Romania

Fiscal Council

Fiscal Council's Opinions

2015

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I. Fiscal Council's opinion on the draft revision of the Fiscal Code

Released into public debate in late February, the proposed amendment to the Fiscal Code in its final form was formally notified to the Fiscal Council for approval according to Law no. 69/2010 as amended and supplemented (Fiscal Responsibility Law, henceforth FRL) on March 20th, 2015 by letter no. 40943/17.03.2015.

From the perspective of FRL, for this case are relevant art. 13 and 14, according to which:

"Art. 13: Proposals for any legislation leading to a reduction of budgetary revenues must provide a financial statement according to article 15 of Law no. 500/2002, as amended and supplemented and meet at least one of the following conditions:

a) ***to have the endorsement of the Ministry of Public Finance and of the Fiscal Council, confirming that the financial impact was taken into account in the budgetary revenue forecast and does not affect the annual budget targets and medium term targets;***

b) to be accompanied by proposals for measures to compensate the financial impact, by increasing other budgetary revenues*.*

Art. 14: The initiatives promoted under article 13 are adopted concurrently with the proposed compensating measures, approved by the Government."

Moreover, art. 40 let. d) and e) of FRL states among the responsibilities of the Fiscal Council:

„d) analysis and issuing opinions and recommendations on the annual budget laws before approval by the Government and before submission to Parliament, on the supplementary budgets and other legislative initiatives that may have an impact on the budgetary targets, as well as assessing their compliance with the principles and rules specified in this Law;

e) ***preparation of cost estimates and issuing opinions on the budgetary impact of the normative ordinances, other than the ones mentioned on (d) and the amendments made on the annual budget law during the parliamentary debates****;"*

Given the above law articles, the Fiscal Council will assess the aforementioned draft law in terms of **principles, objectives and rules of fiscal policy**.

1. Brief description of the project amending the Fiscal Code and Government's impact estimates

The draft of the new Fiscal Code introduces major changes in the tax rates and tax bases of the main categories of taxes. In short, the changes with significant budgetary impact include:

- **VAT**:
  - Reduction of the standard rate by 4 pp. in 2016 (up to 20%) and by 2 pp. from 2018 (to 18%);
  - Extending a reduced VAT rate for meat products (including live animals and poultry), fish, vegetables, fruits, milk, eggs and sporting events;
- **Excises**:
  - Reduction in excise duties on major energy products (petrol, diesel);
  - Reduction in excise duty on alcohol and alcoholic beverages;
  - Exclusion from the excise duty sphere of crude oil from domestic production and products currently included in "other excise goods" including coffee, jewelry, furs clothing, cars etc.;
- **Personal income tax**:
  - Reduction in tax rate from 16% to 14% starting with 2019;
  - Removal of deductibility for health insurance contributions starting with 2016;
  - In the case of salary income, increase of personal deductions for the basis function, for levels according to the number of dependent persons, between 300 and 800 lei (compared to current levels between 250 and 650 lei), while increasing the income threshold beyond which those deductions are diminishing from 1,000 to 1,500 lei;
  - In the case of pensions, the annual increase of taxable income threshold by 50 lei starting with 2016, up to the value of 1,200 lei (currently the threshold level is 1,000 lei);
  - Change of parameters of the special deduction for rescheduled loans by eliminating income limits for eligibility, by eliminating the time frame in which the restructuring should occur and by raising the ceiling for the granted deduction from 900 to 1,500 lei;
  - Elimination of tax on dividends starting with 2016;
- **Corporate and microenterprises income tax**:
  - Reduction in the corporate income tax rate from 16% to 14% since 2019;
  - Change of the reference value for the previous year turnover used for categorizing as "micro" to 75,000 EUR in 2017, 85,000 EUR in 2018, and 100,000 EUR 2019, compared with a current level of 65,000 EUR;

- Differentiation according to the number of employees for the tax rate applied to microenterprises turnover (currently 3%), such that it becomes 1% for firms with at least 2 employees, 3% for companies with 1 employee and 3% + 1530 RON quarterly for those with no employee, while implementing a turnover tax of 1% for microenterprises start-ups in the first two years of operation regardless of the number of employees;

- **Social contributions:**
  - Reduction of social contribution rates by 3 pp. in the case of employee (to 7.5%) and by 2.3 pp. in the case of employer (to 13.5%) since 2018;
  - Extension of the applicability of a maximum ceiling of 5 average gross salaries currently applicable to pension contributions payable by the employee for health insurance contributions as well;
  - Extension of the payment obligation for social contributions (pensions and health) for all persons with income;
- **Other taxes:**
  - Removal of the special construction tax (currently 1% of the previous year balance sheet gross value) since 2016;
  - Elimination of the differentiation of the property taxes according to the legal nature of the holder (legal or natural person) and introduction of differentiation according to the property's destination (residential or non-residential). Tax rates for buildings can be between 0.08% and 0.2% for residential constructions (compared to a current level of 0.1% for individuals) and between 0.2% and 1.3% for non-residential (compared to the current range of 0.25-1.5% applicable to legal persons).

The explanatory note attached to the draft project amending the Fiscal Code assess the net first round effects[1] of the proposed measures in an amount of -16.4 billion lei in 2016, -16.8 billion lei in 2017, -28.7 billion lei 2018 and -37 billion lei in 2019. The document presents as sources of compensation for the tax cuts impact on budget revenues, the second-round effects (resulting from the additional economic growth) and the supplementary revenues expected from the implementation by the National Agency for Fiscal Administration (NAFA) of the structural measures designed to make the system of revenue collection more efficient and the increase of voluntary compliance, both on declaration and payment. The second-round effects (derived from the additional economic growth) are assessed by the Government at about 7 billion lei in the period 2016-2017, 10.6 billion lei in 2018, and 18 billion lei in 2019. The document also quantifies the additional income receipts from the improvement of NAFA's activity to about 14 billion lei in 2016, and respectively 18 billion lei annually in the period 2017-2019.

[1] Taking into account the economies of budgetary expenditure occasioned by the reduced VAT rates and employer social security contributions.

2. General considerations

The Fiscal Council considers particularly relevant for the case under consideration the following principles and rules established by the Fiscal Responsibility Law:

The principle of fiscal responsibility stated in article 4 of FRL according to which:

„The Government has the obligation to carry out the fiscal and budgetary policy and to manage budgetary resources, obligations and fiscal risks in a manner that ensures sustainability of the fiscal position in the medium and long term such that the Government is able to manage financial risks and unforeseen events in future periods without having to introduce economically or socially destabilizing expenditure or revenue adjustments".

- The fiscal rules stated at article 5^1, 5^2 and 5^3 paragraph (1) according to which:

„Article 5^1

In order to comply with the reference values for budget deficit and public debt, as they are mentioned in the Protocol no. 12 on the Procedure Applicable to Excessive Deficits, attached to the Treaty on the Functioning of the European Union, the budgetary position of the public administration is either balanced or in surplus.

Article 5^2

The rule provided under article 5^1 shall be considered complied if one of the following requirements is fulfilled:

(a) The medium-term budgetary objective does not exceed a lower limit of the annual structural balance of the public administration of -0.5% of GDP expressed at market prices;

(b) When the ratio between the public debt calculated according to the EU methodology and the GDP at market prices is significantly below 60% and when the risks related to long-term sustainability of public finance are low, the lower limit of the medium-term budgetary objective may not exceed an annual structural balance of the public administration of maximum -1.0% of GDP at market prices;

(c) The annual structural deficit of public administration converges towards the medium-term budgetary objective according to an adjustment path agreed with the institutions of the European Union, according to the Council Regulation (EC) no. 1466/1997, as subsequently amended and supplemented.

Article 5[3]

(1) Temporary deviation from the rules provided by article 52 and article 62 is allowed only due to extraordinary circumstances and provided that it does not endanger the medium-term fiscal and budgetary sustainability."

Considering the above-mentioned principles and fiscal rules, the Fiscal Council considers appropriate to answer the following questions in the present opinion:

1) To what extent the proposed amendments are consistent with the provisions of the preventive arm of the Stability and Growth Pact, namely achieving a structural deficit of 1% of GDP since 2015? What are the implications of defining the fiscal policy targets in structural terms compared to a situation where they would be defined in terms of headline deficit?
2) How plausible is the first-round assessment of the effects of the legislative changes according to the explanatory note attached to the legislative proposal?
3) How plausible is the assessment of the second round effects supposed to materialize according to the explanatory note attached to the legislative proposal?
4) To what extent is it prudent to consider the favorable effects due to a collection improvement in the amounts set out in the explanatory note attached to the legislative proposal?
5) To what extent is the legislative proposal appropriate in terms of the fiscal policy effectiveness in achieving its scope of smoothing the business cycle fluctuations (countercyclical policy)?

3. The fiscal policy objectives. The implications of their definition in structural terms

The fiscal policy in EU Member States is ruled by the two arms of the Stability and Growth Pact - the corrective arm and preventive arm that, in the case of the signatory states (including Romania) are reinforced by the provisions of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (known as the Fiscal compact). The corrective arm enforces the limit of the actual deficit to 3% of GDP, while the preventive arm - under which Romania entered from 2013 following the exit from the excessive deficit procedure at the end of 2012 - requires gradual convergence towards the so-called medium term objective (MTO). In the case of Romania, the MTO is defined as a structural deficit of 1% of GDP and the convergence towards this value should end this year[2].

[2] An adjustor of 0.25% of GDP under the so-called "investment clause" is included in the 2015 budget and allows a temporary deviation from the MTO.

This level of the structural deficit is required to ensure the public finances sustainability, creating safety margins to accommodate the adverse cyclical developments (such as the actual deficit should not exceed 3% of GDP during a normal economic cycle) and allowing to pay future contingent liabilities arising from the demographic trends (population aging) and avoiding excessive accumulation of public debt stock.

The structural balance is defined as the budgetary position that would prevail when the economy is operating at its potential level. This means that when in the economy a demand deficit is recorded (negative output gap – actual GDP is below potential GDP), the actual deficit is larger than the structural deficit by an amount directly related to the size of the recorded demand shortfall[3] while in the conditions under which the economy operates above its potential level (there is an excess demand/a positive output gap), the actual deficit is lower than the structural deficit[4].

Defining the objectives of fiscal policy in terms of structural deficit has major implications for the projection of the fiscal policy discretionary measures. The effect of any discretionary measures introduced can be decomposed into a structural component and an automatic stabilizer, the latter with opposite impact on the actual deficit, which is basically equivalent to the first-round effects, respectively, the second round effects[5]. Referring particularly to the discretionary measures targeting the budgetary revenue, the first-round effects describe the impact on the income aggregates based on the assumption that the macroeconomic base/the economic growth remains at the same level as in the baseline scenario (which would have prevailed in the absence of the fiscal measures), while the second-round effects describe the impact on the budgetary aggregates of the changes stirring from the macroeconomic bases/ economic growth (compared to the baseline scenario, basically the additional economic growth) following the introduction of the discretionary measures. The first-round effect is contained exclusively by the category of budgetary revenue targeted by the discretionary measures, while the second-round effect occurs in all categories of revenue and expenditure that could response to changes in macroeconomic

[3] Thus, in 2012, 2013 and 2014 for actual deficits of the consolidated budget (ESA 2010) of 3%, 2.2% and 1.8% of GDP (European Commission estimates of Winter forecast 2015), the corresponding structural deficits were 2.1%, 1.4% and 1.41% of potential GDP (estimated by the European Commission).

[4] Such a situation was observed, for example, in 2007 and 2008, when the levels of the actual deficit were 2.9% and 5.6% of GDP while the structural deficits estimated by the European Commission amounted to 5.3% and 8.6% of the potential GDP.

[5] The overlap between the structural effect and first-round effect, i.e. between the effect of the second round and the automatic stabilizer is perfect under the assumption that potential output does not change under the impact of discretionary measures. If, hypothetically, the impact of measures would be found fully in the potential GDP, the structural component would be the sum of the first-round and second-round effects.

bases/economic growth - in essence, the categories that may be affected include on the revenue side the fiscal revenues and social contributions, and on the spending side the unemployment benefits.

The implication of the above statements is that the second-round effects which are attributable to the action of automatic stabilizers appear only when the first-round effects attributable to the structural component, are accommodated. In other words, the structural deficit should be allowed to vary (increase in this case) with the amount of the structural component of the discretionary measures addressed to budgetary revenue (a fiscal impulse should exist) to allow the second-round effects occurrence. **Specifically, in the case of a reduction in the level of taxation, the structural deficit should be allowed to increase by the amount of the first-round effects permitting the second-round effects that are likely to generate an increase in the actual deficit lower than in the structural deficit, to manifest.**

The arguments presented above point out that the use of the second round effects as a source of compensation for the expected impact of tax cuts is irrelevant given that the deficit target is defined in structural terms. The additional economic growth necessarily implies a proportional reduction in the level of the actual deficit target corresponding to the structural deficit target, unless is recorded an almost impossible to imagine case, when the whole amount of the additional growth would be included in the potential GDP without any changes in the cyclical position of the economy compared to the baseline scenario (in the absence of the discretionary measures).

Practically, defining the deficit target in structural terms moves the attention, in terms of respecting the fiscal policy rules, to the first-round effects and significantly diminishes, to almost irrelevance the importance of the second-round effects.

The compliance with the structural deficit target when adopting permanent fiscal loosening measures (as tax cuts according to the Fiscal Code draft) involve the necessity to adopt compensatory structural measures also of a permanent nature (i.e. reduction/freeze of spending compared to the baseline scenario, tax increases, increases in collection efficiency etc.). These measures have, in turn, second-round effects opposite to those which, *ceteris paribus*, would be generated by the fiscal loosening measures. In such a case, the existence of net second-round effects, although possible, would be due only to taking advantage of favorable differences in the fiscal multipliers, between the various components of the discretionary measures *mix* and, necessarily, should be of low magnitude.

As regards increasing the collection efficiency/diminishing the informal economy, this may represent, in theory, a source of additional income to reduce the impact of the discretionary measures on the structural deficit, but an *ex ante* evaluation of the amount of additional income is impossible to be done. Given this, and the prudence required by the fiscal responsibility principle stated in FRL, in the Fiscal Council's opinion, these revenues cannot be considered *ex ante* as a valid source of compensating the financial impact as in the meaning of article 13 letter b) of FRL, especially at the excessively optimistic levels presented in the substantiation note. The Fiscal Council will return to this topic in the section dedicated to this subject.

Concluding this section and anticipating its own estimates presented further down, the Fiscal Council considers that the implementation of the Fiscal Code draft will lead to a permanent and major weakening of the structural fiscal position. The second-round effects are relevant from the perspective of structural deficit target compliance, only in the proportion in which the additional economic growth is reflected in the potential GDP, which is unlikely to happen in a significant extent, especially given that reducing consumption taxation is the main part of the discretionary measures package contained in the new Fiscal Code: or, in a hierarchy of effects on long-term economic growth, according to the literature, consumption taxation is considered to be among the categories with lower influence on the long-term economic growth (Cournède et al., 2013).

4. An evaluation of the first and second round effects of measures included in the draft revision of the Fiscal Code

Following its own assessment, the Fiscal Council doesn't have significant reserves to the aggregate amount of the first-round effects included in the explanatory note associated to the normative act draft. However, it should be noted that an own estimate of the income loss related to extending goods and services categories that are subject to a reduced VAT rate could not be achieved given that by the time of writing this opinion, NAFA failed to provide to Fiscal Council the necessary data required under art. 41, paragraph 1 and 2 of FRL by letter no. 49/11.03.2015. Annex 1 summarizes the results of the parallel assessment undertaken.

We argued earlier the idea that the second-round effects are virtually irrelevant in terms of ensuring compliance with a structural deficit target. However, their quantification is important in terms of determining the actual deficits that would prevail after implementing the measures stipulated by the new draft Fiscal Code.

The Fiscal Council considers that the government estimates regarding the amounts of additional revenues generated by the economic growth driven by the fiscal stimulus are excessive. These involve a degree of recovery of nearly 50% of the income loss associated to the first-round effects, both at the level of 2016 and at the end of 2019. It is impossible to reconcile such a level of additional income with reasonable and plausible levels of the fiscal multiplier (describing GDP growth in response to the reduction of budget revenues due to tax cuts, both in absolute terms[6]) and of elasticities to GDP change of the main income categories.

The Fiscal Council undertook an alternative estimation of the second-round effects using a calibrated level of the fiscal multiplier based on the methodology described in Battini et al. (2014) and the set of aggregate elasticities of budget revenues to GDP change to those used by the European Commission for Romania (Mourre et. al., 2014), estimated at their request by OECD (Price et al., 2014).

The literature review generally indicates that the "normal" dimension of the fiscal multipliers lies between 0 and 1; those associated to the budgetary revenues tend to be lower than those related to budgetary spending (government consumption and public investment) – the standard Keynesian theory explains the latter phenomenon by the fact that households save some of the extra disposable income arose from the reduction of taxation. Recent studies using a qualitative approach for the advanced economies identify fiscal multipliers associated to budgetary revenues significantly higher than those typically obtained through econometric estimates. Moreover, the recent literature identifies major deviations in the size of the multipliers as compared with the 'normal" ones depending on the cyclical position of the economy (Auerbach, A.J., Y. Gorodnichenko, 2012; Baum et al., 2012), in the sense that they tend to be higher in severe recessions and lower in situations characterized by the existence of excess demand.

Analyzing the literature dedicated to emerging economies, the estimated fiscal multipliers are in general significantly lower than those in developed countries (Ilzetzki et al., 2013; Ilzetzki, 2011; Estevão și Samake, 2013), without identifying relevant differences between the multipliers size associated to budgetary revenues and to budgetary expenses. For example, Ilzetzki (2011) obtains a range of 0.1-0.3 for the impact spending multipliers and 0.2-0.4 for those of revenues (long-term multiplier reaches about 0.8).

From a theoretical perspective, the factors contributing to a higher size of the fiscal multipliers are (Battini et al., 2014):

- Prevalence of the lack of "smoothing" behavior of consumption, consistent with the existence of high marginal propensity to consume, given that a high proportion of households are facing liquidity constraints;
- Accommodative monetary policy;
- Small automatic stabilizers;

[6] The impact multiplier is defined as $-\Delta Y(t)/\Delta T(t)$, and the one at the i horizon as $-\Delta Y(t+i))/\Delta T(t)$, where ΔY is the variation of nominal GDP (in absolute terms) and $\Delta T(t)$is the first-round impact (in lei) of tax cuts initiated in year t.

- Low level of public debt.

Towards reducing the fiscal multipliers dimension the following factors would impact, in accordance to the article quoted above:

- A more pronounced tendency to precautionary saving given the history of economic instability;
- Inefficiency in public expenditure management and tax collection system;
- Higher risk premiums, an increased potential for credibility effects;
- Reduced size of the economies and the existence of high trade openness that increase the likelihood of "leakages" by increasing imports.

Battini et al. (2014) conducted a comprehensive review of the results regarding the size of fiscal multipliers and, on this basis, they constructed a calibrated algorithm of fiscal multipliers dimension taking into account the structural characteristics of the economy and the existence of conjunctural factors that may cause temporary deviations from the ”normal” values of the structural multipliers. The calibration methodology, described in Annex 2, indicates a level of the impact multiplier for Romania of about 0.4. Regarding the persistence effects of discretionary measures, we assume that the size of the annual multiplier decreases linearly to zero at the end of a period of five years, similar to the standard assumption of Battini et al. (2014), considering a maximum level in the second year from baseline (+10% compared to the first year level); in the case of an impact multiplier of 0.4, the hypothesis regarding the persistence implies a multiplier at the end of the action horizon of about 1.2. The hypotheses appear as optimistic and favorable in terms of the second-round effects size- the impact multiplier t is quantified at the top of range results for emergent economies and the persistence assumption is possible excessive especially in terms of fiscal loosening measures dominated by cuts in consumption taxes. In addition, it is arbitrarily assumed that the monetary policy is accommodative, so it is likely to determine a higher size of the multiplier than it would be normal.

