Romania

Fiscal Council

Fiscal Council's Opinions

2017

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TABLE OF CONTENTS

I. Fiscal Council's preliminary opinion on the State Budget Law and Social Insurance Budget Law for 2017

On January 23, 2017, the Fiscal Council received from the Ministry of Public Finances (MPF) the letter no. 5408 dated to January 21, 2017, requesting under art. 53, paragraph (2) of the Fiscal Responsibility Law no. 69/2010 republished (FRL), the opinion on the draft of the Budget Law for 2017, the draft of the Social Insurance Budget Law for 2017, the Report on the macroeconomic situation for 2017 and the projection for the period 2017-2020, the Fiscal Strategy for 2017-2019 and the corresponding explanatory note and the draft of the ceilings law of certain indicators specified in the fiscal framework for the year 2017. However, the set of documents necessary for the elaboration of the Fiscal Council's opinion was incomplete in the absence of Fiscal Strategy for 2017-2019 and the Fiscal Council requested additional information and clarifications from MPF under the letter no. 7 dated 23 January 2017. Meanwhile, the draft budget has undergone significant changes compared to the version originally notified to the Fiscal Council, the updated construction budget being sent by MFP (with the text of the Fiscal Strategy) on the morning of January 27, 2017.

Under article 53, paragraph (4) of the FRL, the Government and Parliament are required to consider the opinions and recommendation of the Fiscal Council when **elaborating and approving the Fiscal Strategy and the annual budgets, as well as in the preparation of other measures triggered by the implementation of this law.** Given the Government's intention to approve the above documents at the meeting on 27.01.2017, which clearly involves an insufficient time for analysis, development and approval of the requested opinion and the lack of the full set of documents and the required clarifications, the Fiscal Council is unable to develop a complete opinion on the above documents. In the preliminary opinion, written in order to avoid the delaying of budget adoption in the government meeting and submission to Parliament, the Fiscal Council will only write some general considerations, following that development of the complete opinion to be finalized in the week 30 January - 3 February 2017. After its completion, the Fiscal Council will notify the Parliament and publish the opinion on the website of the institution.

Therefore, the Fiscal Council considers appropriate the following preliminary general considerations:

- The State Budget Law targets a deficit below the reference level of 3% of GDP corresponding to the corrective arm of the Stability and Growth Pact (SGP), but, regardless of the output gap used (there are major differences between the estimates of the National Commission for Economic Forecasting and the latest available estimates of the European Commission), the budget confirms a very large slippage (and widening until 2018) from the requirements of the SGP's preventive arm, adopted in the national legislation through FRL;

- The macroeconomic scenario behind the budget construction appears as significantly more favorable than the earlier assessments of the National Commission for Economic Forecasting. Such a development is justified to a certain proportion by the new measures introduced by the government but, given the information available at this time, the Fiscal Council considers this scenario as optimistic and inappropriate from the perspective of a prudent budget construction. The preliminary assessment of the Fiscal Council, however, shows that the MPF's revenue projection does not appear to fully incorporate the more favorable evolution of the macroeconomic scenario. However, the Fiscal Council has reservations about the revenues projected in the draft budget, the preliminary analysis indicating their potential overestimation.
- The estimated developments of the revenue aggregate "Amounts received from the EU in the account of payments made and pre-financing" and its expenditure counterparty (projects funded by EU non-reimbursable funds) are not comparable with the historical ones, in the context of the agricultural subsidies transiting the 2017 budget (the European Agricultural Guarantee Fund (EAGF) -8.1 billion lei, the European Agricultural Fund for Rural Development (EAFRD) -4.1 billion lei, whose final beneficiary is the private sector). Moreover, these amounts will not transit the general consolidated budget in terms of the European methodology (ESA 2010).
- The Fiscal Council had concerns regarding the projected development of some expenditure aggregates included in the budget construction received on the 23 of January - especially at the level of goods and services and the personnel expenses who appeared as potential undersized in the context of a preliminary analysis performed without having the detailing sources of savings (relative to the impact of the announced fiscal measures). The updated projection of the budget expenditures received by the Fiscal Council on the morning of 27th January brings major changes at the level of some expenditure aggregates, changes that are likely to increase significantly the concerns already existing in regard to the possible under dimension of personnel expenses and adding to these new concerns regarding potential under budgeted aggregates "social assistance", "interest expenses" and "other transfers". Compared to the initial version remitted to the Fiscal Council, the second one includes current expenditure cuts worth around 5 billion lei localized in a descending order, at the level of "other transfers" (-1.7 bn. lei, with an unexplained reduction of the Romania's due contribution to the EU budget), "interest" (-1.5 bn. lei), "personnel expenses" (-867 mil. lei) and "social assistance" (-821 mil. lei). In return, the capital expenditures are increased by 5 billion lei, the source of the increase being localized

at the level of Ministry of Defense's capital expenditures. In this context, it is worth mentioning the further development of this aggregate after 2017, the supplementation of allocations to the Ministry of Defense appearing as temporary because the allocations return in 2018 to levels comparable to the historical ones.

The Fiscal Council's preliminary assessment therefore indicates a potential over-estimation of budget revenues and a probable under-estimation of current expenditure, which is likely to strongly tilt the balance of risks in the sense of recording in execution a deficit higher than projected in the absence of corrective measures.

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 27th of January, 2017.

27th January 2017 Chairman of the Fiscal Council,

IONUȚ DUMITRU

II. Fiscal Council's Opinion on the State Budget Law, the Social Insurance Budget Law for 2017 and the Fiscal Strategy for 2017-2019

On 23 January, 2017, the Fiscal Council (FC) received from the Ministry of Public Finance (MPF) the letter no. 5408, dated 21 January 2017, requesting, under art. 53, paragraph (2) of the Fiscal Responsibility Law (FRL) no. 69/2010 republished, the opinions on the Budget Law draft for 2017, the Report on the macroeconomic situation for 2017 and the projections for the years 2018-2020, the draft of the Social Insurance Budget Law for 2017 and the corresponding explanatory note, and also the Fiscal Strategy (FS) for 2017-2019, the explanatory note and the associated ceilings law of certain indicators specified in the fiscal framework for 2017. But, the complete set of documents necessary for the elaboration of the Fiscal Council's opinion and the updated budgetary projection, was received by our institution on the morning of January 27, 2017.

Given the objective time constraints determined by the Government's intention to approve the above documents at the meeting scheduled for January 27th, the Fiscal Council has decided to elaborate a preliminary opinion, containing some general considerations arising from a quick analysis that partially covered the set of information put at its disposal, the preliminary opinion being notified to the authorities on the same day. However, the FC has publicly announced that it will return during the week January 30th to February 3rd with a complete opinion.

Preamble

The draft budget for 2017 targets a deficit in cash terms of 2.96%, enlarged from a 2.4% of GDP deficit recorded at the end of 2016, accommodating the impact of further cuts of taxation enacted in the context of the changes introduced by the Fiscal Code in 2015, of some reductions of newly introduced taxes as well as some increases of social and personnel expenditures[1].

Framing in the deficit limit of 3% of GDP is planned to be achieved through the introduction of compensatory measures such as the elimination of capping the tax base related to social contributions, extending measures of taxation of the energy sector and a temporary increase in the percentage distributed as dividends from the profit of state-owned companies[2],

[1] Annex 1 presents the list of discretionary measures incorporated into the draft budget.

[2] MPF estimated additional income from dividends of state owned companies of 865 mil. lei.

combined with a quasi-nominal freezing of the goods and services expenditures and by a macroeconomic scenario substantially more favorable than the one envisaged in the autumn forecast of the National Commission for Economic Forecasting (NCEF).

In the context of its opinion on the budget construction of the previous year and the projection for the medium term, the Fiscal Council noticed the abandonment of the idea of a fiscal framework based on rules, given that it was expected a persistent and difficult to correct deviation from the balanced budget rule held as an objective by FRL and by the European treaties of which Romania is a signatory (in this case the Stability and Growth Pact and the so-called Fiscal Compact) as a result of concomitant enactment of some tax cuts and some increases in expenditures, both being permanent. The budget construction for the current year and its medium-term projection strengthen the validity of the assertions made earlier by the Fiscal Council. The major deviation from the so-called medium-term objective of 1% of GDP in structural terms, already produced in the context of the budget execution for the year 2016, is expected to persist throughout the projection horizon covered by the medium-term framework (2017-2020) and the beginning of a convergence trajectory towards it is delayed until 2019. The explanatory note of the Law on approving ceilings for some certain indicators specified in the fiscal framework for 2017 records exemptions from art. 6 and 7 of FRL, which formalize in the national legislation the link with the Treaty of the European Union in terms of reference values for the budget deficit and public debt, as well as exemptions from art. 14 para. 1 and art. 26 para. 3 of FRL, which implies the abdication from the commitment which refers to correcting the deviation, once emerged, from the medium-term budgetary objective.

The concern about the objective of a balanced budgetary position as defined by FRL and European treaties is replaced (in the medium term) by the avoidance of ceiling overruns of 3% of GDP for the headline deficit (according to ESA 2010) stipulated by the corrective arm of the Stability and Growth Pact, persistent levels of deficit placed in their immediate vicinity of this level being by default considered benign. The Fiscal Council objections, actually formulated in the past, regarding this approach, mainly refer to the prudence principle stated by FRL, in the idea of desirability of a countercyclical fiscal policy conduct and to avoid the deterioration of Romania's public finances position:

- A 3% deficit is not at all a "target", but rather a maximum level that is allowed only under cyclical effects of deep recession, which obviously is not at all the case now in Romania.
- Avoiding the outrun of the deficit ceiling of 3% of GDP is possible in the conditions of a large upward revision of the NCEF projection for economic growth both in 2017 and over the medium term, compared to its previous assessments (on average by one percentage point on the period 2017-2019, an acceleration of the economic growth from 4.8% in 2016 to 5.2% in 2017, continuing to 5.7% in 2019 being expected).

- The NCEF autumn projections were already significantly above the assessments of other institutions (e.g. European Commission anticipated in its autumn projection, growths rates of 3.9% and 3.6% in 2017 and 2018), and the current revision of the forecast, even though justified in the sense of the additional fiscal stimulus newly legislated, remains difficult to be reconciled with their lower size compared to those that prevailed in 2016. Also, the extremely favorable macroeconomic projection over the medium term makes the balance of risks to be exclusively tilted in the sense of registering growth rates lower than those forecasted (NCEF's scenario for economic growth significantly exceeds alternative forecasts[3]), which, in the absence of a fiscal space compared to the reference value of 3% of GDP, makes likely the need for additional measures of fiscal policy in order to allow the control of the deficit (in the event of a materialization of a less favorable macroeconomic scenario than expected).
- Also, the Fiscal Council has reservations regarding the internal consistency of the macroeconomic scenario review operated by NCEF in the light of the evolution of domestic absorption components. Thus, we find it difficult to reconcile the operated upward revisions for the growth of household consumption (average upward revision of 1.3 pp. between 2017 and 2019) and of gross fixed capital formation (average upward revision of 0.6 pp.) with the fact that the growth pace for imports remains virtually unchanged compared to the autumn forecast of NCEF. In their current form, the revisions operated by NCEF suggest that the extra domestic absorption should be fully covered from domestic production, without generating an acceleration in imports, an unlikely evolution that is enough to justify reserves on both the forecasted economic growth trajectory and the size of the substantial acceleration projected to occur in the number of employees in the economy (from growth rates of 2.8%, 2.6% and 2.5% in 2017, 2018 and 2019 in the autumn forecast, to growth rates of 4.3%, 4.2% and 4.3% in the current forecast).

- NCEF also operates a massive upward revision of potential growth between 2017-2019 - compared to its autumn projection, when potential GDP growth was regarded to be accelerated from 4% in 2016 to 4.3-4.4% in the period 2017-2019. The macroeconomic projection that underlies the draft budget envisages accelerations of growth rate of potential GDP from 4.6% in 2017, 5.1% in 2018 and 5.4% in 2019, so in the NCEF assessing, the closing of the aggregate demand deficit occurs in 2018. The Fiscal Council considers as extremely optimistic such a trajectory of potential GDP, very surprising being the fact that the upward revision

[3] Bloomberg survey indicates a median of expectations for economic growth in 2017 of 3.5%, with a minimum of 2.2% and a maximum of 4.2%.

of the assessments on potential GDP growth rate (averaging 0.8 pp. in addition to the growth rate between 2017 and 2019) appears as quasi-equivalent in magnitude with the forecast revisions in terms of real economic growth (1 pp. on average), given the relatively low magnitude revisions for the projections regarding the dynamics of gross fixed capital formation (0.6 percentage points on average between 2017 and 2019). We are extremely skeptical that differences between forecast horizons and newly announced fiscal measures (found mainly in social assistance expenses, personnel expenses in the public system and the taxation of pensions) are capable of justifying such steep differences compared to assessments of potential GDP growth dynamics by the European Commission (in contrast to NCEF's assessments, the European Commission projections indicate a potential GDP growth acceleration from 3.4% in 2016 to 3.76% in 2018). Moreover, an optimistic assessment by the NCEF on potential GDP growth, not confirmed by the European Commission's evaluations directly leads to underestimating the structural deficit and the necessary fiscal consolidation to restore a gradual compliance with the budgetary target in the medium term, given the obligations set for Romania in the European regulations.

- Framing the budget deficit at the ceiling of 3% of GDP while the economy is in the upward phase of the business cycle is far from being a benign situation. This situation corresponds to a pro cyclical fiscal policy, which presses the accelerator in the expansion phase of the economic cycle (when the economy would grow anyway with high rates) and which is unable to stimulate it – because of the lack of fiscal space - in the event (inevitable) of a reverse of the economic cycle (in the future), even creating the prerequisites for adopting structural adjustment measures in an economic slowdown (a situation which Romania experienced, in fact, not long ago). Moreover, the recent literature[4] identifies 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.
- Government assessments indicate a ratio of public debt / GDP relatively constant at the level of 37.7% in the period 2017-2019, a possible phenomenon in the conditions of deficits located close to the level of 3%, only due to the extremely favorable assumptions on economic growth during this period. Beyond the doubts about the materialization of economic growth scenario that was taken into account, the Fiscal Council believes that maintaining or entering on an even moderate growth path of public debt / GDP ratio in the context of a period of high

[4] Auerbach, A. and Y. Gorodnichenko, "*Fiscal Multipliers in Recession and Expansion*", NBER Working Paper 17447, September 2011.

economic growth, conceals the accumulation of vulnerabilities that will become apparent in an (inevitable) future downward phase of the economic cycle. Moreover, the sense of security induced by the significant distance towards the ceiling of 60% of GDP (the Maastricht criteria) should be tempered. Arguments in this regard are linked on one hand on the fact that a recession may cause episodes of extremely rapid growth of public debt to GDP ratio (recent experiences of Spain, Finland or Croatia are illustrative). On the other hand, an additional constraint is related to the relatively high level of the public debt compared to the dimension of the domestic financial sector and its most likely limited ability to absorb an additional stock of public debt at the current level of financial intermediation, given that the share of exposure to the government sector in the total assets of local banks, the main holder of the domestic public debt, is among the highest in the EU. The corollary of this situation is most likely a high dependence on non-resident investors, which is associated with a rising vulnerability to interest shocks and changes in risk appetite in global financial markets and to any change in the sovereign rating. The current climate of global financial markets, still characterized by the abundance of liquidity, conceals for the moment these vulnerabilities, but a deterioration of liquidity conditions can occur quickly, especially given the increases expected in the interest rate of the US central bank (FED) in the current complicated global context.

Budgetary revenues and expenditures in the 2017 budget draft

The draft budget anticipates total revenues of 254.72 billion lei (31.2% of GDP) and estimates total expenditures of 278.82 billion lei (34.2% of GDP), both in a significant increase compared with the levels in the execution of the previous year, by 223.72 billion lei (29.5% of GDP), respectively 242.02 billion lei (31.9% of GDP). The dynamics of the amounts received from the EU in the account of payments made (which can be found on both the revenue and the expenditure side of the budget) is the component that largely explains the increases above, given that this component is designed to increase from a level of 6.9 billion lei in 2016 (0.9% of GDP) to 22.26 billion lei in the draft budget (2.7% of GDP). By adjusting the budget revenue and expenditure for the influence of this component, the budget revenues expressed as a percentage of GDP would record a marginal increase (from 28.5% to 28.6% of GDP), while budget expenditures would increase from 31% GDP at the end of 2016 to 31.5% of GDP in the draft budget. Moreover, the evolution of the revenues and expenditures aggregates net of influence of EU funds remains influenced by the presence, both at the level of the budget execution for 2016, and for the 2017 projection, of the compensation schemes to settle outstanding budgetary obligations (so-called swaps), amounting 750 million lei in 2016 and 1,593 million lei in 2017. By further adjusting for their influence, budgetary revenues expressed as a percentage of GDP would be virtually identical to those in 2016 (28.5% of GDP), while the expenditure to GDP ratio would increase by 0.4 pp.

Budgetary revenues

The Fiscal Council's analysis reveals that the MPF's projection of tax revenues and social contributions is evolving basically in line with the macroeconomic scenario of the NCEF underlying the draft budget, but the parallel evaluation of the Fiscal Council, made also from the NCEF's updated macroeconomic framework indicates potentially lower revenue by about 1 billion lei. The biggest difference (-395 million lei) is appears in revenues from excise duties, however, we have to mention that the Fiscal Council considers its disappearance as possible, to the extent that less favorable developments in terms of receipts from excise duties for fuels at the end of 2016 are due to postponement of consumption as a result of the anticipation of excise of 7 cent elimination from January 1st 2017.

Regarding the impact of newly introduced fiscal measures, the Fiscal Council assessments do not differ significantly from those of MPF's except the impact of eliminating the capping of five national average salaries for the tax base related to contributions to the public pension system. MPF's assessment indicates extra revenue of 1,057.1 million lei, having as sources 493 million lei additionally collected from the individual contribution to the pension scheme, generating additional transfers to the Pillar 2 of the pension system of 177 million lei (negative influence) and 741 million lei from eliminating the capping for the tax base related to contributions payable by the employer. The Fiscal Council's assessment indicates an amount close to that indicated by the MPF in terms of revenues related to the pension contributions payable by employees (+373 million lei, after taking into account the net impact of additional transfers to Pillar 2), but considers as less likely to materialize a significant impact as having source the elimination of the capping the tax base related to contributions payable by the employer because the cap was acting at the level of the wage bill; thus, the impact of the legislative change would occur only in case of companies where the average wage at the company level would exceed the amount of five national average salaries, a situation which we regard as unlikely. Despite this difference, the Fiscal Council's calculations do not identify a significant difference in the level of projected revenues from social contributions, indicating perhaps that the MPF uses assumptions more conservative regarding the ratio of social contributions payable and receivable, a cautious approach in the light of historical developments.

Regarding the impact of the measure modifying the regime of microenterprises (changing the annual turnover ceiling to 500,000 EUR from 100,000 EUR and the standardization of the tax rate of 1% on turnover), MPF's evaluation indicates a negative impact of 429 million lei at the level of income tax and capital gains tax from juridical entities, while the Fiscal Council estimates (see Annex 8) indicates a potential loss of revenue of 662 million lei. We appreciate, however, that the difference in the estimated impact appears relatively minor in relation to the uncertainty about the behavior of firms regarding declaring themselves as paying the profit tax or the income tax for microenterprises.

The central issue in the assessment of the budget revenue projection remains the validity of the extremely favorable macroeconomic scenario used to substantiate it. In the preamble to current opinion, the Fiscal Council appreciated the character of extreme value of the growth forecast level for 2017 and estimated that the balance of risks is tilted to the materialization of a macroeconomic scenario less favorable than that advanced by the NCEF, especially in the context of the inconsistencies identified in the review of macroeconomic framework compared to the autumn forecast. Even if the Fiscal Council is unable or does not have the responsibility to offer a complete macroeconomic alternative forecast, considers as illustrative, in the view of an assessment of the size of potential losses of revenue which would occur if the favorable parameters of macroeconomic scenario taken into account for the budget construction fail to materialize, the revenue aggregates forecast being based on the macroeconomic parameters that prevailed in the autumn forecast of the NCEF. The forecast takes into account the first-round impact at the level of revenues of the new fiscal policy measures enacted. The forecast (see Annex 2) reveals lower budget revenues by about 4.5 billion lei than the MPF's ones based on the NCEF's updated projection. The Fiscal Council considers a reasonable event the materialization of a macroeconomic scenario whose parameters lie between those of the autumn forecast and those of the updated forecast of NCEF and the indicative amount of the budget revenues associated with this scenario (located halfway between the two forecast versions of NCEF) would be lower by about 2.7 billion lei compared to the current projection of the MPF.

The draft budget foresees a massive acceleration in respect of the amounts received from the EU in the account of payments made, whose amount is set to increase from 6.86 billion lei in 2016 to 22.2 billion lei in 2017. But the size of the increase is largely due to the inclusion in the general consolidated budget of the amounts of direct payments in agriculture from the European Agricultural Guarantee Fund (EAGF), amounting to 8.1 billion lei, as well as those related to payments to European Agricultural Fund for Rural Development amounting 4.1 billion lei, whose ultimate beneficiary is the private sector, with a virtually identical impact on the revenue and expenditure side. It has to be mentioned that the figures related to the budget execution in 2016 include such payments for farmers, amounting to about 3 billion lei (of which 2.2 billion lei EAGF subsidies). Including these amounts makes the size of this revenue aggregate not being comparable to historical developments related to the previous financial year (2007-2013). It should also be noted that, according to ESA 2010 methodology, these amounts, whose beneficiary is the private sector will not be included in the government sector. The relevant amounts from the EU related to the general consolidated budget according to ESA 2010 (and comparable with historical developments) would therefore be about 10 billion lei, increasing by about 6 billion lei compared to equivalent amounts related to the budget execution of 2016.

Budgetary expenditure

The Fiscal Council has doubts regarding the budgeted levels of expenditures for social assistance, interest and other transfers, which we consider as being probably undersized in the absence of an indication by the MFP of some specific measures to justify their level:

- *Social assistance*: potential under dimension of at least 2 billion.

a. Expenditures for social security state budget are forecasted to increase by 8.7%, while the average value of the pension point in 2017 (for 958.8 lei, corresponding to some levels of 917.5 lei in January-July 2017 respectively 1,000 lei in the period July-December 2017) implies an increase of about 10% compared with the pension point value for 2016 (871.7 million). Assuming a relatively constant number of pensioners in the social security system, we believe that these expenditures are probably undersized by about 680 mil. lei.
b. Social assistance spending related to the state budget is estimated to grow in nominal terms by 1,285 mil. lei compared to the 2016 level. We consider that the proposed level is severely underestimated, given that the execution of the previous year reveals an increasing trend of flows of the quarterly spending (in fact, both budget amendments in 2016 supplemented significantly this expenditure aggregate) and extrapolating on annual basis the flow of expenses related to the second half of the previous year (24,307.8 million. lei, corresponding to a flow of 12,153.9 million lei in the second half of 2016) would already produce annual expenditure about equal to the proposed amount in the draft budget (24.472 2 mil. lei). Given that the amount proposed for 2017 should contain the additional impact of increasing the minimum guaranteed social pension (+1,200 million lei) and the impact of increasing the military pensions by 5.25% from 1st January, 2017 (+255 million lei according to the calculations of the Fiscal Council), there is sufficient reason for considering this expenditure aggregate's projection undersized by about 1,300 to 1,400 million lei.

- *Interest spending:* potential underestimation of about 500 million lei
  a. In his opinions from the previous years, the Fiscal Council usually noticed the apparent oversizing of this aggregate in the construction of the initial budget, as the execution regularly revealed further savings for this chapter. In contrast, we consider the current draft budget, indicating an increase in interest expenses by only 180 million lei compared with the execution of the previous year, is potential undersized, in the context of a widening budget deficit and a reduced probability for a further decrease in the financing costs compared to previous years, especially given that the FED's interest rate growths have already triggered widespread increases in long-term yields of the sovereign bonds in global financial markets. The execution for the year 2016 indicated an increase in interest expenses compared to 2015 by about 435 million lei (4.5%). For the reasons stated above, we consider as prudent to estimate an increase in interest expenses higher than that recorded in the previous year and, accordingly we consider as credible the materialization of higher interest expenses by about 500 million lei compared to the budgeted level. A framing in the current budgetary envelope is likely to remain still possible under an orientation towards increasing financing for short term maturities or using the

liquidity buffer of the Treasury, but such an approach would cause additional risks in terms of resilience to external shocks, related to the liquidity of financial markets or to investors' risk aversion, which is likely to grow in a complicated international context.

- *Other transfers:* potential under budgeted by about 1,500 million lei
    a. The Fiscal Council's reserves are related to the projection for the Romanian's due contribution to the EU budget (see Appendix 2 of the draft budget, p. 19). Thus, the draft budget advances a value of 5.55 billion lei for this aggregate of expenditure, while the amount of spent in the previous year was 6.65 billion lei (which, in turn, was higher compared to that of the execution from 2015 of 6.4 billion lei). The due contribution to the EU budget is established according to the gross national income level, and therefore we expect it to be on an upward trend, as it is also revealed by the historical data. We consider that the amount advanced for this indicator in the first version of the draft general consolidated budget submitted to the Fiscal Council, of 7.05 billion lei, is most likely to materialize. Compared to the latter, the level of expenditure from the current projected budget appears as undersized by 1.5 billion lei.

Personnel spending are estimated to increase compared with the execution of 2016 by about 6.8 billion lei (from 7.5% to 7.8% of GDP); by adjusting with the compensatory payments made in 2016 (about 1 billion lei) and those established for 2017 (probably about 200 million lei), the nominal increase would be of 7.6 billion lei. The Fiscal Council's calculations indicate that the budgeted amount appears as sufficient to cover the impact of wage increases already enacted for 2017 (described in Appendix 1). But the Fiscal Strategy 2017-2019, announces at pages 66-67, additional wage increases in the education and research sector (20%) and for actors (50%), even making reference to a 20% increase of the average salary in the public sector (which presumably includes the above mentioned measures) from July 1, 2017 (page 66); the Fiscal Council considers that the draft budget does not allocate in its current form the needed budgetary resources for those additional measures.

The amount of goods and services spending is projected in contraction in nominal terms compared to the level in 2016 (-318 million lei). Even if the development of this budgetary aggregate as a percentage of GDP represented a permanent source of fiscal consolidation between 2014-2016 (from 6% of GDP in 2013 to 5.4% of GDP in 2016), there has never been an episode of contraction of the nominal spending, even while reducing the standard VAT rate in 2016. The Fiscal Council anticipates that maintaining this indicator in the initial budgetary envelope during the budget execution, although possible, will probably prove to be difficult.

The investment spending is expected to massively increase in 2017 relative to the execution of 2016 (+9.9 billion lei). The expansion is located in the highest proportion in the capital spending (+6.2 billion lei), which occurs mainly for the Ministry of Defense with an increase of the capital spending compared with the 2016 execution (by +5.4 billion lei), but also an increase in co-financing costs included in this aggregate in the context of the projected increase in the absorption of EU funds, major increases occurring also in terms of expenses related to EU-funded projects (+4.5 billion lei). In contrast, the transfers of the nature of investments are expected to be reduced by about 800 million lei. However, the historical budgetary executions recorded constantly deviations of considerable amounts from the initial budgeted amounts or at the budget amendments in the sense of capital expenditure lower than allocations (see Appendix 9), and a similar trend cannot be excluded for 2017 even if the assumption of improving the absorption of structural and cohesion funds (from 3 billion to 10 billion lei) appears not necessarily unfeasible - but historical data shows that the initial estimates for absorption were never materialized at the estimated levels.

The Fiscal Strategy 2017-2019

Regarding the Fiscal Strategy 2017-2019, the government attention is again exclusively concentrated on the current year, while not giving the same attention to the medium-term budget projections. In almost all fiscal strategies that the Fiscal Council has received over the years (since 2010), there was the temptation to generate with an extremely high easiness fiscal consolidation in the medium term, without a rigorous estimation for the budgetary revenue and expenditure and without providing an assessment of the impact of the envisaged discretionary measures. The current strategy indicates a quasi-stable structural deficit in 2018 (up from 2.91% in 2017 to 2.97% of GDP), followed by a reduction by 0.3 pp. in 2019. Thus, even accepting some extremely favorable assessments of NCEF regarding the potential GDP growth (Fiscal Council expressed skepticism about them in the preamble of this opinion) at the end of the horizon covered by the strategy would remain a deviation of 1.7 pp. compared to the level of 1% in terms of structural deficit of the medium-term objective consistent with FRL perspective of a balanced budget. Given the considerable differences between the trajectories of the potential GDP forecasted by NCEF and the European Commission, registering a higher deviation from the medium-term objective at the end of the forecasted period appears as probable.

