
Projects funded by external post-accession grants 2014- 2020	495.2		495.2	12,449.2		12,449.2	11,954.0	11,954.0	2,414.0%	2414.0%	0.1%	1.7%	1.6%
Other expenditure	4,062.0		4,062.0	3,524.5		3,524.5	-537.5	-537.5	-13.2%	-13.2%	0.6%	0.5%	-0.1%
Reserve funds	0.0		0.0	100.0		100.0	100.0	100.0			0.0%	0.0%	0.0%
Expenditure funded from reimbursable funds	369.6		369.6	532.8		532.8	163.2	163.2	44.1%	44.1%	0.1%	0.1%	0.0%
Capital expenditure	16,906.8	542.7	16,364.1	19,200.5		19,200.5	2,293.7	2,836.4	13.6%	17.3%	2.3%	2.6%	0.2%
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	-1,025.5		-1,025.5	0.0		0.0	1,025.5	1,025.5			-0.1%	0.0%	0.1%
SURPLUS(+) / DEFICIT(-)	**-8,352.6**		**-8,352.6**	**-20,905.5**		**-20,905.5**	**-12,552.9**	**-12,552.9**	**150.3%**	**150.3%**	**-1.2%**	**-2.8%**	**-1.6%**

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

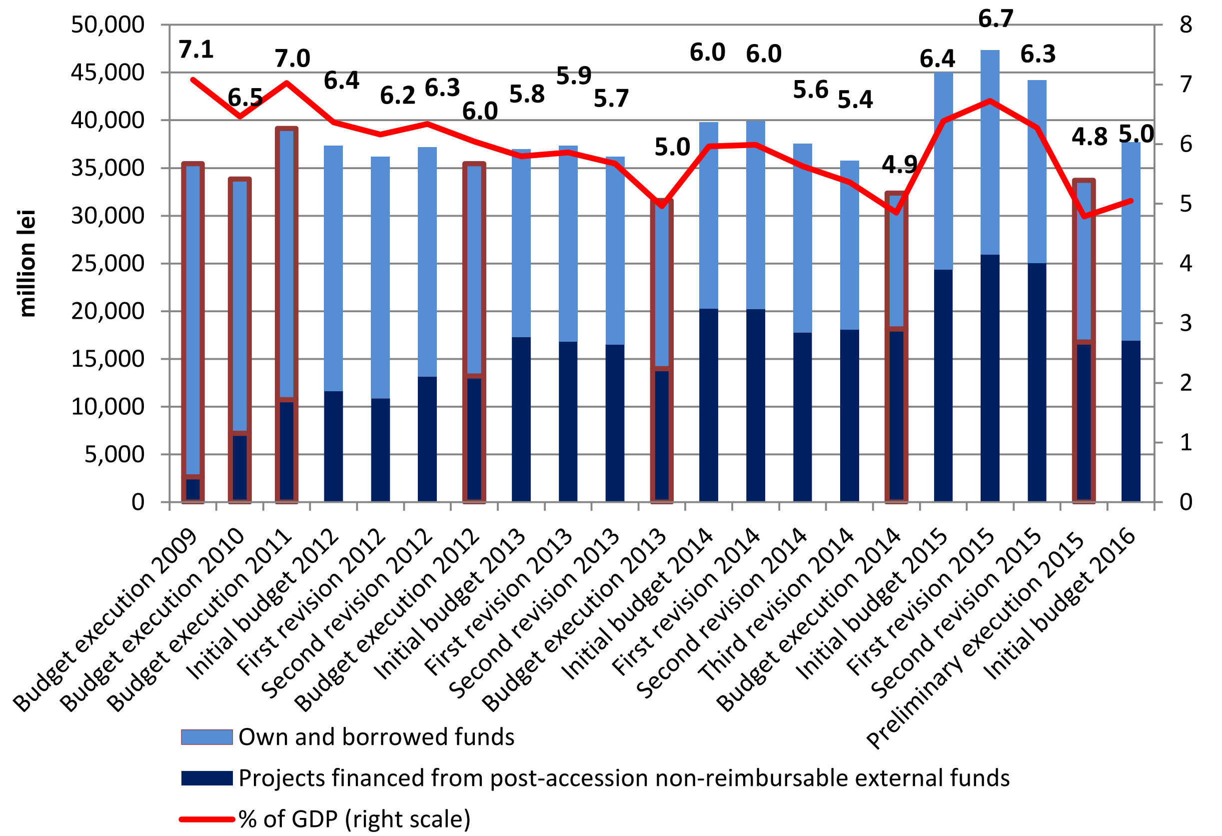
Annex 5: Revenue Projection	2015	2016						
	Preliminary execution for 2015 according to MPF (without swap)	The influence of the compensation schemes in 2016	Fiscal policy measurs	Explanations	The growth of the relevant macroeconomic basis	The revenue projection 2016 of the Fiscal Council	CGB revenues according to the 2016 budget draft (with swap)	Differences
TOTAL REVENUE	**226,287.0**	**850**	**-10,680.1**			**228,963.2**	**231,125.5**	**-2,162.2**
Current revenue	211,342.5	850	-10,680.1			214,740.4	217,018.1	-2,277.8
Tax revenue	135,985.5	850	-10,680.1			134,096.9	136,123.0	-2,026.0
Corporate income tax	14,633.2					15,945.6	14,983.4	962.2
Profit	13,725.5		-77.5	(The starting point of extrapolation is represented by the level projected in the Preliminary execution for 2015 according to MPF)*(1+Δ% macroeconomic base *2 (elasticity acording to EC) to which are added fiscal policy measures	Nominal GDP (+5.98%)	15,288.4	14,384.9	903.6