The combined use of the parameters described above (fiscal multipliers and elasticities[7]) and the first-round effects estimated for the entire package in the year of implementation involves additional GDP growth rates and second-round effects on the aggregate categories of income and expenses sensitive to the GDP change (personal income tax, social contributions, unemployment benefits) as follows:

[7] The elasticities of budgetary aggregates to GDP reported for Romania by Price et al. 2014 are presented in the table from Annex 2.

Table 1: Second-round effects of the Fiscal Code amending proposal on real GDP and on general consolidated budget during 2016-2019				
	2016	**2017**	**2018**	**2019**
Additional increase in real GDP if the impact multiplier is 0.4 (pp.)	0.9	0.9	1.2	1.2
Aggregate budgetary effects of the second round if the fiscal multiplier is 0.4 (billion lei)	1.6	3.5	6.2	9.3
Aggregate second round effects according to MPF (billion lei)	7.0	7.0	10.6	18.0

Source: Fiscal Council's calculations

Compared to the budgetary aggregates elasticities of Price et al. (2014), the second-round effects trajectory estimated by the Government in the explanatory note associated to the draft normative act most likely imply the impact fiscal multipliers significantly higher than those used by the Fiscal Council, together with a lower persistence. Assuming that the full effect acts in the same year that the discretionary measures occur, levels close to the government's estimates of the second-round effects can be obtained (using the elasticities of Price et al., 2014) only if the impact multiplier is 1.7 – an excessive amount, far outside any range of estimators in the literature, and that would imply an economic growth of about 7% in 2016.

Combining the first-round effects reported by the MPF and the second-round effects identified by the Fiscal Council as in Table 1, the increases of the actual deficit relative to the baseline scenario as a result of the introduced measures would be of about 14.8 billion lei in 2016, 13.2 billion lei in 2017, 22.5 billion lei in 2018 and 27.7 billion lei in 2019, that is equivalent to 2.0%, 1.7%, 2.7% and respectively 3.0% of the (higher) GDP that would prevail in the event of the measures. Defining the baseline scenario characterized as actual deficits of 1.1% of GDP in 2016 and 2017[8] and effective deficits consistent with a structural deficit of 1% in 2018 and 2019[9], the effective deficits that would prevail after the adoption of the new Fiscal Code would be **3.1% of GDP in 2016, 2.7% of GDP in 2017, 3.5% of GDP in 2018 and 3.7% of GDP in 2019**. Based on the assumptions described in the previous footnote, the appropriate level of the structural deficit **is estimated to be 3.2%, 3.3%, 4.7% and 5.5% of the potential GDP in 2016, 2017, 2018 and 2019**. This is equivalent to a high and growing deviation from the MTO – at the end of the interval, the structural deficit returning around the level from the end of 2010 (5.8% of the potential GDP according to the European

[8] In line with the targets defined in the 2015-2017 Fiscal Strategy.

[9] At the level of structural deficit of 1% of potential GDP we added the cyclical component, determined as the product of the standard semi-elasticity of 0.33 used by the European Commission and the level of excess/deficit demand. The latter is determined as difference between the path of the latest GDP projection of NCEF and the level of potential GDP, all relative to potential GDP. To this end, for 2016 the level of potential GDP from the 2015 Winter Forecast of the European Commission is used, that implies a growth rate of 2.6%, while for the period 2017-2019 we arbitrarily assume that the growth rate of potential GDP would be 3%.

Commission estimates). Moreover, the Fiscal Council's calculations indicate a level higher than the 3% limit stated by the Stability and Growth Pact on almost the entire considered period (exception being 2017), that would involve the reentry of Romania in the excessive deficit procedure. Table 2 summarizes the results presented above.

Table 2: The impact of the amending proposal of the Fiscal Code on the effective and structural deficit in the period 2016-2019

	2016	2017	2018	2019
Effective deficit baseline scenario	1.1	1.1	0.9	0.7
Effective deficit post-measures	3.1	2.7	3,5	3.7
Structural deficit baseline scenario	1.0	1.1	1.0	1.0
Structural deficit post-measures	3,2	3.3	4.7	5.5
Output gap baseline scenario	-0.4	-0.1	0.3	0.8
Output gap post shock	0.5	1.6	3.2	4.8

Source: Fiscal Council's calculations

5. The reduction of the tax evasion as a source of covering revenue losses

The explanatory note of the draft revision of the Fiscal Code indicates as sources of coverage for the negative impact on budget revenues due to the lowering in the taxation level, the additional revenue from the improvement in the collection of taxes by NAFA, valued in 2016 at about 14 billion lei, and respectively at about 18 billion lei annually in the 2017-2019 period (around 2% of GDP).

The principle of fiscal responsibility stipulated in the article 4 of the FRL, requires the government "to manage the fiscal and budgetary policy prudently". It is obvious that *ex ante* quantification of any additional income generated by the institutional reform of NAFA is impossible - there is not a history of performance that can substantiate such calculations, and in no case the interpretation, no matter how benevolent, of the existing data could generate comparable figures with those from the explanatory note. There is no doubt that the potential for acquiring additional revenues from better collection exists - actually, the Fiscal Council is among the institutions that have published estimates relating to the size of the tax evasion (see its annual reports), but the existence of this potential does not mean that the *ex-ante* assumption of its materialization is reasonable or prudent, especially in a so consistent amount.

A basic principle of a healthy budgetary design is that permanent reductions in revenue (as is the case following the proposed measures by the draft revision of the Fiscal Code) must be offset by measures which are likely to also be permanent. The Fiscal Council however fully agrees with the idea of including the additional revenue from the improvement of collection *ex-post* in the budget construction as a source of compensation for the tax cuts, but only after their amount could be measured with a high degree of confidence and sufficient evidence of the occurrence of a trend of reducing the tax evasion would exist - that would be equivalent to a permanent character of these revenues. We are extremely skeptical that the existence of several months of budget execution showing greater revenues than those that would be justified by the development of the macroeconomic bases (as seems to be the case for the first two months of this year) allows the identification of such a trend, given the high monthly volatility prevalent in the history of the budget revenues aggregates. In addition, at least at the VAT level, high annual growth rates reported for the first two months of 2015 are in a significant proportion affected by the temporary effect of the payment in advance of VAT refunds at the end of 2014 (in the approximate amount of 1.5 billion lei).

6. Conclusions

The Fiscal Council considers that the Government's initiative to rewrite the Fiscal Code is justified and welcomed given the numerous changes that this document has suffered over the years, but considers that it provides extensive and unsustainable cuts in the level of taxes. The efficiency gains in the collection of taxes and public spending are a valid source of fiscal space, but it must be used cautiously and gradually, without jeopardizing the macroeconomic equilibriums whose preservation is a key ingredient for a sustainable process of real convergence.

According to the estimates of the Fiscal Council, the draft revision of the Fiscal Code in its present form involves an extreme risk of a permanent and major deterioration of Romania's public finances. The Fiscal Council estimates indicate headline deficits above the reference value of 3% of GDP in the interval 2016-2019, and the estimated developments in the structural budget balance suggest the reversal of the progresses made so far in terms of fiscal consolidation; at the end of 2019, the structural deficit will come back to a level close to the one recorded in 2010. Such developments are in flagrant contradiction with the principles and rules established by the FRL and with the fiscal governance treaties at the European level at which Romania adhered.

Moreover, the estimates presented by the Fiscal Council do not take into account a number of factors with a potential significant impact in the sense of an increase in the recorded headline deficit:

- The recent political agreement to increase defense expenditures up to a level of 2% of GDP for a period of at least 10 years from 2017 (from a level of about 0.8% at the end of 2013);
- The reaction of the financial markets to a potential permanent and major deterioration of the structural position of public finances in Romania.

Regarding this last point, it should be noted that rating agencies emphasize in their recent reports that their assessments are conditional of the progress’s preservation in terms of public finances structural position[10]. Moreover, the recent experience of Bulgaria indicates a significant probability of occurrence of jumps in the country risk premium, which implies higher funding costs for both the state and the private sector: the considerable widening of the deficit at the end of 2014 (from 1.2% in 2013 to 3.4% of GDP in 2014, according to the European Commission estimates) has generated a jump of about 100 basis points of the risk premium applicable to the neighbor state while it continues to remain significantly above that of Romania.

In addition, it is impossible to reconcile such a projected evolution of the public finances position with the announced target by the Government for adopting the euro in 2019, while the Fiscal Council estimates indicate the existence of an excessive deficit for the coming years in the situation in which the new Fiscal Code will be applied.

Finally, the opportunity of a fiscal stimulus of this magnitude is questionable as the cyclical position of the economy is estimated by the European Commission to be close to equilibrium (output gap close to 0) in 2016. Romania risks fell again into the trap of a pro-cyclical fiscal policy, pressing on the accelerator in the expansion phase of the economic cycle while risking to be forced to implement structural adjustment measures in a future phase of recession. There is a quasi-unanimous consensus in the recent literature regarding identifying a significantly higher levels of fiscal multipliers in recessions and lower values during expansions, which means that the benefits in terms of supplementary economic growth in the short term due to the pro-cyclical fiscal stimulus are outweighed by the costs that an inevitable fiscal consolidation could generate in the downward phase of the economic cycle. Otherwise, the experience of Romania in the last 10 years demonstrates this in full.

Given the extremely high probability that the implementation of the draft revision of the Fiscal Code will lead to major deviations from the medium-term budgetary objectives, the Fiscal Council cannot endorse the legislative proposal.

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to Article 43, paragraph (2), letter d) of Law no. 69/2010, based on the vote of the Fiscal Council members in the meeting on March 30th, 2015.

30th March 2015

Chairman of the Fiscal Council
IONUȚ DUMITRU

[10] The latest press releases of Fitch, Standard & Poor's and Moody's mentioned among the factors that could cause a negative review of Romania's rating a fiscal relaxation that can affect the stability of public finances.

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	Annex 1		Estimated impact, mil. RON			
	Proposals to amend the Fiscal Code		**2016**	**2017**	**2018**	**2019**
Personal Income Tax	Change of the personal deduction	1	-698.0	-817.0	-877.6	-942.8
	Elimination of the health contribution deduction - employees	2	1089.2	1229.8	1273.7	1319.1
	Reaction of the pension contribution (impact on revenues)	3			666.4	753.0
	Reduction of the single rate - PIT	4				-3304.7
	Credit special deduction (maximum impact) *	5	-1853.5	-2169.3	-2330.4	-2503.4
	Health contribution non-deductibility + Increase of the tax free threshold - pensioners	6	1.4	-149.1	-308.8	-451.1
	Removal of the tax on dividends	7	-2037.2	-2269.7	-2533.5	-2828.0
	Increase of the lump expenditure share **	8	-115.1	-118.2	-121.2	-124.3
	Total impact PIT - Fiscal Council	**9=1+2+3+4+6+7+8**	**-1759.8**	**-2124.2**	**-1901.0**	**-5578.8**
	Total Impact PIT - MPF	**10**	**-1819.5**	**-1390.1**	**-904.6**	**-4056.5**
	Estimated impact difference FC - MPF	**11=9-10**	**59.7**	**-734.1**	**-996.4**	**-1522.3**
Corporate income tax	Revision of the dividend income regime **	12	-59.0	-80.0	-82.0	-84.1
	Modification of the expenditure deduction principle **	13	-14.0	-21.0	-22.0	-23.0
	Reduction of the single rate - CIT	14				-1502.3
	Total impact CIT - Fiscal Council	**15=12+13+14**	**-73.0**	**-101.0**	**-104.0**	**-1609.4**
	Total impact CIT - MPF	**16**	**-73.0**	**-101.0**	**-104.0**	**-1559.0**
	Estimated impact difference FC - MPF	**17=15-16**	**0.0**	**0.0**	**0.0**	**-50.4**
VAT	Reduction of the standard VAT rate (20% in 2016 + 18% in 2018)	18	**-8722.4**	**-10052.9**	**-15124.3**	**-15994.6**
	Reduction of the VAT rate at 9% for meat, fish, vegetables and fruit (from 2016) **	19	**-2700.0**	**-3100.0**	**-2500.0**	**-2900.0**
	Impact of the excise reduction	20	**-699.3**	**-738.8**	**-781.3**	**-826.2**
	Total impact VAT - Fiscal Council	**21=18+19+20**	**-12121.7**	**-13891.7**	**-18405.5**	**-19720.8**
	Total impact VAT - MPF	**22**	**-12295.5**	**-14070.5**	**-19051.7**	**-20880.4**
	Estimated impact difference FC - MPF	**23=22-21**	**173.8**	**178.8**	**646.2**	**1159.6**

Excise	Reduction of the excise rate for energy products	24	-2660.2	-2810.4	-2972.2	-3143.2
	Rearrangement of the excise for alcoholic products	25	-178.4	-188.4	-199.3	-210.7
	Removal of tax for oil from domestic production and natural gas	26	-3.8	-4.0	-4.2	-4.5
	Removal of tax for other excisable products	27	-71.3	-75.3	-79.6	-84.2
	Total impact EXCISE - Fiscal Council	**28=24+25+26+27**	**-2913.6**	**-3078.2**	**-3255.3**	**-3442.6**
	Total impact EXCISE - MPF	**29**	**-3013.6**	**-3114.7**	**-3225.4**	**-3346.4**
	Estimated impact difference FC - MPF	**30=28-29**	**100.0**	**36.5**	**-29.9**	**-96.2**
Social security contributions	Capping the health contribution at 5 salaries	31	-281.77	-318.1	-329.5	-341.3
	Net impact of the pension contribution reduction	32			-8047.0	-9,091.7
	Total impact SSC - Fiscal Council	**33=31+32**	**-281.8**	**-318.1**	**-8376.5**	**-9433.0**
	Total impact SSC - MPF	**34**	**-501.6**	**-87.3**	**-8303.5**	**-9627.1**
	Estimated impact difference FC - MPF	**35=33-34**	**219.8**	**-230.8**	**-73.0**	**194.1**
	Impact MICROENTERPRISES INCOME TAX**	**36**	**300.0**	**385.0**	**357.9**	**332.7**
	Impact CONSTRUCTIONS TAX **	**37**	**-1038.0**	**-1066.0**	**-1093.0**	**-1120.7**
	Total impact - Fiscal Council	**38=9+15+21+28+33+36+37**	**-17887.8**	**-20194.2**	**-32777.5**	**-40572.6**
	Total impact - MPF	**39=10+16+22+29+34+36+37**	**-18441.2**	**-19444.6**	**-32324.3**	**-40257.4**
	Estimated impact difference FC and MPF	**40=38-39**	**553.4**	**-749.6**	**-453.2**	**-315.2**

* The impact of the special deduction on loans was not included due to the uncertainties regarding its dimension – the sum from the table represents the maximum impact, but any value between zero and this sum could materialize depending on the attractivity of the scheme.

** Impact according to the MPF's estimates.

Annex 2

Determination of the fiscal multipliers using the methodology described in Battini et al. (2014)

Step 1: Assign scores based on the structural characteristics of the economy:

- **Low trade openness:** The economy is relatively closed, if the ratio of imports to domestic demand is below 30 percent on average over the past five years.
- **High labor market rigidities:** The labor market in the analyzed country is strongly regulated.
- **Small automatic stabilizers**: The automatic stabilizers measured by the ratio of public spending to nominal GDP are "small" (for instance, when the ratio is below 0.4).
- **Fixed or quasi-fixed exchange rate regime:** The exchange rate arrangement of the country is not fully flexible.
- **Low/safe public debt level:** The country's gross government debt is below a level that is generally considered "safe" by financial markets; a threshold of 40% can be used in the case of Emerging Market Economies.
- **Effective public expenditure management and revenue administration.**

In the case of Romania, the assignment of scores according to the criteria above mentioned can be found in the next table:

Scoring based on structural characteristics	
Low trade openness	0
High labor market rigidities	0
Small automatic stabilizers	1
Fixed or quasi-fixed exchange rate regime	0
Low/safe public debt level	1
Effective public expenditure management and revenue administration	0
Total score	**2**

Step 2: Summing the scores in order to determine the likely level of the first – year multiplier (low, medium, or high) in "normal" times.

Framing the fiscal multipliers for the first year based on the scores		
Multiplier type	Score	Multiplier value
Low	< 3	0,1 - 0,3
Medium	3 - 4	0,4 - 0,6
High	4 - 6	0,7 - 1,0

Step 3: Adjusting the fiscal multipliers based on conjunctural factors

- **Adjust the range for the cycle:** If the economy is at the lowest point of the cycle (maximum negative output gap based on historical patterns), increase both the lower and upper bound of the multipliers range by 60 %. If on the other hand, the economy is at a peak (maximum positive output gap), decrease both bounds by 40%. When the output gap is zero, no adjustment should be made.
- **Adjust the range for the monetary stance:** if the monetary policy is perfectly accommodative (The Central Bank does not react to the fiscal changes by increasing the interest rate), then the bounds of the multiplier increase by 30%.

Adjusting the fiscal multipliers based on conjunctural factors, for Romania	
Adjust the range for the cycle	0
Adjust the range for the monetary stance	30%

Given the persistence of a fiscal shock over a period of 4 years, the effect in a particular year is determined based on a matrix whose generic form is shown below:

The effect on GDP relative to the baseline scenario of a fiscal stimulus in amount of 1 RON initiated in each year of the period 2016-2019							
	2016	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
2016	0.4	0.4	0.3	0.1	…	…	…
2017	…	0.4	0.4	0.3	0.1	…	…
2018	…	…	0.4	0.4	0.3	0.1	…
2019	…	…	…	0.4	0.4	0.3	0.1

The impact of the measures on GDP (million lei)							
	2016	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
2016	6358.6	6994.4	4662.9	2331.5	0.0	0.0	0.0
2017	0.0	58.1	63.9	42.6	21.3	0.0	0.0
2018	0.0	0.0	4512.2	4963.4	3309.0	1654.5	0.0
2019	0.0	0.0	0.0	2245.6	2470.2	1646.8	823.4
Cumulated	6358.6	7052.5	9239.1	9583.2	5800.5	3301.3	823.4

The other inputs required are the elasticities of the budgetary aggregates on GDP (estimated for Romania by Price et al., 2014) and the amount of the first – round effects of the measures introduced in the year when the fiscal impulse takes place (additional fiscal impulse relative to the baseline scenario).

The elasticites of the budgetary aggregates on GDP for Romania	
PIT to GDP Elasticity	1.3
CIT to GDP Elasticity	2.0
SSC to GDP Elasticity	0.6
Indirect taxes to GDP Elasticity	1.0
Unemployment expenses to GDP Elasticity	-3.9

Source: Price et al. (2014)

The fiscal impulse determined by the proposed measures, in the period 2016-2019	
2016	16304
2017	149
2018	11570
2019	5758

II. Fiscal Council's opinion on the draft Emergency Ordinance amending and supplementing Law no. 571/2003 regarding the Fiscal Code (extending the application scope of the reduced VAT rate of 9% for food products and restaurant services)

On the 15th of April 2015, the Ministry of Public Finance (MPF) remitted to the Fiscal Council, the letter no. 675981 from the 7th of April 2015, requesting the Fiscal Council's endorsement on the draft law amending and supplementing Law no. 571/2003 (extending the application scope of the reduced VAT rate of 9% for food products and restaurant services) under art. 13 of the Fiscal Responsibility Law no. 69/2010 as amended and supplemented (FRL).