Regarding the revenue projections for the year 2018, the Fiscal Council considers that they appear rather consistent with a scenario of unchanged fiscal policies, excluding the aggregates personal income tax and social contributions that seem to accommodate, in the first case, the reduction of taxation on pensions higher than 2,000 lei to 10% (from 16% in 2017), while in the second case, the increase of the transfers to Pillar 2 of the pension system in order to achieve the target of 6% provided in the law (in 2017, the transfers remained at the previous year's level of 5.1%). The estimates of the budget expenditures include significant increases for social assistance spending (+9.3 billion lei) in order to accommodate the propagated effect of the pension point indexation to 1.000 lei in the mid-year and the increase to 1,100 lei from July 2018 and the increase in minimum social pension to 640 lei starting 1 January 2018 (from 520 lei). Personnel spending are projected to increase by 3.3 billion lei (corresponding to a nominal growth of 5.2%), but the budgeted amount appears insufficient compared to the target of 20% increase in public sector wages from July 1, 2018 announced the Fiscal Strategy

(page 66). Maintaining the deficit below 3% of GDP in 2018 is designed under a sharp reduction in capital expenditure (by 6.5 billion lei compared with 2017), while the capital expenditure allocations to the Ministry of Defense decrease from 7.4 billion lei in 2017 to 3.4 billion lei in 2018 despite an increase in co-financing costs (but capital expenditure allocations to the Ministry of Defense are expected to return to higher values starting 2019. However, the public investment spending is expected to continue to grow rapidly (+8 billion lei) due to the substantial acceleration of the amounts of structural and cohesion funds attracted, the expenses related to European funds indicating higher amounts of structural and cohesion funds compared to the peak year 2015 in terms of absorption of EU funds for the previous financial year.
The Fiscal Council considers that, given the reservations expressed relative to the optimistic macroeconomic scenario for 2017 and on the medium term that impact the trajectories of budget revenues, to which is added the apparent undersized budget expenditure for 2017, shows a balance of risks tilted mainly in the direction of recording higher budget deficits than projected according to the Fiscal Strategy, under the assumption of unchanged fiscal policies.

Conclusion

The draft budget for 2017, as well as that one of the previous year, deviates deliberately and substantially from the fiscal rules imposed by both national laws and European treaties signed by Romania. The Fiscal Council maintains its objections to the approach of persistent placing the budget deficit in the immediate vicinity of the reference level of 3% of GDP that is considered to be benign, appreciating that this is likely to lead to vulnerabilities of the public finances' position, significantly complicating the response in the event of adverse shocks, keeping the fiscal policy in the trap of a pro-cyclical behavior.

The Fiscal Council's assessments indicate a high probability for the manifestation of a negative revenue gap in 2017, determined by the highly optimistic macroeconomic scenario underlying the budgetary projections. Moreover, the Fiscal Council identifies a potential significant underestimation of budgetary aggregates of non-discretionary nature and, therefore, considers as likely the need to adopt corrective measures targeting revenues or expenses in order to avoid exceeding the threshold of 3% of GDP during the budgetary execution of 2017.

The budgetary slippage recorded since 2016 and which is predicted to continue in the coming years is caused by a mix of aggressive tax cuts, particularly on consumption, combined with huge increases in government expenditure, particularly in the social spending area. The estimates indicate that Romania, since 2016, has probably, by far the lowest fiscal revenues (including social security contributions) in the EU (along with Ireland), which will greatly complicate the construction of the medium-term budget. The gap between Romania and the EU28 average for fiscal revenues is about 14 pp. of GDP. In these circumstances, the Fiscal Council recommends that the government should accelerate the structural reform measures impacting the revenue collection rate and the efficiency of public spending. In this regard, the Fiscal Council believes that speeding up the implementation of the program on the modernization of the revenue administration system signed with the World Bank in 2013 by Romania should be an immediate priority. Also, the rapid operationalization of the process of prioritizing public investments and the real reform of the public administration, designed to set the functioning of the state on the basis of performance management at various levels, could generate significant efficiency gains at the level of public 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 3rd of February, 2017.

3rd February 2017 Chairman of the Fiscal Council,

IONUȚ DUMITRU

Annexes

Annex no. 1: Fiscal policy measures and impact according to MPF

Fiscal policy measures - budgetary revenues	Budgetary Impact (million lei)	Revenue category
Total	**-7,176.8**	
Exemption of personal income tax on pensions below 2,000 lei	-1,200.0	Personal income tax
Changing the taxation on real estate transfers from the personal property	-300.0	Personal income tax
Romanian legal persons paying income tax which on December 31, 2016 have incomes below 500,000 euro are required to pay income tax from 1 February 2017. The tax rates: 1% for firms that have one or more employees; 3% for firms that have zero employees*	-429.0	Other taxes on profits, income and capital gains from legal persons
Eliminating special tax on constructions since January 1st, 2017	-1,000.0	Fees and taxes on property
Reducing the standard VAT rate from 20% to 19% since 1 January 2017	-2,200.0	Value added tax
Elimination of excise duty of 7 cents and increased excises from 430.71 lei / 1,000 cigarettes in 2016 to 435.58 lei / 1,000 cigarettes in 2017	-2,886.0	Excise
Prolongation G.D. no. 5/2013 - Tax monopoly in the electricity and natural gas	152.5	Other taxes on goods and services
Prolongation G.D. no. 5/2013 - Tax on income from natural resources, other than natural gas (G.D. no. 6/2013)	58.7	Other taxes on goods and services
Prolongation G.D. no. 5/2013 - Additional income tax resulting from the deregulation of prices of natural gas (G.D. no. 7/2013)	708.6	Other taxes on goods and services
Elimination of health contribution payment for pensioners	-900.0	Social contributions
Eliminating the capping of 5 gross average salaries for the calculation of individual social security contribution and for the social insurance contributions payable by employers or persons assimilated, for the income from wages or salaries **	1,100.0	Social contributions
Eliminating 104 non-fiscal taxes	-281.6	Non-fiscal taxes
state budget	*-146.0*	Non-fiscal taxes
local budget	*-135.6*	Non-fiscal taxes

Source: Ministry of Public Finance

* In the case of introduction of the tax rate of 1% of income for microenterprises with one or more employees and of changing from February 1st, the threshold at which a firm is considered microenterprise from 100,000 euros to 500,000 euros, the Fiscal Council has a different estimate or impact of -662.1 million. lei, which is detailed in Appendix 8.
**In the case of elimination the cap of 5 average gross salaries of the social contribution's tax base, the Fiscal Council estimate differs significantly from the MPF, the plus of income being estimated at 372.8 million lei by the Fiscal Council, less by about 727 million lei compared to MPF's projection.

Fiscal policy measures - budgetary spending	Budgetary Impact (million lei)	Spending category
Total	**-10,474.2**	
The increase of the pension point to 917.5 lei to 1,000 lei from July 1 st, 2017	-2,502	Social assistance
The increase of the minimum guaranteed social pension from 400 lei to 520 lei starting with March 1st, 2017	-1,200	Social assistance
Free transportation to all categories of domestic rail trains, the class II, for students enrolled at higher education institutions (day courses)	-75	Social assistance
Establishing the amount allocated to the fund for scholarships and social protection of students to the value of 201 lei / month during teaching activities (for day classes, without tuition fees)	-285	Social assistance
20% increase of the gross salaries and bonuses for personnel from local administration, starting February 1st 2017	-1,478	Personnel spending
50% increase of the gross wage and bonuses for personnel enrolled in public institutions of performances or concerts, starting February 1st 2017	-84	Personnel spending
15% increase of the gross wages and bonuses for the personnel in the health sector, social assistance system and education system and a 25% increase in the basic salary for the staff of the House of Health Insurance, increase the remunerations for the staff of the Directorates of Public Health and County's Health Houses at the level of 85% of the wages of National Health Insurance House and similar employment rights to the Inspectorate for Emergency Situations for the staff of the Romanian Agency for Saving Life at Sea starting January 1st 2017 (GEO 20/2016).	-4,850.2	Personnel spending

Source: Ministry of Public Finance

Annex no. 2: Revenue projection based on the Autumn macroeconomic framework published by NCEF in November 2016

Mil. lei	2016	2017						
	Preliminary execution for 2016 according to MPF (without swap)	The influence of the compensation schemes in 2017	Fiscal policy measures	Explanations	Relevant macroeconomic basis	Revenue projection consistent with macroeconomic framework published by NCEF in autumn 2016	CGB revenues according to the 2017 budget draft (with swap)	Differences between revenue projection consistent with autumn macroeconomic framework and revenues in 2017 budget draft
TOTAL REVENUE	**223,721.8**	**1,593**	**-5,479.8**			**250,211.5**	**254,716.5**	**-4,505.0**
Current revenue	215,618.8	1,593	-5,479.8			227,146.1	231,618.1	-4,472.1
Tax revenue	136,406.1	1,593	-5,479.8			139,140.2	142,836.0	-3,695.8
Corporate income tax	16,398.0		-662.1	(The starting point of extrapolation is represented by the amount from the preliminary execution for 2016 according to MPF)*(1+Δ% macroeconomic base *1.75 elasticity) to which are added fiscal policy measures	Nominal GDP (+6.5%)	17,513.9	18,055.3	-541.5
Personal income tax	28,383.6					29,574.8	30,782.0	-1,207.2
Wages and income tax	27,756.4		-1,373.3	The starting point of extrapolation is represented by the amount from the preliminary execution for 2016 according to MPF corrected with fiscal measures and extrapolated with the number of employees and the dynamic of earnings	The average number of employees (+2.8%) Average gross earnings (+6.4%)	28,907.2	30,108.2	-1,201.0
Other taxes on income. profit and capital gains	627.219			The starting point of extrapolation is represented by the amount from the preliminary execution for 2016 according to MPF)*(1+Δ%the relevant macroeconomic growth)	Nominal GDP (+6.5%)	667.7	673.9	-6.2
Property tax	5,898.1		-1,000.0	According to MPF projection		5,161.1	5,161.1	0.0
Taxes on goods and services	84,127.1	1,593				85,251.9	87,068.8	-1,816.9
VAT	51,675.1	1,593	-3,241.0	The starting point of extrapolation is represented by the **amount from the preliminary execution. excluding swap schemes effect**	Household's final consumption expenditure (+7%)	53,319.7	54,142.3	-822.6

Mil. lei	2016	2017						
	Preliminary execution for 2016 according to MPF (without swap)	The influence of the compensation schemes in 2017	Fiscal policy measures	Explanations	Relevant macroeconomic basis	Revenue projection consistent with macroeconomic framework published by NCEF in autumn 2016	CGB revenues according to the 2017 budget draft (with swap)	Differences between revenue projection consistent with autumn macroeconomic framework and revenues in 2017 budget draft
				that was extrapolated with the relevant macroeconomic base and then adjusted with fiscal policy measures				
Excises	26,957.0		-2,886.0	(The starting point of extrapolation is represented by the available series in the preliminary execution according to MPF)* The growth of macroeconomic base plus the impact of the fiscal policy measures	Household's final consumption expenditure in real terms (+5.4%)	25,326.8	26,051.3	-724.5
Other taxes on goods and services	2,250.3		919.8		Household's final consumption expenditure (+7%)	3,326.9	3,385.6	-58.7
Taxes on using goods. authorizing the use of goods or on carrying activities	3,244.6			(The starting point of extrapolation is represented by the available series in the preliminary execution according to MPF)* The growth of macroeconomic base	Real GDP (+4.3%)	3,278.5	3,489.6	-211.1
Tax on foreign trade	882.7			(The starting point of extrapolation is represented by the available series in the preliminary execution according to MPF)* The growth of macroeconomic base	Imports of goods and services (+3.3%)	894.3	951.3	-57.0
Other tax revenue	716.7			(The starting point of extrapolation is represented by the available series in the preliminary execution according to MPF)* The growth of macroeconomic base	Nominal GDP (+6.5%)	744.2	817.6	-73.3
Social security contributions	61,274.4		2,762.8	(The starting point of extrapolation is represented by the amount from the preliminary execution	The number of employees (+2.8%)	68,982.1	69,758.4	-776.3

Mil. lei	2016	2017						
	Preliminary execution for 2016 according to MPF (without swap)	The influence of the compensation schemes in 2017	Fiscal policy measures	Explanations	Relevant macroeconomic basis	Revenue projection consistent with macroeconomic framework published by NCEF in autumn 2016	CGB revenues according to the 2017 budget draft (with swap)	Differences between revenue projection consistent with autumn macroeconomic framework and revenues in 2017 budget draft
				excluding swap schemes effect minus the impact of pensions contributions from court decisions in 2016 of 434 million lei)* The growth of macroeconomic base plus fiscal policy measures	%) Average gross earnings (+6.4%)			
Non-tax revenue	17,938.3			According to MPF projection		19,023.7	19,023.7	0.0
Capital revenue	769.4			(The starting point of extrapolation is represented by the available series in the preliminary execution according to MPF)* Consumer price index	The average rate of inflation forecasted for 2017 (1.9%)	784.0	817.0	-33.0
Grants	1.6			According to MPF projection		19.7	19.7	0.0
Amounts received from the EU in the account of payments made and pre-financing	949.9			According to MPF projection		184.3	184.3	0.0
Financial operations						0.0	0.0	0.0
Amounts collected in the single account (State budget)	472.7					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	5,909.5			According to MPF projection		22,077.3	22,077.3	0.0

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

Note: Fiscal policy measures considered - impact:	
Other taxes on profits, income and capital gains from legal persons	Increase the threshold for a firm to be considered microenterprise from 100,000 euro in 2016 to 500,000 euro in 2017, starting January 1st, 2017 (-662.1 mil. lei)
Personal income tax	1. Increase minimum salary to 1,450 lei per month starting February 1st, 2017 (+370 mil. lei)
	2. 20% increase of the gross salaries for personnel from local administration, increase by 50% the gross wages for personnel of performances or concerts, increase by 15% the gross wage and bonuses for the personnel in the health sector, social assistance system and education system and a 25% increase in the basic salary for the staff of the House of Health Insurance, increase the remunerations for the staff of the Directorates of Public Health and County's Health Houses at the level of 85% of the wages of National Health Insurance House and similar employment rights to the Inspectorate for Emergency Situations for the staff of the Romanian Agency for Saving Life at Sea starting January 1st 2017 (+542 mil. lei)
	3. Exemption of personal income tax on pensions below 2,000 lei (-1200 mil. lei)
	4. Introducing a non-taxable threshold for income resulting from the transfer of property rights in the amount of 450,000 lei starting February 1st 2017 (-300 mil. lei)
	5. Decrease of the personal income tax resulting from the reduced tax base following the elimination of the capping of 5 average gross salaries for the payment of social insurance contributions (-700 million lei on dividend tax and -85.3 million lei on personal income)
Fees and taxes on property	Eliminating special tax on constructions staring January 1st, 2017 (-1000 mil. lei)
VAT	Adjusting the starting point of extrapolation (VAT implementation in 2016) due to revenue recorded in January 2016 with 24% VAT (for December 2015) (-700 million. lei), reduction of VAT rate to 19% and lowering VAT income resulting from the elimination of extra excise of 7 cents per liter of fuel (-2,541 mil. lei)
Excise duty	Elimination of excise duty of 7 cents and increase from 430.71 lei / 1,000 cigarettes in 2016 to 435.58 lei / 1,000 cigarettes in 2017 (-2,886 million lei). There were not extrapolated excise taxes collected from the sale of tobacco products considering that they do not grow in line with real consumption growth.
Other taxes on goods and services	1. Application of tax rates from 0.1 to 0.85 lei / MWh on revenue from electricity and gas transmission and distribution (152.5 million lei)
	2. Apply a 0.5% tax on revenue from natural resources, other than natural gas (forestry, quarrying, extraction of non-ferrous ores, etc.) (58.7 million lei)
	3. Applying a tax of 60% on additional revenues as a result of deregulation of natural gas (708.6 million lei)
Social contributions	1. 20% increase of the gross salaries for personnel from local administration, increase by 50% of the gross salaries for personnel of performances or concerts, increase by 15% of the gross wages and bonuses for the personnel in the health sector, social assistance system and education system and a 25% increase in the basic salary for the staff of the House of Health Insurance, increase the remunerations for the staff of the Directorates of Public Health and County's Health Houses at the level of 85% of the wages of National Health Insurance House and similar employment rights to the Inspectorate for Emergency Situations for the staff of the Romanian Agency for Saving Life at Sea since January 1st 2017 (+2190 mil. lei)
	2. Increase minimum salary to 1,450 lei per month starting February 1st, 2017 (+1,100 mil. lei)
	3. Elimination of health contribution payment for pensioners (-900 mil. lei)
	4. Eliminating the capping of 5 gross average salaries for the calculation of individual social security contribution and for the social insurance contributions payable by employers or persons assimilated, for the income from wages or salaries (+372.8 mil. lei)

Annex no. 3: Revenue projection based on the Winter macroeconomic framework published by NCEF in January 2017

Mil. lei	2016	2017						
	Preliminary execution for 2016 according to MPF (without swap)	The influence of the compensation schemes in 2017	Fiscal policy measures	Explanations	Relevant macroeconomic basis	Revenue projection consistent with macroeconomic framework published by NCEF on 20 January 2016	CGB revenues according to the 2017 budget draft (with swap)	Differences between revenue projection consistent with winter macroeconomic framework and revenues in 2017 budget draft
TOTAL REVENUE	**223,721.8**	**1,592.7**	**- 9,681.8**			**253,708.6**	**254,716.5**	**-1,007.9**
Current revenue	215,618.8	1,592.7	-9,681.8			230,647.0	231,618.1	-971.1
Tax revenue	136,406.1	1,592.7	-9,681.8			141,934.0	142,836.0	-902.0
Corporate income tax	16,398.0		- 662.1	(The starting point of extrapolation is represented by the amount from the preliminary execution for 2016 according to MPF)*(1+Δ% macroeconomic base *1.75 elasticity) to which are added fiscal policy measures	Nominal GDP (+7.48%)	17,807.8	18,055.3	-247.5
Personal income tax	28,383.6					30,497.1	30,782.0	-284.9
Wages and income tax	27,756.4		- 2,285.3	The starting point of extrapolation is represented by the amount from the preliminary execution for 2016 according to MPF corrected with fiscal measures and extrapolated with the number of employees and the dynamic of earnings	The average number of employees (+4.3%) Average gross earnings (+11.2%)	29,823.0	30,108.2	-285.2
Other taxes on income. profit and capital gains	627.2			The starting point of extrapolation is represented by the amount from the preliminary execution for 2016 according to	Nominal GDP (+7.48%)	674.1	673.9	0.3

Mil. lei	2016	2017						
	Preliminary execution for 2016 according to MPF (without swap)	The influence of the compensation schemes in 2017	Fiscal policy measures	Explanations	Relevant macroeconomic basis	Revenue projection consistent with macroeconomic framework published by NCEF on 20 January 2016	CGB revenues according to the 2017 budget draft (with swap)	Differences between revenue projection consistent with winter macroeconomic framework and revenues in 2017 budget draft
				MPF)*(1+Δ%the relevant macroeconomic growth)				
Property tax	5,898.1		-1,000.0	According to MPF projection		5,161.1	5,161.1	0.0
Taxes on goods and services	84,127.1	1,592.7				86,758.9	87,068.8	-309.9
VAT	51,675.1	1,592.7	-3,241.0	The starting point of extrapolation is represented by the **amount from the preliminary execution. excluding swap schemes effect that was extrapolated with the relevant macroeconomic base and then adjusted with fiscal policy measures**	Household's final consumption expenditure (+8.9%)	54,319.1	54,142.3	176.8
Excises	26,957.0		-2,886.0	(The starting point of extrapolation is represented by the available series in the preliminary execution according to MPF)* The growth of macroeconomic base plus the impact of the fiscal policy measures	Household's final consumption expenditure in real terms (+7.23%)	25,655.8	26,051.3	-395.5
Other taxes on goods and services	2,250.3		919.8		Household's final consumption expenditure (+8.9%)	3,370.7	3,385.6	-14.9
Taxes on using goods. authorizing the use of goods or on carrying activities	3,244.6			(The starting point of extrapolation is represented by the available series in the preliminary execution according to MPF)* The	Real GDP (+5.2%)	3,413.3	3,489.6	-76.3

Mil. lei	2016	2017						
	Preliminary execution for 2016 according to MPF (without swap)	The influence of the compensation schemes in 2017	Fiscal policy measures	Explanations	Relevant macroeconomic basis	Revenue projection consistent with macroeconomic framework published by NCEF on 20 January 2016	CGB revenues according to the 2017 budget draft (with swap)	Differences between revenue projection consistent with winter macroeconomic framework and revenues in 2017 budget draft
				growth of macroeconomic base				
Tax on foreign trade	882.7			(The starting point of extrapolation is represented by the available series in the preliminary execution according to MPF)* The growth of macroeconomic base	Imports of goods and services (+8.5%)	957.7	951.3	6.5
Other tax revenue	716.7			(The starting point of extrapolation is represented by the available series in the preliminary execution according to MPF)* The growth of macroeconomic base	Nominal GDP (+7.48%)	751.4	817.6	-66.1
Social security contributions	61,274.4		- 527.2	(The starting point of extrapolation is represented by the amount from the preliminary execution. excluding swap schemes effect MPF minus the impact of pensions contributions from court decisions in 2016 of 434 million lei)* The growth of macroeconomic base plus fiscal policy measures	The average number of employees (+4.3%) Average gross earnings (+11.2%)	69,689.2	69,758.4	-69.1
Non-tax revenue	17,938.3			According to MPF projection		19,023.7	19,023.7	0.0

Mil. lei	2016	2017						
	Preliminary execution for 2016 according to MPF (without swap)	The influence of the compensation schemes in 2017	Fiscal policy measures	Explanations	Relevant macroeconomic basis	Revenue projection consistent with macroeconomic framework published by NCEF on 20 January 2016	CGB revenues according to the 2017 budget draft (with swap)	Differences between revenue projection consistent with winter macroeconomic framework and revenues in 2017 budget draft
Capital revenue	769.4			(The starting point of extrapolation is represented by the available series in the preliminary execution according to MPF)* Consumer price index	The average rate of inflation forecasted for 2017 (1.4%)	780.2	817.0	-36.8
Grants	1.6			According to MPF projection		19.7	19.7	0.0
Amounts received from the EU in the account of payments made and pre-financing	949.9			According to MPF projection		184.3	184.3	0.0
Financial operations						0.0	0.0	0.0
Amounts collected in the single account(State budget)	472.7					0.0		
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	5,909.5			According to MPF projection		22,077.3	22,077.3	0.0

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

Note: Fiscal policy measures considered - impact	
Tax on income, profits and capital gains from legal entities	Increasing the threshold at which a firm is considered microenterprise from 100,000 euros to 500,000 euros in 2016 from January 1st 2017 (-662.1 mil. lei)
Personal income tax	1. Exemption of personal income tax on pensions below 2,000 lei (-1,200 mil. lei)
	2. Introducing a non-taxable threshold for income resulting from the transfer of property rights in the amount of 450,000 lei starting February 1st 2017 (-300 mil. lei)
	3. Decrease of the personal income tax resulting from the reduced tax base following the elimination of the capping of 5 average gross salaries for the payment of social insurance contributions (-700 million lei on dividend tax and -85.3 million lei on personal income)
Fees and taxes on property	Eliminating special tax on constructions staring January 1st, 2017 (-1,000 mil. lei)
VAT	Adjusting the starting point of extrapolation (VAT implementation in 2016) due to revenue recorded in January 2016 with 24% VAT (for December 2015) (-700 million. lei), reduction of VAT rate to 19% and lowering VAT income resulting from the elimination of extra excise of 7 cents per liter of fuel (-2,541 mil. lei)
Excise duty	Elimination of excise duty of 7 cents and increase from 430.71 lei / 1,000 cigarettes in 2016 to 435.58 lei / 1,000 cigarettes in 2017 (-2,886 million lei). There were not extrapolated excise taxes collected from the sale of tobacco products considering that they do not grow in line with real consumption growth.
Other taxes on goods and services	1. Application of tax rates from 0.1 to 0.85 lei / MWh on revenue from electricity and gas transmission and distribution (152.5 million lei)
	2. Apply a 0.5% tax on revenue from natural resources, other than natural gas (forestry, quarrying, extraction of non-ferrous ores, etc.) (58.7 million lei)
	3. Applying a tax of 60% on additional revenues as a result of deregulation of natural gas (708.6 million lei)
Social contributions	1. Elimination of health contribution payment for pensioners (-900 mil. lei)
	2. Eliminating the capping of 5 gross average salaries for the calculation of individual social security contribution and for the social insurance contributions payable by employers or persons assimilated, for the income from wages or salaries (+372.8 mil. lei)

Annex no. 4: The evolution of the budget aggregates in the period 2016-2017

Mil. lei	Preliminary execution for 2016 according to MPF	*Swap* exec. 2016	Preliminary execution for 2016 according to MPF (without swap)	The draft budget 2017	The planned *swap* *for* 2017	The draft budget 2017 (without swap)	The draft budget 2017 – Prelim. execution for 2016	The draft budget 2017 – Prelim. execution for 2016	The draft budget 2017 / Prelim. execution for 2016	The draft budget 2017 / Prelim. execution for 2016	Prelim. execution for 2016	The draft budget 2017	The draft budget 2017 – Prelim. execution for 2016	Prelim. execution for 2016	The draft budget 2017	The draft budget 2017 – Prelim. execution for 2016
								without swap		without swap	with swap, % GDP			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	14	15	16=15-14
TOTAL REVENUE	**223,721.8**	**750.3**	**222,971.5**	**254,716.5**	**1,592.7**	**253,123.8**	**30,994.7**	**30,152.3**	**13.9%**	**13.5%**	**29.5%**	**31.2%**	**1.8%**	**29.4%**	**31.1%**	**1.7%**
Current revenue	215,618.8	740.9	214,877.9	231,618.1	1,592.7	230,025.4	15,999.3	15,147.5	7.4%	7.0%	28.4%	28.4%	0.0%	28.3%	28.2%	-0.1%
Tax revenue	136,406.1	441.5	135,964.7	142,836.0	1,592.7	141,243.3	6,429.9	5,278.7	4.7%	3.9%	18.0%	17.5%	-0.5%	17.9%	17.3%	-0.6%
Corporate income tax	44,781.6	137.1	44,644.5	48,837.4		48,837.4	4,055.7	4,192.9	9.1%	9.4%	5.9%	6.0%	0.1%	5.9%	6.0%	0.1%
Profit	15,442.0	64.8	15,377.2	16,629.9		16,629.9	1,187.9	1,252.7	7.7%	8.1%	2.0%	2.0%	0.0%	2.0%	2.0%	0.0%
Wages and income tax	27,756.4	72.4	27,684.0	30,108.2		30,108.2	2,351.8	2,424.2	8.5%	8.8%	3.7%	3.7%	0.0%	3.6%	3.7%	0.0%
Other taxes on income, profit and capital gains	1,583.3		1,583.3	2,099.3		2,099.3	516.0	516.0	32.6%	32.6%	0.2%	0.3%	0.0%	0.2%	0.3%	0.0%
Property tax	5,898.1		5,898.1	5,161.1		5,161.1	-737.0	-737.0	-12.5%	-12.5%	0.8%	0.6%	-0.1%	0.8%	0.6%	-0.1%
Taxes on goods and services	84,127.1	286.8	83,840.2	87,068.8	1,592.7	85,476.1	2,941.7	1,635.9	3.5%	2.0%	11.1%	10.7%	-0.4%	11.1%	10.5%	-0.6%
VAT	51,675.1	286.8	51,388.3	54,142.3	1,592.7	52,549.6	2,467.2	1,161.3	4.8%	2.3%	6.8%	6.6%	-0.2%	6.8%	6.4%	-0.3%
Excises	26,957.0	0.1	26,956.9	26,051.3		26,051.3	-905.6	-905.6	-3.4%	-3.4%	3.6%	3.2%	-0.4%	3.6%	3.2%	-0.4%
Other taxes on goods and services	2,250.3		2,250.3	3,385.6		3,385.6	1,135.2	1,135.2	50.4%	50.4%	0.3%	0.4%	0.1%	0.3%	0.4%	0.1%
Taxes on using goods, authorizing the use of goods or on carrying activities	3,244.6		3,244.6	3,489.6		3,489.6	245.0	245.0	7.6%	7.6%	0.4%	0.4%	0.0%	0.4%	0.4%	0.0%
Tax on foreign trade and international transactions	882.7		882.7	951.3		951.3	68.6	68.6	7.8%	7.8%	0.1%	0.1%	0.0%	0.1%	0.1%	0.0%
Other tax revenue	716.7	17.5	699.2	817.6		817.6	100.9	118.4	14.1%	16.9%	0.1%	0.1%	0.0%	0.1%	0.1%	0.0%
Social security contributions	61,274.4	299.4	60,975.0	69,758.4		69,758.4	8,483.9	8,783.4	13.8%	14.4%	8.1%	8.6%	0.5%	8.0%	8.6%	0.5%
Non-tax revenue	17,938.3		17,938.3	19,023.7		19,023.7	1,085.5	1,085.5	6.1%	6.1%	2.4%	2.3%	0.0%	2.4%	2.3%	0.0%
Capital revenue	769.4		769.4	817.0		817.0	47.6	47.6	6.2%	6.2%	0.1%	0.1%	0.0%	0.1%	0.1%	0.0%
Grant	1.6		1.6	19.7		19.7	18.1	18.1	1141.8%	1141.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Amounts received from the EU in the account of payments made and prefinancing	949.9		949.9	184.3		184.3	-765.5	-765.5	-80.6%	-80.6%	0.1%	0.0%	-0.1%	0.1%	0.0%	-0.1%
Amounts collected in the single account (State budget)	472.7	9.4	463.3	0.0		0.0	-472.7	-463.3	-100.0%	-100.0%	0.1%	0.0%	-0.1%	0.1%	0.0%	-0.1%