Other corporate taxes on profits, income and capital gains	907.7		-359.0	(The starting point of extrapolation is represented by the level projected in the Preliminary execution for 2015 according to MPF)*(1+Δ% macroeconomic base *2 (elasticity acording to EC) to which are added fiscal policy measures	Nominal GDP (+5.98%)	657.2	598.5	58.6
Personal income tax	26,768.9					26,863.5	26,776.2	87.3
Wage and income tax	26,118.8		-2,143.6	(The starting point of extrapolation is represented by the level projected in the Preliminary execution for 2015 minus additional revenues from the payment of certain salary rights earned in court in 2015, estimated at 447.5 million lei)*The growth of relevant macroeconomic basis, plus fiscal policy measures (-2500.7 million lei)	The average number of employees (3.46%) Average gross earnings (+6.77%)	26,598.5	26,206.9	391.6
Other taxes on income, profits and capital gains	650.1		-110.7	(The starting point of extrapolation is represented by the level projected in the Preliminary execution for 2015 according to MPF)*(1+Δ% macroeconomic base *2 (elasticity acording to EC) to which are added fiscal policy measures	Nominal GDP (+5.98%)	617.1	569.3	47.8
Property tax	5,774.8		-13.4	According to the projection of the Ministry of Public Finance: Revenues are expected to slightly increase compared to 2015, and this development is possible given that local authorities will use their rights to modify local taxes given the fact that there is any general increase in the level of this category of taxes.		5,980.1	5,980.1	0.0