According to the aforementioned article of the FRL, *"proposals for any legislation leading to a reduction of budgetary revenues must provide a financial statement according to article 15 of Law no. 500/2002, as amended and supplemented and meet at least one of the following conditions:*

a) to have the endorsement of the Ministry of Public Finance and of the Fiscal Council, confirming that the financial impact was taken into account in the budgetary revenue forecast and does not affect the annual budget targets and medium term targets;

b) to be accompanied by proposals for measures to compensate the financial impact, by increasing other budgetary revenues."

The case in question is covered by paragraph a) of the FRL article cited above, given the fact that there have not been taken any relevant compensation measures to offset the negative impact on revenues. The explanatory note, attached to the proposed legislative measure, lists some possible compensation measures, on which the Fiscal Council will state its opinion in the present document, but they do not fall under the paragraph b) of the FRL article cited above.

Brief description of the legislative proposal and its budgetary impact. General considerations

The legislative proposal envisages several amendments to the Fiscal Code, of which only the proposals on extending the application scope of the reduced VAT rate of 9% to food products, including beverages, without alcoholic beverages, live animals and birds from domestic species, seeds, plants and ingredients normally used in food preparation and also restaurant and catering services, excluding alcoholic beverages, are relevant in terms of the budgetary impact and in terms of the Fiscal Council's endorsement. The provisions of the aforementioned emergency ordinance will be applicable starting from June 1st, 2015.

The draft emergency ordinance has been approved by the Government on April the 7th and subsequently published in the Official Gazette from April the 14th, without having the Fiscal Council's endorsement, required under article 13 of the FRL. The ease with which the fiscal rules were repeatedly circumvented in the past and the violations the article 13 provisions of the FRL which stipulate as compulsory the Fiscal Council's endorsement on legislative measures that lead to reduced revenues, in the absence of other measures that increase budget revenue categories as required by the FRL, highlights the weakness of the constraints exerted by the provisions of the FRL. Given all these, there are serious concerns regarding the commitment to the European fiscal rules that were established into the national law given the provisions of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the Fiscal Compact).

It should be noted that a few weeks ago the Government adopted a draft law that contains major changes regarding the tax rates and tax bases of the main tax categories, the implementation of which is scheduled for the period 2016-2019 and on which the Fiscal Council issued a negative endorsement on March 30th [11]. This proposal completes the comprehensive package of fiscal loosening above mentioned, expanding the application scope of the reduced VAT rate of 9% and moving forward the implementation deadline of these changes from January 1st, 2016 to June 1st, 2015.

From the perspective of the first-round budgetary impact, the explanatory note attached to the draft project amending the Fiscal Code assesses a budgetary income loss of 2.44 billion lei in 2015 (corresponding to a period of 6 months of execution in cash standards), 5.17 bn. lei in 2016, 5.51 bn. lei in 2017 and 5.87 bn. lei in 2018. The document presents as sources of compensation for the tax cuts impact on VAT revenues, the second-round effects (resulting from the additional economic growth) and the supplementary revenues expected from the implementation by the National Agency for Fiscal Administration (NAFA) of the structural measures designed to make the system of revenue collection more efficient and to increase the voluntary compliance, both on declaration and payment. The second-round effects (derived from the additional economic growth) are assessed by the Government at about 1 bn. lei in 2015 and at about 1.8 bn. lei in the period 2016-2018. The document also quantifies the additional income receipts from the improvement of NAFA's activity to about 5.5 bn. lei in 2015, 14 bn. lei in 2016 and respectively 18 bn. lei annually in the period 2017-2019.

[11] See Fiscal Council's opinion on the draft revision of the Fiscal Code (http://www.fiscalcouncil.ro/FiscalCouncil-sOpiniononthedraftrevisionoftheFiscalCode.pdf).

A parallel evaluation conducted by the Fiscal Council on this measure's first-round budgetary impact, having as a starting point the household expenditure in Romania with the considered products for applying the reduced rate, extracted from the National Institute of Statistics's (NIS) publication "The coordinates of living standards in Romania. The household revenues and consumption in 2013" and detailed in Annex 1 indicates a revenue loss of 2.78 bn. lei in 2015, 5.86 bn. lei in 2016, 6.22 bn. lei in 2017 and 6.61 bn. lei in 2018, levels relatively close to those estimated by the MPF. Regarding the second-round effects, reapplying the algorithm described in the Fiscal Council's opinion from March 30th 2015 and detailed in Annex 2 indicate additional revenue of 0.22 bn. lei in 2015, 0.73 bn. in 2016, 1.22 bn. lei in 2017 and 1.58 bn. lei in 2018, corresponding to an additional economic advance of 0.2 pp in 2015, 0.3 pp in 2016 and 2017 and 0.2 pp in 2018, levels significantly lower than from those estimated by the MPF, mostly in the period 2015-2016.

Analyzing the VAT system in the EU countries, it can be observed the widespread practice of using differentiated low rates for food products excluding alcoholic beverages and/or restaurant and catering services as it can be seen in Annex 3. Therefore, implementing such a measure in Romania would be in line with the practices from many EU countries, even if there are plenty of countries that opted for applying a single VAT rate[12]. Also, such a measure could be socially justified, given the regressive nature of the VAT although it made be brought into question the fact that there may be other ways to support disadvantaged/low revenue social categories, the reduced VAT on food having a general nature. The literature has shown that similar effects in terms of social equity can be achieved with lower budgetary costs through targeted direct transfers to poor families or by increasing the deductions granted in the case of personal income tax for low wages.

Reducing tax evasion as a source of offsetting the revenue losses

Basically, the main source indicated by the Government to cover the revenue gap caused by extending the application scope of the reduced VAT rate of 9% is the additional revenue generated by the improvement of the NAFA activities regarding tax collection. Moreover, in the Government's view this improvement has represented the main source of compensation also for the comprehensive package of tax cuts proposed for the period 2016-2019, as the extra revenue assessed by the Government a few weeks ago were of around 14 bn. lei in 2016, and respectively, at about 18 bn. lei per year for the period 2017-2019. Compared to these figures, the explanatory note attached to the current draft emergency ordinance estimates for 2015 additional revenue of about 5.5 billion lei by reducing tax evasion in the context that in Q1 there were collected 3 bn. lei in addition to the program.

The Fiscal Council considers that it is premature to use the additional revenue collected compared to the quarterly program until there are strong indications that these achievements are of a permanent nature and are not only attributable to a temporary

[12] Bulgaria, Denmark, Estonia, Lithuania, Slovakia.

reduction in tax evasion and/or better than expected developments of the relevant macroeconomic bases (an additional economic growth); in the latter case there is the possibility that these revenues are cyclical with no impact on compliance with the budgetary targets set in terms of structural deficit (MTO of -1% of GDP). Moreover, in the first quarter, the net revenues from VAT, where is located the main surplus compared to the revenue quarterly program, respectively 1.8 bn. lei, were favorably influenced by lower reimbursements of VAT compared to the same period from the previous year (given especially the higher repayments made in December 2014), which again calls for caution. In Annex 4 which details VAT receipts from the period January 2014 - March 2015, it can be seen that in the first quarter of this year the advance of the collected VAT was 9.04%, while the net receipts increased by 20.84%, the latter being favorably influenced by the decrease of VAT refunds compared to the same period of the previous year by 21.91%, equivalent to 1 bn. lei. As a golden rule, permanent measures that reduce taxes should be compensated by increases of the same kind of budget revenues and/or permanent expenditure cuts. Relevant to the present situation is also the principle of fiscal responsibility stated by the article 4 of FRL, which requires the government "to manage the fiscal policy in a prudent manner".

The Fiscal Council has argued on many occasions that it is impossible to quantify ex-ante the size of the additional revenues generated by reducing tax evasion, while fully agreeing to the idea of including ex post the additional revenue from collection improvement in the construction of the budget, but only after their amount could be assessed with a high degree of confidence and there is sufficient evidence of the occurrence of a trend in reducing tax evasion at least in the medium term - which would confirm the permanent character of these revenues.

Conclusions

A more rigorous analysis could be conducted in the context of the half-yearly report on the economic and budgetary situation that, beyond the fact that analyzes six months of budget execution, it is also the starting point for drafting the budget revisions, which are accompanied by an updated projection of the budgetary aggregates. Thus, in addition to the analysis of the budget revenues, the development of budgetary expenditure and the extent to which they fall within the initial targets should also be considered, particularly given that the budget execution for the first three months of 2015 recorded a level well below the spending program, particular in the case of investment spending. In the absence of such projections, the Fiscal Council can not validate without reserves that the financial impact of extending the application scope of the reduced VAT rate starting from June 1st, 2015 was taken into account in the forecast of the budgetary revenues and does not affect the annual and the medium term budgetary targets, as required by article 13 of FRL in order to obtain the FC’s endorsment.

Given the above mentioned arguments, the Fiscal Council endorses, but with reservations the draft Emergency Ordinance amending and supplementing Law no. 571/2003 regarding

the Fiscal Code (extending the application scope of the reduced VAT rate of 9% on food products and restaurant services). If the additional revenue observed at the 3 months execution[13] prove to be not only due to a more favorable than expected evolution of the macroeconomic relevant bases or to conjectural factors, thus reflecting indeed a permanent progress in terms of collection efficiency, the Fiscal Council considers that the fiscal space necessary to compensate the scope broadening of the reduced VAT rate of 9% for food products and restaurant services could be identified. The Fiscal Council warns that an accommodation of the VAT reduction under discussion in this opinion, by a further reduction in public investments, given that from 2012 they registered a noticeable downward trend (recording in 2014 a minimum of the past nine years as a percentage of GDP in ESA2010 standards[14]) could have major consequences on the medium and long term economic growth potential, given the major need for public investment in infrastructure.

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to Article 43, paragraph (2), letter d) of Law no. 69/2010, based on the vote of the Fiscal Council members in the meeting on May 12th, 2015.

May 12th, 2015.

Chairman of the Fiscal Council

IONUŢ DUMITRU

[13] Representing the most recent monthly budget execution available on the MPF's website.

[14] The year 2014 recorded a budget deficit of only 1.5% of GDP according to ESA 2010 standards, given an initial target of 2.2% of GDP, which lead to achieving in advance the medium term objective (MTO), a structural deficit of 1% in GDP, although this target was planned to be achieved in 2015. Romania has not used the fiscal space available in 2014, mainly to the underperformance of investment expenses.

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Price, R. W., Dang T., Guillemette, Y. (2014) - "*New Tax and Expenditure Elasticity Estimates for EU Budget Surveillance*", OECD Economics Department Working Papers, No. 1174, OECD Publishing.

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ANNEX 1

General assumptions:
1. The starting point for estimating the revenue loss involved by the legislative proposal was the household expenditure with the considered products for applying a reduced VAT rate, extracted from the NIS publication "Coordinates of living standards in Romania. Household revenues and consumption in 2013 ".
2. The input data refer to the money spent on consumed and unconsumed food and drinks, animal and poultry feed products, livestock purchases, purchases of seeded products (excluding the value of agricultural products from own resources) from which the households' expenditure for bread, flour and bakery products (they are already in the scope of the reduced VAT rate) and those for the purchase of alcoholic beverages were deducted.
3. More specifically, the input data were represented by that in Tables 20 and 41 in the aforementioned publication, considering the average number of people in a household, respectively 2.857.
4. To determine the budgetary impact for the period 2015-2018, the estimated revenue loss for the 2013 was extrapolated with the growth of the household final consumption related to the purchase of goods recorded or projected by NCEF for the period 2014-2018 (8.36%, 5.68%, 5.47%, 6.12% and 6.27%).

	No.	2013
Expenses for food and beverages consumed (lei / person / month)	1	182.75
Expenses for unconsumed food and beverages (lei / person / month)	2	16.68
Expenses for feeding live animals and birds domestic species, for animal purchases, for seeding products (lei / person / month)	3	4.52
Expenses for bread products (lei / person / month)	4	29.97
Expenditure for alcoholic beverages (lei / person / month)	5	6.33
Expenses for the products proposed for applying a VAT rate of 9% (lei / person / month)	6=1+2+3-4-5	167.65
Expenses for the products proposed for applying a VAT rate of 9% net of VAT (lei / person / month)	7=6/1,24	135.20
Population (mil. inhabitants)	8	19.94
Total annual expenditures for products proposed for applying a VAT rate of 9% net of VAT (mil)	9=7*8*12	32355.33
Annual revenue loss due to the application of VAT rate of 9% (mil. lei)	10=9*0,15	4853.3

Source: NIS, Fiscal Council's calculation

The impact of applying a reduced VAT rate of 9% for food products and non-alcoholic beverages, live animals and birds from domestic species, seeds					
	2014	2015	2016	2017	2018
Annual revenue loss due to the application of VAT rate of 9% (mil. lei)	5259.3	5557.9	5861.7	6220.5	6610.8
Loss of revenue to the budget in terms given the measurement application starting from June 1, 2015	-	2778.9	5861.7	6220.5	6610.8

Source: Fiscal Council's calculation

	The growth of household final consumption related to the purchase of goods
2014/2013	8.36%
2015/2014	5.68%
2016/2015	5.47%
2017/2016	6.12%
2018/2017	6.27%

Source: NCEF

ANNEX 2

The effect on GDP relative to the baseline scenario of a fiscal stimulus amounting to 1 m.u.					
	2015	**2016**	**2017**	**2018**	**2019**
2015	0,4	0,4	0,3	0,1	0,0
2016	0,0	0,4	0,4	0,3	0,1
Cumulative	0,4	0,8	0,7	0,4	0,1

The impact on GDP of the proposed measure (million lei)					
	2015	**2016**	**2017**	**2018**	**2019**
2015	1083,8	1192,2	794,8	397,4	0,0
2016	0,0	1143,0	1257,3	838,2	419,1
Cumulative	1083,8	2335,2	2052,1	1235,6	419,1

Source: Fiscal Council's calculation

The other required inputs are the elasticities of the budgetary aggregates to GDP (estimated for Romania in Price et al., 2014) and the amount of the first-round effects of the introduced measures in the year they occur (an additional fiscal impulse relative to the baseline scenario).

Elasticities of the budgetary aggregates to GDP for Romania	
PIT to GDP Elasticity	1,3
CIT to GDP Elasticity	2,0
SSC to GDP Elasticity	0,6
Indirect taxes to GDP Elasticity	1,0
Unemployment expenses to GDP Elasticity	-3,9

Sursa: Price et. al. (2014)

The amount of the fiscal impulse initiated in year i (mil. lei)	
2015	2779
2016	2931

Source: MPF

ANNEX 3

VAT rates across EU member states – situation on the 1st of January 2015

<table>
<tr><th rowspan="3">Member state</th><th rowspan="3">VAT standard rate</th><th colspan="4">VAT rates applied to foodstuffs and restaurant services and catering</th></tr>
<tr><th colspan="2">Foodstuffs</th><th colspan="2">Restaurants</th></tr>
<tr><th>VAT rate</th><th>Remarks</th><th>VAT rate</th><th>Remarks</th></tr>
<tr><td>Austria</td><td>20.0</td><td>10.0</td><td>Food, beverages, excluding alcoholic beverages, live animals, seeds, plants and ingredients for food processing</td><td>10.0</td><td>incl. catering, excl. coffee, tea, alcoholic and soft drinks</td></tr>
<tr><td>Belgium</td><td>21.0</td><td>6.0</td><td>Food, beverages, excluding alcoholic beverages, live animals, seeds, plants and ingredients for food processing</td><td>12.0</td><td>incl. catering, excl. coffee, tea, alcoholic and soft drinks</td></tr>
<tr><td>Bulgaria</td><td>20.0</td><td>20.0</td><td></td><td>20.0</td><td></td></tr>
<tr><td rowspan="2">Croatia</td><td rowspan="2">25.0</td><td>5.0</td><td>All types of bread and milk, including breast milk substitute; excluding milk and milk chocolate</td><td rowspan="2">13.0</td><td rowspan="2">incl. catering, excl. provision of alcoholic and soft drinks</td></tr>
<tr><td>13.0</td><td>Animal and vegetable fats, sugar, and cereals food for babies and small children</td></tr>
<tr><td>Cyprus</td><td>19.0</td><td>5,0</td><td>Food, beverages, excluding alcoholic beverages</td><td>9.0</td><td>incl. catering, excl. provision of alcoholic and soft drinks</td></tr>
<tr><td rowspan="2">Czech Republic</td><td rowspan="2">21.0</td><td>10.0</td><td>Basic foods for small children</td><td rowspan="2">21.0</td><td rowspan="2"></td></tr>
<tr><td>15.0</td><td>Food, beverages, excluding alcoholic beverages</td></tr>
<tr><td>Denmark</td><td>25.0</td><td>25.0</td><td></td><td>25.0</td><td></td></tr>
<tr><td>Estonia</td><td>20.0</td><td>20.0</td><td></td><td>20.0</td><td></td></tr>
<tr><td>Finland</td><td>24.0</td><td>14.0</td><td>Food, beverages, excluding alcoholic beverages</td><td>14.0</td><td>Restaurant and catering services excl. provision of alcoholic beverages</td></tr>
<tr><td>France</td><td>20.0</td><td>5.5</td><td>Food, beverages, excluding alcoholic beverages</td><td>10.0</td><td>incl. catering, excl. provision of alcoholic beverages</td></tr>
</table>

Member state	VAT standard rate	VAT rates applied to foodstuffs and restaurant services and catering			
		Foodstuffs		Restaurants	
		VAT rate	Remarks	VAT rate	Remarks
Germany	19.0	7.0	Food, beverages, excluding alcoholic beverages	19.0	
Greece	23.0	13.0	Food, beverages, excluding alcoholic beverages	13.0	incl. catering, excl. provision of alcoholic beverages
Hungary	27.0	18.0	Milk, dairy products and products containing cereals, flour, starch or milk	27.0	
Ireland	23.0	4.8	Supply of live animals	9.0	incl. catering, excl. provision of alcoholic beverages
		9.0	Food, beverages, excluding alcoholic beverages		
Italy	22.0	4.0	Basic foods	10.0	incl. catering, excl. provision of alcoholic beverages
		10.0	Food, beverages, excluding alcoholic beverages		
Latvia	21.0	12.0	Basic foods for small children	21.0	
Lithuania	21.0	21.0		21.0	
Luxemburg	17.0	3.0	Food, beverages, excluding alcoholic beverages	3.0	incl. catering, excl. provision of alcoholic beverages
Malta	18.0	0.0	Food, beverages, with the exception of pre-cooked foods or highly processed (ice cream, chocolate, beverages and pet food) and alcoholic beverages	18.0	
Netherlands	21.0	6.0	Food, beverages, excluding alcoholic beverages	6.0	incl. catering, excl. provision of alcoholic beverages
Poland	23.0	5.0	Food, beverages, excluding alcoholic beverages	8.0	incl. catering, excl. provision of alcoholic beverages
Portugal	23.0	6.0	Basic foods	23.0	
		13.0	Food (except basic foods), beverages, excluding alcoholic beverages		
Romania	24.0	9.0	Bread, flour and wheat	24.0	
Slovakia	20.0	20.0		20.0	

Member state	VAT standard rate	VAT rates applied to foodstuffs and restaurant services and catering			
		Foodstuffs		Restaurants	
		VAT rate	Remarks	VAT rate	Remarks
Slovenia	22.0	9.5	Food, beverages, excluding alcoholic beverages	9.5	excl. provision of alcoholic beverages
Spain	21.0	4.0	Basic foods (bread, flour, eggs, milk)	10.0	incl. catering, excl. provision of alcoholic beverages
		10.0	Food, except basic foods, water drinks		
Sweden	25.0	12.0	Food, beverages, excluding alcoholic beverages	12.0	incl. catering, excl. provision of alcoholic beverages
United Kingdom	20.0	0.0	Food, except desserts, chocolate, ice cream, alcoholic and soft drinks	20.0	

Source: http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/vat_rates_en.pdf; http://www.ibfd.org/IBFD-Products/International-VAT-Monitor-Latest-Articles; Council Directive 2006/112/EC (the VAT Directive) and Annex III - Council Directive 2006/112/EC

ANNEX 4

Collected VAT, refunded VAT, and VAT revenues according to the General Consolidated Budget (GCB), between January 2014 – March 2015

	Collected VAT		Refunded VAT		VAT revenues	
	Million lei	% compared to the same period from the previous year	Million lei	% compared to the same period from the previous year	Million lei	% compared to the same period from the previous year
Jan-14	6,729.06	10.37	1,701.69	-6.89	5,027.60	17.76
Feb-14	4,827.26	-5.00	1,464.91	16.49	3,362.12	-12.07
Mar-14	5,076.61	0.28	1,424.69	35.31	3,651.92	-8.92
Apr-14	5,795.63	2.20	1,422.63	-20.39	4,373.00	12.60
Mai-14	5,542.49	-1.33	1,389.79	5.85	4,152.70	-3.52
Jun-14	5,431.65	4.76	1,323.89	5.11	4,107.76	4.64
Jul-14	6,166.07	3.98	1,480.19	3.61	4,685.88	4.09
Aug-14	5,817.57	3.04	1,878.43	33.34	3,939.14	-7.03
Sep-14	6,024.39	4.80	1,347.40	32.61	4,676.99	-1.17
Oct-14	6,502.42	4.51	1,621.54	22.65	4,880.88	-0.39
Nov-14	6,230.40	2.86	1,482.93	11.25	4,747.47	0.49
Dec-14	6,407.92	7.91	3,134.90	**120.36**	3,273.02	-27.52
Jan-15	7,049.66	4.76	1,090.03	**-35.94**	5,959.62	18.54
Feb-15	5,335.07	10.52	1,270.61	**-13.26**	4,064.47	20.89
Mar-15	5,751.41	13.29	1,224.78	**-14.03**	4,526.63	23.95

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

Note: VAT revenues represent VAT receipts according to GCB, and are composed of collected VAT minus refunded VAT, to which are added the penalties for late payment of VAT. The latter, however, are relatively low, the monthly average in 2014 being 51.21 mil. lei (53.91 mil. lei in 2015).