Mil. lei	Preliminary execution for 2016 according to MPF	*Swap* exec. 2016	Preliminary execution for 2016 according to MPF (without swap)	The draft budget 2017	The planned *swap for* 2017	The draft budget 2017 (without swap)	The draft budget 2017 – Prelim. execution for 2016	The draft budget 2017 – Prelim. execution for 2016	The draft budget 2017 / Prelim. execution for 2016	The draft budget 2017 / Prelim. execution for 2016	Prelim. execution for 2016	The draft budget 2017	The draft budget 2017 – Prelim. execution for 2016	Prelim. execution for 2016	The draft budget 2017	The draft budget 2017 – Prelim. execution for 2016
								without swap		without swap	with swap, % GDP			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	14	15	16=15-14
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	5,909.5		5,909.5	22,077.3		2,077.3	16,167.8	16,167.8	273.6%	273.6%	0.8%	2.7%	1.9%	0.8%	2.7%	1.9%
TOTAL EXPENDITURE	**242,016.3**	**750.3**	**241,266.0**	**278,816.5**	**1,592.7**	**277,223.8**	**36,800.2**	**35,957.8**	**15.2%**	**14.9%**	**31.9%**	**34.2%**	**2.3%**	**31.8%**	**34.0%**	**2.2%**
Current expenditure	223,001.1	750.3	222,250.8	253,629.6	1,422.7	252,206.9	30,628.4	29,956.0	13.7%	13.5%	29.4%	31.1%	1.7%	29.3%	30.9%	1.6%
Personnel	57,040.1		57,040.1	63,884.3		63,884.3	6,844.2	6,844.2	12.0%	12.0%	7.5%	7.8%	0.3%	7.5%	7.8%	0.3%
Goods and services	40,950.2		40,950.2	40,631.9	522.7	40,109.2	-318.3	-841.0	-0.8%	-2.1%	5.4%	5.0%	-0.4%	5.4%	4.9%	-0.5%
Interest	10,008.3		10,008.3	10,185.0		10,185.0	176.7	176.7	1.8%	1.8%	1.3%	1.2%	-0.1%	1.3%	1.2%	-0.1%
Subsidies	6,604.9		6,604.9	7,161.5		7,161.5	556.6	556.6	8.4%	8.4%	0.9%	0.9%	0.0%	0.9%	0.9%	0.0%
Total Transfers	107,953.3	750.3	107,203.0	131,133.4	900.0	130,233.4	23,180.1	23,030.4	21.5%	21.5%	14.2%	16.1%	1.9%	14.1%	16.0%	1.8%
Transfers for public entities	820.9		820.9	1,977.2	900.0	1,077.2	1,156.3	256.3	140.9%	31.2%	0.1%	0.2%	0.1%	0.1%	0.1%	0.0%
Other transfers	10,951.8		10,951.8	11,302.4		11,302.4	350.6	350.6	3.2%	3.2%	1.4%	1.4%	-0.1%	1.4%	1.4%	-0.1%
Projects funded by external post-accession grants	4,019.7		4,019.7	974.5		974.5	-3,045.2	-3,045.2	-75.8%	-75.8%	0.5%	0.1%	-0.4%	0.5%	0.1%	-0.4%
Social assistance	81,837.2		81,837.2	88,499.3		88,499.3	6,662.2	6,662.2	8.1%	8.1%	10.8%	10.9%	0.1%	10.8%	10.9%	0.1%
Projects funded by external post-accession grants 2014-2020	6,352.0		6,352.0	24,126.7		24,126.7	17,774.7	17,774.7	279.8%	279.8%	0.8%	3.0%	2.1%	0.8%	3.0%	2.1%
Other expenditure	3,971.7		3,971.7	4,253.3		4,253.3	281.5	281.5	7.1%	7.1%	0.5%	0.5%	0.0%	0.5%	0.5%	0.0%
Reserve funds	0.0		0.0	153.9		153.9	153.9	153.9			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Expenditure funded from reimbursable funds	444.4		444.4	479.6		479.6	35.2	35.2	7.9%	7.9%	0.1%	0.1%	0.0%	0.1%	0.1%	0.0%
Capital expenditure	19,015.2		19,015.2	25,187.0	170.0	25,017.0	6,171.8	6,001.8	32.5%	31.6%	2.5%	3.1%	0.6%	2.5%	3.1%	0.6%
Financial operations	0.0		0.0	0.0		0.0	0.0	0.0			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Payments made in previous years and recovered in the current year	0.0		0.0	0.0		0.0	0.0	0.0			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
SURPLUS(+) / DEFICIT(-)	**-18,294.5**		**-18,294.5**	**-24,100.0**		**-24,100.0**	**-5,805.5**	**-5,805.5**	**31.7%**	**31.7%**	**-2.4%**	**-2.96%**	**-0.5%**	**-2.4%**	**-2.96%**	**-0.5%**

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

Annex no. 5: The evolution of the budget aggregates in the period 2017-2018

Mil. lei	The draft budget 2017	The draft budget 2018	The draft budget 2018 - The draft budget 2017	The draft budget 2018/ The draft budget 2017	The draft budget 2017	The draft budget 2018	The draft budget 2018 - The draft budget 2017
					% GDP		
	1	2	3=2-1	4=2/1	5	6	7=6-5
TOTAL REVENUE	**254,716.5**	**284,303.7**	**29,587.1**	**11.6%**	**31.25%**	**32.38%**	**1.13%**
Current revenue	231,618.1	249,786.9	18,168.7	7.8%	28.41%	28.45%	0.04%
Tax revenue	142,836.0	153,728.3	10,892.2	7.6%	17.52%	17.51%	-0.01%
Corporate income tax	48,837.4	53,897.5	5,060.2	10.4%	5.99%	6.14%	0.15%
Profit	16,629.9	17,968.2	1,338.3	8.0%	2.04%	2.05%	0.01%
Wages and income tax	30,108.2	33,682.6	3,574.5	11.9%	3.69%	3.84%	0.14%
Other taxes on income, profit and capital gains	2,099.3	2,246.7	147.4	7.0%	0.26%	0.26%	0.00%
Property tax	5,161.1	5,564.2	403.1	7.8%	0.63%	0.63%	0.00%
Taxes on goods and services	87,068.8	92,525.1	5,456.3	6.3%	10.68%	10.54%	-0.14%
VAT	54,142.3	58,057.0	3,914.7	7.2%	6.64%	6.61%	-0.03%
Excises	26,051.3	28,297.6	2,246.2	8.6%	3.20%	3.22%	0.03%
Other taxes on goods and services	3,385.6	2,529.5	-856.1	-25.3%	0.42%	0.29%	-0.13%
Taxes on using goods, authorizing the use of goods or on carrying activities	3,489.6	3,641.1	151.5	4.3%	0.43%	0.41%	-0.01%
Tax on foreign trade and international transactions	951.3	955.1	3.8	0.4%	0.12%	0.11%	-0.01%
Other tax revenue	817.6	786.4	-31.1	-3.8%	0.10%	0.09%	-0.01%
Social security contributions	69,758.4	76,631.2	6,872.8	9.9%	8.56%	8.73%	0.17%
Non-tax revenue	19,023.7	19,427.4	403.7	2.1%	2.33%	2.21%	-0.12%
Capital revenue	817.0	963.4	146.4	17.9%	0.10%	0.11%	0.01%
Grant	19.7	6.7	-13.1	-66.2%	0.00%	0.00%	0.00%
Amounts received from the EU in the account of payments made and prefinancing	184.3	60.9	-123.4	-66.9%	0.02%	0.01%	-0.02%
Amounts collected in the single account (State budget)	0.0	0.0	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	22,077.3	33,485.8	11,408.5	51.7%	2.71%	3.81%	1.11%
TOTAL EXPENDITURE	**278,816.5**	**310,292.9**	**31,476.3**	**11.3%**	**34.20%**	**35.34%**	**1.14%**
Current expenditure	253,629.6	291,597.3	37,967.7	15.0%	31.11%	33.21%	2.10%
Personnel	63,884.3	67,200.9	3,316.6	5.2%	7.84%	7.65%	-0.18%

Mil. lei	The draft budget 2017	The draft budget 2018	The draft budget 2018 - The draft budget 2017	The draft budget 2018/ The draft budget 2017	The draft budget 2017	The draft budget 2018	The draft budget 2018 - The draft budget 2017
					% GDP		
	1	2	3=2-1	4=2/1	5	6	7=6-5
Goods and services	40,631.9	44,189.7	3,557.8	8.8%	4.98%	5.03%	0.05%
Interest	10,185.0	12,295.0	2,110.0	20.7%	1.25%	1.40%	0.15%
Subsidies	7,161.5	7,503.2	341.7	4.8%	0.88%	0.85%	-0.02%
Total Transfers	131,133.4	159,790.5	28,657.1	21.9%	16.09%	18.20%	2.11%
Transfers for public entities	1,977.2	2,365.9	388.7	19.7%	0.24%	0.27%	0.03%
Other transfers	11,302.4	13,102.8	1,800.5	15.9%	1.39%	1.49%	0.11%
Projects funded by external post-accession grants	974.5	936.9	-37.6	-3.9%	0.12%	0.11%	-0.01%
Social assistance	88,499.3	97,770.3	9,270.9	10.5%	10.86%	11.14%	0.28%
Projects funded by external post-accession grants 2014- 2020	24,126.7	40,415.1	16,288.4	67.5%	2.96%	4.60%	1.64%
Other expenditure	4,253.3	5,199.5	946.2	22.2%	0.52%	0.59%	0.07%
Reserve funds	153.9	107.0	-46.9	-30.5%	0.02%	0.01%	-0.01%
Expenditure funded from reimbursable funds	479.6	511.1	31.4	6.5%	0.06%	0.06%	0.00%
Capital expenditure	25,187.0	18,695.6	-6,491.4	-25.8%	3.09%	2.13%	-0.96%
Financial operations	0.0	0.0	0.0				0.00%
Payments made in previous years and recovered in the current year	0.0	0.0	0.0				0.00%
SURPLUS(+) / DEFICIT(-)	**-24,100.0**	**-25,989.2**	**-1,889.2**	**7.8%**	**-2.96%**	**-2.96%**	**0.00%**

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

Annex no. 6: The evolution of the budget aggregates in the period 2018-2019

Mil. lei	The draft budget 2018	The draft budget 2019	The draft budget 2019 - The draft budget 2018	The draft budget 2019/ The draft budget 2018	The draft budget 2018	The draft budget 2019	The draft budget 2019 - The draft budget 2018
					% GDP		
	1	2	3=2-1	4=2/1	5	6	7=6-5
TOTAL REVENUE	**284,303.7**	**311,667.3**	**27,363.6**	**9.6%**	**32.38%**	**32.95%**	**0.56%**
Current revenue	249,786.9	273,108.3	23,321.5	9.3%	28.45%	28.87%	0.42%
Tax revenue	153,728.3	166,468.5	12,740.3	8.3%	17.51%	17.60%	0.09%
Corporate income tax	53,897.5	59,983.7	6,086.1	11.3%	6.14%	6.34%	0.20%
Profit	17,968.2	19,676.7	1,708.5	9.5%	2.05%	2.08%	0.03%
Wages and income tax	33,682.6	37,900.8	4,218.2	12.5%	3.84%	4.01%	0.17%
Other taxes on income, profit and capital gains	2,246.7	2,406.1	159.4	7.1%	0.26%	0.25%	0.00%
Property tax	5,564.2	5,934.3	370.1	6.7%	0.63%	0.63%	-0.01%
Taxes on goods and services	92,525.1	98,788.6	6,263.5	6.8%	10.54%	10.44%	-0.10%
VAT	58,057.0	62,074.3	4,017.3	6.9%	6.61%	6.56%	-0.05%
Excises	28,297.6	30,264.8	1,967.3	7.0%	3.22%	3.20%	-0.02%
Other taxes on goods and services	2,529.5	2,590.1	60.6	2.4%	0.29%	0.27%	-0.01%
Taxes on using goods, authorizing the use of goods or on carrying activities	3,641.1	3,859.4	218.3	6.0%	0.41%	0.41%	-0.01%
Tax on foreign trade and international transactions	955.1	958.9	3.8	0.4%	0.11%	0.10%	-0.01%
Other tax revenue	786.4	803.2	16.7	2.1%	0.09%	0.08%	0.00%
Social security contributions	76,631.2	86,443.5	9,812.3	12.8%	8.73%	9.14%	0.41%
Non-tax revenue	19,427.4	20,196.3	768.9	4.0%	2.21%	2.13%	-0.08%
Capital revenue	963.4	1,005.4	42.0	4.4%	0.11%	0.11%	0.00%
Grant	6.7	4.9	-1.8	-26.4%	0.00%	0.00%	0.00%
Amounts received from the EU in the account of payments made and prefinancing	60.9	2.7	-58.3	-95.6%	0.01%	0.00%	-0.01%
Amounts collected in the single account (State budget)	0.0	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	33,485.8	37,546.0	4,060.2	12.1%	3.81%	3.97%	0.16%
TOTAL EXPENDITURE	**310,292.9**	**335,884.9**	**25,592.1**	**8.2%**	**35.34%**	**35.51%**	**0.16%**

Mil. lei	The draft budget 2018	The draft budget 2019	The draft budget 2019 - The draft budget 2018	The draft budget 2019/ The draft budget 2018	The draft budget 2018	The draft budget 2019	The draft budget 2019 - The draft budget 2018
					% GDP		
	1	2	3=2-1	4=2/1	5	6	7=6-5
Current expenditure	291,597.3	307,805.7	16,208.4	5.6%	33.21%	32.54%	-0.67%
Personnel	67,200.9	68,642.1	1,441.2	2.1%	7.65%	7.26%	-0.40%
Goods and services	44,189.7	45,607.9	1,418.2	3.2%	5.03%	4.82%	-0.21%
Interest	12,295.0	13,238.2	943.1	7.7%	1.40%	1.40%	0.00%
Subsidies	7,503.2	7,837.0	333.9	4.4%	0.85%	0.83%	-0.03%
Total Transfers	159,790.5	171,996.6	12,206.2	7.6%	18.20%	18.18%	-0.02%
Transfers for public entities	2,365.9	2,331.4	-34.6	-1.5%	0.27%	0.25%	-0.02%
Other transfers	13,102.8	13,453.7	350.9	2.7%	1.49%	1.42%	-0.07%
Projects funded by external post-accession grants	936.9	446.3	-490.6	-52.4%	0.11%	0.05%	-0.06%
Social assistance	97,770.3	102,734.1	4,963.9	5.1%	11.14%	10.86%	-0.28%
Projects funded by external post-accession grants 2014- 2020	40,415.1	47,551.5	7,136.5	17.7%	4.60%	5.03%	0.42%
Other expenditure	5,199.5	5,479.6	280.2	5.4%	0.59%	0.58%	-0.01%
Reserve funds	107.0	107.0	0	0.0%	0.01%	0.01%	0.00%
Expenditure funded from reimbursable funds	511.1	376.8	-134.2	-26.3%	0.06%	0.04%	-0.02%
Capital expenditure	18,695.6	28,079.2	9,383.6	50.2%	2.13%	2.97%	0.84%
Financial operations	0.0	0.0	0			0.00%	0.00%
Payments made in previous years and recovered in the current year	0.0	0.0	0			0.00%	0.00%
SURPLUS(+) / DEFICIT(-)	**-25,989.2**	**-24,217.7**	**1,771.5**	**-6.8%**	**-2.96%**	**-2.56%**	**0.40%**

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

Annex no. 7: The calculation of the eliminating impact of the cap of 5 gross average salaries for the calculation of individual social security contribution and for the social insurance contributions payable by employer and employees

Fiscal Code in force in December 2016
The tax base for the contribution to the state social security budget is capped for the individual contribution of the employee (10.5%) at five gross average salaries. For the employer, the SSC capping (15.8%) at five gross average salaries is applicable at the aggregate wage bill.
Emergency Ordinance no. 3/2017 - amending the Fiscal Code since February 2017
Removing the cap of five gross average salaries for the calculation of employee and employer SSC.
General assumptions:
1. The starting point for estimating the impact on budget revenues caused by the removal of 5 gross average wages cap on the payment of SSC by the employer and the employee, is represented by the gross income distribution achieved by the insured with full time program and those working part time, extracted from the publication MMJS "Pensions and social insurance", with the latest data available at the level of June 2016. (http://www.mmuncii.ro/j33/images/buletin_statistic/pensii_II_2016.pdf) that have been updated for the year 2017 using salary increases indices estimated by the National Commission for Economic Forecasting (11.2% according to Winter forecast for 2017)
2. The impact of removing the SSC capping is basically just at the level of the individual contribution, because at the level of payable contribution by the employer the total wage bill (art. 140 of the Fiscal Code) is taken into account, which makes the impact of the cap in this case to be negligible (the share of employees with average gross salaries over 5 gross average wages in the economy is tiny for private companies or public institutions).
3. The measure will be applied from 1st February, 2017 (10 months of budget execution in cash terms). To determine the impact, regarding the data, the average wage considered to substantiate state insurance budget was set for the year 2017 at 3,131 lei per month and was applied to the income distribution in the aforementioned publication. The calculation of revenues from social contributions and personal income tax before and after the legislative proposal is made at the level of full and part-time employment, with monthly income over the cap of 5 gross average wages (15,655 =5*3,131 lei). The pension contribution directed to Pillar 2 (5.1%) was calculated from the percentage of participants with paid contributions into total participants at Pillar 2 pension in last 3 months of 2016 resulting 59%, according to the statistics taken from the website of CSSPP: http://www.csspp.ro/evolutie-indicatori/pilon2/part-virat/1-5 and http://www.csspp.ro /evolutie-indicatori/pilon2/norma/1).

Calculation of impact (287.5 mil. lei for 10 months of application)		
	No.	**Mil. lei/2016**
The gross average salary per economy, lei	1	3,131.0
Cap, 5 gross average salary, lei	2=5*1	15,655.0
Proceeds from capped individual SSC	3	865.8
of which, the Pillar 2 pension	4=3*(5.1%/10.5%)*59%	248.1
Proceeds from the personal income tax, considering the cap on individual social contributions	5	2,001.8
Proceeds from the individual SSC considering removing cap	6	1,492.8
of which, the Pillar 2 pension	7=6*(5.1%/10.5%)*59%	427.8
Proceeds from the personal income tax, considering the removing of the cap on individual social contributions	8	1,899.5
Total impact on revenues from individual SSC	9=(6-7)-(3-4)	447.3
Total impact on revenues from personal income tax	10=8-5	-102.4
Net impact SSC 10 months	11=9*(10/12)	372.8
Total impact personal income tax 10 months	12=10*(10/12)	-85.3
Total net impact	**13=11+12**	**287.5**

Source: MPF, Fiscal Council's calculations

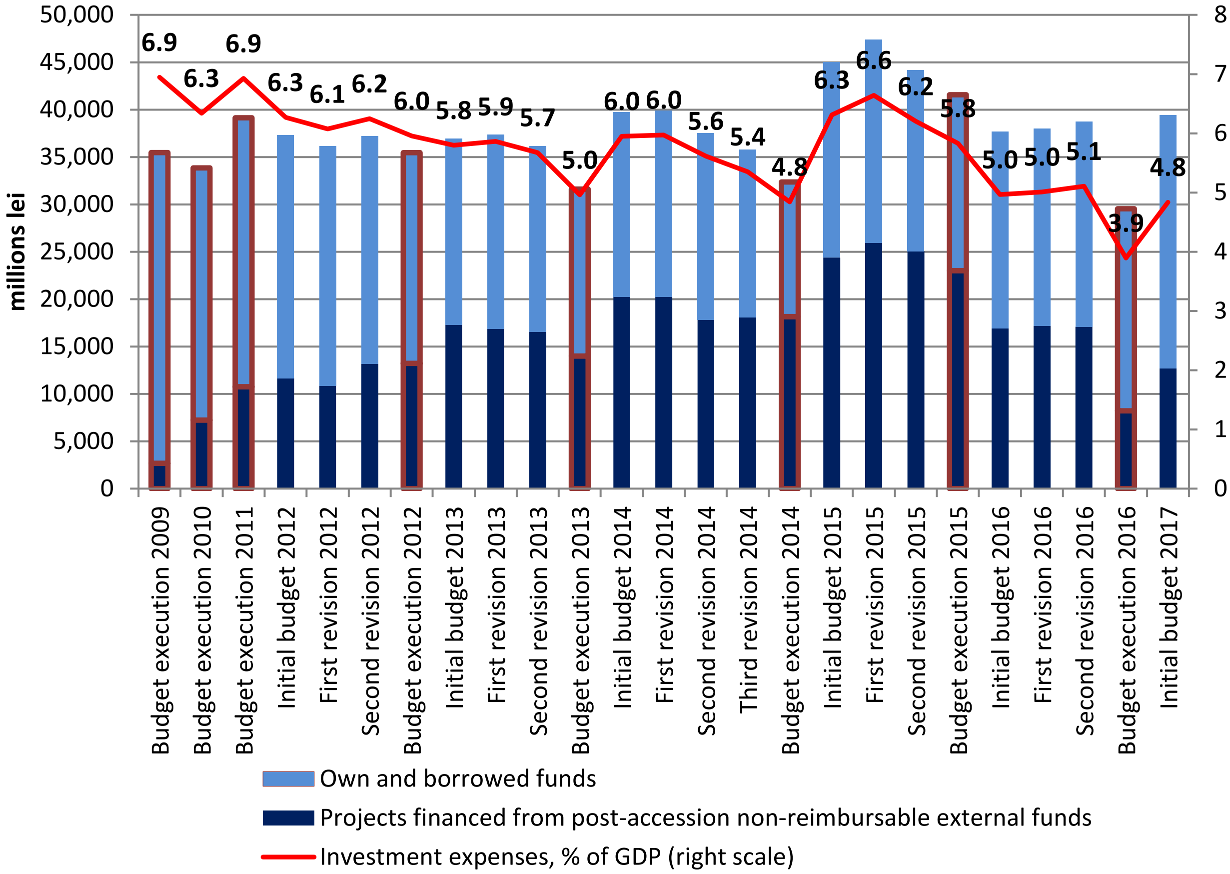
Annex no. 8: Calculating the impact on microenterprises stemming from legislative changes on taxation

The changes on taxation of microenterprises would result in a decline of the total tax paid by microenterprises by around 662 mil. lei
1.Revenues ceiling until which a company is registered as microenterprise was increased to 500,000 euro from 100,000 euro previously. As a result more companies would qualify to microenterprises (by around 75,000 based on our estimates).
2. A taxation rate of 1% on revenues was introduced for microenterprises with at least one employee, while microenterprises with zero employees would continue to be taxed with a rate of 3%. Previously, a taxation rate between 1% and 3% was applied, as follows: 1% for microenterprises with at least 2 employees, 2% for those with 1 employee and 3% for those with zero employees. As a result, companies with 1 employee would pay lower taxes.
3. A microenterprise can choose between paying the corporate income tax (16%) and the tax on revenues (1% or 3%) if its social capital is higher than a threshold of 45,000 lei. In 2016 the threshold was higher amounting to 25,000 euro. As result more companies can exercise this option. However, the number of microenterprises which fulfill the criteria is low; respectively out of total microenterprises less than 2% have a social capital above 25,000 euro and around 5% of them have a social capital above 45,000 lei. Hence, the majority of microenterprises will pay the tax on revenues (1% or 3%).

Number of employees	Number of micro enterprises		Total revenues (mil. lei)		Total employees		Taxes 2016 (mil lei)		Taxes 2017 (mil. lei)		Change (RON mil. lei)	
	< 100,000 euro	100,000 - 500,000 euro	< 100,000 euro	100,000 - 500,000 euro	< 100,000 euro	100,000 - 500,000 euro	< 100,000 euro	100,000 - 500,000 euro	< 100,000 euro	100,000 - 500,000 euro	< 100,000 euro	100,000 - 500,000 euro
Zero employees	100,769	6,040	6,551.0	5,642.30	-	-	193.3	122.2	192.1	157.2	-1.2	34.9
One employee	109,697	6,849	10,203.2	5,766.90	109,697	6,849	202.0	143.1	100.6	55,6	-101.4	-87.4
More than 2 employees	114,465	62,181	19,940.3	72,302.00	426,048	643,093	195.2	1,172.10	193.0	667,3	-2.2	-504.8
Total	324,931	75,070	36,694.4	83,711.10	535,745	649,942	590.6	1,437.40	485.7	880.1	-104.8	-557.3
Total impact of legislative changes	400,001		120,405.60		1,185,687		2,028.0		1.365.80		**-662.1**	

Source: based on balance sheets data submitted by the economic agents to MPF, Fiscal Council's calculations

Annex no. 9: The evolution of investment expenses between 2009-2017 – planned level vs. execution (million lei)



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

III. Fiscal Council's Opinion on the Draft Budget Revision for 2017 and the Half-Year Report Regarding the Economic and Budgetary Situation

On September 8th 2017, the Fiscal Council (CF) received from the Ministry of Public Finance (MPF) by letter no. 10754/8.09.2017, the draft of the budget revision for 2017, the explanatory note and the draft Government Ordinance regarding the draft of the budget revision for 2017, the explanatory note and the Government Ordinance regarding the draft of the revised social security budget for 2017, as well as the half-year report regarding the economic and budgetary situation requesting, under article 53 paragraph (2) of the Fiscal Responsibility Law (no. 69/2010 republished, hereafter referred to as FRL) the Fiscal Council's opinion.

Compliance with the fiscal rules

With one exception (and that only partially), the draft budget revision does not comply with the fiscal rules established by the FRL. Compared to the approved budget, the draft budget revision increases the total revenues and expenditures of the general consolidated budget (GCB) by 1.7 and 2.35 billion lei respectively, leading to an increase of the programmed deficit by 644.5 million lei. Since the projection of interest expenses is revised upward by 493.9 million lei, the GCB primary deficit is programmed to increase by 150.6 million lei.

The ceilings for the headline deficit and the primary deficit of the GCB established by Law no. 5/2017 are thus exceeded, which leads to the non-observance of the fiscal rule established by article 12 letter b) of the FRL. Given that the level of nominal gross domestic product is increased (a justified decision, given its evolution recorded in the first six months of the year) by 21.9 billion lei, the deficit level expressed as a percentage of GDP remains at 2.96%, representing the ceiling defined for the current year by the Law no. 5/2017, which makes the draft budget revision partially compliant with the rule defined at article 12 letter a) of the FRL, according to which *"the balance of the general consolidated budget and the personnel expenditure of the general consolidated budget, expressed as a percentage of the gross domestic product, cannot exceed the annual ceilings set in the Fiscal Strategy's budgetary framework for the first 2 years covered by it"*.

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

- The programmed level in the budget revision of the personnel expenditures (68.93 billion lei, i.e. 8.23% of GDP) exceeds the corresponding ceiling defined by the Law no. 5/2017 both in terms of nominal level (by 5.46 billion lei), as well as percentage of GDP (by 0.4 pp, despite the above mentioned upward revision of the nominal GDP compared to the estimation used in the initial budgetary construction). The absence of compliance with the fiscal rules therefore occurs at the level of article 12 letter a) (for the level expressed as percentage of GDP) and letter c) (for the nominal level) of the FRL and in terms of the rule established by article 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 (259.31 billion lei), exceeds the corresponding ceiling defined by the Law no. 5/2017 by 2.78 billion lei. The lack of compliance with the fiscal rules occurs at the level of article 12 letter c) of the FRL and article 24, which prohibits the increase of the 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. Given that the total expenditure increase is also due to the supplementary allocation in interest expenses (by 493.9 million lei), as well as for the payment of Romania's contribution to the EU budget (the "other transfers" component of the MPF budget is supplemented by about 990 million lei as a result of the amounts allocated to the payment of Romania's contribution to the EU budget[5] revision), the exceeding of the ceiling established by the Law no. 5/2017 appears as partially justified from the fiscal rules perspective (within that amount).