Taxes on goods and services	87,739.7	850				84,008.3	87,137.6	-3,129.3
VAT	55,608.0	850	-8,089.5	(The starting point of extrapolation is **represented by the projection of the Fiscal Council for this item, excluding swap schemes effect and considering the budget execution at 10 months and the other information available of 56,107 million lei, it being above MPF estimate by 500 million lei, minus** the impact on 6 month of the reduced VAT on food products and restaurant services given the fact that measure was applied from 1 June 2015)* The growth of macroeconomic base, plus the swap for 2016 and the negative impact of fiscal measures estimated by the Fiscal Council (different from MPF's estimate, in particular with a higher revenue losses of about 1,148.6 million lei)	Household's final consumption expenditure excluding self-consumption and related market (+6.2%)	49,159.9	52,342.3	-3,182.3
Excises	26,042.2		134.9	(The starting point of extrapolation is represented by the level projected in the Preliminary execution for 2015 according to MPF)* The growth of macroeconomic base plus the impact of the fiscal policy measures	Household's final consumption expenditure excluding self-consumption and related market in real terms (+4.78%)	27,428.5	27,382.3	46.2
Other taxes on goods and services	2,764.5			According to the MPF projection. The difference of about 1 billion lei between estimated revenues according MPF and receipts that would prevail given the dynamic of the relevant macroeconomic base was justified by MFP through initiating cost-volume contracts in the health system.	Household's final consumption expenditure excluding self-consumption and related market (+6.2%)	3,958.6	3,958.6	0.0
Taxes on using goods, authorizing the use of goods or on carrying activities	3,325.0		-16.9	(The starting point of extrapolation is represented by the level projected in the Preliminary execution for 2015 according to MPF)* The growth of macroeconomic base plus the impact of the fiscal policy measures	Real GDP (+4.1%)	3,461.3	3,454.5	6.8
Taxes on foreign trade and international transactions	773.0		2.5	(The starting point of extrapolation is represented by the level projected in the Preliminary execution for 2015 according to MPF)* The growth of macroeconomic base	Imports of goods and services (+7.4%)	831.2	836.7	-5.5
Other tax revenue	441.9			(The starting point of extrapolation is represented by the level projected in the Preliminary execution for 2015 according to MPF)* The growth of macroeconomic base	Nominal GDP (+5.98%)	468.3	409.0	59.3

Social security contributions	56,850.7		-6.9	(The starting point of extrapolation is represented by the level projected in the Preliminary execution for 2015 according to MPF minus the impact of pensions contributions from court decisions in 2015 of 1,306.4 milliom lei)* The growth of macroeconomic base plus fiscal policy measures; from the total amount the impact of the increase in the Second Pension Pillar by 0.1 pp (-100 million lei) is deducted.	The average number of employees (3.46%) Average gross earnings (+6.77%)	61,497.1	61,748.8	-251.7
Nontax revenue	18,360.3			According to the projection of the Ministry of Public Finance		19,146.4	19,146.4	0.0
Capital revenue	912.5			(The starting point of extrapolation is represented by the level projected in the Preliminary execution for 2015 according to MPF)*Consumer price index	The average rate of inflation forecasted for 2016 (0.5%)	917.1	951.7	-34.7
Grants	5.2			According to the projection of the Ministry of Public Finance		20.6	20.6	0.0
Amounts received from EU	13,599.6			According to the projection of the Ministry of Public Finance		336.9	336.9	0.0
Financial operations	0.0					0.0	0.0	0.0
Amounts collected for the state budget	150.2					150.2	0.0	150.2
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	416.3			According to the projection of the Ministry of Public Finance		12,798.1	12,798.1	0.0

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

Annex 6: The evolution of investment expenses between 2009-2016 – planned level vs. execution (million lei)