III. Fiscal Council's opinion on title II, art. II, of the draft Emergency Ordinance amending and supplementing certain legislative acts (extending the application scope of the reduced VAT rate of 9% for retransmission services of television programs through electronic communications networks)

On the 9th of June 2015, the Ministry of Public Finance (MPF) remitted to the Fiscal Council (FC), the letter no. 40973 from the 8th of June 2015, requesting the Fiscal Council's endorsement on title II, art. II, of the draft Emergency Ordinance amending and supplementing certain legislative acts (extending the application scope of the reduced VAT rate of 9% for retransmission services of television programs through electronic communications networks) under art. 21 of the Fiscal Responsibility Law no. 69/2010 (FRL) republished.

According to the aforementioned article of the FRL*, "proposals for any legislation leading to a reduction of budgetary revenues must provide a financial statement according to article 15 of Law no. 500/2002, as amended and supplemented and meet at least one of the following conditions:*

a) to have the endorsement of the Ministry of Public Finance and of the Fiscal Council, confirming that the financial impact was taken into account in the budgetary revenue forecast and does not affect the annual budget targets and medium term targets;

b) to be accompanied by proposals for measures to compensate the financial impact, by increasing other budgetary revenues."

The case in question is covered by paragraph a) of the FRL article cited above, given the fact that there have not been announced/taken any relevant compensation measures to offset the negative impact on revenues.

Brief description of the legislative proposal and its budgetary impact. General considerations

The article of law on which the endorsement of the Fiscal Council is requested regards the amendment of the Fiscal Code to extend the application scope of the reduced VAT rate of 9% for „retransmission services of television programs through electronic communications networks”. The provisions of the draft legislation would come into force starting July 1, 2015.

From the perspective of the first-round budgetary impact, the explanatory note attached to the draft project assesses a budgetary income loss of 167.6 million lei in 2015 (corresponding to a period of 5 months of execution in cash standards), 402.2 million lei in 2016, 420.4 million lei in 2017 and 473.6 million lei in 2018. The document presents as sources of compensation for the tax cuts impact on VAT revenues in 2015, the supplementary revenues collected by the National Agency for Fiscal Administration (NAFA) relative to the intra-annual budget programming, assessed in the explanatory memorandum to 3.9 billion lei at the end of May. Regarding the medium-term impact, the document states that "at the elaboration of the annual budget laws the measure will be taken into account at the substantiation of revenues and expenditures, in order that the deficit targets assumed trough the Stability and Growth Pact will be respected".

The Fiscal Council has no objections/reservations about the first-round budgetary impact estimated by the MPF that it considers as a conservative estimate. If reliable data regarding the number of cable TV users are available (6.9 million, 92% penetration degree at the households’ level), being reported by ANCOM (the National Authority for Management and Regulation in Communications), there is uncertainty regarding the characteristics/price of the relevant service package from the average consumer perspective. The implicit average price of this representative service package related to the estimation of revenue losses from the Explanatory Note of the normative act is about 40 lei/month (including VAT of 24%), while the offers for the basic package of the main operators of cable television services are about 30 lei monthly – therefore, the estimation has also a substantial safety margin in terms of a representative service package including more options compared to the basic package.

The Explanatory Note provides as an argument for the proposed measure the fact that ”the application of the reduced VAT on these services will generate significant positive effects on the business environment by improving the cash-flows, thus reducing a number of difficulties faced by the economic agents in this perspective”. In the Fiscal Council’s opinion, the argument validity appears to be ambiguous, considering that reducing a consumption tax in a branch in which practically there is no VAT evasion can generate additional cash-flows only to the extent that it is not transferred in the final price to the consumer while the potential of further expansion from a 92% penetration degree at the household levels appears insignificant. Obviously, the arguments that occur in the case of food products, where there is a significant percentage of economic agents that operate on the black market and a VAT reduction has the potential to improve the competitive position of the honest taxpayers, cannot be sustained in the case of the cable television services sector.

The financial sources for covering the revenue losses

The Explanatory Note of the normative act indicates as sources of coverage for the budgetary impact in the current year the additional revenues collected by NAFA compared to the budgetary programming in the first 5 months of 2015, evaluated at 3.9 billion lei and states that revenue and expenditure projections in the medium term will be elaborated such as the budgetary targets assumed under international treaties and FRL to be respected. However, it should be noted that these additional revenues have been already indicated as a source of compensation for the extension of the reduced VAT rate for food products starting with June 2015 (2.44 billion lei in 2015, respectively 5.2 billion lei from 2016) and in the meantime the measure regarding doubling the children allowance was also adopted (with an impact of 900 million lei in 2015, respectively 1.8 billion lei in 2016). Therefore, the discussion on the present measure cannot disregard the impact of the above measures already adopted.

The Fiscal Council admits that the dimension of the tax measure's impact is rather small for the current year - preserving the surplus revenue realized now, due both to an improvement in the collection, as well as to an economic growth much higher than initially forecasted, should not create problems in terms of achieving the deficit target for 2015, taking into account the other discretionary measures adopted, given their application only from the second half of the year. But the assessments get complicated when it comes to achieving the medium-term targets for several reasons:

1. In the year 2016, the impact of extending the reduced VAT rate on food is more than 5 billion lei, reflecting a full year application;
2. In the year 2016, the impact of doubling children benefits is 1.8 billion lei, also corresponding to a full year of application;
3. To the extent that the economic growth for the current year will be higher than expected, and this will be reflected, as it is natural, only in a small proportion in the potential GDP growth, this would entail an upward revision of the size of the cyclical component of the deficit, which would imply a headline deficit target for 2016 below the levels currently envisaged (1.2% of GDP in ESA 2010 standard under the Convergence Programme 2015-2018), in order to be consistent with respecting the MTO defined as structural deficit of 1% of GDP.

About a month ago, the Fiscal Council has endorsed with reservations the extension of the reduced VAT tax rate for food products, invocating the uncertainties about the size, persistence and the origins of additional budget revenues cited as an element of compensation for the budgetary impact of that measure. Even if the Fiscal Council would suspend these reserves (despite the fact that it believes that the reasons given in its previous opinion remain relevant) it cannot give a favorable opinion on the proposed measure extending the reduced VAT rate to services of television retransmission using electronic communications networks without a complete budgetary projection that would identify the concrete ways envisaged in order to ensure the compliance with the medium-term budgetary targets, especially since, in the meantime, the measure of doubling the children benefits must be also accommodated. According to the Fiscal Council, the discretionary measures already adopted, mentioned above, exhausted the additional fiscal space created on the medium-term under the assumption of maintaining the collection efficiency gains achieved so far (assuming that the budget expenditure are also maintained at the level approved in the medium-term budgetary framework).

Conclusions

Given the above mentioned arguments, and the previous opinions of the FC cited above, the Fiscal Council cannot endorse title II, article II of the draft Emergency Ordinance amending and supplementing certain acts (extending the scope of the reduced VAT rate of 9% for television retransmission services through electronic communications networks).

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, based on the vote of the Fiscal Council members in the meeting on June 12th, 2015.

June 12th, 2015.

Chairman of the Fiscal Council

IONUŢ DUMITRU

IV. The Fiscal Council's response to the letter no. 491 / 02.07.2015 of the Department of Economic and Social Policies of the Presidential Administration

Considering your letter no. 491 / 02.07.2015, that requests the Fiscal Council's official position regarding the sustainability of public finances and the Romania's possibility to comply with its commitments regarding the medium-term objectives in the context of the measures envisaged by the Fiscal Code adopted by the Romanian Parliament on 06/24/2015, we notify the following:

- **In the Fiscal Council's opinion, the implementation of the draft revision of the Fiscal Code is likely to lead to a permanent and major deviation from the objectives arising from the European treaties at which Romania adhered (The Stability and Growth Pact and the Fiscal Compact) and from the relevant national legislation (The Fiscal Responsibility Law No 69/2010).** The updated projection that incorporates the latest information on the macroeconomic framework, the set of the fiscal policy measures adopted and budget execution up to date, indicate a level of about 3% of GDP both for headline and structural deficit in 2016, assuming compensatory reductions of the public investment (of about 0.3% of GDP) and the prevalence of moderation in the public sector salary policy. The risk of re-entering in the excessive deficit procedure appears to be significant. According to the latest public projections of the European Commission, such a level of the structural deficit would place Romania to fourth ranked among the 28 EU Member States at the end of 2016 (after Croatia, UK and Ireland). Noting that the Government now publicly admits that the deficit could reach a level of 2.9% of GDP in 2016, although in the explanatory memorandum to the original legislative proposal submitted in Parliament claimed that the actual impact on the deficit would be fully covered by the additional budgetary revenues resulting from the acceleration of the economic growth compared to the baseline scenario and to the massive increase of the tax collection efficiency *ex ante* assumed by the government to generate extra revenue of 14 billion lei in 2016 and 18 billion lei annually in the period 2017-2019.
- **The Fiscal Council considers that there is a major qualitative difference between having structural/headline deficits still high as a result of a fiscal adjustment trajectory less abrupt and achieving a relatively similar structural/headline deficit following a deliberate slippage in flagrant contradiction to the principles and rules established both by national law and European treaties.** An adverse reaction of the

financial markets, from the perspective of the required financing costs cannot be excluded especially in the context of the recent developments in Greece.

- **The aforementioned European treaties oblige Romania to correct the deviation from the medium-term objective of 1% of GDP structural deficit** - it is not at all clear at this moment how this will be done, especially since **the current budgetary projections do not incorporate the additional allocation for defense expenditure up to a level of 2% of GDP (currently, from 0.8% - 0.9% of GDP) starting with 2017 and maintaining this level for at least 10 years, according to the political commitment from the beginning of the year.** The correction of a 2 pp. of GDP deviation from the medium term objective defined as structural deficit of 1% of GDP will not be an easy one - for comparison, the cumulative fiscal adjustment in the years 2013 and 2014 was 1.1% of GDP. In addition, the accumulation of other pressures on public expenditure should not be ignored, especially from the perspective of the unified wage law revision envisaged by the Government.

- **Placing the structural deficit to such a level (3% of GDP) involves maintaining the public debt expressed as a percentage of GDP on an upward trajectory**, despite the fact that in the short term the liquidity buffer accumulated by the treasury can accommodate the additional financing requirements. **Even if the current level of the public debt stock (39.8% of GDP at end of 2014) seems much lower than the reference level of 60% of GDP, continuing an upward trend, even moderate of the public debt size as share of GDP in the upward phase of the economic cycle, instead of using such a period to reduce indebtedness, could lead to excessive accumulation of vulnerabilities that would become visible in a future downward phase of the economic cycle.** A relevant example in the sense of potential rapid growth of public debt in the context of adverse cyclical developments simultaneously with high structural deficits is exactly Romania, which in 2008 recorded a debt level of only 13.2% of GDP. Other examples of rapid growth of public debt in the context of prolonged recessions are provided by Croatia (38.9% of GDP in 2008, 85% of GDP in 2014) and Finland (32.7% of GDP in 2008, 59.3% of GDP in 2014). In addition, continuing the growth of the public debt above 40% of GDP could become problematic given the present level of development of the economy and limited absorption capacity of the local financial markets.

- **It is questionable the fiscal loosening opportunity of this magnitude given that the cyclical position of the economy is likely to be at equilibrium or even to record the existence of an excess demand (zero or positive *output gap*) in 2016**. Romania risks remaining into the trap of a pro-cyclical fiscal policy, pressing the accelerator in the expansion phase of the economic cycle and risking to be forced to implement structural adjustment measures in an inevitable next phase of recession.

- **The Fiscal Council is very reserved regarding the possible implications for the economic growth in the long term given the composition of the legislative package focused on reducing consumption taxation.** We believe that the most likely scenario is that of a temporary increase of the aggregate demand, unaccompanied by a similar impact on the potential long term economic growth – the consumption tax reduction does not improve the domestic and external competitiveness of the national products, and there is a high probability that it will lead to a deterioration in the trade balance due to the increase in imports.
- The Fiscal Council doubts that the promotion of this package is consistent with the public declared objective of euro adoption in 2019.

A brief context for the above assertions

The Fiscal Council has published this year, on March 30th, the opinion regarding the initial proposed revision of the Fiscal Code approved by the Government and sent to Parliament. **The Fiscal Council could not endorse the legislative proposal in question**, considering the extremely high probability of a major deviation from the medium-term budgetary targets following the implementation of its provisions. Subsequently, the Government decided to extend one of the measures provided in the aforementioned form of the draft revision of the Fiscal Code, namely the one related to the extension of the scope of the reduced VAT rate of 9%.[15] Through its opinion from May 12th, the Fiscal Council endorsed (*post-factum* with some reservations) the legislative proposal in question, considering that the measures viewed in isolation can be accommodated without the budgetary targets to be affected in a significant manner, given the superior performance compared to the initial estimates regarding the budget revenue due to the improvement that was already made at the tax collection level. On May 20th, the Parliament approved doubling the child benefits (the annualized budgetary impact of approximately 1.8 billion lei, or 0.25% of GDP). Finally, the form approved by the Parliament on June 24th, 2015 of the draft revision of the Fiscal Code significantly differs from the original one, the main changes being aimed at reducing the size of the VAT standard rate (from 24% to 19%, instead of 20%), replacing the removal of the tax on dividends with the reduction of the tax rate from 16% to 5%, eliminating the reduction of the employee and employer social contributions starting from 2018, as well as reducing the income tax for individuals and legal entities taken into account for 2019.

Given the budget execution and the current macroeconomic context, the Fiscal Council considers that the existence of a fiscal space is apparent relative to the budget deficit target

[15] The Government decision makes that under a reduced VAT rate to be all the food and restaurant and *catering* services (not just meat products, fish, milk, eggs, vegetables and fruits as the initial project stipulated) and the entry into force of this provision to occur this year on 1 June and not on 1 January 2016.

for the year 2015. This is created by a combination of an economic growth far superior than the initial projections (possibly 4% compared to a 2.5% estimate in the initial budget construction), improved tax collection (especially in the case of VAT) and the probable repetition of the 2014 situation, that of under-execution of the public investment expenses. However, we believe that this fiscal space has already been exhausted by extending the application scope of the reduced VAT rate for food products, increasing the child allowances and by the reduction of the special construction tax from 1.5% to 1% (not included in the initial budget). Considering as permanent the gains from the collection efficiency obtained until now, we appreciate as probable the enrollment in the medium-term budgetary targets in the absence of further fiscal relaxation measures introduced by the revision of the Fiscal Code approved by the Parliament and virtually impossible in the case of their inclusion.

The main measures of the Fiscal Code			
No.	**Measure**	**Budgetary Impact**	
		Billion lei	**% of GDP**
1	Reduction of the standard VAT rate from 24% to 19%	-8.9	-1.2
2	Reduction of the tax on dividends from 16% to 5%	-1.3	-0.2
3	Various reductions of the excises (including the impact on VAT)	-3.6	-0.5
4	Changes of income tax exemptions	-1.2	-0.2
5	Changes regarding the social contributions	-0.7	-0.1
6	Removal of the special construction tax	-1.0	-0.1
7	Other measures	-0.4	-0.1
Total		**-17.1**	**-2.3**

Overview of the obligations under the European treaties and national legislation

The fiscal policy in EU member states falls under the two arms of the Stability and Growth Pact – the corrective and the preventive arms that, in the case of the signatory states (including Romania since June 2012), are reinforced by the provisions of the Treaty of Stability, Coordination and Governance in the Economic and Monetary Union (named also Fiscal Compact). The corrective arm imposes a maximum limit for the headline deficit of 3% of GDP, while the preventive arm - under which Romania entered from 2013 along with the exit from the excessive deficit procedure at the end of 2012 – imposes a gradual convergence to the so-called medium term objective (MTO). In the case of Romania, this is defined as a structural deficit of 1% of GDP and the convergence was achieved at the end of 2014, one year before the agreed term, given that the major under-execution of public investment and intermediate consumption (goods and services expenditure) made that the headline deficit to register a level of 1.5% of GDP, compared to the initial target of 2.2% of GDP (according to the Convergence Programme 2014-2017).

Such a level of the structural deficit (1% of GDP) is considered necessary to ensure public finance sustainability, creating safety margins to accommodate the adverse cyclical evolutions (so that the headline deficit does not exceed 3% of GDP over a regular economic cycle) and the future payment obligations arising from demographic trends (aging population) and to avoid the accumulation of an excessive pubic debt stock. From the perspective of the Stability and Growth Pact, the MTO that meets the above criteria is currently estimated at 1¼% of GDP – the Fiscal Compact introduces an additional restriction that limits the structural deficit to 1% of GDP. The national legislation practically operationalizes the provisions of European treaties mentioned above.

This document was approved by the Chairman of the Fiscal Council after its appropriation by the Council's members by vote, during the meeting on July 6th, 2015.

July 6th, 2015

Chairman of the Fiscal Council

IONUŢ DUMITRU

V. Fiscal Council's Opinion on the Draft Budget Revision for 2015

On July 24th 2015, the Fiscal Council received from the Ministry of Finance by letter no. 101896/24.07.2015, *the draft of the budget revision for 2015, the explanatory note and the draft Government Ordinance project regarding the draft of the budget revision for 2015, as well as the explanatory note and the Government Ordinance project regarding the draft of the revised social security budget for 2015*, requesting the Fiscal Council's opinion under article 53, paragraph (2) of the Law no. 69/2010 republished. In addition, the Fiscal Council also received the half-year report regarding the economic and budgetary situation of which conclusions, alongside the Fiscal Council's opinion on it, should be taken into account in the construction of the budget revision proposal in accordance with article 15, paragraph (1) of the Fiscal Responsibility Law (FRL) republished. The Fiscal Council's opinion disregards the subsequent amendments of the draft budget revision that were notified to the Fiscal Council on the morning of Tuesday, July 28.