The draft Government Ordinance regarding the budget revision draft for 2017 provides the corresponding derogations from the aforementioned fiscal rules and redefines the ceilings stipulated by the Law no. 5/2017 according to the levels proposed by the budget revision for the budgetary aggregates. The lack of coercion and the *de facto* inefficiency of fiscal rules are issues about which the Fiscal Council has repeatedly warned in recent years in the context of its opinions and reports, but the magnitude of exceeding the current year's ceiling for the personnel expenditure is unprecedented.

The updated coordinates of the budgetary revenues and expenditures

The budget revision draft supplements the estimated total revenues of GCB by 1,705.9 million lei, despite a significant decline in tax revenue (-2,861 million lei) and a reduction by 490 million lei in the programmed entries from European post-accession funds related to the financial year 2014-2020, in the context of upward revisions operated at the level of social security contributions (+1,615.9 million lei) and especially in non-tax revenues (+3.345 million

[5] The Fiscal Council warned about the under-budgeting of this expenditure chapter in the context of its Opinion on the initial budget draft from February 3, 2017.

lei). However, the developments above reflect the reduction in the programmed amount of the chain-linked compensation scheme for outstanding obligations to GCB (-167.7 million lei, with a symmetric impact on the expenditure side) and, in particular, the change in revenue distribution of the expected income from it - if in the initial budget construction the revenues amounting 1,592.7 million lei were envisaged to fully realize at the level of VAT, the budget revision draft allocates the majority of the additional receipts at the level of social contributions, with additional amounts at the level of several budget revenue aggregates, reflecting the manner in which the compensation scheme is implemented (see Annex II). Adjusted where appropriate for the impact of the change in the size and distribution of the abovementioned swap compensation scheme, the main revisions to the revenue side of the budget are as follows:

- Tax revenues: -1.977 million lei, out of which:
    - Corporate income tax: -1.924 million lei, of which -2.396 million lei for the corporate income tax due by non-bank economic agents (we consider that the impact of the change in the distribution of income related to the compensation scheme is found in this category) and +284 million lei for the corporate income tax due by the banking sector. The downward revision is required by the low level of achievement of the initial program at the level of the first semester (88.9%) and a lower than expected performance of receipts in July (month that cumulates monthly and quarterly payments) when, despite the high nominal GDP growth rate, the annual growth rate stood at only 0.9%. It is very likely that to these developments has also contributed the underestimation of the budgetary impact resulting from the change in the microenterprises' regime operated at the beginning of the year (generalization of the turnover tax rate to 1%, together with increasing the ceiling of application from an annual turnover of 100,000 EUR to EUR 500,000), but the uncertainties were inherent given that the financial impact assessment was based on the financial statements of economic agents at the end of 2015 (for data availability reasons). The Fiscal Council considers that the estimated level of corporate income tax revenue appears to be feasible by extrapolating the available execution data, but this implies a mitigation of the negative growth rates of the monthly flows compared to the previous year's achievements. A more conservative estimation, however, indicates possible unrealized revenues of about 300 million lei.
    - Personal income tax: -173 million lei. The small downward revision of the programmed level appears consistent with the 99.9% achievement of the half-year program, but given the significant widening of the wage bill in the public sector, there is a potential for exceeding (possibly minor) the programmed level.

- VAT: -66 million lei. Adjusting for the impact of swap revenue's change in the size and structure, the budget revision draft maintains quasi-unchanged the initial revenue estimate, despite an achievement of the half-year program of only 94% (-1.614 billion lei). The available data for July and the preliminary data for August indicate an acceleration in the annual growth rate of annual VAT receipts, due to a significant increase in the annual growth rates of collected VAT, but also due to a sharp decline in the VAT reimbursements in August (-27.1% compared to the same period of the previous year). However, by extrapolating the favorable performance recorded in August at the level of collected VAT (+8.3% in annual terms) and considering a VAT refunded / VAT collected report slightly lower than the historical average, the Fiscal Council's calculations indicate a potential overestimation of VAT revenues of about 1 billion lei.
- Excise duties: +450.8 million lei. The upward revision reflects the impact of the two-step reintroduction of the increased fuel excise from September 15th, 2017 (+640 million lei at the end of the year) which, together with the July and August developments, more than compensates the achievement of only 96% of the half-year program revenues.

- Social security contributions: +899.8 million lei. The execution at the end of the first quarter shows an over-performance relative to the program of 101.7% (+582 million lei), partly determined by the implementation of the compensation scheme which, although initially expected to be at the level of VAT revenues, generated an amount of 318 million lei for the social insurance contributions. The extrapolation of the over-performance adjusted for the impact of the compensation scheme and of the updated execution data and also the strong upward revision of the public-sector wage bill in the context of the budgetary rectification indicate that the proposed level appears as reasonable, with even the possibility of slightly exceeding the designated level.
- Non-tax revenues: +3345 million lei. The substantial increase in the proceeds estimated for this component reflects the already apparent overperformance at the end of the first quarter (105% compared to the half-yearly program, +456 million lei), but is mainly the result of the unexpected distribution of dividends by the state-owned companies. The state companies temporarily distribute at least 90% of the net profit of the previous year in the form of dividends (although the measure was taken into account in the budgetary construction, the revenues collected in July were above expectations), and more, according to the provisions of GEO no. 29/2017, it is intended to distribute a super-dividend of the reserves accumulated in the previous years, estimated at about 1.5 billion lei. The Fiscal Council considers the proposed level as achievable in the context of the above-mentioned decisions.
- Amounts received from the EU for payments made and pre-financing (for the 2014-2020 financial framework): -490.2 million lei. The apparently inexplicable minor

revision of the aggregated amount (if we refer to the very poor up to date execution) disguises a huge downward revision of the structural funds (-4.44 billion lei from 9.6 billion lei to 5.2 billion lei) partly compensated by the increase of the funds allocated to EU agricultural payments (by 1,488.6 million lei) and the passing through the general consolidated budget of the amounts intended to pre-finance the projects of the non-governmental sector in the case of the temporary unavailability of the European funds, according to the provisions of GEO no. 40/2015 (+2,464 million lei). The latter two categories mentioned above generate a symmetric impact on revenue and expenditure (the impact on the deficit is zero), but the reduction in the structural and cohesion funds flows of whose final beneficiary is the state generates a higher reduction in expenditure due to the decrease in co-financing needs and in the ineligible expenditure (at the level of the budgetary expenditure the effect of the reduction in the structural and cohesion funds is equivalent with a decrease of about 8.4 billion lei). As the Fiscal Council has already stated in the context of the opinion prepared for the draft budget for the current year, the relevant amount of EU funds in terms of ESA 2010 methodology is only for those structural funds whose final beneficiary is the state, the amounts for agriculture and pre-financing granted to the non-government sector are not included in the public administration sector. Furthermore, the transit of these amounts through the general consolidated budget makes it impossible to compare the aggregate data from the current budget execution to those for the previous year (in the case of the amounts granted under article 10 of GEO no. 20/2015) and also with the historical flows of the European Funds from the previous EU financial year (2007-2013).

The budgetary expenditures, excluding the influence of the compensation scheme, are revised upwards by 2,518 million lei, the sources of this evolution being the following:

- Personnel expenditure: +5.050 million lei. The need for an upward revision was already apparent in the day-to-day budget execution, indicating insufficient initial allocations from the first months of the year. The size of the upward revision is due both to the initial under-budgeting and to the impact of the wage increases decided upon after approval of the draft budget. These developments reveal shortcomings in the budgetary planning process and the lack of effective constraining fiscal rules, and both could raise concerns about future pressures from this budgetary aggregate.
- Goods and services: -1.512 million lei. The revised level of this expenditure category implies a nominal decrease of -4.5% compared to the year 2016. In the Fiscal Council's opinion, reaching the programmed level will be a challenge, given that the preliminary execution at the end of August shows a 3.6% increase in spending compared to the same period of the previous year.
- Social assistance: +3.320 million lei. The upward revision operated validates the warning issued by the Fiscal Council in the context of the approval of the initial budget

law when it identified a possible under-budgeting of this expenditure aggregate by at least 2 billion lei. The social insurance budget expenditures are increased by 650 million lei (the Fiscal Council identified at the moment of the approval of the initial budget a under-budgeting of about 680 million lei) and the social assistance spending related to the state budget is increased by 2,526.5 million lei - the Fiscal Council considered at the time of approving the initial budget as likely to have a significant under estimation of this aggregate based on an extrapolation of the observable trends at the quarterly execution level of the previous year, but the magnitude of the rectification increase exceeds its assessment at that time.

- Interest spending: +493.3 million lei. The review is also in line with the under-budgeting of the initial aggregate identified by the Fiscal Council on the occasion of the approval of the annual budget law.
- Investment spending: -10.66 billion lei. The reduction in investment spending is by far the highest at least in recent history, and the funds for public investment, expressed as a percentage of GDP, are at a minimum of the last 10 years, being inferior in nominal terms to the level of the investment expenditure in 2016. The reduction in investment expenditure is mainly due to the downward revision of the absorption of structural and cohesion funds (-4.44 billion lei), which also generates lower allocations for co-financing and non-eligible expenditures. The aggregate reduction in investment projects funded with European non-reimbursable funds (around 5.5 billion lei) is accompanying smaller allocations for investment programs funded with reimbursable funds (by about 130 million lei) and capital expenditures (the difference to the total reduction of 10.66 billion lei, respectively 5 billion lei, also includes amounts related to the co-financing of projects from European structural funds).
- Other transfers: +715.5 million lei. The increase reflects the need to increase the amounts for payment of Romania's contribution to the EU budget by 990 million lei given the initial under-budgeting identified in the Fiscal Council’s opinion on the occasion of the approval of the annual budget law.
- Other expenses: +833 million lei.

Conclusions

The total consolidated budget revenues are revised upward by 1,873.6 million lei (net of the impact of the swap compensation scheme), reflecting divergent developments in tax revenues and social contributions (which depend directly on macroeconomic developments) and of non-tax revenues (as a result of the extraordinary distributions of dividends by state-owned companies requested by the Government). Consequently, despite the economic growth superior to the initial estimates and with a more favorable structure for the budget revenues, the execution of the fiscal revenues and of the social contributions at the end of the first semester was below the programmed level, with an achievement degree of only 97.44 % (by 2.682 million lei below the programmed level), mainly as a result of the weaker developments in the personal income tax and indirect taxes (VAT and excise taxes), only partly compensated by the over-performance of the social security contributions. Even in the context of re-introduction of the over-excise for fuels which was eliminated at the beginning of this year and the adoption of additional discretionary measures on the revenue side (the basis for calculating the social security contributions due by the employer for part-time employees is determined at least at the level of the minimum wage, the increase in the excise for cigarettes), the aggregate fiscal revenues plus social security contributions is revised downwards in the context of the current budgetary rectification by 1,077 million lei. The Fiscal Council identifies a significant risk of failure to achieve VAT revenue, estimated at about 1 billion lei, despite the favorable developments recorded during July and August, but this is mitigated to some extent by the significant probability of recording higher than projected proceeds for personal income tax and social security contributions, amid a very rapid rise in wages in the economy.

However, the unfavorable developments mentioned above for the aggregate fiscal revenues and social security contributions appear to be small compared to the size of the additional needs for budget allocations for personnel and social assistance expenditures (revised upward by 8,370 million lei, respectively by 1% of GDP). In these circumstances, keeping the deficit within the ceiling of 3% of GDP is possible only in the context of a massive downward revision in investment expenditures (-10.6 billion lei, mainly due to lower expenses related to investment projects financed by EU non-reimbursable funds) and the discretionary request for extraordinary dividend distributions addressed to the state companies (which largely explains the increase by 3.3 billion lei for non-tax revenues). Although such measures probably create the premises to avoid exceeding the deficit target this year, the situation in 2017 is likely to greatly complicate the construction of the budget in the coming years. First of all, the distribution of a super dividend in 2017 from the reserves accumulated in previous years by state-owned companies is, by its nature, a singular event, or the increases in the current expenditure that are partially covered by it are of a permanent nature. In this manner are thus covered the pressures from permanent expenditure from temporary resources, which is totally not indicated. Secondly, additional cuts in investment spending in the context of continued pressure from the current expenditure, beyond the undesirability from the perspective of the infrastructure needs of the country, appear as hardly to be achieved as the probable intensification of the absorption of the structural funds and cohesion policy funds in the coming years will demand for increases in co-financing and ineligible expenditure over the coming years.

Concluding, the Fiscal Council has identified on the occasion of the initial budgetary construction, several elements that suggested not only the existence of significant short-term risks in the context of avoiding to enter in the excessive deficit procedure on the background of oversized budget revenues and under-budgeting of certain categories of expenditure, but also signaled the vulnerability of public finances in the medium term in terms of registering a persistent and widespread deviations from the medium-term objective. The economic growth above expectations was not sufficient to ensure the convergence of the fiscal revenues with the programmed targets, as it would be expected, and the initial assessments on the necessary additional current expenditure (the underestimation of the expenditure identified by the Fiscal Council) were significantly exceeded by the budget execution. The avoidance of exceeding the deficit ceiling appears to be achievable only as a result of the massive reduction of public investment compared to the programmed level, the reversal of past tax cuts and the introduction of additional discretionary revenue measures as well as of the extraordinary proceeds of dividends from state companies. The above-mentioned elements determine the Fiscal Council to recommend the Government to elaborate urgently an action plan for the coming years for repositioning the budget deficit on a path consistent with the medium-term objective, as indicated both by FRL and European treaties that Romania signed.

The opinions and the recommendations above mentioned by the Fiscal Council were approved by the Chairman of the Fiscal Council, according to Art. 56, para (2) letter d) of the Law no. 69/2010 republished, after being approved by the Council members through vote, on 13th September 2017.

13th September 2017 — Chairman of the Fiscal Council,

IONUȚ DUMITRU

ANNEX I - Budget execution semester I 2017 vs. the half-year program	The half-year program 2017 with *swap* (mil. lei)	Budget execution semester I 2017 with *swap* (mil. lei)	Program *swap* semester I 2017	The half-year program 2017 without *swap* (mil. lei)	Budget execution semester I 2017 without *swap* (mil. lei)	Sem. 1 2017/ Sem. 1 2016 without *swap*	Differences from the half-year program 2017 without *swap* (mil. lei)	The achievement degree of the half-year program without *swap* (%)	Differences from the half-year program 2017 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	**122,902.6**	**117,227.7**	**877.9**	**122,024.7**	**116,349.8**	**7.6%**	**-5,674.9**	**95.3%**	**-5,674.9**	**95.4%**
Current revenue	113,680.2	111,432.8	870.5	112,809.7	110,562.3	4.0%	-2,247.4	98.0%	-2,247.3	98.0%
Tax revenue	71,249.2	67,994.5	422.5	70,826.6	67,572.0	-1.3%	-3,254.7	95.4%	-3,254.6	95.4%
Taxes on profit, wages, income and capital gains	23,981.6	22,913.7	190.6	23,791.1	22,723.1	4.4%	-1,067.9	95.5%	-1,067.9	95.5%
Corporate income tax	8,116.9	7,212.6	64.9	8,052.0	7,147.7	-6.7%	-904.3	88.8%	-904.3	88.9%
Personal income tax	14,876.4	14,866.9	125.6	14,750.8	14,741.3	10.7%	-9.5	99.9%	-9.5	99.9%
Other taxes on income, profit and capital gains	988.3	834.2		988.3	834.2	4.5%	-154.1	84.4%	-154.1	84.4%
Property tax	3,286.8	3,578.7		3,286.8	3,578.7	-5.2%	291.9	108.9%	292.0	108.9%
Taxes on goods and services	42,992.0	40,558.0	188.6	42,803.5	40,369.4	-4.1%	-2,434.0	94.3%	-2,434.0	94.3%
VAT	26,902.2	25,291.0	188.6	26,713.7	25,102.4	-4.6%	-1,611.2	94.0%	-1,611.3	94.0%
Excises	12,443.2	11,945.6		12,443.2	11,945.6	-7.6%	-497.6	96.0%	-497.6	96.0%
Other taxes on goods and services	1,721.5	1,684.2		1,721.5	1,684.2	62.1%	-37.3	97.8%	-37.3	97.8%
Taxes on using goods, authorizing the use of goods or on carrying activities	1,925.1	1,637.2		1,925.1	1,637.2	-10.1%	-287.9	85.0%	-287.9	85.0%
Tax on foreign trade and international transactions	462.2	478.1		462.2	478.1	1.9%	15.9	103.4%	16.0	103.5%
Other tax revenue	526.6	465.9	43.4	483.2	422.5	-6.7%	-60.7	87.4%	-60.7	88.5%
Social security contributions	33,645.8	34,218.1	448.0	33,197.9	33,770.1	15.2%	572.3	101.7%	572.3	101.7%
Nontax revenue	8,785.2	9,220.2		8,785.2	9,220.2	9.3%	435.0	105.0%	435.0	105.0%
Capital revenues	398.3	396.4		398.3	396.4	14.2%	-1.9	99.5%	-1.9	99.5%
Grants	10.3	0.0		10.3	0.0	-	-10.3	0.0%	-10.3	0.0%
Amounts received from the EU in the account of payments made and prefinancing	156.7	94.4		156.7	94.4	-80.2%	-62.3	60.2%	-62.3	60.3%
Amounts collected in the single account	0.0	-234.8	7.4	-7.4	-242.2	-249.5%	-234.8	3282.1%	-234.8	-

ANNEX I - Budget execution semester I 2017 vs. the half-year program	The half-year program 2017 with *swap* (mil. lei)	Budget execution semester I 2017 with *swap* (mil. lei)	Program *swap* semester I 2017	The half-year program 2017 without *swap* (mil. lei)	Budget execution semester I 2017 without *swap* (mil. lei)	Sem. 1 2017/ Sem. 1 2016 without *swap*	Differences from the half-year program 2017 without *swap* (mil. lei)	The achievement degree of the half-year program without *swap* (%)	Differences from the half-year program 2017 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	0.0	-146.9		0.0	-146.9	-291.5%	-146.9	-	-146.9	-
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	8,657.1	5,685.8		8,657.1	5,685.8	736.0%	-2,971.3	65.7%	-2,971.4	65.7%
TOTAL EXPENDITURE	**134,979.7**	**123,522.8**	**877.9**	**134,101.8**	**122,644.9**	**9.6%**	**-11,456.9**	**91.5%**	**-11,456.9**	**91.5%**
Current expenditure	128,619.7	120,091.4	877.9	127,741.8	119,213.5	11.5%	-8,528.3	93.3%	-8,528.2	93.4%
Personnel	33,256.5	33,236.6		33,256.5	33,236.6	19.5%	-19.9	99.9%	-19.9	99.9%
Goods and services	18,859.1	17,544.4		18,859.1	17,544.4	0.9%	-1,314.7	93.0%	-1,314.7	93.0%
Interest	6,802.3	6,049.9		6,802.3	6,049.9	-4.2%	-752.4	88.9%	-752.4	88.9%
Subsidies	4,296.5	3,589.4		4,296.5	3,589.4	34.4%	-707.1	83.5%	-707.1	83.5%
Total Transfers	65,136.5	59,543.0	877.9	64,258.6	58,665.1	11.6%	-5,593.5	91.3%	-5,593.5	91.4%
Transfers for public entities	1,318.3	468.9	356.2	962.2	112.7	-32.0%	-849.4	11.7%	-849.5	35.6%
Other transfers	6,927.3	6,152.4	521.7	6,405.6	5,630.7	19.2%	-774.9	87.9%	-774.9	88.8%
Projects funded by external post-accession grants	698.4	473.0		698.4	473.0	-90.2%	-225.4	67.7%	-225.4	67.7%
Social assistance	44,590.4	44,106.3		44,590.4	44,106.3	9.8%	-484.1	98.9%	-484.1	98.9%
Projects funded by external post-accession grants 2014-2020	9,421.7	6,126.8		9,421.7	6,126.8	545.4%	-3,294.9	65.0%	-3,294.9	65.0%
Other expenditure	2,180.4	2,215.6		2,180.4	2,215.6	25.2%	35.2	101.6%	35.2	101.6%
Reserve funds	49.0	0.0		49.0	0.0	-	-49.0	0.0%	-49.0	0.0%
Expenditure funded from reimbursable funds	219.6	128.1		219.6	128.1	-6.3%	-91.5	58.3%	-91.5	58.3%
Capital expenditure	6,360.0	4,078.2		6,360.0	4,078.2	-19.0%	-2,281.8	64.1%	-2,281.8	64.1%
Payments made in previous years and recovered in the current year	0.0	-646.8		0.0	-646.8	-	-646.8	-	-646.8	-
EXCEDENT (+) / DEFICIT (-)	**-12,077.1**	**-6,295.1**		**-12,077.1**	**-6,295.1**	**63.3%**	**5,782.0**	**52.1%**	**5,782.0**	**52.1%**

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

ANNEX II	Initial budget 2017	*Swap* program 2017	Initial budget 2017	First budget revision (R1) 2017	*Swap* R1	First budget revision 2017	R1 - Initial budget 2017	R1 - Initial budget 2017	Budget execution semester I 2017/ Budget execution semester I 2016	R1 2017/ Budget execution 2016
			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
TOTAL REVENUE	**254,721.0**	**1,592.7**	**253,128.3**	**256,426.9**	**1,425.0**	**255,001.9**	**1,705.9**	**1,873.6**	**8.15%**	**114.37%**
Current revenue	231,622.6	1,592.7	230,029.9	233,722.6	1,425.0	232,297.5	2,100.0	2,267.7	4.49%	108.11%
Tax revenue	142,836.1	1,592.7	141,243.4	139,974.9	708.9	139,266.0	-2,861.1	-1,977.3	-1.09%	102.43%
Taxes on profit, wages, income and capital gains	48,837.4		48,837.4	46,917.3	327.2	46,590.1	-1,920.0	-2,247.2	4.95%	104.36%
Corporate income tax	16,629.9		16,629.9	14,836.6	131.1	14,705.5	-1,793.3	-1,924.4	-6.27%	95.63%
Personal income tax	30,108.2		30,108.2	30,130.6	196.1	29,934.5	22.4	-173.7	11.45%	108.13%
Other taxes on income, profit and capital gains	2,099.3		2,099.3	1,950.2		1,950.2	-149.1	-149.1	4.50%	123.18%
Property tax	5,161.1		5,161.1	5,395.4		5,395.4	234.3	234.3	-5.25%	91.48%
Taxes on goods and services	87,068.8	1,592.7	85,476.1	85,706.6	296.5	85,410.1	-1,362.3	-66.1	-3.90%	101.87%
VAT	54,142.3	1,592.7	52,549.6	52,846.0	296.5	52,549.5	-1,296.3	-0.1	-4.25%	102.26%
Excises	26,051.3		26,051.3	26,502.1		26,502.1	450.8	450.8	-7.60%	98.31%
Other taxes on goods and services	3,385.6		3,385.6	3,398.4		3,398.4	12.8	12.8	62.08%	151.02%
Taxes on using goods, authorizing the use of goods or on carrying activities	3,489.6		3,489.6	2,960.1		2,960.1	-529.6	-529.6	-10.15%	91.23%
Tax on foreign trade and international transactions (customs duty)	951.3		951.3	945.6		945.6	-5.7	-5.7	1.88%	107.13%
Other tax revenue	817.6		817.6	1,010.1	85.2	924.9	192.5	107.3	1.08%	132.28%
Social security contributions	69,758.4		69,758.4	71,374.3	716.1	70,658.1	1,615.9	899.8	16.13%	115.88%
Nontax revenue	19,028.2		19,028.2	22,373.4		22,373.4	3,345.2	3,345.2	9.25%	124.72%
Capital revenues	817.0		817.0	849.1		849.1	32.1	32.1	14.24%	110.36%
Grants	19.7		19.7	18.0		18.0	-1.8	-1.8	-	1,130.85%
Amounts received from the EU in the account of payments made and prefinancing	22,261.7		22,261.7	21,837.3		21,837.3	-424.4	-424.4	399.50%	318.35%
TOTAL EXPENDITURE	**278,820.9**	**1,592.7**	**277,228.2**	**281,171.3**	**1,425.0**	**279,746.3**	**2,350.4**	**2,518.1**	**10.05%**	**115.95%**
Current expenditure	253,592.8	1,422.7	252,170.1	261,004.2	1,255.0	259,749.2	7,411.4	7,579.1	12.01%	116.87%

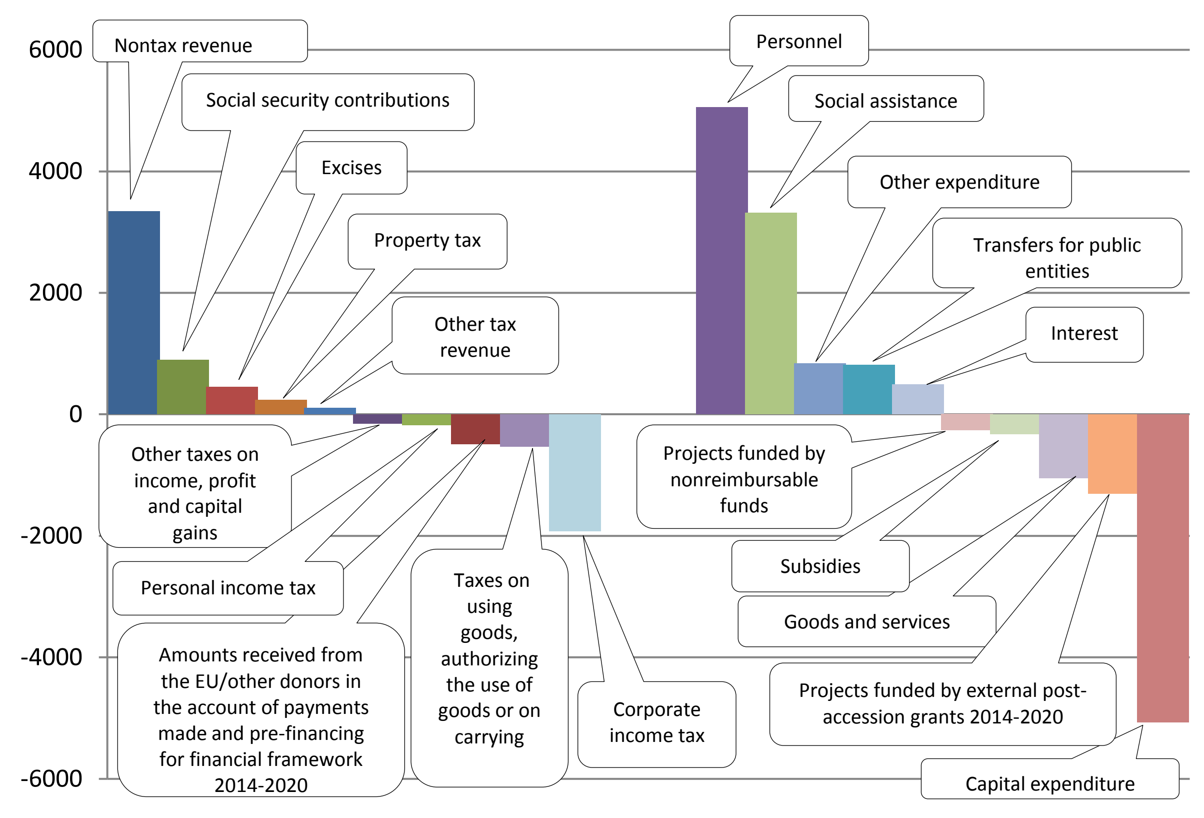
ANNEX II	Initial budget 2017	*Swap* program 2017	Initial budget 2017	First budget revision (R1) 2017	*Swap* R1	First budget revision 2017	R1 - Initial budget 2017	R1 - Initial budget 2017	Budget execution semester I 2017/ Budget execution semester I 2016	R1 2017/ Budget execution 2016
			without *swap*			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
Personnel	63,879.3		63,879.3	68,929.9		68,929.9	5,050.7	5,050.7	19.49%	120.84%
Goods and services	40,675.0	522.7	40,152.3	39,107.3		39,107.3	-1,567.7	-1,045.0	0.88%	95.50%
Interest	10,185.0		10,185.0	10,678.9		10,678.9	493.9	493.9	-4.24%	106.70%
Subsidies	7,161.5		7,161.5	6,834.3		6,834.3	-327.2	-327.2	34.38%	103.47%
Total Transfers	131,061.4	900.0	130,161.4	135,012.9	1,255.0	133,757.9	3,951.5	3,596.5	12.60%	124.77%
Transfers for public entities	1,945.6	900.0	1,045.6	2,593.6	733.3	1,860.4	648.0	814.7	-1.03%	226.62%
Other transfers	11,302.8		11,302.8	12,018.2	521.7	11,496.5	715.5	193.8	30.23%	104.97%
Projects funded by external post-accession grants	974.5		974.5	715.0		715.0	-259.5	-259.5	-90.16%	17.79%
Social assistance	88,458.5		88,458.5	91,778.6		91,778.6	3,320.1	3,320.1	9.84%	112.15%
Projects funded by external post-accession grants 2014-2020	24,126.7		24,126.7	22,821.1		22,821.1	-1,305.6	-1,305.6	545.40%	359.28%
Other expenditure	4,253.3		4,253.3	5,086.3		5,086.3	833.0	833.0	25.16%	128.06%
Reserve funds	151.0		151.0	90.9		90.9	-60.1	-60.1	-	-
Expenditure funded from reimbursable funds	479.6		479.6	350.0		350.0	-129.7	-129.7	-6.29%	78.74%
Capital expenditure	25,228.1	170.0	25,058.1	20,167.2	170.0	19,997.2	-5,061.0	-5,061.0	-18.98%	105.17%
EXCEDENT (+) / DEFICIT (-)	**-24,100.0**		**-24,100.0**	**-24,744.4**		**-24,744.4**	**-644.5**	**-644.5**	**63.30%**	**135.26%**

