Fiscal Council's Opinion on the updated version of Fiscal Strategy for 2019-2021 and the draft Government Ordinance for approving the ceilings of certain indicators in the fiscal framework for the year 2019

On March 9th, 2019, the Fiscal Council received from the Ministry of Public Finances in electronic format, the letter no. 7007/08.03.2019, requesting under art. 53, paragraph (2) of the Fiscal Responsibility Law no. 69/2010 republished (FRL), the opinion on the draft Government Ordinance for approving the ceilings of certain indicators in the fiscal framework for the year 2019 and the Fiscal Strategy (FS) for 2019-2021. The need for updated versions appeared in the context of the parameters of the 2019 budget law approved in the Parliament. The letter of the Government requested for the Fiscal Council to issue an opinion with celerity, given the intention to approve the aforementioned documents at the government meeting scheduled for Monday 11th of March at 11:00 AM.

Concerning the parameters of the general consolidated budget in the period 2019-2021 in the notified form, together with the aforementioned letter, the Fiscal Council has the following observations:

- A first remark refers to the significant differences that occur in the consolidated budget for the year 2019 between the version sent to the Fiscal Council for issuing an opinion on January 31st 2019 and the one subsequently approved by the Government and sent to the Parliament. The total revenues and expenditures are higher by 1.165 billion lei, with significant differences in the size of some expenditure aggregates. Thus, on the revenues side, the increase is located exclusively at the level of the estimated inflows from EU non-reimbursable funds, and these seem to be accompanied by the higher co-financing of the capital expenditures (+ 2.47 billion lei, out of which 1.4 billion seem to correspond to additional EU revenues and the related co-financing[1]). Beyond the aforementioned increase in the capital expenditures, there are significant increases in the goods and services expenditures (+1.5 billion lei) and other expenditures (+0.5 billion lei). In compensation, there are significant reductions in social assistance (-2.2 billion lei) and other transfers (-0.7 billion lei). Both expenditures reductions appear to be extremely problematic and therefore, we appreciate that there are *ab initio* additional pressures on the consolidated budget deficit reported to those already identified in the Fiscal Council's opinion from February 5th 2019.
    - Regarding the social assistance expenditures, downward revisions are operated of the expenditures estimated at the level of state budget (-0.9 billion lei) and social insurance state budget (-1.2 billion lei). Given the budgetary execution for January 2019 and the increase of the pension point

[1] The budgetary expenditures related to European funded projects can be found in the chapters "Projects funded by external post-accession grants 2014-2020" and "Capital expenditures". The additional expenses that have as source the increase of revenues from EU and the afferent co-financing were determined by comparing the inflows related to the category "Projects funded by external post-accession grants 2014-2020" before the consolidations.

from 1,100 to 1,265 lei starting with 1st September 2019, we estimate that the amount budgeted in the government approved version of social insurance state budget (SISB) is likely to be lower than the probable payment requirements for the year 2019 by almost 2 billion lei, a higher amount than the decrease of 1.2 billion lei operated at the SISB level. In addition, the Fiscal Council did not identify elements likely to justify the decrease of the social assistance expenditure related to the state budget compared to the initial version of draft budget.

  - In the case of the downward revision operated at the level of other transfers, the main source is represented by Romania's contribution to the EU budget (-0.52 billion lei), another non-discretionary (mandatory) expenditure, for whose reduction we can not find a justification.

- Following the parliamentary debates, the government-approved draft budget for 2019 has incurred an increase in total expenditures and, consequently, in its deficit by 2.13 billion lei, the main source of which was an increase of 2.03 billion lei in social assistance expenditures, generated by the adoption of the amendment regarding the doubling of the children allowance, accompanied by other increases in goods and services (+0.47 billion lei) and capital expenditures (+0.28 billion lei), partially offset by a decrease in personnel expenses (-0.42 billion lei). The annualized impact of the increase in children allowances (+2,56 billion lei) is also reflected in the medium-term budgetary projections (2020 and 2021), the deficit targets being increased by that amount compared to the version notified to the Fiscal Council on January 31st.
  - The Fiscal Council emphasizes that, for the first time since its establishment, the budget deficit target is increased after the submission of the draft budget to Parliament, in direct contradiction with the provisions of art. 15 of the Public Finance Law;
  - The upward revision of the deficit targets for the 2019-2021 period implies the lack of any structural adjustment in the first two years covered by the Fiscal Strategy and a minor reduction (0.25 pp of GDP) of the structural deficit in 2021, given the trajectory of the actual and potential economic growth projected by the National Commission for Strategy and Prognosis. The deviation from the medium-term objective is estimated to remain high at the end of the 2019-2021 period (1.8 pp of GDP), despite the fact that there will be 6 years since its initial occurrence. Regardless of the objections that may be raised concerning the optimism of the macroeconomic projections and the budget deficit, the above evolution shows a complete lack of commitment to the rules established by the Fiscal Responsibility Law and by the European treaties;
  - The Fiscal Council maintains its comments from the February 5th opinion concerning the excessively optimistic nature of the macroeconomic assumptions behind the budget construction in 2019 and on the medium term, the exaggerated projections of budget revenues and the apparent

under sizing of certain non-discretionary expenditures (social assistance and personnel). The upward revisions that were operated for expenditures with goods and services (+2 billion lei compared to the initial budget construction) led us to raise the reservations expressed in the initial opinion concerning the underestimation of this budgetary aggregate. However, given the changes that occurred in comparison to the initial budget draft, the Fiscal Council formulates additional and larger reservations concerning the underestimation of social assistance expenditures and of the contribution to the EU budget (see above).

In conclusion, the increase of the deficit target for 2019 and the apparent underestimation of social assistance expenditures and of the contribution to the EU budget imply a deficit in the immediate vicinity of the 3% of GDP reference level, even in the case of ignoring the overestimation of budget revenues (4.5 billion lei, assuming that the tax on bank assets would be maintained in its current form) as it was identified in the Fiscal Council's opinion from February 5th. Taking into account this fact as well, we estimate that the budget deficit is likely to reach about 3.5% of GDP at the end of the current year under a no-policy change scenario. In what concerns the medium-term developments, the Fiscal Council maintains its assertion that the balance of risks is overwhelmingly tilted towards higher deficits than those projected by the 2019-2021 Fiscal Strategy, well above the 3% of GDP reference level from the corrective arm of the Stability and Growth Pact. Moreover, compared to the initial assessment, the Fiscal Council considers that the likelihood of such an evolution is significant, given the current fiscal-budgetary coordinates of 2019 and the upward revisions to the deficit targets for 2020-2021.

The opinions and 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 March 11th, 2019.

March 11th, 2019 **Chairman of the Fiscal Council,**

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