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

Annex 7: Evolution of budget aggregates over the period 2016-2017	Buget draft 2016	Budget draft 2017	Budget draft 2017 – Budget draft 2016	Budget draft 2017/ Budget draft 2016	Buget draft 2016	Budget draft 2017	Budget draft 2017 – Budget draft 2016
					share in GDP		
	1	2	3=2-1	4=2/1	5	6	7=6-5
TOTAL REVENUE	231,125.50	236,855.70	5,730.30	2.50%	31.00%	29.80%	-1.18%
Current revenue	217,018.10	221,957.50	4,939.30	2.30%	29.10%	27.90%	-1.16%
Tax revenue	136,123.00	135,714.40	-408.5	-0.30%	18.20%	17.10%	-1.17%
Corporate income tax	41,759.60	44,601.00	2,841.40	6.80%	5.60%	5.60%	0.01%
Profit	14,384.90	15,035.30	650.4	4.50%	1.90%	1.90%	-0.04%
Wages and income tax	26,206.90	28,354.20	2,147.30	8.20%	3.50%	3.60%	0.06%
Other taxes on income, profit and capital gains	1,167.80	1,211.50	43.7	3.70%	0.20%	0.20%	0.00%
Property tax	5,980.10	5,649.80	-330.3	-5.50%	0.80%	0.70%	-0.09%
Taxes on goods and services	87,137.60	84,131.30	-3,006.30	-3.50%	11.70%	10.60%	-1.09%
VAT	52,342.30	51,826.60	-515.7	-1.00%	7.00%	6.50%	-0.49%
Excises	27,382.30	25,772.70	-1,609.60	-5.90%	3.70%	3.20%	-0.43%
Other taxes on goods and services	3,958.60	2,893.30	-1,065.30	-26.90%	0.50%	0.40%	-0.17%
Taxes on using goods, authorizing the use of goods or on carrying activities	3,454.50	3,638.70	184.3	5.30%	0.50%	0.50%	-0.01%
Tax on foreign trade and international transactions	836.7	895.9	59.2	7.10%	0.10%	0.10%	0.00%
Other tax revenue	409	436.4	27.5	6.70%	0.10%	0.10%	0.00%
Social security contributions	61,748.80	66,487.50	4,738.70	7.70%	8.30%	8.40%	0.09%
Non-tax revenue	19,146.40	19,755.50	609.1	3.20%	2.60%	2.50%	-0.08%
Capital revenue	951.7	994.5	42.8	4.50%	0.10%	0.10%	0.00%
Grant	20.6	2.8	-17.8	-86.40%	0.00%	0.00%	0.00%
Amounts received from EU	336.9	184.3	-152.5	-45.30%	0.00%	0.00%	-0.02%
Amounts collected in the single account(State budget)	0	0	0		0.00%	0.00%	0.00%
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	12,798.10	13,716.70	918.5	7.20%	1.70%	1.70%	0.01%

Annex 7: Evolution of budget aggregates over the period 2016-2017	Buget draft 2016	Budget draft 2017	Budget draft 2017 – Budget draft 2016	Budget draft 2017/ Budget draft 2016	Buget draft 2016	Budget draft 2017	Budget draft 2017 – Budget draft 2016
					share in GDP		
	1	2	3=2-1	4=2/1	5	6	7=6-5
TOTAL EXPENDITURE	252,030.90	258,858.00	6,827.00	2.70%	33.80%	32.50%	-1.21%
Current expenditure	232,830.40	238,779.50	5,949.10	2.60%	31.20%	30.00%	-1.16%
Personnel	57,253.00	59,033.80	1,780.70	3.10%	7.70%	7.40%	-0.25%
Goods and services	43,114.40	44,949.00	1,834.60	4.30%	5.80%	5.70%	-0.12%
Interest	11,084.00	12,079.10	995.1	9.00%	1.50%	1.50%	0.03%
Subsidies	6,451.00	6,457.20	6.2	0.10%	0.90%	0.80%	-0.05%
Total Transfers	114,295.10	115,611.50	1,316.40	1.20%	15.30%	14.50%	-0.77%
Transfers for public entities	1,966.80	1,245.30	-721.5	-36.70%	0.30%	0.20%	-0.11%
Other transfers	12,370.90	12,220.50	-150.4	-1.20%	1.70%	1.50%	-0.12%
Projects funded by external post-accession grants	4,610.70	240	-4,370.70	-94.80%	0.60%	0.00%	-0.59%
Social assistance	79,372.90	81,777.00	2,404.10	3.00%	10.60%	10.30%	-0.35%
Projects funded by external post-accession grants 2014- 2020	12,449.20	16,052.30	3,603.10	28.90%	1.70%	2.00%	0.35%
Other expenditure	3,524.50	4,076.30	551.8	15.70%	0.50%	0.50%	0.04%
Reserve funds	100	107	7	7.00%	0.00%	0.00%	0.00%
Expenditure funded from reimbursable funds	532.8	541.9	9.1	1.70%	0.10%	0.10%	0.00%
Capital expenditure	19,200.50	20,078.50	877.9	4.60%	2.60%	2.50%	-0.05%
Financial operations	0	0	0				
Payments made in previous years and recovered in the current year	0	0	0				
SURPLUS(+) / DEFICIT(-)	-20,905.50	-22,002.20	-1,096.80	5.20%	-2.80%	-2.80%	0.03%

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