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

ANNEX III EU Funds	Initial budget 2017 (million lei)		Influences (updates + budget revision) (million lei)	First budget revision 2017 (million lei)	
	with agriculture	without agriculture		with agriculture and amounts according to art. 10 lit. a) of GEO no. 40/2015	without agriculture and amounts according to art. 10 lit. a) of GEO no. 40/2015
Revenue					
Post-accession funds	22,077.3	9,642.7	-490.2	21,587.1	5,199.9
Expenditure					
EU expenditure + national co-financing	29,457.1	17,022.5	-4,462.2	24,994.9	8,607.7

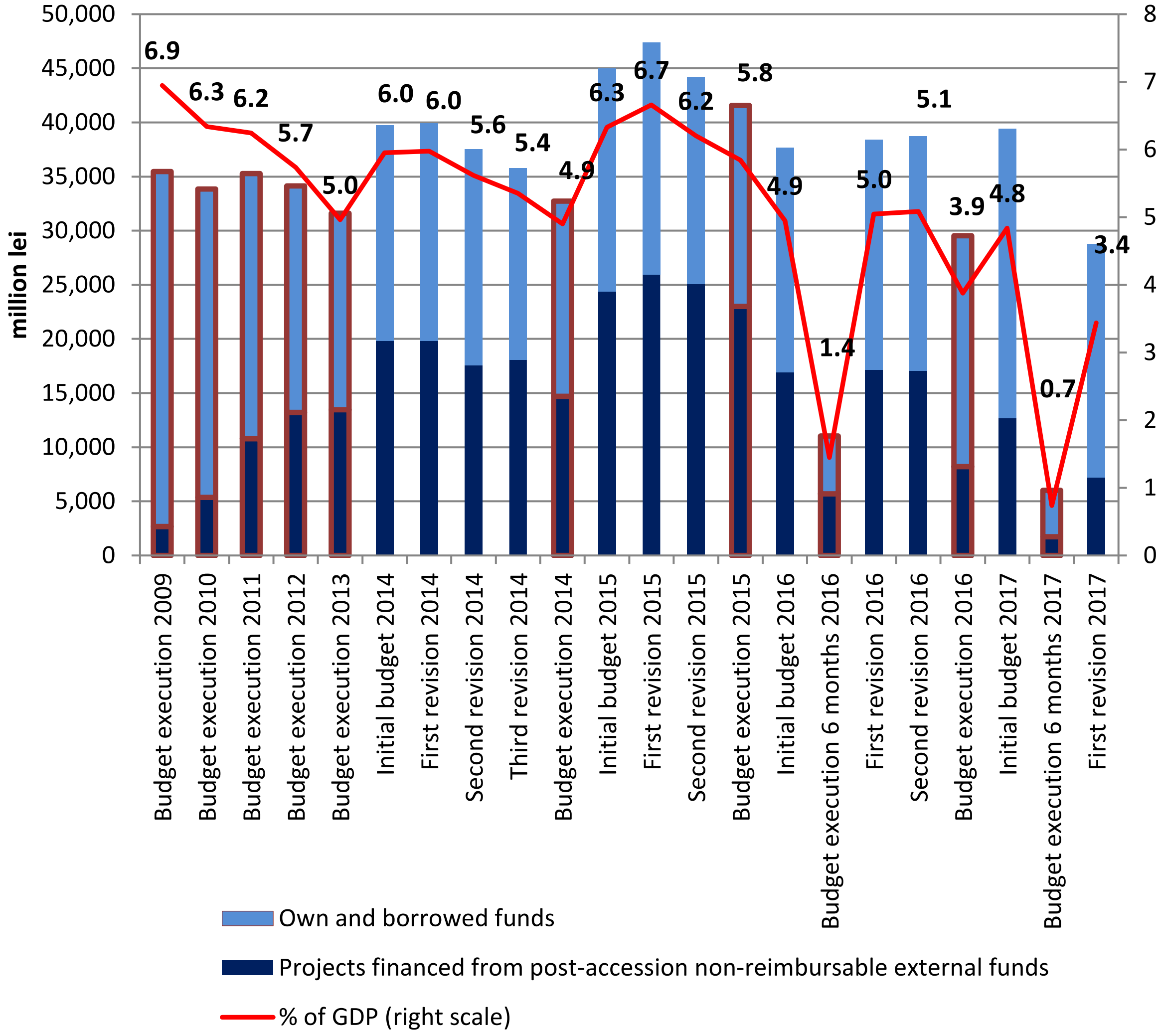
Source: Ministry of Public Finance

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



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

Figure 2: Evolution of the investment expenditure in the period 2009-2017 - planned vs. execution, million lei



Source: Ministry of Public Finance

IV. Fiscal Council's opinion on the draft Emergency Ordinance amending and supplementing Law no. 227/2015 regarding the Fiscal Code

On the 27th of October 2017, the Ministry of Public Finance (MPF) remitted to the Fiscal Council (FC) the letter no. 714901/26.10.2017, requesting the Fiscal Council's opinion on the draft Emergency Ordinance for amending and supplementing Law no. 227/2015 regarding the Fiscal Code.

It is relevant to this case article 21 of the Fiscal Responsibility Law no. 69/2010 republished (FRL), according to which *„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."

Short description of the legislative proposal and its budgetary impact

The amendments with relevant budgetary impact introduced by the draft Emergency Ordinance are as follows:

1. Social Contributions:
    a. The number of social contributions is reduced from 6 to 3, two of which are exclusively payable by the employee (social security contribution - SSC and health insurance contribution - HIC, of 25% and 10%, respectively), the employer paying only the newly created employment insurance contribution (EIC) of 2.25%. Compared to the current situation, where the aggregate level of social contributions for normal working conditions is 39.25% (of which 16.5% paid by the employee and 22.75% paid by the employer), the proposed aggregate level of social contributions in the draft normative act is 37.25%.
    b. The basis of calculation for social contributions for individuals who obtain income from self-employment is modified and the exceptions to the obligation to pay them are extended:

i. In SSC case:
   - There is no obligation to pay SSC by individuals who earn monthly income from self-employment below the minimum wage level and, also, by those who already earn salary income or assimilated to salary for which they are insured in the public system;
   - The new SSC rate of 25% is established at an income chosen by the taxpayer, at least equal to the country's gross minimum wage, regardless of the level of income achieved, compared to the current situation where the minimum level is 35% of the gross average salary used to substantiate the social security budget (SSB).

ii. In HIC case:
   - There is no obligation to pay HIC by individuals who earn monthly income from self-employment below the minimum wage level and, also, by those who already earn salary income or assimilated to salary for which they are insured in the public system;
   - The basis of calculation for the new HIC of 10% is limited to the minimum wage on the economy.

2. Income tax:
   a. The tax rate is reduced from 16% to 10%;
   b. There is a substantial increase in the amount of personal deductions granted in fixed amount (from a current range of 300-800 lei, depending on the number of dependents persons, to a range of 510-1,310 lei); the level of gross salary according to which they are granted is rescaled: the salary level up to which the personal deductions are granted in fixed amount increases from 1,500 lei to 1,950 lei (in line with the increase in the minimum wage from 1,450 lei to 1,900 lei), and the salary level to which they are granted in a regressive way increases from 3,000 lei to 3,600 lei (in line with the 20% increase in the gross wages necessary to avoid the reduction of the net salary given the transfer of contributions from the employee's burden to the employer).

3. Turnover tax for micro-enterprises:
   a. Increasing the threshold for the taxation system for micro-enterprises (which implies a 1% tax on turnover for firms with one or more employees and 3% for firms without employees) from 500,000 euro to 1,000,000 euro annual turnover, while eliminating the possibility to opt between this system and the profit taxation for companies with a social capital of more than 45,000 lei;

b. Eliminating the exception regarding the turnover tax on firms that earn income from consultancy and management.

The budgetary impact presented by the MPF has as basis for comparison a revenue projection substantiated on a macroeconomic scenario that appears in line with the autumn projection of the National Commission for Economic Forecasting. From the perspective of this macroeconomic scenario, the issues relevant to the impact assessment mainly concern the behavior of gross salaries in response to the proposed legislative changes (in this case, the almost full shift of social contributions to the employee's burden) and the level of transfers to the Pillar II of pensions:

- The MPF's hypothesis is that the gross average wage will increase additionally compared to the baseline scenario by 21.8% (up to a level of 4.162 lei) under the combined effect of raising the minimum wage (from 1,550 in the baseline scenario to 1,900 lei), a 25% increase in public sector salaries as of 1st January 2018, and the transfer towards the employees from the private sector employers, in the form of a rise in gross wages, of the entire cost savings resulting from the reduction of social contributions from the employer's duty. The computations of the Fiscal Council (see Annex 1) indicate that a 19.9% gross wage increase is sufficient to prevent a nominal reduction in the net wage, without this increase leading to a rise in the gross average wage of the employer[6].
- The transfers towards Pillar II are projected to increase both in the baseline scenario as well as in scenario that incorporates the changes in the Fiscal Code from 5.1% to 6%, resulting in an annual weighted average transfer rate of 5.85% assuming actual transfers on the new quota would become operable from March 2018. The change in this parameter (probably in the sense of reducing the share transferred to 3.75% according to public statements) is mentioned in the explanatory note as a possible coverage source of the impact of the legislative package.

Given the above-mentioned assumptions, the impact of the budgetary measures relative to the baseline scenario for 2018 is:

1. Social contributions:
    a. At the level of contributions from wage revenue (excluding income from self-employment), the change in the aggregate level of social contributions from 39.25% (16.5% for employee and 22.75% for employer) to 37.25% (35% for the employee and 2.25% for the employer) is more than offset by the additional

[6] The calculation ignores the impact of any personal deductions, as well as the case in which the employee is operating in a tax-exempt sector (such as IT).

increase of 21.8% in the gross salary (if private sector employers increase gross salaries so that net salaries will not decrease relative to the baseline scenario). Under these assumptions, the income from social contributions would be higher by about 9 billion lei compared to the base scenario.

   b. At the level of social contributions related to income from self-employed activities, by eliminating the obligation to pay SSC and HIC for those earning less than the minimum wage and for those who earn salary income or wage assimilated income for which they are insured in the public system, the number of taxpayers is assumed to be reduced drastically, with about 213.6 thousand in case of SSC (up to only 27.6 thousand taxpayers) and about 305 thousand in case of HIC (up to only 154 thousand taxpayers). Together with this reduction in the number of taxpayers, the change in the applicable SSC and HIC quotas (from 10.5% to 25% and 5.5% to 10% respectively), simultaneously with the redefinition of the calculation bases of the contributions (from a minimum of 35% of the average salary used to base the SSC budget to the minimum wage in the case of SSC, respectively on the level of the income achieved at the minimum wage in HIC) leads to a loss of income from social contributions of about 640 million lei (of which 170 million lei at SSC level and 470 million lei at HIC level).

2. Personal income tax:
   a. The reduction of the tax rate from 16% to 10% is estimated to generate revenues lower than those in the base scenario by about 12.7 billion lei, the income losses at the level of other income than wage being about 1.4 billion lei.
   b. The increase in the level of personal deductions is estimated to generate revenue losses of about 867 million lei relative to the baseline scenario.

3. Corporate income tax:
   a. Increasing the threshold for taxation of the micro-enterprises from a turnover of 500,000 euros to 1 million is estimated to generate revenue losses (relative to the baseline scenario) of 214 million lei for the 3 quarters in 2018 (annualized 285 million lei).

The Fiscal Council validates in principle MPF's impact assessments as being in line with the macroeconomic assumptions considered. Together, the proposed the amendments to the Fiscal Code would generate a revenue loss in the consolidated budget of 5.2 billion lei (0.6% of GDP) in 2018 compared to the baseline scenario. In the explanatory note of the normative act, the positive impact of the measures for the split VAT payment, the increase of the payments from the firms for persons with disabilities (GEO no. 60/2017) and the promotion of a normative act modifying the system of contribution to privately managed pension funds.

In the opinion of the Fiscal Council, it is difficult to make an *ex-ante* evaluation of the possible revenue surplus that would be generated by the split VAT payment. The additional revenue to the budget from the provisions from GEO no. 60/2017, according to the explanatory note, is already intended to cover the growth of social benefits for disabled adults and the families of children with disabilities, with a net effect only in 2018 (158 million lei), given that some of the increases in benefits occur in the middle of 2018. However, the increase in the gross minimum salary from 1,550 lei in the baseline scenario to 1,900 lei under the conditions of the amendments to the Fiscal Code would generate additional incomes compared to those identified in the explanatory note of the GEO no. 60/2017 of about 240 million lei. Ultimately, a possible limitation of transfers to the pillar II at 3.75 pp of the social security contribution (compared to the baseline assumption of an effective level of 5.85 percentage points in 2018) would have an important impact on the loss of revenue calculated for measures amending the Fiscal Code (generating about 4.1 billion lei additional revenue), implying also a long-term cost associated with a substantial reduction in the amounts accumulated in private pension accounts, together with the increase in the future payment obligations of the public pension system (Pillar I), by increasing the participation share of Pillar I from 77.6% (corresponding to a 6% transfer rate reported at the current SSC level of 26.3%) to 85% (corresponding to a transfer rate of 3.75% equivalent for the proposed SSC rate of 25%). However, the above-mentioned measures still do not cover a minus of about 800 million lei in the level of consolidated budget revenues.

Risks

According to the Fiscal Council, the risks associated with the assessment of the impact of the proposed measures are unusually high - using the hypothesis that the private sector employers will raise salaries by at least 20% above the level that would have prevailed in the absence of the package promotion and which would have recorded a significant increase in gross wage compared to the current year. It is easy to imagine a situation where, in the absence of an explicit obligation in this regard, the employer chooses not to increase the salary of the employee in an amount sufficient to avoid the impact on net salary considered for next year before taking into account the promotion of the normative act in question - he may, for example, choose to increase gross wage in 2018 by only 19.9%, thus ensuring the neutrality of the proposed measures on the net salary compared to 2017, but without ensuring the salary increases that would have been involved according to the baseline scenario, or even if unlikely, he may increase the gross wage to an insufficient amount to avoid the reduction in the net salary. The latest evolution appears as unlikely in the context of a tense labor market, but it is by no means impossible, especially since the degree of labor market tension is different at both branch level and territorial level. In essence, an increase in gross wage lesser by one percentage point to that assumed by the MPF in the impact assessments would generate a higher revenue loss of around 0.1% of GDP than the one estimated by MPF.

Furthermore, a simple calculation reveals that the reduction of the personal income tax rate from 16% to 10%, together with the transfer of social contributions to the employee (with a 2.25% residual to the employer in the form of the insurance contribution for work) and the reduction in their aggregate level of 2 pp contributes only in an absolutely marginal manner to the reduction of the tax burden for the employees, at least at the level of the average gross wage (unaffected by the tax deductions), as the gross wage would increase by 19.9% so that the net salary would remain unchanged compared to the baseline scenario (or the initial level); the change, however, affect the composition of labor income taxation, by strongly increasing the share of social contributions to the personal income tax expense. The calculation presented in Annex 1 shows that to pay a certain net salary, the employer's wage cost falls marginally (by 0.12%) compared to the original scenario, and the tax burden, defined as the amount of social contributions and personal income tax due reported to the employer's costs related to salaries, remains virtually unchanged (it is reduced from 42.86% to 42.79%). Given the above, the loss of revenue in the consolidated budget compared to the baseline scenario arises almost entirely from the combined effect of income tax reduction from 16% to 10% for other revenue than salaries (pension benefits, agricultural activities, interest, capital gains, etc.), with an impact of about -1.4 billion lei, the increase of personal deductions, with an impact of about -866 million lei, changes occurring in the social security contributions paid by independent activities (-642 million lei), changes in the taxation regime for microenterprises (-214 million lei) and, finally, higher transfers to the second pillar generated by the gross wage increase (assuming the transferred share will remain at the actual effective level of 5.85% in 2018, these transfers would increase by about 2 billion lei).

The above-mentioned elements are also relevant from the perspective of another source of risk arising from the proposed amendments to the Fiscal Code. Thus, according to the Fiscal Council, the exemption from the obligation to pay the social and health contributions granted for the persons who receive income from independent activities but also from salaries or from other income for which are ensured in the public system, creates a fiscal arbitrage opportunity with significant potential consequences. Given the fact that the tax burden on the labor force level remains virtually unchanged, a more favorable tax regime for self-employment and micro-enterprises (specifically, in the latter case is relevant the abolition of restrictions on the applicability of this system for the entities that generate income from consultancy and management) encourages the sub-declaration of the salary incomes. The Fiscal Council also considers as unfair that employees have to pay social and health contributions for all their income, while for the income resulted exclusively from independent activities the tax base is limited to the minimum wage regardless of the income level (so taxing became profoundly regressive - at high incomes, taxation is much lower than at low incomes), especially since the public healthcare package is the same regardless of the source of income. The Fiscal Council considers that a fair and equitable approach would have been to reduce the fiscal treatment gap between wage income and self-employment income as a prerequisite for improving the collection by closing tax optimization "loopholes" and not the proposed measures which involves a massive reduction in the tax burden for self-employment, while that corresponding to the wage income remains virtually the same.

In addition, the massive reduction of personal income tax revenues will greatly weaken the financial position of local authority's budgets, as many of them have a high degree of dependence on the amounts deducted from the personal income tax.

Last but not least, the major change in tax philosophy by shifting social contributions almost exclusively to the employee, a unique case at least at the level of the EU Member States is not accompanied by a justification that will make this approach credible and acceptable to the social partners.

Conclusions

Considered in isolation, the impact of the fiscal change package implies a loss of about 5.2 billion lei, while an assessment of the compensation measures identified in the substantiation note does not indicate its full coverage. However, such an approach is inappropriate - the identified impact is conditioned by the assumptions about the rise in gross salaries that has as a source of origin inclusively the massive increase in the remuneration of public sector employees under the unitary wage law, with major consequences on the size of budgetary expenditures.

Article 21 of the revised FRL conditions the endorsement of the Fiscal Council by the fact that the impact of the proposed measures was taken into account in the forecast and does not affect the achievement of the annual and medium-term budgetary targets. Considering the above, the Fiscal Council cannot certify, in the absence of a complete budgetary construction, the compliance with the budgetary targets assumed through the Fiscal and Budgetary Strategy and, in essence, a general government deficit under 3% of GDP in 2018 (in fact, the actual budget deficit should fall significantly in the coming years in order to meet Romania's commitments at the European level, especially those related to the Fiscal Compact).

Moreover, the Fiscal Council reiterates its objections regarding the approach according to which the persistency of placing the budgetary deficit in the immediate proximity of the 3% reference level would be a benign phenomenon - not only that such an approach is flagrantly contradictory to the fiscal rules established by national law and the European one (the Preventive Arm of the Stability and Growth Pact, the Fiscal Compact), but such a behavior weakens the position of public finances, depriving it of fiscal space in the event of adverse shocks. In this respect, the Fiscal Council considers that the proposal to amend the Fiscal Code is likely to contribute to the widening of the actual and structural budget deficits.

Considering the above and the identified risks, which appear tilted to higher income losses than the assessed ones, the Fiscal Council does not endorse the proposal to amend the Fiscal Code, failing to certify, in the absence of a complete budgetary construction, the fact that

the annual and medium-term budgetary targets assumed by the Fiscal and Budgetary Strategy 2017-2019 will not be overcome, these being anyway incompatible with the domestic fiscal rules and European treaties.

The opinions and the recommendations above mentioned by the Fiscal Council were approved by the Chairman of the Fiscal Council, according to Art. 56, para (2) letter d) of the Law no. 69/2010 republished, after being approved by the Council members through vote, on 3rd November 2017.

3rd November 2017 Chairman of the Fiscal Council,

IONUȚ DUMITRU

Annex no. 1

Table 1: Comparative analysis of the change in labor taxation					
	Tax rates, % current legislation	**Measure**	**Tax rates, % proposed amendment**	**Measure**	**Percent change, %**
Gross salary		100.00		119.90	19.90
SSC employer	22.75	22.75	2.25	2.70	-88.14
SSC employee	16.50	16.50	35.00	41.96	154.33
Income tax	16.00	13.36	10.00	7.79	-41.67
Total employer cost		122.75		122.60	-0.13
Net salary		70.14		70.14	0.00
Total contributions		39.25		44.66	13.79
Income tax		13.36		7.79	-41.67
Total taxes		52.61		52.46	-0.29

V. Fiscal Council's opinion on the Second Supplementary Budget Draft for 2017

On November 9th 2017, the Fiscal Council received from the Ministry of Public Finance by letter no. 445825/09.11.2017, the draft of the second budget revision for the general consolidated budget for 2017, the explanatory note and the draft Government Emergency Ordinance (GEO) project regarding the second budget revision for the state budget for 2017, as well as the explanatory note and the GEO project regarding the second revised social security budget for 2017, requesting the Fiscal Council's opinion under article 53, paragraph (2) of the Fiscal Responsibility Law no. 69/2010 republished (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) revenues increase by 376 million lei and the GCB expenditures increase by 600.4 million lei, so that the GCB headline deficit is projected to a level of 24,968.0 million lei, standing by 868 million lei above the ceiling for the budget deficit defined by Law no. 5/2017 (the law for approving ceilings for certain indicators specified in the budgetary framework). The GEO project regarding the second budget revision for 2017 records a number of exemptions from the provisions stipulated by article 12 letters a) to c), article 17 paragraph (2), article 24 and article 26 paragraph (4) and (5) of the Law no 69/2010 republished and also from the provisions stipulated by article 2 letter (2) and article 3 letter (5) and (6) of the Law no. 5/2017, stating thus the failure to comply with practically all the fiscal rules excepting the GCB balance rule as a share in GDP. Article 12 letters a), b) and c), article 24 and article 26 paragraph (4) and (5) of the FRL stipulate as mandatory the nominal and the percentages shares of GDP for the ceilings established by the Fiscal Strategy and by the accompanying law regarding the level of the GCB headline deficit, the GCB primary deficit, the total spending excluding the financial assistance from the European Union (EU) and other donors and also for the personnel spending, allowing the possibility of increasing total expenditure of the GCB on the occasion of the budgetary revisions exclusively for servicing public debt and, respectively, for paying the contribution to the EU budget.

- The first budget revision already recorded significant deviations from the mandatory ceilings stipulated in the Law no. 5/2017 and the non-observance of all the fiscal rules except the one regarding the level expressed as a percentage of GDP for the GCB headline deficit (but in the context of the upward revision operated at the level of nominal GDP compared to the initial budget estimate) as follows: nominal GCB headline deficit (by 644.3 million lei, the primary deficit of GCB (+150.4 million lei), the GCB personnel expenditure (by 5.11 billion lei in nominal terms, and also as a percentage of GDP by 0.4 pp). On that occasion, the Fiscal Council drew attention to the unprecedented amplitude of exceeding the personnel spending ceiling for the current year. Also, the programmed level for the total CGB expenditures, excluding financial assistance from the EU and other donors, exceeded the ceiling defined by Law no. 5/2017 by 2.78 billion lei, only partially justified from the perspective of the fiscal rules up to the supplemented amounts for the interest spending (+493.9 million lei) and for the payment of Romania's contribution to the EU budget (+990 million lei). The absence of compliance with the fiscal rules intervened also at those stated by art. 12 letter a) (regarding the level expressed as a percentage of GDP for personnel spending) and letter c) (for the nominal level of the total expenditure and personnel spending) and with the rules established by art. 17 letter (2) (which prohibits increasing personnel spending during the budget revisions) and of art. 24 (which allows the increase in the context of budgetary amendments of the total GCB expenditure net of financial assistance from the EU and other donors, exclusively for paying the debt service, or for the Romania's contribution to the EU budget). To the aforementioned violations of the fiscal rules is added that of art. 12 letter e) (which prohibits the use during the budgetary year of the approved and unused budget appropriations for covering the current expenditures), provided that the total expenditures supplementation (by 2.35 billion lei) was made simultaneously with a reduction of 10.8 billion lei in the investment spending.

- The changes introduced by the second supplementary budget draft increase the size of the non-compliance with the ceiling for personnel expenditures by 626.6 million lei (respectively, the ceiling defined by Law no. 5/2017 for the GCB personnel expenditure is exceeded in nominal terms by 5.7 billion lei and as a percentage of GDP by 0.5 pp, even given the increase of the forecast for GDP with 27.3 billion lei compared to the estimate on the occasion of drafting the Law no. 5/2017), the increase by another 865 million lei compared to the first budget revision of the surpassing the ceiling for total expenditure excluding financial assistance from the EU and other donors, respectively the ceiling ruled by the Law no. 5/2017 being exceeded with 3.6 billion lei. Furthermore, the compliance with the limits stipulated by the Law no. 5/2017 for the ceiling on primary balance of GCB (the primary deficit exceeds the ceiling with 554.7 million lei) was not met, given that the downward revision of the interest expenditure (-180.6 million lei compared to the first budget revision) is accompanied by an increase of other expenses, though not entailing an equivalent reduction in the GCB headline deficit. Therefore, the draft for the second budget revision violates the provisions of art. 12, letter a), b) (except the ceiling on GCB balance as a percentage of GDP) and c), art. 17, letter (2), art. 24 and art. 26, letter (4) and (5) of the FRL. The government ordinance draft concerning the second supplementary state budget for 2017 provides the corresponding derogations from the fiscal rules mentioned above and redefines the ceilings of the Law no. 5/2017 according to the levels of the budget aggregates in the draft budget. Similar to the first budget revision, intervenes also the violation of the rule stipulated by art. 12 letter e), provided that the additional reduction in investment expenditure (by 1.7 billion lei compared to the level of the first budget revision) is accompanied by a higher increase in current expenditures, which leads to an increase of the total expenditure level by 0.6 billion lei.

The Fiscal Council noticed again the violation of almost all fiscal rules, including the one related to the GCB deficit as a nominal value, excluding the compliance with the value expressed as a percentage of GDP, ascertaining their *de facto* inefficiency. The lack of coercion of these "auxiliary" rules, confirmed by the ease and frequency with which they are ignored, undermines the integrity and coherence of the rule-based fiscal framework and prevents obtaining at least two benefits considered by the lawmaker in the context of their enactment:

- if the "auxiliary" fiscal rules were fully operational, they would have contributed to the fiscal framework's coherence in the light of the principles of transparency and stability established by law, they would have motivated the decision makers to fully include the relevant information in the initial budgetary construction and would have led to increased predictability of the budgetary parameters, discouraging *ad hoc* measures;
- if the rule on the nominal ceiling of budget expenditures would have been operational, there would have been a real-time mechanism for complying with the structural balance benchmarks or limiting deviations from them, in the context of more favorable cyclical developments than anticipated (as is the case with Romania at present).