1. The draft budget revision – compliance with fiscal rules

Compared to the original approved budget, the draft budget revision maintains the nominal budget balance of -13,004 million lei, thus respecting the budget deficit ceiling defined by the Law no. 182/2014 (Law for the approval of ceilings for certain indicators specified in the fiscal framework for 2015), thus ensuring the observance of the fiscal rule established by article 12 letter b) of FRL. If it is considered the minor downward revision of the interest expenses (-55 million lei), the general consolidate budget (GCB) primary deficit is programmed to exceed by the same amount the corresponding ceiling defined by the Law 182/2014.

Even if the budget deficit remains constant compared to the initial level, both revenues and expenditures are scheduled to significantly increase. From the perspective of the fiscal rules established by the FRL, we notice the non-compliance, as follows:

- The programmed level of the personnel expenditures (49,761.5 million lei, i.e. 7.1% of GDP) exceeds the corresponding ceiling defined by the Law no. 182/2014 both in terms of nominal level, as well as percentage of GDP[16] by 1,388.1 million lei, i.e. 0.28% of GDP. The absence of compliance with the fiscal rules occurs at the level of art. 12 letter a) (for the level expressed as percentage of GDP) and letter c) (for nominal level) of FRL and in terms of the rule established by art. 17 paragraph 2, which prohibits increasing the personnel expenses during the budgetary revisions.
- The programmed level of the GCB expenditures, excluding the financial assistance from the EU and other donors exceed the corresponding ceiling defined by the Law no. 182/2014 with 4,932 million lei, the absence of the conformity occurring at the level of the rule established by art. 12 letter c) of the FRL, as well as at the rule established by art. 24 which prohibits the increase of the GCB expenditures, net of financial assistance from the EU and other donors during the budget revisions, unless it is due to the supplementing of the interest expenses or those related to Romania's contribution to the EU budget.

The legislative proposals provide the corresponding derogations from the aforementioned fiscal rules and redefine the limits of the ceilings stipulated in the Law 182/2014 according to the levels proposed by the budget revision for the budgetary aggregates. The systematic recourse to derogation from the fiscal rules that do not target the GCB balance (the *ex-ante* non- compliance to these intervened in almost all the budget revisions operated since the adoption of FRL in 2010) confirms the existence of two classes of fiscal rules – one of "strong" rules (rules targeting GCB balance), and one of the "weak" rules (fiscal rules targeting the mandatory ceilings for all other relevant elements from the perspective of law - primary balance, personnel expenses, total expenses without financial assistance from the EU and other donors, reinforced by prohibitions of the increasing total expenditures and personnel expenditures during the budget revisions), despite the fact that such a distinction is not provided by law, and derogations can easily be operated from all of them. According to the Fiscal Council, the "weak" rules complete the deficit rule for the perspective of

[16] The law 182/2014 defines the limit for the personnel spending for 2015 at 48,373.4 million lei, respectively 6.8% of GDP.

compliance with the transparency and stability principles established by FRL and their relevance consists in the following reasons:

- In terms of moving to the structural deficit benchmarks concerning the budget balance, the rule regarding the prohibition of the increasing of the total expenses during the year allows the *ex-post* compliance to the structural deficit target and not just the *ex-ante* (even in the case of higher revenues obtained on account of a higher than anticipated economic growth). In other words, if the compliance with the headline deficit target itself does not ensure the conformity with the structural deficit target upon the conditions of a higher than anticipated economic growth, the existence of the total expenditure ceiling has the potential to ensure in real-time the alignment to the structural benchmark instead of generating a necessary structural fiscal consolidation during the next budgetary iteration;
- The mandatory ceilings of the total and personnel expenditures, as well as that for the primary balance, appear as relevant in terms of: ensuring predictability of budget parameters (e.g. in terms of average wage trajectory and the number of personnel from the public sector), enhancing the authorities' motivation to entirely include the relevant information in the initial budget construction and implicitly promoting the commitment to a certain set of budget parameters.

De facto, the inoperability of the set of adjacent fiscal rules regarding the level of the budget deficit, meaning their failure to constrain in any way the behavior of the authorities according to the legislator's intention, emphasize either the need for a law enforcement aiming at limiting the possibility to recourse to derogation only under a precisely defined set of circumstances and the introduction of motivating penalties for breaking the fiscal rules (the optimal solution), or putting together the *de jure* with the *de facto* situations by affirming the supremacy of the fiscal rule regarding the budget deficit (in accordance with the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union) and the formal abandonment of the related rules' set.

1. *The Draft Budget Revision – the updated coordinates of revenues and expenses*

The draft budget revision massively supplements, in an equal amount, revenues and expenditures (+6,916 million lei, or 1% of GDP). At the level of budget revenues, the sources of the operated revisions are as follows:

- Tax revenues: +1,589 million lei, of which:
    - Corporate income tax: +817 million lei. Updating the programmed level for the whole year appears to be justified in relation with the over performance compared to the initial program at the end of the first semester - the achievement degree, according to the Half-year Report on economic and budgetary situation , was 107.7% (+487 million lei in nominal terms),
    - Personal income tax: +784 million lei. Updating the programmed level for the whole year appears to be justified in relation with the over performance compared to the initial program at the end of the first semester - the achievement degree, according to the half-year report on economic and budgetary situation, was 104.4% (+553 million lei in nominal terms),
    - Property taxes: -579 million lei. The downward revision is due to the reduction of the special construction tax from 1.5% la 1%, not included in the initial budget,
    - VAT: -253 million lei. The over performance compared to the initial program for this revenue category, of 9.6% at the end of the first semester (+2.568 billion lei), easily allows offsetting the impact of extending the scope of reduced VAT rate for food, restaurant and catering services (about 2.8 billion lei). The update estimate for the whole year's VAT receipts appear as prudent from the perspective of the first semester's performance.
- Social security contributions: +1,821 million lei. At the end of the first semester, the budgetary revenues slightly exceeded the initial program (100,7%, respectively +202 million lei), most likely due to a dynamic much higher than anticipated of wages and also based on a higher than expected economic growth compared to the initial program. The programmed increases for the personal spending compared to the initial allocations, of about 1.4 billion lei, are expected, according to MPF, to

generate some 600 million lei additional revenues from social contributions. In the Fiscal Council's opinion even if extrapolating the amount collected in the first semester and adding the corresponding social contributions receipts resulting from augmenting the personal spending, the major increase of the social contributions revenues cannot be explained, the shortfall being probably of about 800 million lei. Although, given the prudent manner of estimating the fiscal revenues, a possible underperformance of social contributions revenues compared to the programmed level will be probably offset by increased fiscal revenues relative to the programmed level (especially VAT).

- Nontax revenues: + 1,504.5 million lei. The program achievement at the end of June was 91.3% (-858 million lei), but the Half-year Report states that this underachievement is due to the postponement of distributing the dividends by the state-own companies and, most likely will be recovered in July. The increase of the level of the programmed revenues to be collected is also determined by two temporary components, respectively certificates for greenhouse gases emissions (+498 million lei) and recovered amounts following the decision of incompatibility of State Aid (+508 million lei), that are supplemented by additional payments of the net profit of NBR estimated at 257 million lei.
- Amounts received from the EU in the account of payments made and pre-financing: +1,984 million lei. The increase of the programmed level is quite surprising given the underperformance relative to the initial program for the first semester – the achievement degree is only 41.9% of the program (-6,110 million lei). Reaching the forecasted level at the end of the year is possible only if we assume tripling of the amounts received from the EU in the second semester compared to the first semester, which is unlikely to happen, even of the perspective of a historical pattern regarding the acceleration of these revenues' collection in the second part of the year.

The sources of the upward revisions for the budgetary spending amounting to 6,916.6 million lei are the following:

- Personal spending: +1,388 million lei. The supplementing amount is partially the result of including new salary related rights earned by court decisions (of about 1 billion lei).
- Goods and services: +385 million lei.
- Projects funded by external post accession grants: +2,165 million lei. The increase is the counterpart of the upward revision of the program for the amounts received from the EU in the account of payments made and pre-financing. Our reserves already expressed regarding the speed of EU funds accelerating in order to ensure the convergence towards the programmed levels are applicable in the case of the correlated spending.
- Social assistance: +1,284 million lei. The increase of the allocations is determined by the impact for 6 months of doubling the child benefits (+900 de million de lei), the difference representing the impact of re-establishing the service pensions for pilots and aircrew, auxiliary personnel of courts and increased allowances for the politically and ethnic persecuted persons, veterans and war widows.
- Other expenses: +585 million lei. The increase is determined mainly by CEDO decisions, compensation corresponding to the restitution of property and allocations for restoring some cult entities.
- Capital spending: +691 million lei. This increase appears to be quite surprising given the substantial underperformance for this spending category at the end of the first semester, as the achievement degree is only 34% (-7,450 million lei). The convergence to the forecasted level for this year would imply an increase of this spending flow of about four times in the second part of the year compared to the first semester – for illustration, in 2014 the execution has a similar profile, and in the second half of the year the capital spending accelerated by 2.5 times compared to the first semester.
- In conclusion, the substantial upward revision for the budgetary revenues seems to be substantiated from the perspective of the up to date revenue performance, as a result of a mix between a better than initially anticipated economic growth with a composition favorable to increased fiscal revenues, and an improved collection efficiency based on both NAFA efforts and probably a pro-cyclical development for

the taxpayers' compliance[17]. The Fiscal Council has serious reserves in the case of the upward revision of the social contribution revenues, but considers that the high risk of underachievement of this budgetary aggregate is compensated in great extent by possible better than expected fiscal revenues, given the prudent approach of extrapolating the performance attained in the first semester. Also, the Fiscal Council is skeptical about the likelihood of materializing the estimated amounts of post-accession EU funds revised upward by about 2 billion lei, given the performance reported in the first quarter compared to the program and the implicit assumption regarding tripled receipts in the second half of the year - however, the failure in achieving these estimates should not cause an increase of the budget deficit, given the automatic adjustment of the associated budgetary spending component.

At the level of the budgetary expenditure, beyond the considerations about the irrelevance of tax rules related to the budget deficit, their achievement at the programmed level appears to be extremely unlikely given the massive under-execution of the investment spending in the first half of the year and implicit acceleration of the public investment flows required by the convergence to the annual allocation (it should be four times higher in the second half of the year compared to the first semester). In this context, operating a large upward revision of the latter compared to the initial budget (+2.9 billion lei) on the occasion of the first budget revision that reflects, on the one hand an increase above the initial budget for the European funds and on the other hand, a supplementation of the capital spending appears as quite surprising. The execution in the preceding years reflects a systematic trend of non-materializing of the programmed allocations, despite of ambitious projections (see Figure no. 2 in the Annex).

In conclusion, the Fiscal Council considers that respecting the fiscal deficit target for the current year in the context of maintaining the actual parameters of the fiscal policy could be easily achieved and the balance of risks appears to be tilted to recording a lower than expected budget deficit, while the under-execution of investment spending appears to be

[17] The cost-benefit ratio for the decision of tax evasion varies in the favor of the perceived benefits during the recessions and in the favor of the estimated costs in the economic boom. See Brondolo, J., 2009, "Collecting Taxes During an Economic Crisis: Challenges and Policy Options," IMF Staff Position Note 09/17 and Pogoshyan T., 2011,"Assessing the Variability of Tax Elasticities in Lithuania", IMF WP/11/270.

highly probable, given the experience of both the 2014' execution and the first semester's program execution.

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to article 43, paragraph (2), letter d) of Law no. 69/2010, as amended and supplemented, after being approved by the Council members through vote, on 28st July 2015.

28st July 2015

Chairman of the Fiscal Council

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ANNEX I – budget execution semester I 2015 vs. the half-year program	The half-year program 2015 with *swap* (mil. lei)	Budget execution semester I 2015 with *swap* (mil. lei)	Program swap semester I 2015	The half-year program 2015 without *swap* (mil. lei)	Budget execution semester I 2014 without *swap* (mil. lei)	Sem. 1 2015/ Sem. 1 2014 without *swap*	Differences from the half-year program 2015 without *swap* (mil. lei)	The achievement degree of the half-year program without *swap* (%)	Differences from the half-year program 2015 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	**113,432.1**	**110,611.1**	**425.0**	**113,007.1**	**110,350.6**	10.2%	**-2,656.5**	**97.6%**	**-2,821.0**	**97.51%**
Current revenue	102,499.7	105,848.8	425.0	102,074.7	105,589.0	9.0%	3,514.3	103.4%	3,349.0	103.27%
Tax revenue	65,104.2	69,109.7	425.0	64,679.2	68,850.0	13.5%	4,170.7	106.4%	4,005.5	106.15%
Taxes on profit, wages, income and capital gains	19,601.7	20,609.9		19,601.7	20,609.9	13.3%	1,008.3	105.1%	1,008.3	105.14%
Corporate income tax	6,354.8	6,841.8		6,354.8	6,841.8	12.2%	487.0	107.7%	487.0	107.66%
Personal income tax	12,487.1	13,039.9		12,487.1	12,996.4	13.8%	509.3	104.1%	552.8	104.43%
Other taxes on income, profit and capital gains	759.7	728.2		759.7	728.2	8.4%	-31.5	95.9%	-31.5	95.86%
Property tax	3,553.5	3,554.2		3,553.5	3,554.2	-3.8%	0.6	100.0%	0.6	100.02%
Taxes on goods and services	41,414.6	44,353.6		41,414.6	44,353.6	15.3%	2,939.0	107.1%	2,939.0	107.10%
VAT	26,613.0	29,181.1	425.0	26,188.0	29,108.2	18.2%	2,920.2	111.2%	2,568.1	109.65%
Excises	12,014.0	12,003.3		12,014.0	12,003.3	8.6%	-10.8	99.9%	-10.8	99.91%
Other taxes on goods and services	1,303.8	1,591.3		1,303.8	1,591.3	23.6%	287.6	122.1%	287.6	122.06%
Taxes on using goods, authorizing the use of goods or on carrying activities	1,483.8	1,577.9		1,483.8	1,577.9	7.9%	94.1	106.3%	94.1	106.34%
Tax on foreign trade and international transactions (customs duty)	329.2	353.5		329.2	353.5	12.9%	24.2	107.4%	24.2	107.36%
Other tax revenue	205.2	238.6		205.2	238.6	14.6%	33.4	116.3%	33.4	116.27%
Social security contributions	27,505.0	27,707.0		27,505.0	27,573.1	-1.3%	68.0	100.2%	202.0	100.73%
Nontax revenue	9,890.5	9,032.1		9,890.5	9,032.1	11.3%	-858.5	91.3%	-858.5	91.32%
Capital revenues	415.1	448.5		415.1	448.5	14.5%	33.3	108.0%	33.3	108.03%
Grants	2.5	3.2		2.5	3.2	-98.1%	0.7	129.8%	0.7	129.81%
Amounts received from the EU in the account of payments made and prefinancing	10,514.7	3,998.6		10,514.7	3,998.6	47.5%	-6,516.1	38.0%	-6,516.1	38.03%
Amounts collected in the single account(State budget)		-97.9			-97.9	-990.0%			-97.9	

ANNEX I – budget execution semester I 2015 vs. the half-year program	The half-year program 2015 with *swap* (mil. lei)	Budget execution semester I 2015 with *swap* (mil. lei)	Program swap semester I 2015	The half-year program 2015 without *swap* (mil. lei)	Budget execution semester I 2014 without *swap* (mil. lei)	Sem. 1 2015/ Sem. 1 2014 without *swap*	Differences from the half-year program 2015 without *swap* (mil. lei)	The achievement degree of the half-year program without *swap* (%)	Differences from the half-year program 2015 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
Other amounts received from the EU for operational Programmes funded under the convergence objective		4.1			4.1					
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020		405.8			405.8					
TOTAL EXPENDITURE	**126,407.4**	**106,414.5**	**425.0**	**125,982.4**	**106,156.8**	2.5%	**-19,825.6**	**84.3%**	**-19,992.9**	**84.18%**
Current expenditure	115,126.8	103,278.7	425.0	114,701.8	103,021.0	3.8%	-11,680.8	89.8%	-11,848.2	89.71%
Personnel	25,239.7	25,123.6		25,239.7	25,123.6	5.2%	-116.1	99.5%	-116.1	99.54%
Goods and services	18,795.1	17,126.9		18,795.1	17,126.9	-2.4%	-1,668.2	91.1%	-1,668.2	91.12%
Interest	6,481.5	5,768.4		6,481.5	5,768.4	-7.9%	-713.1	89.0%	-713.1	89.00%
Subsidies	3,374.5	3,202.2		3,374.5	3,202.2	0.7%	-172.3	94.9%	-172.3	94.89%
Total Transfers	60,859.5	51,893.6	425.0	60,434.5	51,636.0	7.2%	-8,798.5	85.4%	-8,965.8	85.27%
Transfers for public entities	903.5	450.9	425.0	478.5	193.2	-20.7%	-285.2	40.4%	-452.6	49.90%
Other transfers	7,405.3	6,057.5		7,405.3	6,057.5	-8.0%	-1,347.8	81.8%	-1,347.8	81.80%
Projects funded by external post-accession grants	12,684.6	5,789.3		12,684.6	5,789.3	27.8%	-6,895.4	45.6%	-6,895.4	45.64%
Social assistance	37,328.6	37,176.2		37,328.6	37,176.2	5.6%	-152.4	99.6%	-152.4	99.59%
Projects funded by external post-accession grants 2014-2020	499.7	480.5		499.7	480.5		-19.2	96.2%	-19.2	96.16%
Other expenditure	2,037.7	1,939.3		2,037.7	1,939.3	20.3%	-98.4	95.2%	-98.4	95.17%
Reserve funds	1.0			1.0			-1.0	0.0%	-1.0	0.00%
Expenditure funded from reimbursable funds	375.5	163.9		375.5	163.9	-31.5%	-211.6	43.6%	-211.6	43.64%
Capital expenditure	11,280.6	3,830.8		11,280.6	3,830.8	-20.3%	-7,449.7		-7,449.7	
Payments made in previous years and recovered in the current year	0.0	-695.0			-695.0	42.5%				
SURPLUS(+) / DEFICIT(-)	**-12,975.3**	**4,196.6**		**-12,975.3**	**4,193.8**	**-220.7%**	**17,169.1**	**-32.3%**	**17,172.0**	**-32.34%**

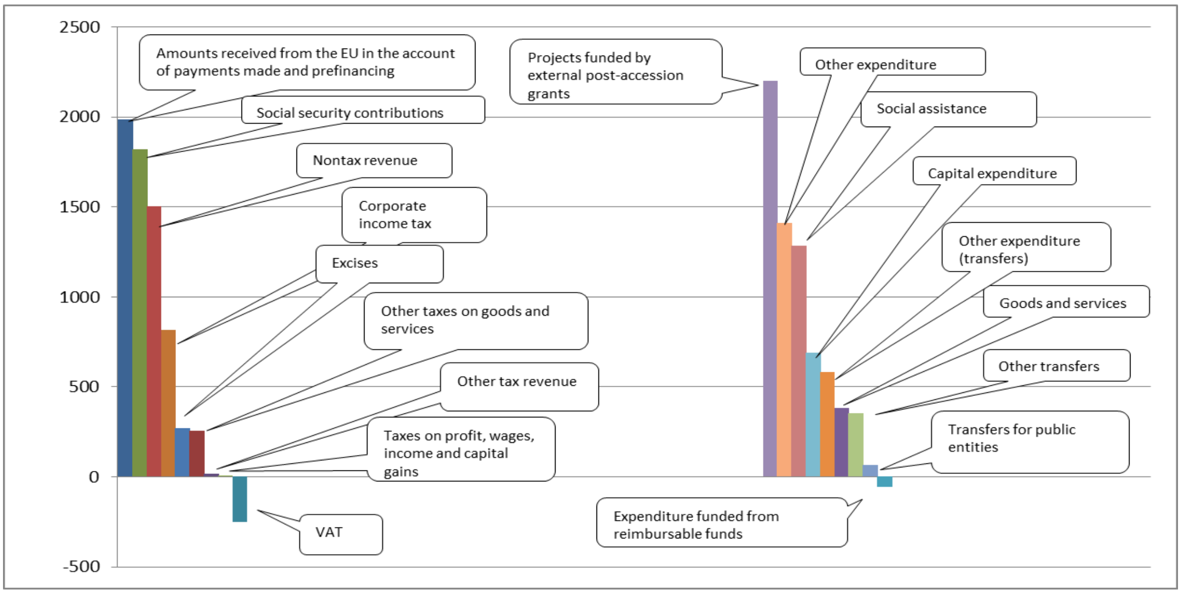
Source: Ministry of Public Finance, Fiscal Council's calculations