The updated coordinates of the budgetary revenues and expenditures

The total estimated revenues of the general consolidated budget recorded a minor upward revision (by 376.8 million lei), with insignificant increases in the tax revenues (17.8 million lei), higher increases in the revenues from social contributions (+484 million lei) and non-tax ones (+189 million lei), but compensated by a decrease in revenues related to EU funds (-225 million lei). By revenue categories, as the estimated impact of the chain-linked compensation scheme for outstanding obligations is assessed not to change compared to the one asserted in the first budget revision, the changes are as follows:

- Tax revenues: +17.8 million lei, out of which:
  - Corporate income tax: -311 million lei. The additional downward revision appears in line with the Fiscal Council's more conservative estimates made

during the first budgetary revision, which seems to have been validated by the preliminary execution of October;
    - Excise duties: +143 million lei. The revised level appears to be feasible, given the available data and the reintroduction of the increased excise duty on fuel;
    - Personal income tax: +86 million lei. Most of the revenues surplus (about 68.1 million lei) corresponds to the increase in personnel expenditure made in the context of the general government budget revision. The Fiscal Council validates the proposed level as being in line with the available execution data;
    - The estimate of VAT revenues is maintained unchanged compared to the first budget revision. Given the current execution data (including the preliminary ones for October), the Fiscal Council withdraws its concerns raised during the first budget revision on the projected level of VAT receipts, given that any likely deviation from it appear to be insignificant as magnitude;
- Social security contributions: +484 million lei. Almost half of the upward revision (+200 million lei) appears as a result of the increase in the public sector's wage bill introduced by the current budget revision. The revised level appears to be feasible, given that higher than expected estimates were already likely in the context of the execution data available on the occasion of the first budget revision, and the first ten-months execution validates these estimates;
- Non-tax revenues: +189 million lei;
- Amounts received from the EU for payments made and pre-financing for the 2014-2020 financial framework: -225 million lei. The downward revision is determined by the diminishing estimates related to the amounts intended for the pre-financing of projects of the non-governmental sector in the case of temporary unavailability of European funds, according to article 10 of GEO no. 40/2015 (-724 million lei), which started to transit the general consolidated budget (symmetric impact on revenues and expenditures) during the first budget revision. The assessments related to funds for agriculture remain unchanged, while structural and cohesion funds benefiting the public sector (the only ones relevant to the general consolidated budget from the perspective of ESA 2010 methodology) are revised upward by about 500 million lei. The available execution data at the end of October indicate revenues of 11.9 billion lei for this category, given that the estimated level of revenues for the whole year is 21.36 billion lei. A massive increase in inflows in the last two months of the year as compared to the average of the previous months appears necessary to ensure convergence with the annual target.

The budgetary expenditures, compared to the first budget revision, are revised upwards by 600.4 million lei, with significant redistribution in the sense of a further increase in current expenditure while reducing investment expenditure:

- Social assistance[7]: + 1.39 billion lei, due to insufficient budgeting with respect to the execution of some social assistance rights and military pensions;
- Personnel expenditure: +626 million lei, given the insufficient budgeting for payments related to salary earned rights by court decisions for certain categories of employees in the public sector;
- Goods and services: +449 million lei. The updated projection of the end-of-year amount is 3.4% lower than last year's execution, as preliminary budget execution at the end of October shows higher spending by 4.2% compared to January-October 2016. An accelerating spending flows over the last two months of the year significantly below historical seasonal patterns appears necessary to ensure meeting in the annual target;
- Interests: -180,1 million lei;
- Contingency reserve fund: +336 million lei, provided that the proposed form of the GEO for the rectification of the state budget also contains a derogation from the provisions of art. 30 letter (2) of the Law no. 500/2002 on the public finances regulating the use of the reserve fund. Thus, amounts from this fund can now be allocated to secure social assistance rights, ensuring national and non-eligible expenditures for projects funded by non-reimbursable funds, providing subsidies to support agricultural producers, and ensuring the amounts of interest payments, commissions and other government debt costs, expenses which cannot be classified as urgent or unforeseen. The Fiscal Council has on many occasions called for increased transparency and amending legislation to establish an explicit use of the contingency reserve fund, specifying the conditions and allocation criteria, while the introduction of the abovementioned derogation is a step towards the opposite direction;
- Investment expenditures: - 1.77 billion lei. At the level of the components of the general consolidated budget, the capital expenditures are revised downwards by 1.37 billion lei, the projects funded by external post-accession grants decrease by 380 million lei and the ones from reimbursable funds by 19 million lei. However, given that the capital expenditure aggregate also includes co-financing for EU-funded projects and the latter's inputs are revised upwards by 500 million lei, the investment expenditure reduction appears to be at the level of projects with financing from domestic sources (-2.44 billion lei), while expenditures related to EU funded projects are increasing by about 691 million lei. The current budgeted level of investment expenditure is lower by about 8.3% compared to the previous year, while the initial budget projected a 33% increase in these expenditures.

[7] See Annex 1.

Conclusions

The revision of the aggregate revenues and expenditures of the consolidated general budget is small, with changes of 377 and 601 million lei, respectively. The estimated revenue level does not raise feasibility issues, taking into account the available information, the Fiscal Council withdrawing its concerns made during the first budget amendment. Possible results under the budgetary targets can only occur at the level of European funds, but given that most of the sums involved (about 75%) only transit the budget, both on incomes and expenditures, their impact on the planned budget deficit is null. Regarding the Structural and Cohesion Funds, their estimated level appears to be sufficiently reduced following the large diminishing on the first budget revision so that the achievement of the annual target appears to be achievable. At the level of the budget expenditures, consistent revisions are made in structure, continuing the phenomenon of increasing the current expenditure allocations to the detriment of investments, the current budgetary revision creating the premises of a gross fixed capital formation in the public sector (according to ESA 2010 and as a percentage of GDP) below 3%, a minimum level of the last 12 years, given that a similar level was reached before EU accession and in the context of a lack of structural fund inflows. From the perspective of fiscal consolidation in the coming years, it is hard to imagine that reducing public investment (nominal or as a share of GDP) may be a source of mitigating budgetary pressures without jeopardizing the medium to long-term growth prospects.

The opinions and the recommendations above mentionated by the Fiscal Council were approved by the Chairman of the Fiscal Council, according to Art. 56, para (2) letter d) of the Law no. 69/2010 republished, after being approved by the Council members through vote, on 15th November 2017.

15th November 2017 Chairman of the Fiscal Council,

IONUŢ DUMITRU

ANNEX I - The main sources for increasing the personnel expenditure and social assistance on the occasion of the second budget revision in 2017		
	Budgetary impact	**Expenditure item**
Payment of the rights for persons with disabilities, state child allowances, child-raising allowances and health insurance contributions related to allowances; (the budget of the Ministry of Labor and Social Justice)	630.9	Social assistance
Ensure the payment of state military pensions to military staff in reserve and to police officers who have ceased service in 2017, as well as the payment of the differences resulting from the recalculation of pension rights (the budget of the Ministry of Internal Affairs)	363.5	Social assistance
Funding the child protection system (local budgets)	61.0	Social assistance
Providing funds for the payment of 2017 installments related to court decisions on salary rights for public employees in the justice system, the amounts of enforceable titles established through the clarification of the meaning of the previous provisions and for salary differences (Ministry of Justice's budget)	232.1	Personnel expenditure
Providing funds for the payment of court decisions on salary rights for public employees in the university education institutions (Ministry of National Education's budget)	30.0	Personnel expenditure
Paying the amounts stipulated by court decisions regarding the granting of salary rights for public employees in the pre-university education institutions (local budget)	550.0	Personnel expenditure

Source: Ministry of Public Finance

ANNEX 2	Initial budget 2017	*Swap* program 2017	Initial budget 2017	First budget revision (R1) 2017	*Swap* R1	R1 without *swap*	Second budget revision (R2) 2017	*Swap* R2	R2 without *swap*	R1 - Initial budget	R2 - Initial budget	R2-R1
										without *swap*		
	1	2	3=1-2	4	5	6=4-5	7	8	9=7-8	10=6-3	11=9-3	12=9-6
TOTAL REVENUE	**254,720.97**	**1,592.70**	**253,128.27**	**256,427.93**	**1,424.99**	**255,002.93**	**256,804.69**	**1,424.99**	**255,379.69**	**1,874.66**	**2,251.42**	**376.76**
Current revenue	231,622.57	1,592.70	230,029.87	233,720.61	1,425.01	232,295.60	234,411.37	1,425.01	232,986.36	2,265.72	2,956.48	690.76
Tax revenue	142,836.07	1,592.70	141,243.37	139,974.95	708.90	139,266.05	139,992.73	708.90	139,283.83	-1,977.32	-1,959.54	17.78
Taxes on profit, wages, income and capital gains	48,837.36		48,837.36	46,917.25	327.20	46,590.05	46,717.44	327.20	46,390.24	-2,247.32	-2,447.12	-199.81
Corporate income tax	16,629.88		16,629.88	14,836.55	131.10	14,705.45	14,525.60	131.10	14,394.50	-1,924.43	-2,235.38	-310.95
Personal income tax	30,108.17		30,108.17	30,130.48	196.10	29,934.38	30,216.63	196.10	30,020.53	-173.78	-87.64	86.15
Other taxes on income, profit and capital gains	2,099.31		2,099.31	1,950.21		1,950.21	1,975.21		1,975.21	-149.10	-124.11	25.00
Property tax	5,161.06		5,161.06	5,395.36		5,395.36	5,430.36		5,430.36	234.30	269.30	35.00
Taxes on goods and services	87,068.84	1,592.70	85,476.14	85,706.64	296.50	85,410.14	85,865.92	296.50	85,569.42	-66.00	93.28	159.28
VAT	54,142.32	1,592.70	52,549.62	52,846.01	296.50	52,549.51	52,845.96	296.50	52,549.46	-0.11	-0.17	-0.06
Excises	26,051.35		26,051.35	26,502.15		26,502.15	26,645.45		26,645.45	450.80	594.10	143.30
Other taxes on goods and services	3,385.57		3,385.57	3,398.39		3,398.39	3,399.43		3,399.43	12.82	13.85	1.03
Taxes on using goods, authorizing the use of goods or on carrying activities	3,489.60		3,489.60	2,960.09		2,960.09	2,975.09		2,975.09	-529.51	-514.51	15.00
Tax on foreign trade and international transactions (customs duty)	951.25		951.25	945.58		945.58	945.58		945.58	-5.67	-5.67	0.00
Other tax revenue	817.56		817.56	1,010.11	85.20	924.91	1,033.42	85.20	948.22	107.36	130.67	23.31
Social security contributions	69,758.35		69,758.35	71,372.15	716.11	70,656.04	71,855.77	716.11	71,139.66	897.69	1,381.30	483.61
Nontax revenue	19,028.15		19,028.15	22,373.51		22,373.51	22,562.87		22,562.87	3,345.36	3,534.72	189.36
Capital revenues	816.98		816.98	849.08		849.08	799.74		799.74	32.10	-17.24	-49.34
Grants	19.74		19.74	18.39		18.39	18.39		18.39	-1.35	-1.35	0.00
Amounts received from the EU in the account of payments made and prefinancing	184.34		184.34	251.85		251.85	212.34		212.34	67.51	28.00	-39.51
Financial operations	0.00		0.00	0.00		0.00	0.00		0.00	0.00	0.00	0.00

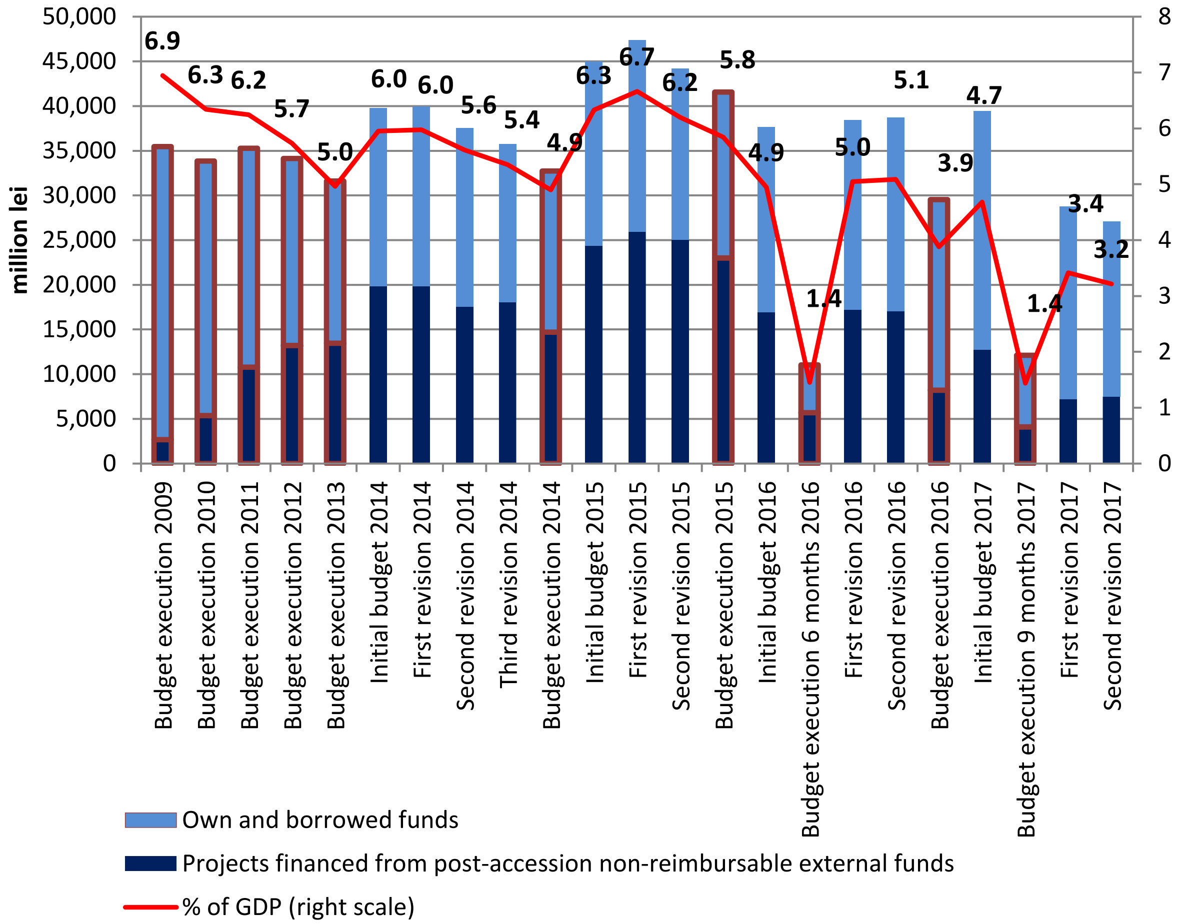
Amounts collected in the single account	0.00		0.00	0.00		0.00	0.00		0.00	0.00	0.00	0.00
Other amounts received from the EU for operational Programmes funded under the convergence objective	0.00		0.00	0.00		0.00	0.00		0.00	0.00	0.00	0.00
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	22,077.35		22,077.35	21,588.00		21,588.00	21,362.85		21,362.85	-489.34	-714.50	-225.15
TOTAL EXPENDITURE	**278,820.94**	**1,592.70**	**277,228.24**	**281,172.25**	**1,424.99**	**279,747.25**	**281,772.69**	**1,424.99**	**280,347.69**	**2,519.01**	**3,119.45**	**600.44**
Current expenditure	253,592.80	1,422.70	252,170.10	261,596.49	1,254.99	260,341.49	263,571.55	1,254.99	262,316.56	8,171.40	10,146.46	1,975.07
Personnel	63,879.29		63,879.29	68,990.47		68,990.47	69,617.03		69,617.03	5,111.18	5,737.74	626.56
Goods and services	40,675.02	522.70	40,152.32	39,100.50		39,100.50	39,549.00		39,549.00	-1,051.82	-603.32	448.50
Interest	10,185.01		10,185.01	10,678.95		10,678.95	10,498.30		10,498.30	493.93	313.29	-180.65
Subsidies	7,161.47		7,161.47	6,835.17		6,835.17	6,862.45		6,862.45	-326.30	-299.02	27.28
Total Transfers	131,061.39	900.00	130,161.39	135,567.63	1,254.99	134,312.64	136,303.70	1,254.99	135,048.70	4,151.25	4,887.31	736.06
Transfers for public entities	1,945.61	900.00	1,045.61	2,471.06	733.29	1,737.77	2,162.01	733.29	1,428.72	692.16	383.11	-309.05
Other transfers	11,302.76		11,302.76	12,030.84	521.70	11,509.14	12,154.22	521.70	11,632.52	206.38	329.76	123.38
Projects funded by external post-accession grants	974.53		974.53	774.28		774.28	544.53		544.53	-200.25	-430.00	-229.75
Social assistance	88,458.54		88,458.54	91,787.46		91,787.46	93,177.78		93,177.78	3,328.91	4,719.23	1,390.32
Projects funded by external post- accession grants 2014-2020	24,126.67		24,126.67	23,477.69		23,477.69	23,268.20		23,268.20	-648.98	-858.47	-209.49
Other expenditure	4,253.28		4,253.28	5,026.31		5,026.31	4,996.96		4,996.96	773.03	743.69	-29.35
Reserve funds	150.97		150.97	63.81		63.81	400.22		400.22	-87.16	249.25	336.41
Expenditure funded from reimbursable funds	479.65		479.65	359.96		359.96	340.86		340.86	-119.69	-138.79	-19.10
Capital expenditure	25,228.14	170.00	25,058.14	19,575.76	170.00	19,405.76	18,201.13	170.00	18,031.13	-5,652.38	-7,027.01	-1,374.63
Financial operations	0.00		0.00	0.00		0.00	0.00		0.00	0.00	0.00	0.00
Payments made in previous years and recovered in the current year	0.00		0.00	0.00		0.00	0.00		0.00	0.00	0.00	0.00
EXCEDENT(+) / DEFICIT(-)	**-24,099.97**		**-24,099.97**	**-24,744.32**		**-24,744.32**	**-24,968.00**		**-24,968.00**	**-644.35**	**-868.03**	**-223.68**

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

ANNEX 3 EU Funds	Initial budget 2017			First budget revision			Second budget revision		
	Structural	Agriculture	Amounts GEO no. 40/2015	Structural	Agriculture	Amounts GEO no. 40/2015	Structural	Agriculture	Sume OUG nr. 40/2015
EU funds inflows	9,642.75	12,434.60	0.00	5,199.90	13,923.20	2,464.00	5,699.85	13,923.20	1,739.85
EU funds expenditure	17,022.47	12,434.60	0.00	8,607.70	13,923.20	2,464.00	9,298.41	13,923.20	1,739.85
National co-financing and ineligible expenses	7,379.72	0.00	0.00	3,407.80	0.00	0.00	3,598.56	0.00	

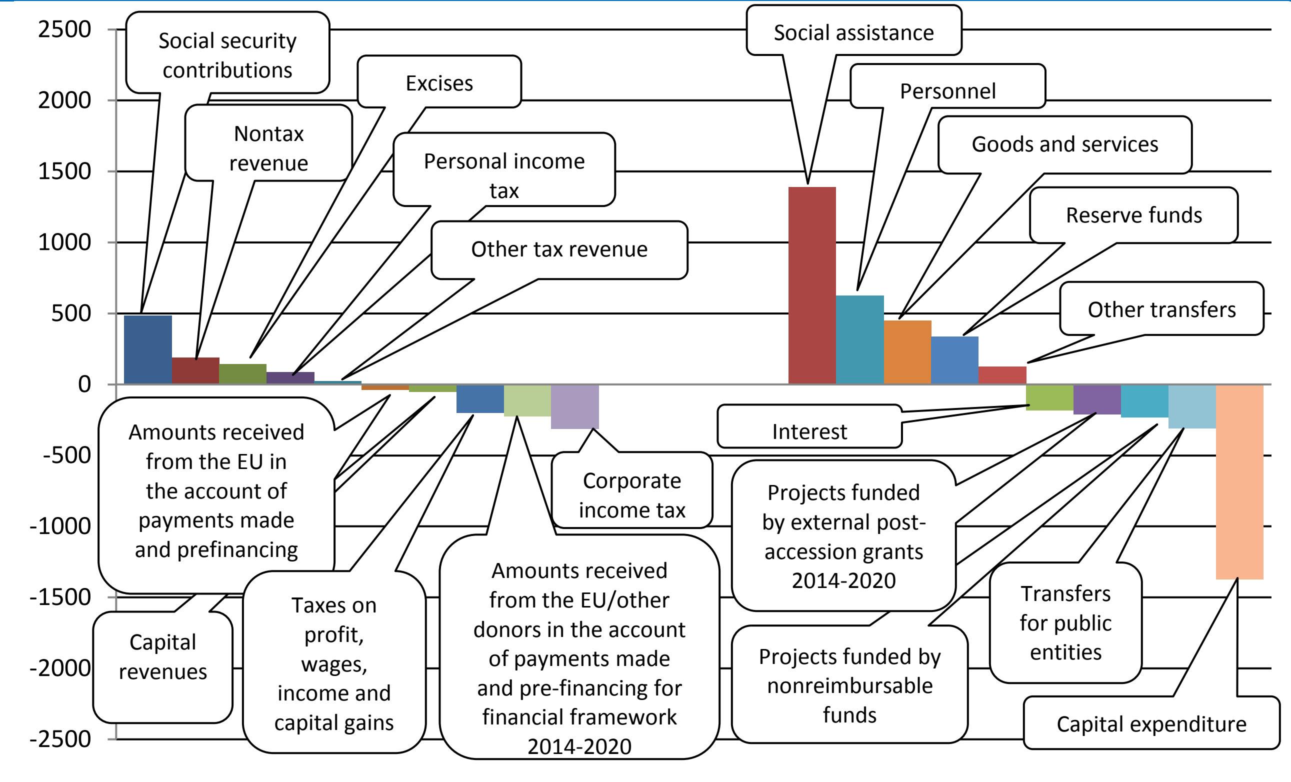
Source: Ministry of Public Finance, Fiscal Council's calculation

Figure 1: Evolution of the investment expenditure in the period 2009-2017 - planned vs. execution, million lei



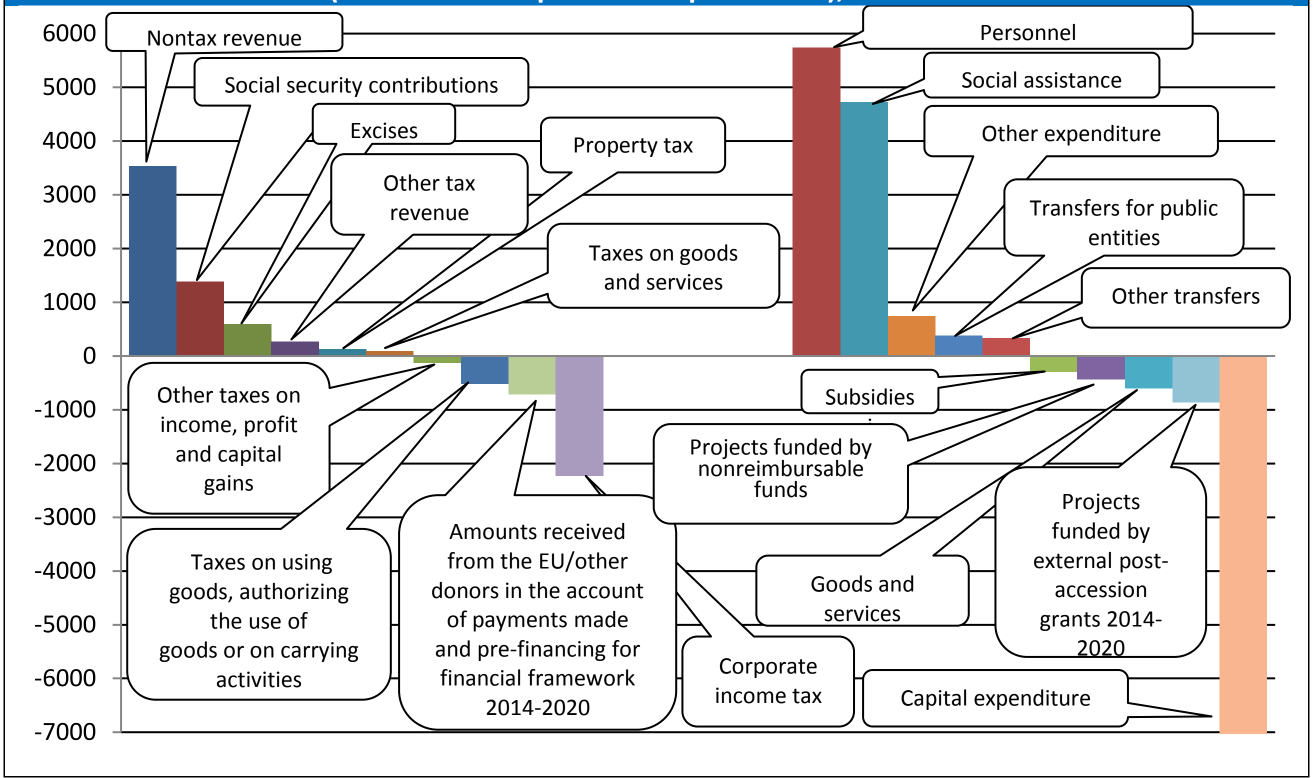
Source: Ministry of Public Finance, Fiscal Council's calculations

Figure 2: The main changes in expenditures and revenues compared to first budget revision (without the impact of swap schemes), million lei



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

Figure 3: The main changes in revenues and expenditures compared to initial budget (without the impact of swap schemes), million lei



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

VI. Fiscal Council's preliminary opinion on the State Budget Law and Social Insurance Budget Law for 2018

On November 29th, 2017, the Fiscal Council received from the Ministry of Public Finances (MPF) the letter no. 446157 dated November 28, 2017, requesting under art. 53, paragraph (2) of the Fiscal Responsibility Law no. 69/2010 republished (FRL), the opinion on the Report on the macroeconomic situation for 2018 and the projection for the period 2019-2021, the draft of the Budget Law for 2018, the draft of the Social Insurance Budget Law for 2018, the Fiscal Strategy for 2018-2020 and the corresponding explanatory note and the draft of the ceilings law of certain indicators specified in the fiscal framework for the year 2018. The Fiscal Council notes that it has received the set of documents necessary for the elaboration of its opinion in the second half of Wednesday, November 29th.

Under article 53, paragraph (4) of the FRL, the Government and Parliament are required to consider the opinions and recommendation of the Fiscal Council when **elaborating and approving the Fiscal Strategy and the annual budgets, as well as in the preparation of other measures triggered by the implementation of this law.** Given the Government's intention to approve the above documents at the meeting from 6.12.2017, while November 30th and December 1st are public holidays, the Fiscal Council does not dispose of sufficient time for analysis and writing a complete opinion. However, in order to avoid the delaying of budget adoption in the Government meeting and submission to Parliament, the Fiscal Council decided to write a preliminary opinion, making some general considerations and identifying some major visible aspects at a first evaluation, which will be followed by a complete opinion in the week December 11-15th, 2017. After its completion, the Fiscal Council will notify the Parliament and publish the opinion on the website of the institution (www.fiscalcouncil.ro).

Therefore, the Fiscal Council considers as appropriate the following preliminary general considerations:

Procyclical fiscal policy, larger deviation from the medium-term objective, in

The budget construction targets a deficit slightly below the 3% of GDP reference value of the Stability and Growth Pact (SGP) corrective arm. Irrespective of the expected excess demand (it should be noted that there are still significant differences between the National Commission for Economic Forecasting

contradiction with FRL's fiscal rules

- NCEF assessments and the most recent evaluations available from the European Commission - EC on the potential and effective growth rate of GDP, the NCEF being substantially more optimistic[8]), the budget construction states a massive slippage which continues to widen in 2018 compared to the requirements of the SGP's preventive arm, also embedded in national legislation through the FRL. Convergence towards the medium-term objective (defined as a structural deficit of 1% of GDP) is expected to start only in 2019, but the assumed budget deficit targets imply a structural effort below the minimum target of 0.5 pp of GDP stated by european regulations in 2019 and just equal to it in 2020.

A rather optimistic macroeconomic scenario with parameters that appear to be at the top of the posibility range. Risks inclined to less favorable developments compared to the ones taken into account.

The medium-term macroeconomic scenario underpinning the budget construction is in line with previous NCEF assessments, but remains significantly more optimistic than other institutions' forecasts, although developments in the current year made the projected increases for the coming years plausible. In the opinion of the Fiscal Council, this scenario is rather inappropriate from the point of view of a prudent budgetary construction, with the balance of risks is tilted towards less favorable macroeconomic developments than those taken into account. The Fiscal Council identifies unusually high risks related mainly to the future behavior of the private sector in response to the recent amendments to the Fiscal Code (in particular the transfer of social contributions from the employer's burden to that of the employee)[9], a scenario where the growth of the gross salary to be lower than the one envisaged in the projected budget revenues having a high probability, with implications for the

[8] The European Commission assesses the growth rate of potential GDP to 3.7% in 2017, then rising to 4% in 2018 and 2019, while the NCEF assesses it at 4.6% in 2017, 5.2% in 2018 and 5.3% in 2019. The differences are also significant in the case of the projected real GDP growth rate, with the European Commission assessing it at 4.4% and 4.1% in 2018 and 2019 respectively, while NCEF anticipates increases of 5.5% and 5.7%. The differences offset each other in the excess demand assessment, with differences between EC and NCEF figures being only 0.4 percentage points of potential GDP in 2017 and 2018 and 0.2 percentage points of potential GDP in 2019.

[9] See the November 3th opinion of the Fiscal Council on the draft amendment to the Fiscal Code.

evolution of private consumption and economic growth in general. To those are added the risks of introducing room for fiscal arbitrage by capping the social contributions calculation base to the minimum wage for self-employed income and a more favorable tax regime for micro-enterprises (with reference to the applicability of the taxation of the turnover for firms that earn income from consultancy and management activities), which could encourage the sub-declaration of wage income (especially for high wages).

VAT revenues projected for 2018 appear to be significantly overvalued, even under the macroeconomic scenario of the NCEF, with implications for ensuring the financing of local authorities.

The Fiscal Council has concerns about the projected evolution of VAT revenues in the draft budget, with a preliminary analysis indicating a potential overvaluation of these even in the context of using the NCEF's macroeconomic scenario. Thus, VAT revenues are projected to increase (after adjusting the corresponding 2017 and 2018 figures with the temporary compensation schemes chain of budget arrears) by 16.3% (or 8.6 billion lei) compared to the estimated level for 2017 in the second budget revision. The advanced dynamics surpasses substantially that of the private consumption (net of self-consumption) forecast by the NCEF, the text of the Macroeconomic Situation Report indicating on page 81 as an explanation for this evolution the impact of the introduction of the VAT split mechanism and measures to improve the VAT collection taken by NAFA, estimated at 4.9 billion lei. The Fiscal Council is skeptical of the validity of such an assessment: beyond the objection of principle to the lack of caution of including *ex ante* in the revenue projection the impact of measures aimed to improve collection, which is difficult or impossible to assess, the additional revenue estimated in the text of the report appears to be inconsistent with the MPF's previous assessments regarding the introduction of the mandatory and generalized VAT split-payment mechanism, which indicated additional revenues of only 2 billion lei in 2018[10]; given that, subsequently, the scope of the VAT split-payment was considerably narrowed (to a level that makes possible the

[10] The explanatory note accompanying GO no. 23/2017 http://gov.ro/fisiere/subpagini_fisiere/NF_OG_23-2017.pdf.

scenario of avoiding entering into business relations with those enrolled in this payment mechanism by the other economic agents). Considering the above, the Fiscal Council considers that VAT revenues for 2018 are most likely overvalued by about 3-4 billion lei, beyond the possible impact of a less favorable cyclical developments than those taken into account in the budget construction.

Furthermore, as additional VAT revenue is the main source of compensation for local government revenue loss as a result of the personal income tax reduction from 16% to 10% while maintaining the split rate transferred, their (probable) non-realization is likely to create them budgetary difficulties.

The positioning of the deficit below the 3% ceiling depends significantly on exceptional revenues

The budget construction includes exceptional revenues from the sale of heavy water out of the state reserve (+1 billion lei for capital revenues) and from renting the 5G frequency bands (+1.3 billion lei for revenues from taxes on using goods, authorizing the use of goods or on carrying activities). In the first case, there is a significant risk of failure to achieve the forecasted level - worldwide heavy water exports amounted to only 62.4 million USD in 2016[11], and domestically Nuclearelectrica S.A.'s total expenditure on goods and services was, according to the company's income and expenditure budget for 2017, 617.5 million lei[12]. In the second case, the concerned revenues will not be reflected in an equivalent manner in the budget execution according to ESA 2010 methodology, where they would be distributed linearly over the duration of the concession, thus contributing to a negative difference between the budget balance according to ESA 2010 and cash methodology and, therefore, *ceteris paribus*, to an ESA 2010 deficit higher than the one according to the national methodology.

Social assistance expenditure appears

Similar to the situation that the Fiscal Council identified on the occasion of approving the 2017 budget law, the social assistance

[11]According to the Observatory of Economic Complexity, https://atlas.media.mit.edu/en/profile/hs92/284510/.

[12] http://www.nuclearelectrica.ro/wp-content/uploads/2017/02/A1.pdf.

to be significantly underestimated

expenditure for 2018 appears to be significantly underestimated in relation to the already apparent trends in the preliminary execution for 2017[13] (relevant given that it represents a permanent expenditure) and the pension point dynamics. Thus, the extrapolation in 2018 of the implicit flow of social assistance expenditure related to the state budget in the fourth quarter of 2017 (determined as the difference between the amount budgeted in the second budget revision and the nine-month execution) would indicate a level of at least 30.9 billion lei which, given that the budget allocation according to the draft budget is 28.4 billion lei, indicates a need of about 2.5 billion lei higher than the budgeted level. Adding to this figure the impact of raising the minimum social allowance from 520 lei to 640 lei (which would generate additional expenses of 600 million lei expenses for the 6 months of application in 2018[14]) and inflation indexation of the special pensions, the social assistance expenditure underestimation for the state budget is, probably, at least 3.1 billion lei. The social assistance expenditure of the social security budget is projected to increase by 8.7% compared to the level recorded in 2017 – given that the weighted value of the pension point is by 9.5% higher in 2018 compared to the previous year, they appear underestimated in relation to the needs of at least 500 million lei. Finally, the Fiscal Council considers as inexplicable the decrease in the social assistance expenditure by 370 million lei compared to the level budgeted for 2017 at the local authorities level. Together, the elements described above seem to indicate an underestimation of social assistance expenditure by about 4 billion lei.

The Fiscal Council's preliminary assessment indicates, therefore, a significant overvaluation of VAT revenues, beyond the risks of the optimistic macroeconomic scenario taken into account in the budgetary construction, by about 3-4 billion lei, which adds to the underestimation of the

[13] We remind that the Fiscal Council's concerns regarding the insufficient amount of social assistance expenditure budgeted at the level of 2017 were validated on the occasion of budget revisions (higher than the originally assessed difference), the first budget revision increasing the social assistance expenditure by 3.3 billion lei and the second one with another 1.4 billion lei.

[14] http://gov.ro/fisiere/subpagini_fisiere/NF_OUG_82-2017.pdf.

needs for social assistance expenditure of about 4 billion lei. These elements are supplemented by the risks associated with the macroeconomic scenario used in the budgetary construction, whose balance is assessed by the Fiscal Council as inclined towards less favorable developments than those envisaged, as well as the risks of non-realization of the exceptional capital revenues taken into account. All this indicates as highly probable the event of a deficit significantly beyond the assumed target and thus the 3% of GDP reference value corresponding to the corrective arm of the Stability and Growth Pact and, as a consequence, the need for additional discretionary revenue measures and / or expenditure cuts to maintain the budget deficit at the level of the assumed target, already inappropriate from the perspective of national and European fiscal rules. The experience of the 2017 budget exercise is eloquent in this respect: given that the budget execution revealed a strong underestimation of (permanent expenditure) personnel expenditure and social assistance expenditure (the risks in this sense being signaled by the Fiscal Council in the opinion on initial budget construction), and the execution of budget revenues was below expectations (despite more favorable macroeconomic developments than the initial expectations), the compliance with the deficit target implied a massive reduction in investment expenditure in the context of budget revisions, the reintroduction of the additional excise duty on fuels and the (unrepeatable) drawing of super-dividends from state-owned companies.

The opinions and the recommendations above mentioned by the Fiscal Council were approved by the Chairman of the Fiscal Council, according to Art. 56, para (2) letter d) of the Law no. 69/2010 republished, after being approved by the Council members through vote, on 6th of December 2017.

6th of December 2017 Chairman of the Fiscal Council,

IONUŢ DUMITRU

VII. Addendum to Fiscal Council's preliminary opinion on the State Budget Law, Social Insurance Budget Law for 2018 and Fiscal Strategy for 2018-2020

On November 29th, 2017, the Fiscal Council received from the Ministry of Public Finances (MPF) the letter no. 446157 dated to November 28th, 2017, requesting under art. 53, paragraph (2) of the Fiscal Responsibility Law no. 69/2010 republished (FRL), the opinion on the Report on the macroeconomic situation for 2018 and the projection for the period 2019-2021, the draft of the Budget Law for 2018, the draft of the Social Insurance Budget Law for 2018, the Fiscal Strategy for 2018-2020 and the corresponding explanatory note and the draft of the ceilings law of certain indicators specified in the fiscal framework for the year 2018. The Fiscal Council states that it has received the set of documents necessary for the elaboration of it's opinion Wednesday afternoon, November 29th.

Given that the government meeting for approving the aforementioned documents was scheduled for Wednesday, December 6, 2017, and the insufficient time available for a complete opinion, the Fiscal Council drew up a preliminary opinion. This text completes and revises the above-mentioned preliminary opinion.

Assessing compliance with fiscal rules

The budget construction for 2018 targets a deficit (according to the national / cash methodology) of 2.97% of GDP, the same as that envisaged for the current year. The draft budget accommodates massive pressures to increase current spending (mainly in personnel and social assistance expenditure) and a slight reversal of public investment spending on projects with European non-reimbursable funding, with downside pressures on the level of budget revenues, in the context of moving the social contributions from the employer to the employee (with a 2 percentage point reduction in their aggregate level), the reduction of the income tax rate (from 16% to 10%), the disappearance of exceptional income from the distribution of dividends from the reserves accumulated by state-owned companies and the return of the amounts collected from the vehicle first registration fee. The widening of the budget deficit (as a percentage of GDP) is expected to be avoided as a result of the reduction of the share transferred to the second pillar of the pension system (from 5.1% to 3.75%), the reintroduction of the additional excise duty on fuels, new sources of exceptional revenues (heavy water sales and frequency concession for mobile operators) and substantial additional VAT revenue due to an expected improvement in collection. Adding to these elements are measures to control expenditure on goods and services and a small expansion, relative to the projected level of 2017, of capital expenditure for projects with exclusively national funding which, in the context of a rapid increase in real and nominal GDP, are likely to represent sources of diminishing the budget deficit expressed as a share of GDP.

The National Commission for Economic Forecasting (NCEF) projection shows faster real GDP growth compared to potential GDP, which implies that the excess demand, which emerged in 2017 (according to the assessments of the NCEF and the European Commission), is widening . A surplus of excess demand while maintaining the level of the actual deficit as a percentage of GDP leads to a positive fiscal impulse and a deepening of the structural imbalance of public finances, with fiscal policy projected to continue a pro-cyclical conduct in 2018. As a consequence, the already existing (from 2016) deviation from the medium-term objective (defined as a structural deficit of 1% of GDP) continues to increase in 2018, with the mid-term fiscal-budgetary projection taking into account a narrowing of it starting 2019, but the elimination of this deviation is not ensured by the levels of budget deficit envisaged at the end of the forecast horizon.

The situation described above is in flagrant contradiction with the fiscal rules set up by the FRL, as evidenced by the extensive list of derogations included in the draft law of State Budget and and the draft of the ceilings law of certain indicators specified in the fiscal framework for the year 2018. The list of derogations from the FRL provisions includes:

- Articles 6 and 7, which formalize in the national legislation the provisions of the Treaty on the Functioning of the European Union in terms of the reference values for the budget deficit and public debt;
- Article 14 para. 1, according to which in case of identifying a deviation from the medium-term budgetary objective or the timetable for adjustment to it, the Government approves or submits to Parliament for approval a set of measures meant to correct this deviation;
- Article 26 para. 3, according to which the companion law on the approval of the limits specified in the fiscal-budgetary framework comprises the medium-term budgetary objective and the adjustment path towards it.

Moreover, the recently approved GEO no. 90/2017 (on some fiscal measures, amending and completing some normative acts and extending some deadlines) introduces additional derogations from:

- Article 29, paragraph 4, in the sense of abandoning the requirement that the statement of responsibility is signed by the Prime Minister and the Minister of Public Finances in order to certify Fiscal Strategy's compliance with the FRL, the targets or limits established by the fiscal rules and with the principles of fiscal responsibility;

- Article 30 paragraph 4, which requires the Government to submit to the Parliament an annual budget that complies with the principles of fiscal responsibility, fiscal rules, the Fiscal Strategy and any other provisions of the FRL;
- Article 30 paragraph 5, which establishes that in the absence of the compliance conditions referred to in the previous paragraph, the statement should mention the deviations, as well as the measures and deadlines until which the Government will ensure compliance with the principles of fiscal responsibility, fiscal rules and the Fiscal Strategy.

The above elements emphasize FRL's full inoperability, the concern over the objective of a balanced budget position as defined by the FRL and the European Treaties being replaced by avoiding exceeding the 3% of GDP reference value for the actual budget deficit. The Fiscal Council has already addressed this issue in its opinions in the context of the annual budget laws for 2016 and 2017, its considerations issued then remaining relevant. In short, such a behavior leads to the vulnerability of public finances position, the failure to create or maintain fiscal space in "good times" (as a result of a pro-cyclical fiscal policy) depriving it of the possibility to act in a stabilizing sense in an inevitable downward phase of the business cycle. Moreover, the concerns regarding the fiscal policy stance in Romania and the deliberate disregard of relevant European Treaties are shared by the European Commission, Romania already being subject to a Significant Deviation Procedure initiated in June 2017: the initial recommendation for a structural adjustment of 0.5% of GDP in 2017 was not met, thus a recommendation of a structural adjustment of 0.8% of GDP in 2018 was made on 5th December. The draft budget, which targets an identical deficit (as a percentage of GDP) as in the previous year, in the context of a widening excess demand (even according to the NCEF's extremely favorable estimates for potential GDP growth), ignores these recommendations - a budget that would comply with the latest recommendation should target an actual deficit of around 2% of GDP in 2018.

The general consolidated budget in 2018 - problems and risks

Beyond deficit target's lack of compliance with the FRL and the relevant European Treaties, the Fiscal Council already identified in the context of the preliminary opinion problematic aspects in the budgetary construction likely to cause a major deviation from the deficit limit envisaged in the absence of compensatory measures. First, the Fiscal Council assessed the macroeconomic scenario underlying the draft budget as being rather inappropriate from the perspective of a prudent budgetary construction, considering that the risk balance is inclined towards recording less favorable macroeconomic developments than those taken into account, mainly in the context of particularly high uncertainties related to private sector behavior in response to recent changes in the Fiscal Code (i.e. the transfer of social contributions from employer to employee). These risks are added to those of introducing some fiscal arbitrage possibilities by capping the calculation base for revenues from independent activities and the more favorable regime for micro-enterprises. Second, a potential overvaluation of VAT revenues of at least 3 billion lei was identified, even when the official macroeconomic scenario was used, their projected level including additional revenue from measures to increase collection efficiency of 4.9 billion lei, inherently uncertain and impossible to assess *ex ante*. Third, the Fiscal Council identified a high probability of not realizing exceptional capital revenues from heavy water sale (1 billion lei in the budget projection) given the size of world exports and Nuclearelectrica's acquisitions. Finally, an insufficient budgeting for social assistance expenditure was identified.

Compared to the preliminary opinion, following the availability of preliminary execution at the end of November, the Fiscal Council reduces the size of its assessment regarding the potential insufficient budgeting for social assistance expenditure to about 1.5 billion lei: thus, the assessment of the insufficient size of social assistance expenditure related to the social security budget by about 500 million lei is maintained, but the Fiscal Council estimates that the allocation of social assistance expenditure at the state budget level appears to be insufficiently budgeted by about 1 billion lei and discards its objections regarding the amount of allocations related to the local budgets.

Fiscal Strategy *(FS) 2018-2020 - budget construction beyond the 2018 horizon*

Similar to the fiscal-budgetary strategies of previous years, in the current iteration of the FS (2018-2020), the authorities' attention is exclusively concentrated on the first year covered by FS, while not giving the same attention to medium-term budgetary projections, being manifested the temptation to generate with an extremely high easiness fiscal consolidation in the medium term, in the absence of rigorous substantiation of revenues and expenditures, and concrete details of the assumptions underlying the trajectories of the revenue and expenditure aggregates[15]. Beyond the 2018 horizon, the year for which the structural deficit is projected to widen, 2019 and 2020 should bring a structural fiscal adjustment of 0.46 pp and 0.49 pp (the ESA 2010 headline deficit decreases by 0.58 pp and 0.56 pp of GDP in 2019 and 2020 respectively,

[15] An example in these regard is VAT revenue for 2019, which increases by only 2.5% compared to the level projected for 2018. Given the magnitude of the dynamics of nominal private consumption projected for 2019, such a trajectory is consistent either with a possible further reduction in the VAT rate (not referred to anywhere in the FS text), provided that the revenue surplus of the 2018 corresponding to an improving in payment compliance would be considered as permanent, or with a no change policy scenario in which the 2018 NAFA residual is viewed as a temporary phenomenon.

while reductions in cash headline deficit are 0.39 percentage points and 0.69 percentage points of GDP, respectively) at the end of the period covered by the strategy persisting a deviation of 1.2 percentage points of GDP from the medium-term objective.

The Fiscal Council expresses his reservations about the medium-term dimension of some expenditure aggregates, which appear as to be unlikely low compared to the macroeconomic scenario assumptions underpinning the medium-term budgetary projection and other expected budgetary parameters. Thus, one of the major sources of fiscal consolidation in 2019 is the increase of only 3.7% of the personnel spending compared to 2018, while the macroeconomic scenario of NCEF shows wage dynamics in the public sector (in a narrow sense, excluding army forces and assimilated personnel) of 11.5% (a realistic number due to the gradual implementation of the Unified Wage Law and the impact propagated in 2019 of the wage increases to be made starting 1st March 2018). If we assume that the wage bill dynamics would be 11.5%, in line with the projected average salary for the public sector (in a narrow sense) and ignoring the projected increase for the number of employees in the public sector (1%), the amount of personnel spending would be about 6 billion lei (0.6% of GDP) higher than the one advanced in the expenditure projection of 2019, which, *ceteris paribus*, would not only lead to the absence of any structural fiscal consolidation, but even a widening of the headline deficit. It should be noted that the average salary in the economy, used in the projection of revenues from social contributions and personal income tax, depends on the dimension taken into account for the wage dynamics in the budgetary sector.

Another element that raise problems in the medium-term projection is that of the SSC social assistance expenditure, for which the projected increases do not appear consistent with the announced developments in the pension point in the years 2019 and 2020. Although in the text of the medium-term strategy there is no reference of the pension point value in the years 2019 and 2020, the projected dynamics appear below those that would prevail if the pension point should evolve according to the trajectory in the government program that provides values of 1,265 lei from April 1st, 2019, and 1,400 lei from April 1st, 2020. This trajectory would imply an average growth of 16.5% and 11.6% in 2019, respectively in 2020, while the projected growth of SSC social assistance spending is only 14.1% and 7.8% respectively. According to the above-mentioned trajectory of the pension point, the expenditure would be higher by 1.5 billion lei (0.16% of GDP) in 2019 and by 4.4 billion lei (0.4% of GDP) in 2020.

To these elements is added in 2019 the probable over-estimation, in relation to the dynamics forecasted by NCEF for the average gross wage and the number of employees (8.3% and 3.8%), of the expected revenues from social insurance contributions, projected with about 2 billion lei (or 0.2% of GDP) higher.

Given the above, the extreme favorable trajectory of the economic growth projected on medium term and the potential under estimation of social assistance expenditures in the year 2018, the Fiscal Council considers that, in the case of no change fiscal policy scenario, the balance of risks is tilted overwhelmingly toward budgetary deficits higher-than-expected in the Fiscal Strategy 2018-2020.

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 21th of December, 2017.

21st of December 2017

Chairman of the Fiscal Council,
IONUŢ DUMITRU

Annexes

Annex no. 1: Fiscal policy measures and their impact according to MPF

Fiscal policy measures - budgetary revenues	Budgetary Impact (million lei)	Revenue category
Total	**15,248**	
Increase of the excise duties for energy products in two stages: 15 September and 1 October 2017	2,707	Excises
Increase of the dividends distributed by national companies from 50% to 90%	1,082	Non-tax revenue
Increase of taxation base in the case of payments made by legal entities for unemployed persons with disabilities starting 1 September 2017.	700	Social contributions
Selling heavy water from the state's reserve	1,000	Capital revenue
Reducing transfers to the second pillar of pensions to 3.75% starting 1 January 2018 (as opposed to maintaining the 2017 quota)	2,600	Social contributions
Maintaining the monopoly tax according to GO no. 5/2013, 6/2013 and 7/2013 (windfall tax)	959	Other taxes on goods and services
Sale of 5G frequency bands licenses	1,300	Taxes on using goods, authorizing the use of goods or on carrying activities
Split VAT payment, optional as of 1 October 2017 and mandatory from 1 January 2018	4.900	VAT
Measures taken by NAFA to improve the collection		

Source: Ministry of Public Finance

Fiscal policy measures - budgetary spending	Budgetary Impact (million lei)	Spending category
Total	**3,719**	
Change in the value of the pension point to 1.100 lei as of 1 July 2018 (6 months of the year)	3,119	Social assistance
Increase in minimum pension (6 months)	600	Social assistance

Source: Ministry of Public Finance

Annex no. 2: The evolution of the budgetary aggregates in the period 2017-2018

Mil. lei	Preliminary execution for 2017 according to MPF *	Swap exec. 2017	Preliminary execution for 2017 according to MPF (without swap)	The draft budget 2018	The planned *swap for* 2018	The draft budget 2018 (without swap)	The draft budget 2018 – Prelim. execution for 2017	The draft budget 2018 – Prelim. execution for 2017	The draft budget 2018 / Prelim. execution for 2017	The draft budget 2018 / Prelim. execution for 2017	Prelim. execution for 2017	The draft budget 2018	The draft budget 2018 – Prelim. execution for 2017
								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	**256,804.7**	**1,425.0**	**255,379.7**	**287,521.7**	**1,020.0**	**286,501.7**	**30,717.0**	**31,122.0**	**12.0%**	**12.2%**	**30.3%**	**31.6%**	**1.2%**
Current revenue	234,411.4	1,425.0	232,986.4	257,274.0	1,020.0	256,254.0	22,862.6	23,267.7	9.8%	10.0%	27.7%	28.2%	0.6%
Tax revenue	139,992.7	708.9	139,283.8	145,135.9	521.6	144,614.3	5,143.2	5,330.5	3.7%	3.8%	16.5%	15.9%	-0.6%
Corporate income tax	46,717.4	327.2	46,390.2	38,598.9	298.0	38,300.9	-8,118.5	-8,089.3	-17.4%	-17.4%	5.5%	4.2%	-1.3%
Profit	14,525.6	131.1	14,394.5	15,020.3	148.0	14,872.3	494.7	477.8	3.4%	3.3%	1.7%	1.6%	-0.1%
Wages and income tax	30,216.6	196.1	30,020.5	20,803.4	150.0	20,653.4	-9,413.3	-9,367.2	-31.2%	-31.2%	3.6%	2.3%	-1.3%
Other taxes on income, profit and capital gains	1,975.2		1,975.2	2,775.2		2,775.2	800.0	800.0	40.5%	40.5%	0.2%	0.3%	0.1%
Property tax	5,430.4		5,430.4	5,824.4		5,824.4	394.1	394.1	7.3%	7.3%	0.6%	0.6%	0.0%
Taxes on goods and services	85,865.9	296.5	85,569.4	98,666.8	184.0	98,482.8	12,800.8	12,913.3	14.9%	15.1%	10.2%	10.8%	0.7%
VAT	52,846.0	296.5	52,549.5	61,308.2	184.0	61,124.2	8,462.2	8,574.7	16.0%	16.3%	6.2%	6.7%	0.5%
Excises	26,645.4		26,645.4	30,218.5		30,218.5	3,573.0	3,573.0	13.4%	13.4%	3.2%	3.3%	0.2%
Other taxes on goods and services	3,399.4		3,399.4	3,814.8		3,814.8	415.4	415.4	12.2%	12.2%	0.4%	0.4%	0.0%
Taxes on using goods, authorizing the use of goods or on carrying activities	2,975.1		2,975.1	3,325.3		3,325.3	350.2	350.2	11.8%	11.8%	0.4%	0.4%	0.0%
Tax on foreign trade and international transactions	945.6		945.6	1,042.0		1,042.0	96.4	96.4	10.2%	10.2%	0.1%	0.1%	0.0%
Other tax revenue	1,033.4	85.2	948.2	1,003.8	39.6	964.2	-29.6	16.0	-2.9%	1.7%	0.1%	0.1%	0.0%
Social security contributions	71,855.8	716.1	71,139.7	91,811.8	498.4	91,313.4	19,956.0	20,173.7	27.8%	28.4%	8.4%	10.1%	1.6%
Non-tax revenue	22,562.9		22,562.9	20,326.3		20,326.3	-2,236.5	-2,236.5	-9.9%	-9.9%	2.7%	2.2%	-0.4%
Capital revenue	799.7		799.7	1,843.6		1,843.6	1,043.9	1,043.9	130.5%	130.5%	0.1%	0.2%	0.1%
Grant	18.4		18.4	2.7		2.7	-15.7	-15.7	-85.3%	-85.3%	0.0%	0.0%	0.0%
Amounts received from the EU in the account of payments made and prefinancing	212.3		212.3	103.5		103.5	-108.8	-108.8	-51.3%	-51.3%	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%	0.0%

Mil. lei	Preliminary execution for 2017 according to MPF *	Swap exec. 2017	Preliminary execution for 2017 according to MPF (without swap)	The draft budget 2018	The planned *swap for* 2018	The draft budget 2018 (without swap)	The draft budget 2018 – Prelim. execution for 2017	The draft budget 2018 – Prelim. execution for 2017	The draft budget 2018 / Prelim. execution for 2017	The draft budget 2018 / Prelim. execution for 2017	Prelim. execution for 2017	The draft budget 2018	The draft budget 2018 – Prelim. execution for 2017
								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	21,362.9		21,362.9	28,297.9		28,297.9	6,935.0	6,935.0	32.5%	32.5%	2.5%	3.1%	0.6%
TOTAL EXPENDITURE	**281,772.7**	**1,425.0**	**280,347.7**	**314,481.3**	**1,020.0**	**313,461.3**	**32,708.6**	**33,113.6**	**11.6%**	**11.8%**	**33.3%**	**34.5%**	**1.3%**
Current expenditure	263,571.6	1,255.0	262,316.6	293,825.7	850.0	292,975.7	30,254.1	30,659.1	11.5%	11.7%	31.1%	32.3%	1.1%
Personnel	69,617.0		69,617.0	81,175.5		81,175.5	11,558.5	11,558.5	16.6%	16.6%	8.3%	8.9%	0.7%
Goods and services	39,549.0		39,549.0	39,926.8		39,926.8	377.8	377.8	1.0%	1.0%	4.7%	4.4%	-0.3%
Interest	10,498.3		10,498.3	12,096.8		12,096.8	1,598.5	1,598.5	15.2%	15.2%	1.2%	1.3%	0.1%
Subsidies	6,862.5		6,862.5	7,210.3		7,210.3	347.8	347.8	5.1%	5.1%	0.8%	0.8%	0.0%
Total Transfers	136,303.7	1,255.0	135,048.7	153,048.0	850.0	152,198.0	16,744.3	17,149.3	12.3%	12.7%	16.0%	16.8%	0.7%
Transfers for public entities	2,162.0	733.3	1,428.7	2,132.8	850.0	1,282.8	-29.2	-145.9	-1.4%	-10.2%	0.2%	0.1%	0.0%
Other transfers	12,154.2	521.7	11,632.5	13,385.5		13,385.5	1,231.3	1,753.0	10.1%	15.1%	1.4%	1.5%	0.1%
Projects funded by external post-accession grants	544.5		544.5	317.2		317.2	-227.3	-227.3	-41.7%	-41.7%	0.1%	0.0%	0.0%
Social assistance	93,177.8		93,177.8	98,620.4		98,620.4	5,442.6	5,442.6	5.8%	5.8%	11.1%	10.9%	-0.2%
Projects funded by external post-accession grants 2014- 2020	23,268.2		23,268.2	32,826.9		32,826.9	9,558.7	9,558.7	41.1%	41.1%	2.8%	3.6%	0.9%
Other expenditure	4,997.0		4,997.0	5,765.1		5,765.1	768.1	768.1	15.4%	15.4%	0.6%	0.6%	0.0%
Reserve funds	400.2		400.2	83.2		83.2	-317.0	-317.0			0.0%	0.0%	0.0%
Expenditure funded from reimbursable funds	340.9		340.9	285.1		285.1	-55.8	-55.8	-16.4%	-16.4%	0.0%	0.0%	0.0%
Capital expenditure	18,201.1	170.0	18,031.1	20,655.7	170.0	20,485.7	2,454.5	2,454.5	13.5%	13.6%	2.1%	2.3%	0.1%
Financial operations	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(-)	**-24,968.0**		**-24,968.0**	**-26,959.6**		**-26,959.6**	**-1,991.6**	**-1,991.6**	**8.0%**	**8.0%**	**-3.0%**	**-3.0%**	**0.0%**