ANNEX II	Initial budget 2015	*Swap* program 2015	Initial budget 2015 without *swap*	First budget revision (R1) 2015	Planned swap First budget revision	First budget revision 2015 without *swap*	R1 - Initial budget 2015 with *swap*	R1 - Initial budget 2015 without *swap*	Budget execution semester I 2015/ Budget execution semester I 2014 with *swap*	R1 2015/ Budget execution 2014 without *swap*
	1	2	3=1-2	4	5	6=4-5	7=4-1	8=6-3	9	10
TOTAL REVENUE	**226.360.5**	**850.0**	**225.510.5**	**233.276.9**	**850,0**	**232.426.9**	**6.916,5**	**6.916,5**	**10.19%**	**10.21%**
Current revenue	206.732.3	850.0	205.882.3	211.646.6	850,0	210.796.6	4.914,4	4.914,4	9.01%	9.03%
Tax revenue	133.391.8	850.0	132.541.8	134.980.7	850,0	134.130.7	1.588,9	1.588,9	13.50%	13.53%
Taxes on profit, wages, income and capital gains	39.567.7		39.567.7	41.177.8		41.177.8	1.610,1	1.610,1	13.29%	13.29%
Corporate income tax	12.670.0		12.670.0	13.486.8		13.486.8	816,8	816,8	12.18%	12.18%
Personal income tax	25.314.7		25.314.7	26.098.9		26.098.9	784,2	784,2	14.18%	13.80%
Other taxes on income, profit and capital gains	1.583.0		1.583.0	1.592.2		1.592.2	9,2	9,2	8.35%	8.35%
Property tax	6.354.0		6.354.0	5.775.0		5.775.0	-579,0	-579,0	-3.81%	-3.81%
Taxes on goods and services	86.402.1	850.0	85.552.1	86.890.6	850,0	86.040.6	488,5	488,5	15.26%	15.26%
VAT	55.537.2	850.0	54.687.2	55.284.6	850,0	54.434.6	-252,6	-252,6	18.26%	18.24%
Excises	25.531.0		25.531.0	25.799.3		25.799.3	268,3	268,3	8.57%	8.57%
Other taxes on goods and services	2.738.4		2.738.4	2.996.2		2.996.2	257,8	257,8	23.64%	23.64%
Taxes on using goods, authorizing the use of goods or on carrying activities	2.595.5		2.595.5	2.810.5		2.810.5	215,0	215,0	7.91%	7.91%
Tax on foreign trade and international transactions (customs duty)	675.0		675.0	726.4		726.4	51,4	51,4	12.92%	12.92%
Other tax revenue	393.0		393.0	410.9		410.9	17,9	17,9	14.65%	14.65%
Social security contributions	55.311.0		55.311.0	57.131.9		57.131.9	1.821,0	1.821,0	-1.33%	-1.31%
Nontax revenue	18.029.5		18.029.5	19.534.0		19.534.0	1.504,5	1.504,5	11.08%	11.28%
Capital revenues	853.8		853.8	871.5		871.5	17,7	17,7	14.50%	14.50%
Grants	2.3		2.3	2.3		2.3	0,0	0,0	-98.09%	-98.09%

ANNEX II	Initial budget 2015	*Swap* program 2015	Initial budget 2015	First budget revision (R1) 2015	Planned swap First budget revision	First budget revision 2015	R1 - Initial budget 2015	R1 - Initial budget 2015	Budget execution semester I 2015/ Budget execution semester I 2014	R1 2015/ Budget execution 2014
			without *swap*			without *swap*	with *swap*	without *swap*	with *swap*	without *swap*
	1	2	3=1-2	4	5	6=4-5	7=4-1	8=6-3	9	10
Amounts received from the EU in the account of payments made and prefinancing	18.772.1		18.772.1	20.756.5		20.756.5	1.984,4	1.984,4	47.49%	47.49%
TOTAL EXPENDITURE	**239.364.4**	**850.0**	**238.514.4**	**246.281.0**	**850,0**	**245.431.0**	**6.916,6**	**6.916,6**	**2.46%**	**2.47%**
Current expenditure	220.937.4	850.0	220.087.4	227.163.3	850,0	226.313.3	6.226,0	6.226,0	3.76%	3.77%
Personnel	48.373.3		48.373.3	49.761.5		49.761.5	1.388,1	1.388,1	5.17%	5.17%
Goods and services	40.037.3		40.037.3	40.422.0		40.422.0	384,7	384,7	-2.39%	-2.39%
Interest	10.529.3		10.529.3	10.474.7		10.474.7	-54,6	-54,6	-7.92%	-7.92%
Subsidies	5.488.8		5.488.8	5.467.1		5.467.1	-21,6	-21,6	0.75%	0.75%
Total Transfers	115.711.7	850.0	114.861.7	120.198.8	850,0	119.348.8	4.487,1	4.487,1	7.17%	7.21%
Transfers for public entities	1.498.5	850.0	648.5	1.562.1	850,0	712.1	63,6	63,6	-10.00%	-20.67%
Other transfers	12.040.3		12.040.3	12.391.9		12.391.9	351,6	351,6	-7.97%	-7.97%
Projects funded by external post-accession grants	24.176.0		24.176.0	26.341.4		26.341.4	2.165,4	2.165,4	27.79%	27.79%
Social assistance	74.095.0		74.095.0	75.379.4		75.379.4	1.284,4	1.284,4	5.62%	5.62%
Projects funded by external post-accession grants 2014-2020	482.3		482.3	519.7		519.7	37,4	37,4		
Other expenditure	3.419.6		3.419.6	4.004.2		4.004.2	584,6	584,6	20.33%	20.33%
Reserve funds	0.6		0.6	101.0		101.0	737,7	737,7		
Expenditure funded from reimbursable funds	796.4		796.4	738.2		738.2	-58,2	-58,2	-31.47%	-31.47%
Capital expenditure	18.427.0		18.427.0	19.117.7		19.117.7	690,7	690,7	-20.31%	-20.31%
SURPLUS(+) / DEFICIT(-)	**-13.004.0**		**-13.004.0**	**-13.004.1**		**-13.004.1**	**-0,1**	**-0,1**	**-220.74%**	**-220.66%**

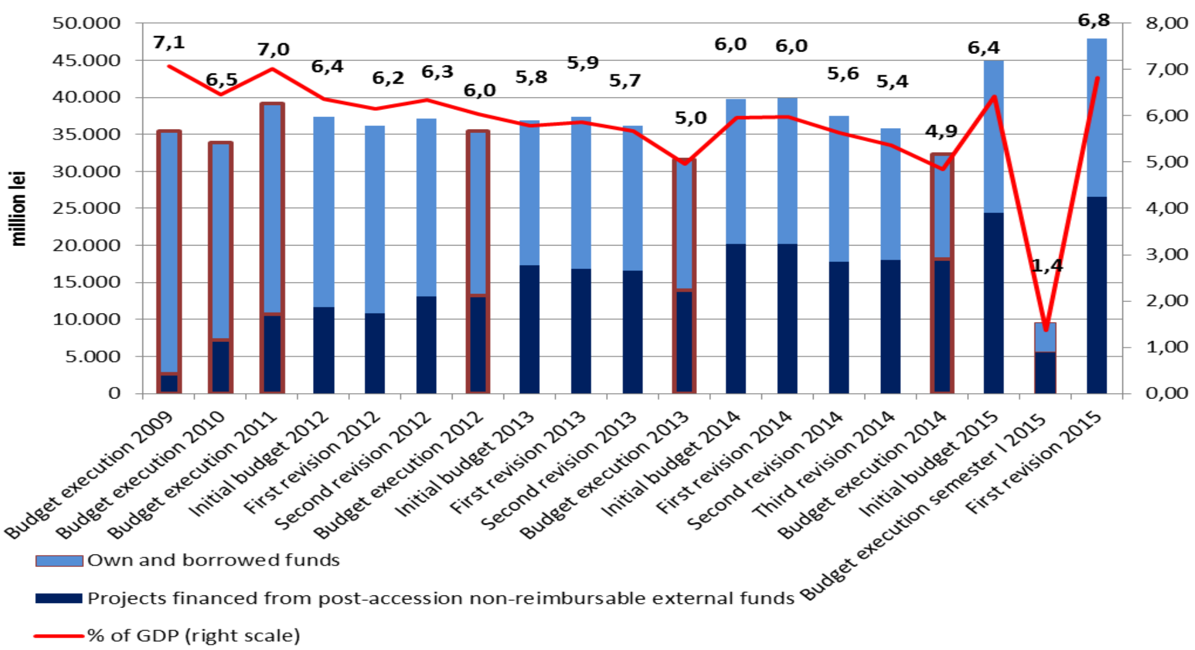
Source: Ministry of Public Finance, Fiscal Council's calculations

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 2009-2015 - planned vs. execution (million lei)



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

VI. The Fiscal Council's Opinion on the Second Supplementary Budget Draft for 2015

On October 21st 2015, the Fiscal Council received from the Ministry of Public Finance by letter no. 419367/20.10.2015, the second supplementary budget draft for 2015, the explanatory note and the draft Government Ordinance project regarding the second budget revision for 2015, as well as the explanatory note and the Government Ordinance project regarding the draft of the revised social security budget for 2015, requesting the Fiscal Council's opinion under article 40, paragraph (2) of the Fiscal Responsibility Law (FRL) no. 69/2010[18] (FRL).

The coordinates of the Second Supplementary Budget Draft – the compliance with the fiscal rules

Compared with the budget approved on the occasion of the first budget amendment, the general consolidated budget (GCB) revenue and expenditure increase by 3.03 billion lei, so that the budget deficit is projected to remain to the level of 13,004 million lei. Article 12 letters b) and c), article 24 and article 26 paragraph (5) of the FRL state as mandatory the ceilings established by the Fiscal Strategy and by the accompanying law regarding the ceilings for the following indicators: the nominal level of the GCB deficit, the GCB primary deficit, the total spending excluding the financial assistance from the EU and other donors and also for the personnel spending - limiting the possibility of increasing total expenditure of the GCB during revisions exclusively for paying the debt service and Romania's contribution to the EU budget.

The first budget amendment already projected major breaches of the above mentioned mandatory ceilings established by the Law no. 182/2014 (Law for the approval of ceilings for certain indicators specified in the fiscal framework for 2015), both in the case of the personnel expenditures (by 1,481 million lei) and total spending excluding the financial assistance from the EU and other donors (by 4,932 million lei). Moreover, at that moment it was noted the non- compliance with fiscal rules stated by art. 12 paragraph (2) (which prohibits increasing the personnel expenses during the budgetary revisions) and by art. 24 (which prohibits the increase of the GCB expenditures, net of financial assistance from the EU and other donors during the budget revisions, unless it is due to the supplementing of the interest expenses or those related to Romania's contribution to the EU budget). The

[18] Corresponding to article 53, paragraph (2) of the Law no. 69/2010 republished.

changes introduced by the draft of the second budget revision significantly increase the size of these ceilings overruns in the case of personnel expenses (by 2,286 million lei), total expenses excluding financial assistance from the EU and other donors (by 3,788 million lei) in the context of increasing the total spending by 3,027 million lei and also the reduction of the projection regarding the amounts from EU funds by 781 million lei. Furthermore, a small deepening is added (+109 million lei) for the exceeding of the primary deficit ceiling, already registered on the occasion of the first budget revision (204.5 million lei). In addition to the breaking of ceilings, the second supplementary budget violates the provisions of art. 17 paragraph (2) and art. 24 which prohibits the increase of personnel expenditures and GCB expenditures, net of financial assistance from the EU and other donors during the year. The draft law provides again the already usual exemption from the above described fiscal rules, diminishing their credibility.

The Fiscal Council has commented extensively in its opinion on the first draft budget revision for 2015 about the *de facto* inoperability of the fiscal rules associated to the one related to budget deficit stated in FRL, in the sense that this rules by no means constrain the behavior of the authorities according to the legislator's intention, and proposed either a law enforcement aiming at limiting the possibility to recourse to derogation only under a precisely defined set of circumstances and the introduction of motivating penalties for breaking the fiscal rules (the optimal solution), or putting together the *de jure* with the *de facto* situations by affirming the supremacy of the fiscal rule regarding the budget deficit (in accordance with the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union) and the formal abandonment of the related rules' set. Given that the second draft budget revision comes with a new round of derogations from almost all the associated rules except the budget deficit related one, the considerations expressed during the first revision remain valid in this case also.

The coordinates of the second budget revision - budgetary revenues

GCB revenues are downwardly revised by 3.03 billion lei compared to the programmed level from the first budget revision, but a part of this review (+688.8 million lei) is due to the new swap compensation scheme, so that the budgetary revenues, net of the impact of the swap schemes, are projected to grow by 2.34 billion lei. The budgetary revenues which register major changes relative to the values expected during the first budget revision, considering the net value of the swap are as follows:

- *Corporate income tax*: +155 million lei. Updating the programmed level for the whole year appears to be justified compared to the up to date budget execution, caracterized by a exceeding of revenue program
- *Personal income tax*: +123 milioane lei. Updating the programmed level for the whole year appears to be prudent given the decision to pay in advance compared to the originally programmed scheduling of salary related rights earned by court decisions, as well as the recent decisions to increase wages

for some categories employeesin the public sector which are likely to generate additional revenue from the personal income tax.

- *VAT*: +1,236 milioane lei. In its opinion on the first draft budget revision of 2015, The Fiscal Council emphasized that the estimate of VAT revenues appeared to be prudent, which did not entirely included the over performance compared to the initial program for this revenue category, of 9.6% at the end of the first semester, even taking into account the application of reduced VAT rate on food products from first of June 2015, so the projection change appears to be justified. Regarding the impact seen in the VAT revenues of the extended scope of the reduced VAT rate for food products and restaurant services, although the time period elapsed is not sufficient to draw strong conclusions, first round impact seems to be approximately equal to the originally estimated one (about 5.5 billion lei per year). Thus, as can be seen in the first chart of the annex, if in the first 6 months the average annual growth rate of VAT collected monthly flows stood at about 10%, during the period July to September it dropped to 1.8% suggesting a monthly measure impact of about 400-500 million lei. If we analyze the values of VAT receivable (those observed in the monthly budget execution, which are equal to the VAT collected less VAT refunded, influenced thus by the dynamic of repayments that can undergo significant monthly variations), the average growth rate in the first 6 months of over 18% experienced a significant slowdown of up to about 7%, being likely to lead to a similar conclusion, namely a monthly impact of the measure concerned of about 400-500 million lei.
- *Excise duties*: +360 million lei. Increasing the projection for this budgetary category appears as optimistic in terms of the budget execution at 8 months, which does not point to an overperformance compared to the programmed levels.
- *Social Contributions*: +204 million lei. The revision may appear as prudent given the significant increase in personnel expenses (2,140 million), which will generate additional social contributions revenue of about 684 million lei, but it must be taken into account the fact that the large increase at the level of this budgetary aggregate, operated at the first budget amendment (1,671 million lei) appeared at that time as overly optimistic. The Fiscal Council has reserves on the figure presented in the Draft of the Second Supplementary Budget, given the up to date budget execution, consideering that the receipts at the end of the year will be most likely below the target by about 500-800 million.
- *Non-tax revenues*: +651 million lei. The change in the projection is given by the increase in the revenues from the sale of greenhouse gas emission

certificates (188.5 million lei) and by the amounts collected at 8 months that exceed the program.

- *Taxes on using goods, authorizing the use of goods or on carrying activities*: 413 million lei due to additional receipts from taxes on gambling.
- *Amounts received from the EU in the account of payments made and prefinancing*: -781 million lei. The amount projected for the end of the year appears, however, as highly unlikely to be achieved given the receipts at 8 months (6,181 million lei), which represents less than a third compared to the budget target for the whole year (19,976 million lei). For reference, the budget execution for the year 2014, with a similar profile, recorded an increase in the amounts drawn from EU funds in the last 4 months of the year by about 37% compared to an increase of 223% required this year to converge towards the current budgeted levels.

The coordinates of the second budget revision – budgetary expenditure

The budgetary expenditure are also reviewed upward by 3.03 billion lei or by 2.34 billion lei if we eliminate the influence of the new swap scheme, the sources of this change being as follows:

- *Personnel expenses*: +2,140 million lei. This increase is explained mainly by the decision to pay in advance some salary rights established by court decisions (1,000 million lei), in contrast to the initial scheduling, to which is added the budgetary impact of higher wages in the health sector by 25% since October the 1st (300 million lei), the impact of local executive authorities staff higher wages by 12% since August the 1st (300 million lei) and the impact of the rise in the defense and public order sector food norm (250 million lei).
- *Goods and services*: +941 million lei, especially for the defense sector.
- *Subsidies*: +1,255 million lei, in the context of the funds allocated for the farmer losses compensations, caused by drought (300 million), for the increase in the subsidy for the diesel fuel and for the public transportation service by rail.
- *Projects funded by external post-accession non-reimbursable grants*: -897 million lei. The decrease represents the counterpart of the downward revision of the program in term of the amounts received from the EU. The reserves expressed there, with respect to the pace that EU funds inflows should perform in order to be provided the convergence with the programmed levels, is applied in the case of the associated expenses, as well.
- *Social assistance*: +439 million lei.

- *Capital expenditures*: -2,349 million lei, the adjustment being in line with the substantial underperformance registered in the first 8 months for the investment spending category.
- *Contingency reserve fund*: +841 million lei. This change appears as surprising given the previous years' pattern, according to which the contingency reserve fund amounts actually spent were not necessary those established via CGB successive amendments, as the financial sources consisted mainly of the allocations for some line credit officers which were not used. The Fiscal Council has previously elaborated exhaustive analyses of the manner the contingency reserve fund amounts are used showing the lack of transparency of their utilization, the nonexistence of explicit criteria identification of expenditure that can be made from the contingency reserve fund, the absence of a Parliamentary or of other institution's control of the money utilization and formulated strong recommendations regarding amending the legislation that regulates the contingency reserve fund use. The figure no. 2 in the Annex shows the allocations of the contingency reserve fund in the period 2007-2014, for the previous year being observed a deterioration of the contingency reserve fund utilization, as the amounts spent were significantly higher compared to the previous years.

In essence, at the level of the budgetary expenditure, is envisaged a significant increase of current spending (personnel, goods and services, subsidies) alongside with a massive reduction in the investment spending that are programmed to be reduced by 3,155 million lei compared to the first budget revision in 2015. This evolution is in line with the first 8 months' execution that shows an investment spending level of 15.13 billion lei (about 2.1% of GDP) in the context of an initial target of 47.36 billion lei (6.72% of GDP), that was modified on this occasion at 44.2 billion lei (6.27% of GDP), which would be equivalent nevertheless to an increase of 37% compared to 2014. The figure no. 4 in the Annex examines the execution of the investment spending compared to the planned spending according to the initial and revised budgets in the period 2012-2014, showing constant major deviations, in the sense that the executions are with no exceptions lower than the estimated amounts both in the initial and revised budgets, and the development registered in the current year indicates a similar pattern.

This evolution is not a desirable one, being well known from the international competitiveness rankings that the low quality of infrastructure represents the main challenge influencing the incentive to invest in Romania. However, the investment spending was continuously reduced over the last years, and probably will reach the minimum of the last 10 years in 2015 as a share in GDP. In this context, decreasing the investment spending without accompanying it by a significant efficiency improvement in order to offset the tax reductions and increased personnel spending in the budgetary sector, is counterproductive and will negatively affect the potential economic growth over the medium term. Moreover, the current investment reduction represents only a postponement, and the necessity of carrying out the investments in the future will put a pressure on the budget over the medium and long term. In addition, reducing investment can only mean their postponement, the need of carrying out the investments in the future being likely to put a pressure on the budget over the medium and long-term.

In the Fiscal Council's opinion, for 2015 the risks are rather tilted towards recording a lower budget deficit than the target due to the inability to execute the expenditure program. However, in the medium term, engaging additional significant expenses of a permanent nature (such as personnel expenses), simultaneously with a massive reduction of taxes provided in the new Fiscal Code (especially in the case of taxes on goods and services: VAT and excises) are likely to bring the deficit in 2016, in the absence of compensatory measures, close to the 3% of GDP limit simultaneously with the significant deviation from the medium-term objective of 1% structural deficit. Moreover, the year 2017 could record exceeding the limit of 3% of GDP, mainly due to the fact that the second series of measures under the new Fiscal Code will enter into force. Therefore, the budgetary slippage would have a structural nature and would make the public finance position more vulnerable during the next downward phase of the economy, the subsequent adjustment costs exceeding the short term benefits in terms of real convergence generated by the higher budgetary deficit from the upward economic phase.

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 the Law no. 69/2010 republished, after being approved by the Council members through vote, on 23rd October, 2015.

23rd October, 2015

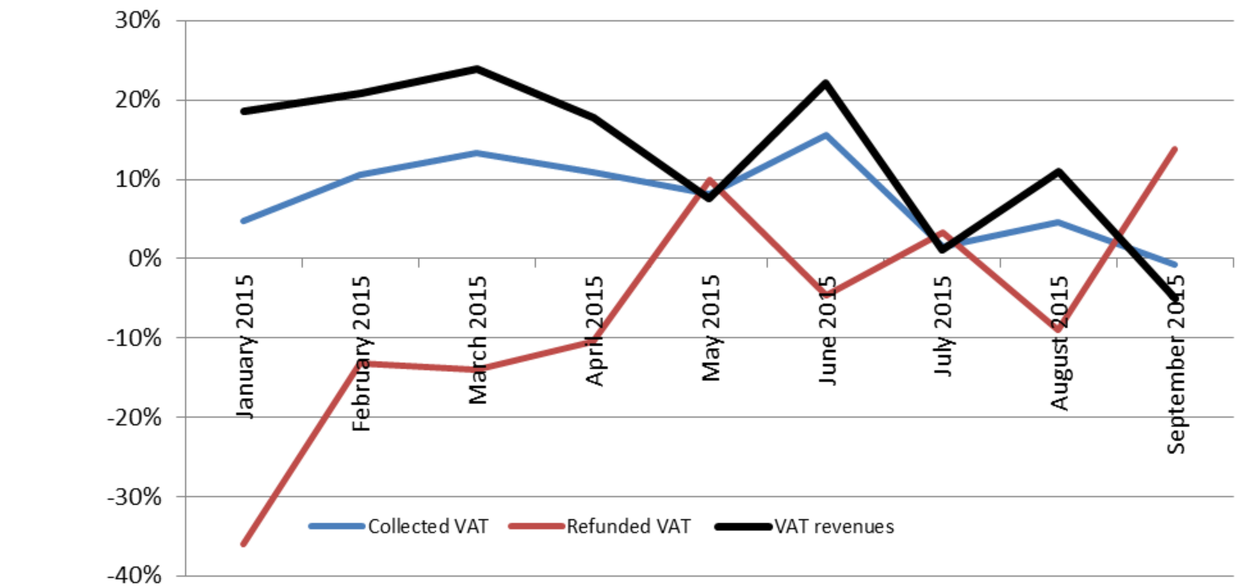
Chairman of the Fiscal Council

IONUŢ DUMITRU

ANNEX I	Initial budget 2015	Swap program	Initial budget 2015 without swap	First budget revision (R1)	Swap	R1 without swap	Second budget revision (R2)	Swap	R2 without swap	R1-Initial budget	R2- Initial budget	R2-R1
										Adjusted values for swap impact		
	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	226,360.5	850.0	225,510.5	233,277.0	850.0	232,427.0	236,303.7	1,538.7	234,765.0	6,916.5	9,254.5	2,338.0
Current revenue	206,732.3	850.0	205,882.3	211,646.7	850.0	210,796.7	215,389.6	1,538.7	213,850.9	4,914.4	7,968.6	3,054.2
Tax revenue	133,391.8	850.0	132,541.8	135,170.1	850.0	134,320.1	137,911.4	1,538.7	136,372.7	1,778.3	3,831.0	2,052.7
Taxes on profit, wages, income and capital gains	39,567.7		39,567.7	41,177.9		41,177.9	41,410.9		41,410.9	1,610.2	1,843.2	233.1
Corporate income tax	12,670.0		12,670.0	13,486.8		13,486.8	13,641.6		13,641.6	816.8	971.6	154.9
Personal income tax	25,314.7		25,314.7	26,098.9		26,098.9	26,222.0		26,222.0	784.2	907.3	123.1
Other taxes on goods and services	1,583.0		1,583.0	1,592.2		1,592.2	1,547.3		1,547.3	9.2	-35.7	-44.9
Property tax	6,354.0		6,354.0	5,820.4		5,820.4	5,757.4		5,757.4	-533.6	-596.6	-63.0
Taxes on good and services	86,402.1	850.0	85,552.1	87,034.5	850.0	86,184.5	89,560.6	1,392.7	88,167.9	632.4	2,615.8	1,983.4
VAT	55,537.2	850.0	54,687.2	55,284.6	850.0	54,434.6	57,063.0	1,392.7	55,670.3	-252.6	983.1	1,235.7
Excises	25,531.0		25,531.0	25,799.3		25,799.3	26,159.5		26,159.5	268.3	628.5	360.2
Other taxes on goods and services	2,738.4		2,738.4	3,040.1		3,040.1	3,014.5		3,014.5	301.7	276.1	-25.6
Taxes on using goods, authorizing the use of goods or on carrying activites	2,595.5		2,595.5	2,910.5		2,910.5	3,323.6		3,323.6	315.0	728.2	413.1
Tax on foreign trade and international transactions (customs duty)	675.0		675.0	726.4		726.4	775.3		775.3	51.4	100.3	48.9
Other tax revenue	393.0		393.0	410.9		410.9	407.2		407.2	17.9	14.2	-3.7
Social security contributions	55,311.0		55,311.0	56,982.0		56,982.0	57,332.4	146.0	57,186.4	1,671.0	1,875.4	204.4
Nontax revenue	18,029.5		18,029.5	19,494.7		19,494.7	20,145.8		20,145.8	1,465.1	2,116.2	651.1
Capital revenues	853.8		853.8	871.5		871.5	916.5		916.5	17.7	62.7	45.0
Grants	2.3		2.3	2.3		2.3	22.1		22.1	0.0	19.8	19.8
Amounts received from the EU in the account of payments made and prefinancing	18,772.1		18,772.1	20,756.5		20,756.5	19,975.6		19,975.6	1,984.4	1,203.5	-780.9
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(State budget)	0.0		0.0	0.0		0.0	0.0		0.0	0.0	0.0	0.0
Other amounts received from the EU for operational Programmes funded under the convergence objective	0.0		0.0	0.0		0.0	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	0.0		0.0	0.0		0.0	0.0		0.0	0.0	0.0	0.0
TOTAL EXPENDITURE	239,364.4	850.0	238,514.4	246,280.9	850.0	245,430.9	249,307.6	1,538.7	247,768.9	6,916.5	9,254.5	2,338.0
Current expenditure	220,937.4	850.0	220,087.4	226,970.2	850.0	226,120.2	231,803.1	996.0	230,807.1	6,032.8	10,719.7	4,686.9
Personnel	48,373.3		48,373.3	49,854.2		49,854.2	52,139.8	146.0	51,993.8	1,480.9	3,620.5	2,139.6
Goods and services	40,037.3		40,037.3	40,926.0		40,926.0	41,867.3		41,867.3	888.7	1,830.0	941.3
Interest	10,529.3		10,529.3	10,324.8		10,324.8	10,216.1		10,216.1	-204.5	-313.2	-108.7
Subsidies	5,488.8		5,488.8	5,776.6		5,776.6	7,031.5		7,031.5	287.8	1,542.7	1,254.9
Total Transfers	115,711.7	850.0	114,861.7	119,314.3	850.0	118,464.3	118,985.3	850.0	118,135.3	3,602.6	3,273.6	-329.0
Transfers for public entities	1,498.5	850.0	648.5	1,562.2	850.0	712.2	1,665.9	850.0	815.9	63.6	167.3	103.7
Other transfers	12,040.3		12,040.3	12,142.8		12,142.8	11,958.8		11,958.8	102.5	-81.5	-184.0
Projects funded by external post-accession grants	24,176.0		24,176.0	25,708.5		25,708.5	24,811.6		24,811.6	1,532.5	635.6	-896.9
Social assistance	74,095.0		74,095.0	75,382.3		75,382.3	75,821.3		75,821.3	1,287.3	1,726.3	439.0
Projects funded by external post-accession grants 2014-2020	482.3		482.3	519.7		519.7	537.9		537.9	37.4	55.6	18.3
Other expenditure	3,419.6		3,419.6	3,998.9		3,998.9	4,189.9		4,189.9	579.3	770.3	191.0
Reserve funds	0.6		0.6	151.0		151.0	992.1		992.1	150.4	991.5	841.1
Expenditure funded from reimbursable funds	796.4		796.4	623.3		623.3	570.9		570.9	-173.1	-225.5	-52.3
Capital expenditure	18,427.0		18,427.0	19,310.8		19,310.8	17,504.5	542.7	16,961.8	883.7	-1,465.2	-2,348.9
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(-)	-13,004.0		-13,004.0	-13,004.0		-13,004.0	-13,004.0		-13,004.0	0.0	0.0	0.0

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

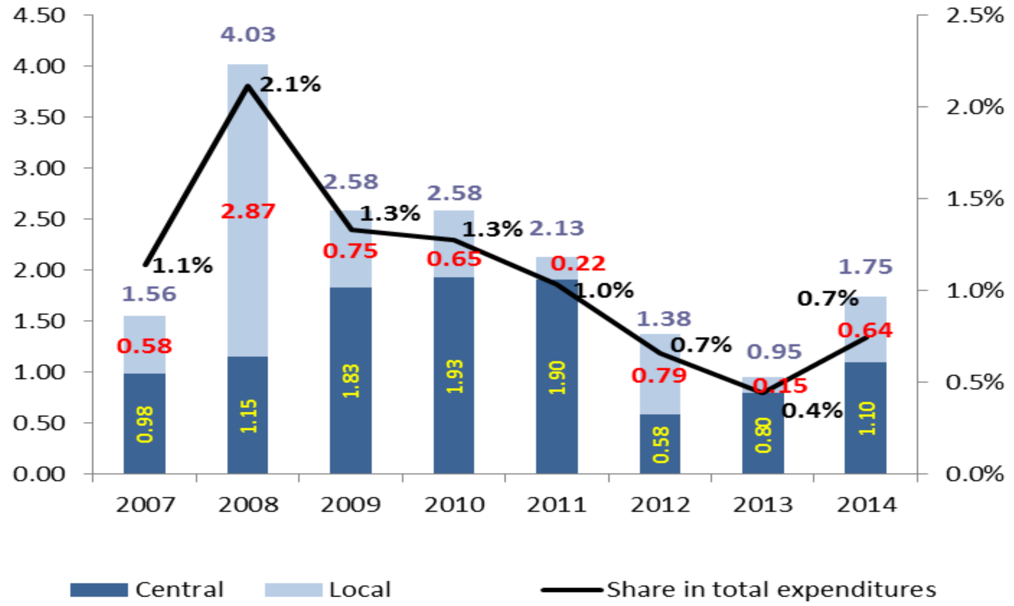
Figure 1: Growth rate of VAT, compared to the same period of the last year



	January 2015	February 2015	March 2015	April 2015	May 2015	June 2015	July 2015	August 2015	September 2015
Collected VAT	4.76%	10.52%	13.29%	10.82%	8.10%	15.60%	1.59%	4.56%	-0.79%
Refunded VAT	-35.94%	-13.26%	-14.03%	-10.46%	9.84%	-4.67%	3.33%	-9.01%	13.76%
VAT revenues	18.54%	20.89%	23.95%	17.74%	7.52%	22.13%	1.03%	11.03%	-4.98%

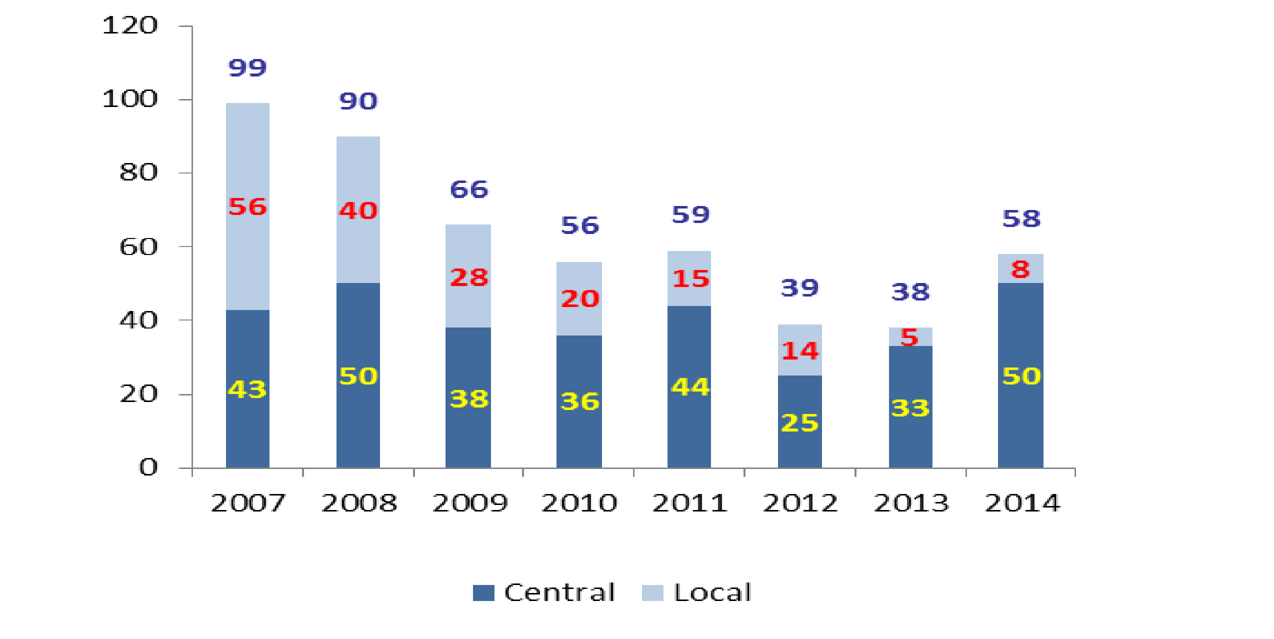
Source: Ministry of Public Finance, Fiscal Council's calculations

Figure 2: Total contingency reserve fund allocations (billion lei)



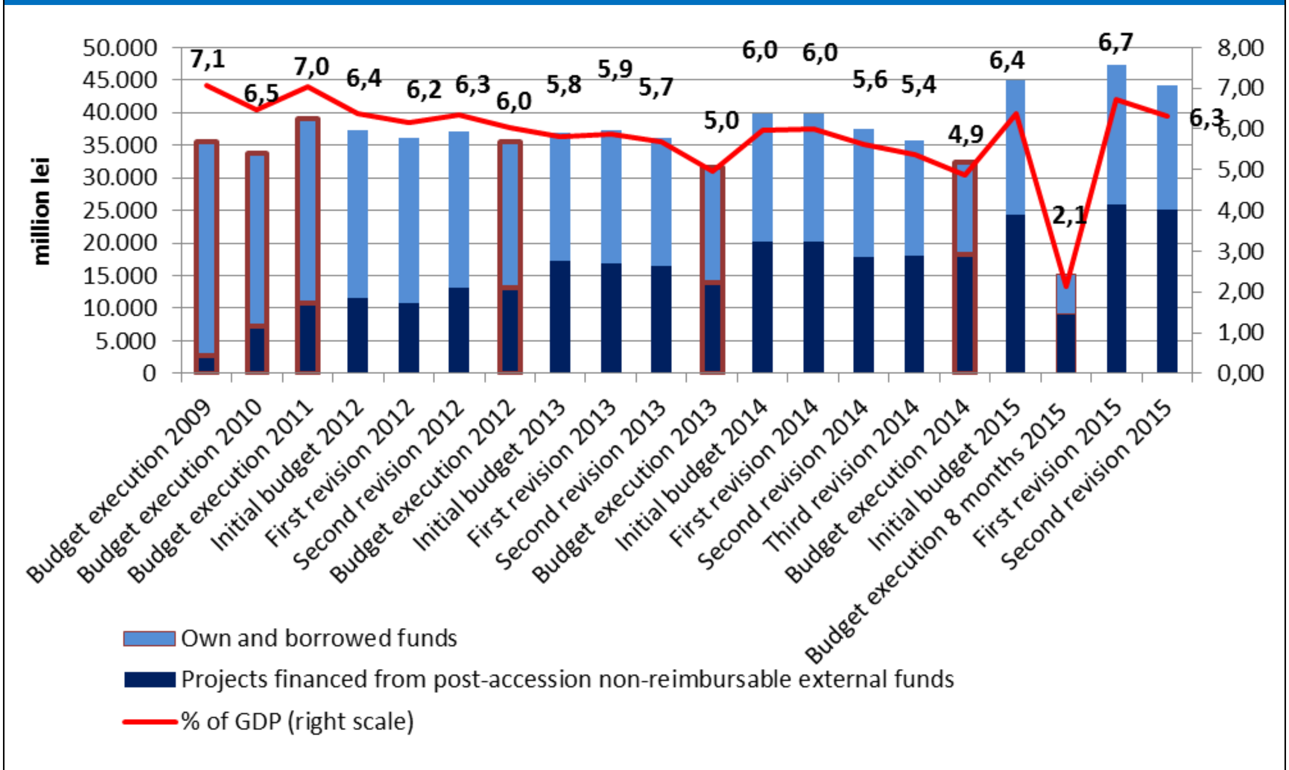
Source: Fiscal Council's calculations based on Government's decisions regarding the contingency reserve fund allocations

Figure 3: Number of Government decisions regarding contingency reserve fund allocations



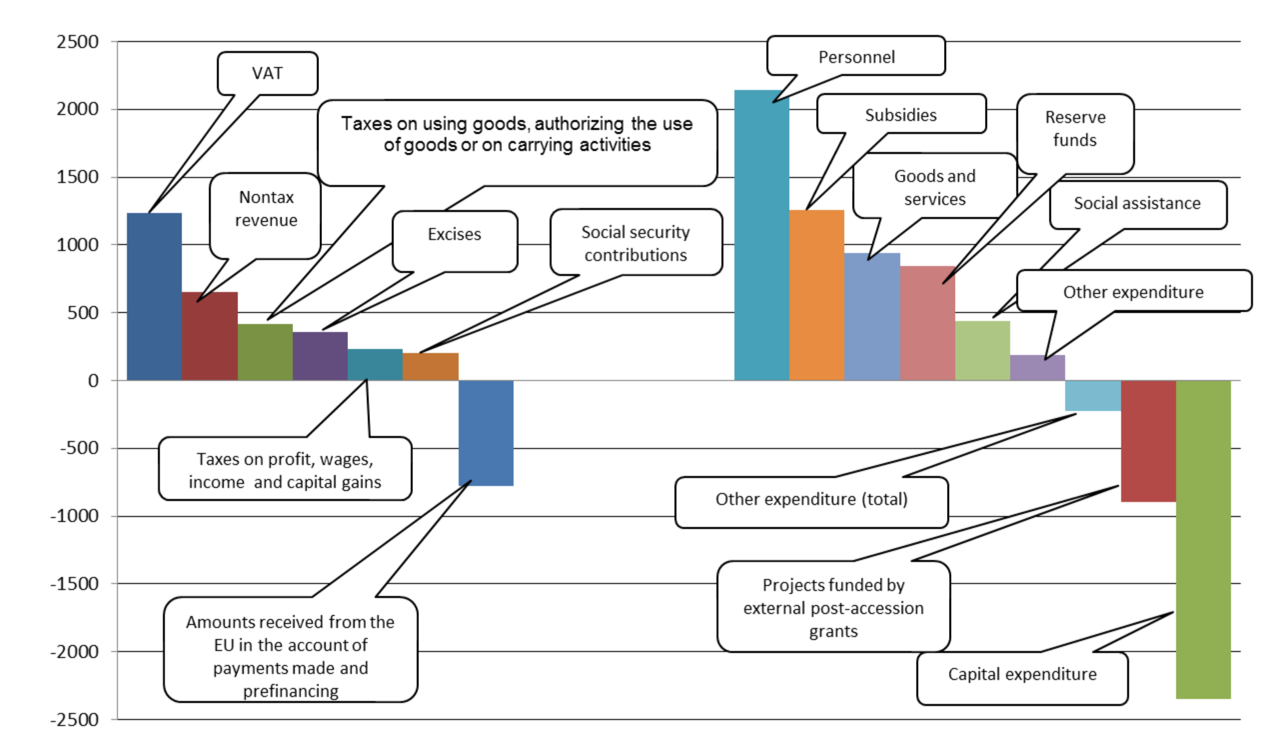
Source: Fiscal Council's calculations based on Government's decisions regarding the contingency reserve fund allocations

Figure 4: The evolution of investment expenses between 2009-2015 – planned level vs. execution (million lei)



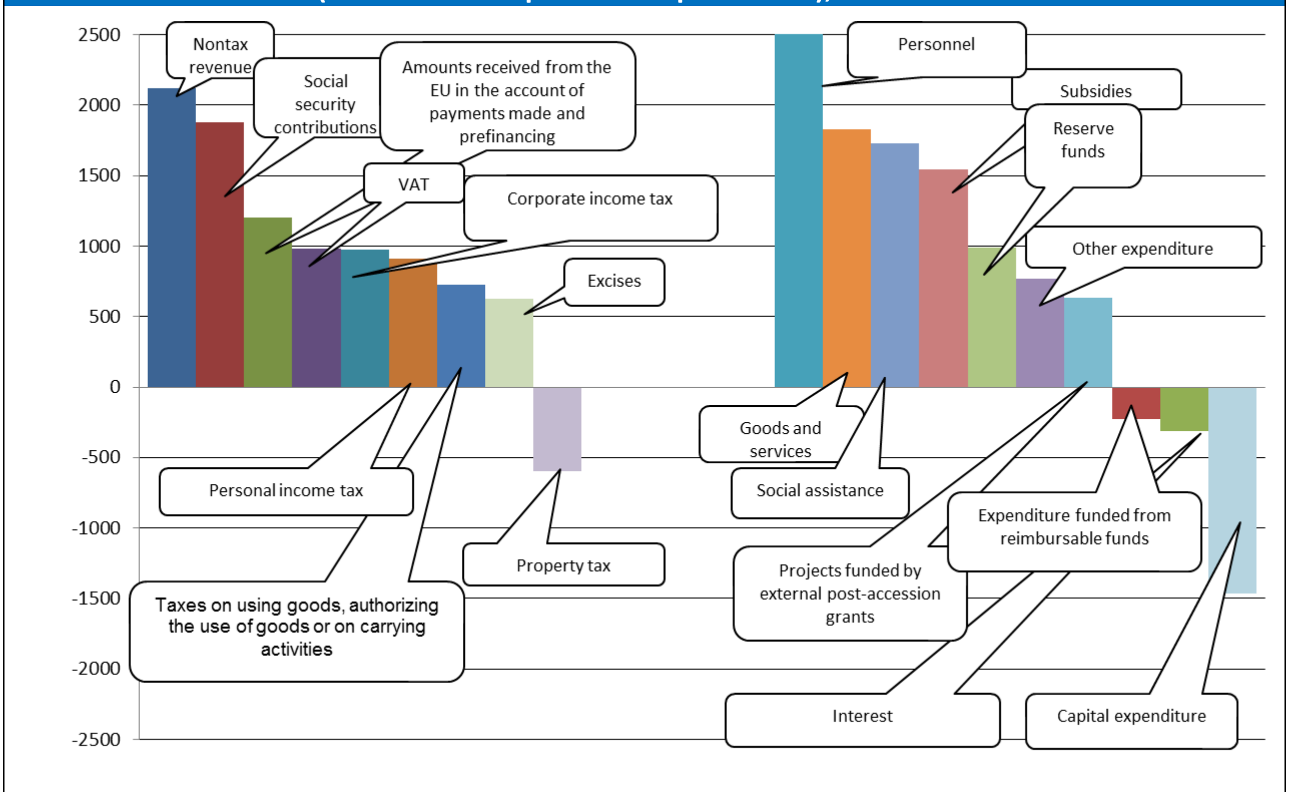
Source: Ministry of Public Finance, Fiscal Council's calculations

Figure 5: The main changes in expenditures and revenues compared to first budget revision (without the impact of swap schemes), million lei



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

Figure 6: The main changes in expenditures and revenues compared to initial budget (without the impact of swap schemes), million lei



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

VII. The Fiscal Council's opinion on the draft Emergency Ordinance regarding the regulation of some fiscal measures (reduction of the personal income tax for dividends revenue, extending the application scope of the reduced VAT rate of 9% for delivery of potable water and irrigation water for agriculture)

On 26th October 2015, the Fiscal Council received from the Ministry of Public Finance by letter no. 678949/22.10.2015, the draft Government Emergency Ordinance (GEO) regarding the regulation of some fiscal measures and the related explanatory note, requesting the Fiscal Council's opinion under article 40, paragraph (2) of the Fiscal Responsibility Law no. 69/2010[19] (FRL).

From the perspective of FRL, for this case are relevant art. 21 and 22, according to which:

„Art. 21: Proposals for any legislation leading to a reduction of budgetary revenues must provide a financial statement according to article 15 of Law no. 500/2002, as amended and supplemented and meet at least one of the following conditions:

a) to have the endorsement of the Ministry of Public Finance and of the Fiscal Council, confirming that the financial impact was taken into account in the budgetary revenue forecast and does not affect the annual budget targets and medium term targets;

b) to be accompanied by proposals for measures to compensate the financial impact, by increasing other budgetary revenues.

Art. 22: The initiatives promoted under article 21 are adopted concurrently with the proposed compensating measures, approved by the Government."

Moreover, art. 53, para. (2), let. e) and f) of FRL states among the responsibilities of the Fiscal Council:

„e) analysis and issuing opinions and recommendations on the annual budget laws before approval by the Government and before submission to Parliament, on the supplementary budgets and other legislative initiatives that may have an impact on the budgetary targets, as well as assessing their compliance with the principles and rules specified in this Law;

[19] Corresponding to art. 53, para. (2) of the Law no. 69/2010 republished.

f) preparation of cost estimates and issuing opinions on the budgetary impact of the normative ordinances, other than the ones mentioned on (d) and the amendments made on the annual budget law during the parliamentary debates".

Brief description of the legislative proposal

The draft version of the GEO received by the Fiscal Council on 26th October contains relevant measures in terms of the fiscal impact deriving from the increase at 100,000 EUR of the ceiling for classifying companies as microenterprises, the differentiation in the applicable tax rates on the microenterprises turnover and the frontloading of the reduction to 5% of the tax rate on dividends for individuals and companies, which, according to the Fiscal Code version approved on September 2015, was scheduled for early 2017. Unlike the version displayed on the web page of the Ministry of Public Finance at the decisional transparency section, neither the draft version of the GEO received by the Fiscal Council, nor the accompanying explanatory note refer to the extending of the applicability of the reduced VAT rate of 9% for potable water and water for irrigation in agriculture. Subsequently to the approval of the proposed regulation in the Government meeting on 27th October in the absence of the endorsement of the Fiscal Council, the latter received the final form of the proposed regulation, which includes amendments to the Fiscal Code, including the extension of the reduced VAT rates mentioned above.

According to the explanatory note which accompanied the GEO, the total impact on revenue in 2016 is equal to -2.05 billion lei and the distribution of the first round impact on individual measures is:

- -300 million lei net effect at the level of microenterprises income tax derived from the aforementioned reclassification and the change in the tax rate from 3% of the turnover at the differentiated rates of 3%, 2%, and 1% when microenterprises have none, one or at least two employees;
- -1,357.2 million lei at the level of the tax on dividends paid to Romanian individuals, where 71.5%, respectively, 970.4 million lei, represents the deducted quota which is incumbent on the local budgets;
- -44 million lei at the level of the tax on dividends paid to Romanian legal entities;
- -110.7 million lei at the level of the tax on dividends paid to non-resident individuals and legal entities;
- -233.8 million lei at the level of the VAT revenues, due to the extending application of the 9% reduced rate for potable water and water for irrigation in agriculture.

Sources of coverage for the budgetary impact

The explanatory note provides an automatic adjustment of the local budget expenditures by the equivalent revenue loss at the level of tax on dividends paid to Romanian individuals incumbent on them after applying deducted quota of 71.5%, the net impact of the first round in the budget balance in 2016 being estimated at a level of -1,077.4 million lei. Also, the explanatory note assesses the budgetary impact of the second round effects to 607 million lei, given that the proposed measures are seen as a source of additional economic growth of 0.05 pp and 19,000 more jobs.

The Fiscal Council validates the assessments made in the explanatory note on the size of the first round effects, but has significant reserves about the estimated additional budgetary revenues due to second round effects, whose size covers more than 55% of the budgetary impact of the first round. If the assessment of additional economic growth of 0.05 pp (about 350 million lei), appears to be perfectly reasonable in terms of size of the fiscal stimulus given an automatic reduction in the size of local budget expenditures (1,077.4 million lei, namely 0.14% of GDP), knowing that the default fiscal multiplier is approximately 0.35, not the same can be said about the assessment of the additional budget revenues which, although has as a source this additional economic growth, end up overcoming it by nearly 1.75 times. It is impossible to imagine how the government could collect 175% of the additional tax base and how such a result could be reconciled in any way with a reasonable set of tax revenue elasticity to GDP change. Also, the assessment of the number of newly created jobs appears to be excessive and inconsistent compared to the stated value of economic growth. The latest projection of National Commission for Economic Forecasting (NCEF) asserted a percentage point of economic growth to 30,000 additional employees, which makes appear extremely surprising the number of 19,000 newly created jobs associated with an additional economic growth of 0.05 percentage points. A reasonable assessment of the second round effects on the budgetary revenues would probably indicate their size to be 4-6 times lower than the one stated, namely around 100-150 million lei.

The Fiscal Council has also reserves concerning the assumption regarding the automatic adjustment of the local budget expenditure based on the provisions of art. 20, para 1, letter a) of the Local Public Finance Law no 273/2006, provided that such adjustments are not individualized by category of expenditure and we cannot be exclude higher discretionary income allocations to the local budgets from other budgetary revenues, which, *caeteris paribus* would result in a higher deficit of the state budget and, consequently in a higher deficit of the general consolidated budget.

Conclusions

In the Fiscal Council's opinion, from the predictability perspective it would be inauspicious that, only after 2 months after the adoption of new Fiscal Code and before entering into force, this is amended and, more than that, in a substantial manner. In its opinions published during this year, the Fiscal Council has drawn the attention on the implications derived from expressing the fiscal policy's objectives in terms of structural deficit, and on the fact that the measures enclosed in the new Fiscal Code are likely to lead, in the absence of compensatory measures, to a permanent and substantial deviation from the objectives derived from both the European treaties signed by Romania (the Stability and Growth Pact and the Fiscal Compact), and from the relevant national legislation (Fiscal Responsibility Law no 69/2010 republished). In their terms, the relevant target for the fiscal policy is not the reference level of 3% of GDP for the headline deficit provided by the corrective arm of the Stability and Growth Pact – a value close to this deficit being reserved to some adverse cyclical situations (which is not the case in the present and in the medium term), but the level of the headline deficit consistent with the medium term objective defined as a structural deficit of 1% of GDP according to the combined provisions of the preventive arm of the Stability and Growth Pact and the Fiscal Compact[20]. In perspective, the headline deficit of 2016 consistent with the medium term objective would be about 1.1-1.2% of GDP. Even if officially not enshrined, still given the absence of a medium term fiscal strategy that incorporates the impact of the new Fiscal Code, the commitment to abandon these targets is clear from the public statements of the Ministry of Public Finance and is also indicated by the Fiscal Council and the European Commission assessments. To the effects on the revenue side is added the impact of recently approved wage increases and the impact of those likely from the perspective of the parameters of the draft unitary salary law that the Government intends to move forward, that means most likely a dangerous approach to the reference level of the headline deficit of 3% of GDP in 2016 and an exceeding above this level in 2017, along with the entry into force of the new Fiscal Code.

Most of the budgetary impact (75% of budget revenues, 50% at the deficit level under the hypothesis of automatic adjustment of the local budget expenditures) of the current legislative proposal has as source the frontloading for one year of the deadline for the entry into force of the tax reduction for dividends and therefore involves a major impact on the deficit only at the level of 2016, compared to a baseline scenario in which the measure would came into force in 2017. However, the baseline scenario described above already does not appear to be in conformity with the rules established by art. 6 and 7 of FRL. Given the above arguments and previous opinions issued during the current year, the Fiscal Council cannot approve a legislative proposal that implies a faster and deepening deviation from the pre-existing fiscal rules.

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, as amended and supplemented, after being approved by the Council members through vote, on 2nd November 2015.

2nd November 2015 — Chairman of the Fiscal Council,

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[20] Moreover, the medium term objective has already been met in 2014, as the MTO corresponded to a headline deficit of 1.4% of GDP, according to ESA 2010.

VIII. 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 single 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[21], 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 risks falling back into the trap of pro-cyclical fiscal policies, pressing the accelerator in the expansion phase of the economic cycle and risking to

[21] 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.

be forced to implement structural adjustment measures in a inevitable next phase 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[22].
- **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

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

deficits in the coming years should be small, beyond the commitments made by Romania at the European level. Moreover, according to a recent study undertaken by the National Bank of Romania (NBR)[23], 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 of GDP, mainly due to public sector wage increases. The Fiscal Council's comments on the dynamics of the individual categories of revenues and

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

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 includes temporary influences from a new compensation scheme of outstanding obligations towards the budget (swap) with a 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[24]), 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 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

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

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 NCEF'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 induces 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	- million lei Revenue item
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 Economic Forecasting 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 Economic Forecasting 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	The draft budget for 2016/ Preliminary execution 2015	The draft budget for 2016/ Preliminary execution 2015	Preliminary execution for 2015	The draft budget 2016	The draft budget for 2016- Preliminary execution 2015
								without swap		without swap	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%
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%

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	The draft budget for 2016/ Preliminary execution 2015	The draft budget for 2016/ Preliminary execution 2015	Preliminary execution for 2015	The draft budget 2016	The draft budget for 2016- Preliminary execution 2015
								without swap		without swap	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 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

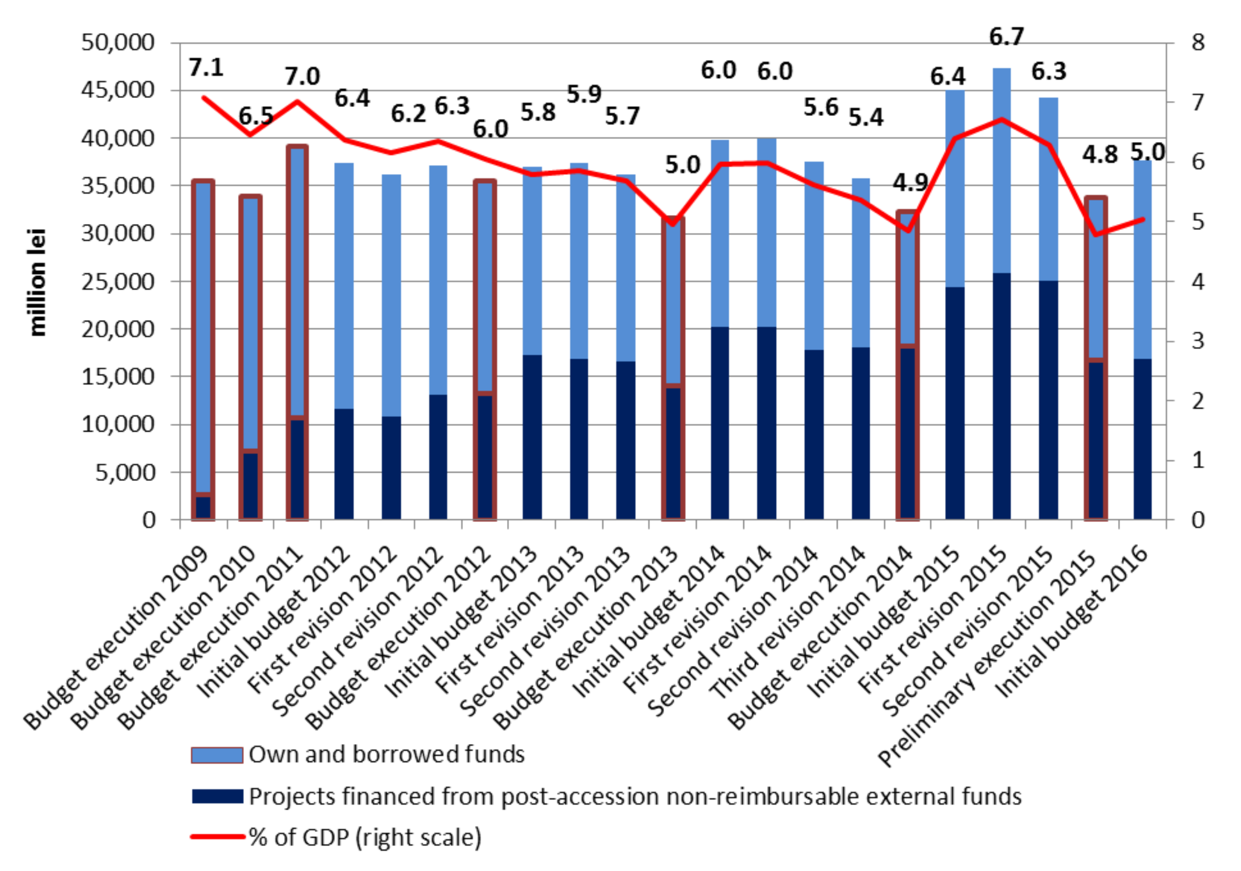
Annex 5: Revenue Projection	2015	2016						
	Preliminary execution for 2015 according to MPF (without swap)	The influence of the compensation schemes in 2016	Fiscal policy measurs	Explanations	The growth of the relevant macroeconomic basis	The revenue projection 2016 of the Fiscal Council	CGB revenues 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