** According to second budget revision.*

Source: Ministry of Public Finance

Annex no. 3: The evolution of the budgetary aggregates in the period 2018-2019

Mil. lei	The draft budget 2018	FS projection 2019	FS projection 2019 - The draft budget 2018	FS projection 2019/ The draft budget 2018	The draft budget 2018	FS projection 2019	FS projection 2019 - The draft budget 2018
					% GDP		
	1	2	3=2-1	4=2/1	5	6	7=6-5
TOTAL REVENUE	287,521.7	311,373.1	23,851.5	8.3%	31.67%	31.86%	-0.19%
Current revenue	257,274.0	277,963.0	20,689.0	8.0%	28.34%	28.44%	-0.11%
Tax revenue	145,135.9	150,966.0	5,830.1	4.0%	15.99%	15.45%	0.54%
Corporate income tax	38,598.9	42,021.9	3,423.0	8.9%	4.25%	4.30%	-0.05%
Profit	15,020.3	16,353.9	1,333.6	8.9%	1.65%	1.67%	-0.02%
Wages and income tax	20,803.4	22,692.6	1,889.2	9.1%	2.29%	2.32%	-0.03%
Other taxes on income, profit and capital gains	2,775.2	2,975.4	200.2	7.2%	0.31%	0.30%	0.00%
Property tax	5,824.4	6,361.4	537.0	9.2%	0.64%	0.65%	-0.01%
Taxes on goods and services	98,666.8	100,411.9	1,745.2	1.8%	10.87%	10.28%	0.59%
VAT	61,308.2	62,827.7	1,519.5	2.5%	6.75%	6.43%	0.32%
Excises	30,218.5	31,878.6	1,660.2	5.5%	3.33%	3.26%	0.07%
Other taxes on goods and services	3,814.8	3,476.6	-338.2	-8.9%	0.42%	0.36%	0.06%
Taxes on using goods, authorizing the use of goods or on carrying activities	3,325.3	2,228.9	-1,096.4	-33.0%	0.37%	0.23%	0.14%
Tax on foreign trade and international transactions	1,042.0	1,137.9	95.9	9.2%	0.11%	0.12%	0.00%
Other tax revenue	1,003.8	1,032.9	29.1	2.9%	0.11%	0.11%	0.00%
Social security contributions	91,811.8	105,188.0	13,376.2	14.6%	10.11%	10.76%	-0.65%
Non-tax revenue	20,326.3	21,809.0	1,482.6	7.3%	2.24%	2.23%	0.01%
Capital revenue	1,843.6	884.2	-959.4	-52.0%	0.20%	0.09%	0.11%
Grant	2.7	2.7	0.0	-0.3%	0.00%	0.00%	0.00%
Amounts received from the EU in the account of payments made and prefinancing	103.5	59.6	-43.9	-42.4%	0.01%	0.01%	0.01%
Amounts collected in the single account (State budget)			0.0		0.00%	0.00%	0.00%

Mil. lei	The draft budget 2018	FS projection 2019	FS projection 2019 - The draft budget 2018	FS projection 2019/ The draft budget 2018	The draft budget 2018	FS projection 2019	FS projection 2019 - The draft budget 2018
					% GDP		
	1	2	3=2-1	4=2/1	5	6	7=6-5
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	28,297.9	32,463.7	4,165.8	14.7%	3.12%	3.32%	-0.21%
TOTAL EXPENDITURE	314,481.3	336,591.6	22,110.3	7.0%	34.64%	34.44%	0.19%
Current expenditure	293,825.7	314,220.7	20,395.1	6.9%	32.36%	32.16%	0.21%
Personnel	81,175.5	84,147.7	2,972.1	3.7%	8.94%	8.61%	0.33%
Goods and services	39,926.8	40,777.0	850.2	2.1%	4.40%	4.17%	0.22%
Interest	12,096.8	12,547.4	450.5	3.7%	1.33%	1.28%	0.05%
Subsidies	7,210.3	7,115.8	-94.4	-1.3%	0.79%	0.73%	0.07%
Total Transfers	153,048.0	169,041.9	15,993.9	10.5%	16.86%	17.30%	-0.44%
Transfers for public entities	2,132.8	2,318.0	185.1	8.7%	0.23%	0.24%	0.00%
Other transfers	13,385.5	12,694.3	-691.2	-5.2%	1.47%	1.30%	0.18%
Projects funded by external post-accession grants	317.2	135.2	-182.1	-57.4%	0.03%	0.01%	0.02%
Social assistance	98,620.4	110,331.0	11,710.6	11.9%	10.86%	11.29%	-0.43%
Projects funded by external post-accession grants 2014- 2020	32,826.9	37,872.3	5,045.4	15.4%	3.62%	3.88%	-0.26%
Other expenditure	5,765.1	5,691.1	-73.9	-1.3%	0.63%	0.58%	0.05%
Reserve funds	83.2	107.0	23.8	28.6%	0.01%	0.01%	0.00%
Expenditure funded from reimbursable funds	285.1	484.0	198.9	69.8%	0.03%	0.05%	-0.02%
Capital expenditure	20,655.7	22,370.9	1,715.2	8.3%	2.28%	2.29%	-0.01%
Financial operations					0.00%	0.00%	0.00%
Payments made in previous years and recovered in the current year	0.0	0.0	0.0	0.0%	0.00%	0.00%	0.00%
SURPLUS(+) / DEFICIT(-)	-26,959.6	-25,218.5	1,741.2	-6.5%	-2.97%	-2.58%	-0.39%

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

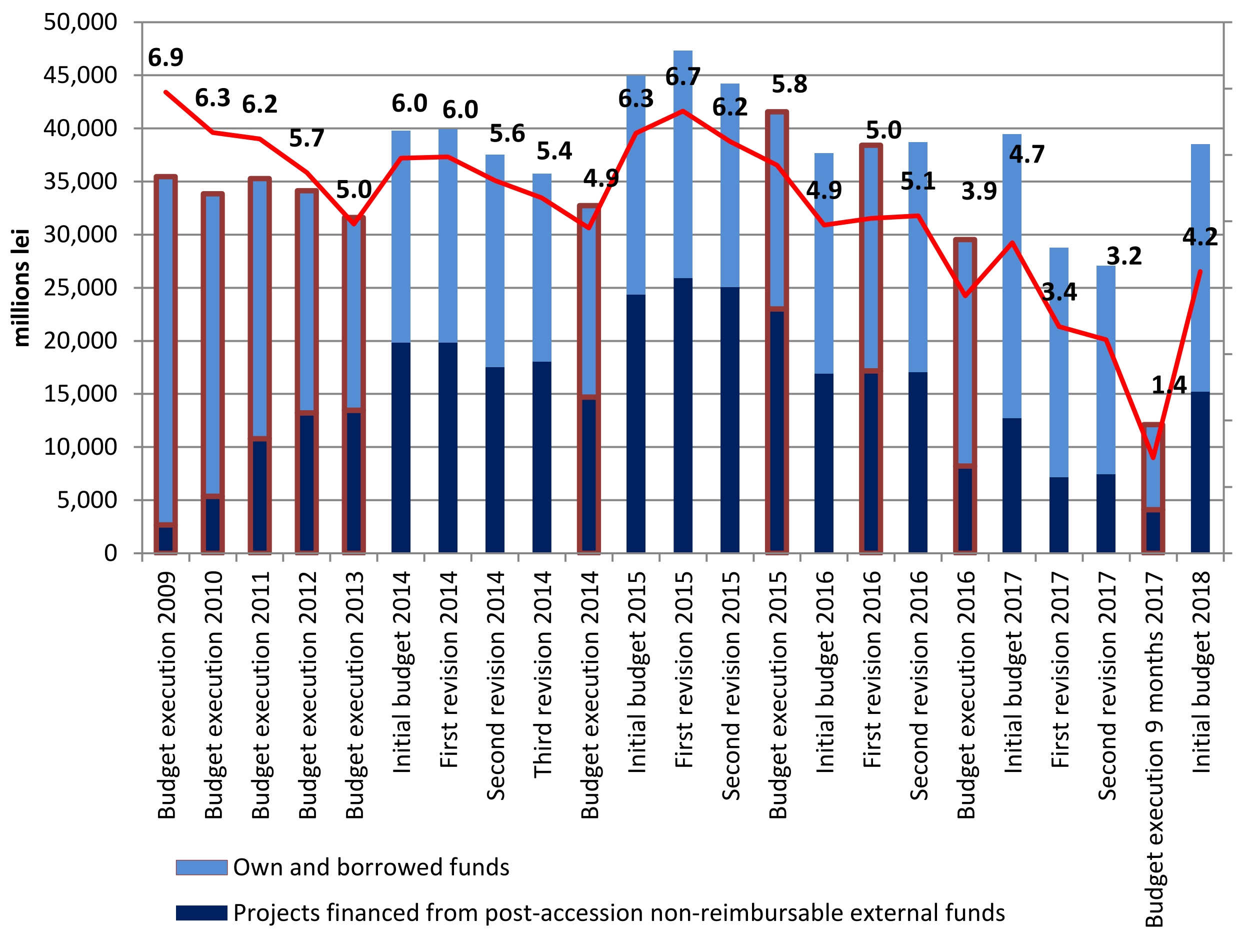
Annex no. 4: The evolution of the budgetary aggregates in the period 2019-2020

	FS projection 2019	FS projection 2020	FS projection 2020 - FS projection 2019	FS projection 2020/ FS projection 2019	FS projection 2019	FS projection 2020	FS projection 2020 - FS projection 2019
					% GDP		
	1	2	3=2-1	4=2/1	5	6	7=6-5
TOTAL REVENUE	311,373.1	336,133.8	24,760.7	8.0%	31.86%	31.95%	0.09%
Current revenue	277,963.0	303,468.0	25,505.0	9.2%	28.44%	28.85%	0.40%
Tax revenue	150,966.0	163,668.8	12,702.8	8.4%	15.45%	15.56%	0.11%
Corporate income tax	42,021.9	46,226.3	4,204.4	10.0%	4.30%	4.39%	0.09%
Profit	16,353.9	17,601.7	1,247.8	7.6%	1.67%	1.67%	0.00%
Wages and income tax	22,692.6	25,434.1	2,741.5	12.1%	2.32%	2.42%	0.10%
Other taxes on income, profit and capital gains	2,975.4	3,190.5	215.1	7.2%	0.30%	0.30%	0.00%
Property tax	6,361.4	6,930.2	568.8	8.9%	0.65%	0.66%	0.01%
Taxes on goods and services	100,411.9	108,208.4	7,796.4	7.8%	10.28%	10.29%	0.01%
VAT	62,827.7	67,630.5	4,802.7	7.6%	6.43%	6.43%	0.00%
Excises	31,878.6	33,633.3	1,754.6	5.5%	3.26%	3.20%	-0.06%
Other taxes on goods and services	3,476.6	3,499.2	22.6	0.6%	0.36%	0.33%	-0.02%
Taxes on using goods, authorizing the use of goods or on carrying activities	2,228.9	3,445.4	1,216.5	54.6%	0.23%	0.33%	0.10%
Tax on foreign trade and international transactions	1,137.9	1,240.3	102.4	9.0%	0.12%	0.12%	0.00%
Other tax revenue	1,032.9	1,063.6	30.8	3.0%	0.11%	0.10%	0.00%
Social security contributions	105,188.0	117,325.1	12,137.2	11.5%	10.76%	11.15%	0.39%
Non-tax revenue	21,809.0	22,474.0	665.0	3.0%	2.23%	2.14%	-0.10%
Capital revenue	884.2	926.8	42.6	4.8%	0.09%	0.09%	0.00%
Grant	2.7	2.5	-0.2	-7.7%	0.00%	0.00%	0.00%
Amounts received from the EU in the account of payments made and prefinancing	59.6	21.2	-38.4	-64.4%	0.01%	0.00%	0.00%
Amounts collected in the single account (State budget)			0.0		0.00%	0.00%	0.00%

	FS projection 2019	FS projection 2020	FS projection 2020 - FS projection 2019	FS projection 2020/ FS projection 2019	FS projection 2019	FS projection 2020	FS projection 2020 - FS projection 2019
					% GDP		
	1	2	3=2-1	4=2/1	5	6	7=6-5
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	32,463.7	31,715.3	-748.4	-2.3%	3.32%	3.02%	-0.31%
TOTAL EXPENDITURE	336,591.6	355,968.5	19,376.9	5.8%	34.44%	33.84%	-0.60%
Current expenditure	314,220.7	327,811.7	13,591.0	4.3%	32.16%	31.16%	-0.99%
Personnel	84,147.7	88,613.2	4,465.5	5.3%	8.61%	8.42%	-0.19%
Goods and services	40,777.0	42,674.0	1,897.0	4.7%	4.17%	4.06%	-0.12%
Interest	12,547.4	13,392.4	845.0	6.7%	1.28%	1.27%	-0.01%
Subsidies	7,115.8	7,270.7	154.8	2.2%	0.73%	0.69%	-0.04%
Total Transfers	169,041.9	175,192.7	6,150.8	3.6%	17.30%	16.65%	-0.64%
Transfers for public entities	2,318.0	2,389.3	71.4	3.1%	0.24%	0.23%	-0.01%
Other transfers	12,694.3	12,749.7	55.4	0.4%	1.30%	1.21%	-0.09%
Projects funded by external post-accession grants	135.2	97.5	-37.6	-27.8%	0.01%	0.01%	0.00%
Social assistance	110,331.0	116,929.5	6,598.5	6.0%	11.29%	11.12%	-0.17%
Projects funded by external post-accession grants 2014- 2020	37,872.3	37,011.5	-860.8	-2.3%	3.88%	3.52%	-0.36%
Other expenditure	5,691.1	6,015.2	324.0	5.7%	0.58%	0.57%	-0.01%
Reserve funds	107.0	107.0	0.0	0.0%	0.01%	0.01%	0.00%
Expenditure funded from reimbursable funds	484.0	561.8	77.8	16.1%	0.05%	0.05%	0.00%
Capital expenditure	22,370.9	28,156.8	5,785.9	25.9%	2.29%	2.68%	0.39%
Financial operations							0.00%
Payments made in previous years and recovered in the current year	0.0	0.0	0.0		0.00%	0.00%	0.00%
SURPLUS(+) / DEFICIT(-)	-25,218.5	-19,834.7	5,383.7	-21.3%	-2.58%	-1.89%	0.70%

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

Annex no. 5: The evolution of investment expenses between 2009-2017 – planned level vs. execution (millions lei)



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

VIII. Analysis of the economic and financial performance of Romania's state-owned companies in 2016

A potential risk for the fiscal sustainability on the medium term is represented by the accumulation of losses and arrears in the sector of companies where the state is the major shareholder (SOEs), because if these companies fail to streamline their activity, the Government will eventually be forced to intervene with public resources, which may lead to a deterioration of public finances, respectively increasing the budget deficit. The present report analyzes the economic and financial performance of Romanian state-owned companies in 2016 on the basis of the annual financial statements submitted by all companies to the Ministry of Public Finance (MPF).

The reduction in the number of state-owned companies included in the analysis in 2016 may diminish to some extent the comparability with the previous years. However, the eliminated companies are of a relatively small size and the results of the study are expected to accurately highlight the trends in the performance of Romanian state-owned companies.

At the end of 2016, an initial number of 1,740 companies reported in their financial statements that they belong to the SOEs' category. However, following a rigorous analysis of the organizational form and activity of these companies, it has been noticed that many limited liability companies have erroneously declared their ownership status, most of them (over 550) claiming to be autonomous administrations. After correcting these errors, the final number of SOEs included in the analysis was 916, down from 1,143 in 2015 (further information on the sample composition for each type of SOE can be found in *Table 1*). Taking into account this significant reduction in the number of companies included in the analysis, the results of the current study may not be fully comparable to those obtained in the previous years. However, it is expected that the study will accurately highlight the trends in the economic and financial performance of Romanian SOEs.

A reduction in total revenues of state-owned companies by 4.1%, while private firms reported higher revenues by about 7%. This led to a decline in the share of state-owned companies in total

The total revenues of the SOEs that were included in the analysis decreased by about 2 billion lei from 48.6 billion lei in 2015 to 46.6 billion lei in 2016. This decrease can be explained by the decline of around 1 billion lei in the total turnover of the companies that were included in the sample, the remaining difference being attributed to the evolution of other revenues apart from the turnover and to the reduction in the number of companies that were included in the analysis. It can be

revenues to a minimum of 3.7%.

observed that the latter factor has a limited contribution, the tendency of decreasing revenues in the SOE sector being correctly highlighted by the current sample. At the same time, private firms reported higher revenues by about 7%, which led to a decline in the share of SOEs in total revenues to a minimum of 3.7%. The gross value added by SOEs followed the downward trend as well, decreasing by more than 0.5 billion lei to a share of 9.1% of the total economy.

Similar to the previous years, the arrears of state-owned companies represent a higher share of total arrears in the economy compared to their contribution to the economic activity. Moreover, 2016 marks a stop to the trend of diminishing this weight. Thus, it seems that the financial discipline of state-owned companies has deteriorated.

On the other hand, SOEs accumulated arrears[16] that account for 20.6% of the total outstanding payments across the economy, up from 18.3% in 2015, which was also the minimum of the 2008-2016 period. This weight is clearly higher than the contribution of these enterprises to the economic activity and may be partially explained by historical developments. Between 2008 and 2016, the share of SOEs' arrears in total arrears decreased from 24.6% to 20.6%. But, in 2016, the arrears of SOEs increased by about 2 billion lei, in stark contrast with the evolution of private companies' arrears, which decreased by about 5.5 billion lei. This situation may signal a deterioration in the financial discipline among SOEs and a reversal of the post-crisis arrears' reduction trend.

The development of the main financial and economic indicators of the Romanian SOEs is presented in *Table 2*.

Labor productivity in state-owned companies is significantly higher in 2016 than in 2008, but this was mainly achieved by reducing the number of employees.

The number of employees in SOEs experienced a continuous decrease in the period 2008-2016 to a level of about 281 thousand persons, respectively by 10 thousand (or by 3.44%) lower compared to the previous year and by about 109 thousand lower than in 2008 (or 27.95%), as gross value added created in these companies increased in nominal terms by 20.23% compared to 2008, but decreased by 2.03% comparative with 2015 (also influenced by the reduction in the number of SOEs considered for analysis). Considering the values expressed in real terms[17], gross value added decreased by 4% in 2016 compared to the previous year and by 6.78%

[16] According to MPF, the companies' arrears are delayed payments to banks, the state budget, social security budget, suppliers and other creditors by more than 30 days against the contractual or legal terms, that generate payment obligations.
[17] The price index used for expressing values in constant prices is the GDP deflator.

compared to 2008. Under these conditions, the labor productivity of SOEs decreased by 0.59% in 2016 compared to the previous year when it recorded a historical maximum of the analyzed period but increased by 29.37% compared to 2008, mainly due to the significant decrease of the number of employees.

In 2016, the profitability of state-owned companies is at the post-crisis peak, if we exclude the profit that comes from the debt cancellation of S.C. Oltchim S.A. from the analysis for 2015. In the period 2013-2016, the gross profits obtained by state-owned companies are significantly better than those for the period 2008-2012.

In terms of profitability of SOEs, measured through the level of the gross profit obtained, in 2016 it reached a level of 4.438 million lei, by 452 million lei less than the maximum recorded in the previous year, including the profit[18] reported last year by S.C. Oltchim S.A. which resulted from the debt cancellation of the company in insolvency. As has been shown in the previous report, it is appropriate to exclude the scriptic profit recorded by this company in 2015 from the detailed analysis that follows in order to obtain undistorted results. Thus, it can be appreciated that the profitability of the SOEs at an aggregate level experienced a significant improvement during the period 2013-2016, the gross profit obtained reaching a historical maximum at the end of the analyzed period, registering also net values significantly higher than in the interval 2008-2012.

A small number of state owned companies generates a profit higher than the total, and the analysis will consider separately both the aggregated values and those obtained by excluding the five most

The analysis of the profitability of SOEs may be extended by excluding from the total the Top 5 companies in terms of the level of gross profit obtained[19] (Top 5 from now - they are found in *Table 3*) provided that to a small number of companies are attributable significant profits that influence considerably the aggregate results. Thus, if we eliminate the influence of the best five SOEs on a profit basis, it can be noticed a negative overall result of the SOEs in 2008-2016, but with a decrease to -23 million lei in the year 2016, compared with a value of -1.527 million lei in 2015 or -957 million lei in 2014. The period 2008-2012 was characterized by high losses,

[18] If from the total profit of SOEs in 2015 we subtract the artificial profit recorded by S.C. Oltchim S.A. as a result of the cancellation of a significant part of the debts, we note that their gross profit is in fact decreasing in 2015 (to about 2,560 million lei) compared to the previous year (when it reached the value of 3,568 million lei), being very close to the value registered in 2013.

[19] S.C. Oltchim S.A. is not included in this Top from considerations mentioned above and all analyzes that include the indicator net/gross profit do not take into account the value from this company's debt cancellation.

profitable state-owned companies - Top 5.

but in the following years they have considerably diminished. On the other hand, SOEs in the Top 5 have consistently recorded significant profits, over the last four years their gross profit increased 1.81 times (from 2.465 million lei in 2012 to 4.461 million lei at the end of 2016).

It is worth noting that in 2016, the profit of the Top 5 SOEs amounts to 3,620.48 million lei, above the profit of the Top 5 SOEs in 2015 (3,311.29 million lei). We note the good profitability of S.P.E.E. Hidroelectrica S.A., S.N.G.N. Romgaz S.A. and S.N.T.G.N. Transgaz S.A. Medias which are in the Top 5 according to profit earned in the last four years (2013-2016).

There is thus a decisive influence of Top 5 SOEs on the aggregate performance of SOEs, and in this context, in order to analyze more rigorously the evolution of the financial performance of the whole sector of SOEs, the present evaluation refers to specific indicators, both at the aggregate level and eliminating the influence of Top 5.

Table 1: The evolution of the number of SOEs that report financial statements by components									
	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Autonomous administrations	117	150	152	173	180	196	193	135	132
Companies owned 100% by the state	358	333	389	437	431	479	479	500	500
National companies and societies	41	45	50	61	48	45	46	43	32
Other companies entirely owned by state or where the state is the major shareholder	51	51	57	130	132	158	154	161	102
State-owned companies, local and foreign state capital (state capital >= 50%)	5	25	9	44	40	56	54	66	22
State-owned companies, local and foreign private capital (state capital >= 50%)	7	20	9	16	18	20	28	23	18
State-owned companies and with local private capital (state capital >=50%)	85	87	82	98	85	103	102	102	77
State-owned companies and with foreign private capital (state capital >=50%)	4	11	12	15	12	21	22	17	4
State-owned companies, privatized in the reporting year	50	52	31	74	60	73	77	96	29
Total number of SOEs	718	774	791	1,.048	1,006	1,151	1,155	1,143	916

Table 2: The evolution of certain financial indicators of Romanian companies that report financial statements considering the form of ownership										
		2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Number of companies	SOEs	718	774	791	1,048	1,006	1,151	1,155	1,143	916
	Total companies excluding financial sector	663,860	602,190	613,080	644,379	630,066	657,500	643,644	647,872	677,843
	Share of SOEs in total	0.11%	0.13%	0.13%	0.16%	0.16%	0.18%	0.18%	0.18%	0.14%
Total income, mil. lei	SOEs	56,660	50,756	55,022	58,511	49,853	51,208	44,487	48,578	46,586
	Total companies excluding financial sector	977,619	845,396	920,600	1,056,190	1,072,777	1,101,386	1,113,445	1,186,900	1,269,290
	Share of SOEs in total	5.80%	6.00%	5.98%	5.54%	4.65%	4.65%	4.00%	4.09%	3.67%
Gross value added, mil. lei	SOEs	21,744	20,454	22,881	24,202	22,339	25,131	25,220	26,687	26,143
	Total companies excluding financial sector	203,875	189,633	195,849	196,151	197,392	233,734	255,957	260,530	286,190
	Share of SOEs in total	10.67%	10.79%	11.68%	12.34%	11.32%	10.75%	9.85%	10.24%	9.13%
Gross value added in real terms, mil. lei (constant prices 2010)	SOEs	23,406	21,177	22,881	23,268	20,527	22,329	22,037	22,731	21,820
Employees number, thousands of persons	SOEs	390	364	364	343	327	321	297	291	281
	Total companies excluding financial sector	4,618	4,019	3,962	4,040	3,898	4,016	3,882	3,959	4,078
	Share of SOEs in total	8.44%	9.05%	9.19%	8.49%	8.40%	8.00%	7.64%	7.36%	6.89%
Labor productivity mil. lei /1,000 employees (constant prices 2010)	SOEs	60.02	58.18	62.86	67.84	62.77	69.56	74.20	78.11	77.65
Percentage change in labor productivity (relative to the previous year)	SOEs	2.6%	-3.1%	8.0%	7.9%	-7.5%	10.8%	6.7%	5.3%	-0.6%
Gross profit, mil. lei	SOEs	(1,026)	(2,777)	(2,101)	1,372	(561)	2,203	3,568	4,890	4,438
	SOEs, excluding best performing 5 comp.	(3,927)	(4,329)	(4,202)	(2,449)	(3,026)	(1,278)	(957)	(1,527)	(23)
	Private companies	23,513	19,914	27,934	10,421	15,623	22,570	27,479	42,753	60,950
Arrears, mil. lei	SOEs	17,294	34,405	28,012	26,251	25,363	26,217	24,369	21,226	23,232
	Private companies	53,127	62,406	69,193	88,882	91,536	99,052	93,508	94,874	89,390
	Total companies excluding financial sector	70,422	96,811	97,205	115,133	116,899	125,269	117,878	116,101	112,622
	Share of SOEs in total	24.56%	35.54%	28.82%	22.80%	21.70%	20.93%	20.67%	18.28%	20.63%
Arrears, % of GDP	SOEs	3.3%	6.7%	5.2%	4.6%	4.3%	4.11%	3.6%	3.0%	3.0%
	Private companies	10.1%	12.2%	13.0%	15.7%	15.4%	15.54%	14.0%	13.3%	11.7%

Table 3: Top 5 SOE's net profit

Top 5 net profit in 2016

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

Top 5 net profit in 2015

	Company name	Net profit (mil. lei)
1	S.N.G.N. ROMGAZ S.A.	1,194.29
2	S.P.E.E.H. HIDROELECTRICA S.A.	899.41
3	S.N.T.G.N. TRANSGAZ S.A. MEDIAŞ	488.73
4	C.N.A.D.N.R. S.A.	368.80
5	C.N.T.E.E. TRANSELECTRICA S.A.	360.05
	Total	**3,311.29**

Top 5 net profit in 2014

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

Top 5 net profit in 2013

	Company name	Net profit (mil. lei)
1	S.N.G.N. ROMGAZ S.A.	1,300.64
2	S.P.E.E.H. HIDROELECTRICA S.A.	901.58
3	S.N. NUCLEARELECTRICA S.A.	517.69
4	S.N.T.G.N. TRANSGAZ S.A. MEDIAŞ	429.93
5	C.N.A.D.N.R. S.A.	330.39
	Total	**3,480.24**

Top 5 net profit in 2012

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

Top 5 net profit in 2011

	Company name	Net profit (mil. lei)
1	TERMOELECTRICA S.A.	1,597.22
2	S.N.G.N. ROMGAZ S.A.	1,031.75
3	S.N.T.G.N. TRANSGAZ S.A. MEDIAŞ	379.57
4	C.N.A.D.N.R. S.A.	246.29
5	S.C. ELECTROCENTRALE BUCUREŞTI S.A.	106.85
	Total	**3,361.69**

Source: MPF, based on balance sheets data submitted by the economic agents from non-financial sector

The share of outstanding payments in the economy as a percentage of GDP has declined substantially, from 35.4% of GDP in 2000 to 14.8% of GDP in 2016, recording a minimum value in 2008 (13.1% of GDP).

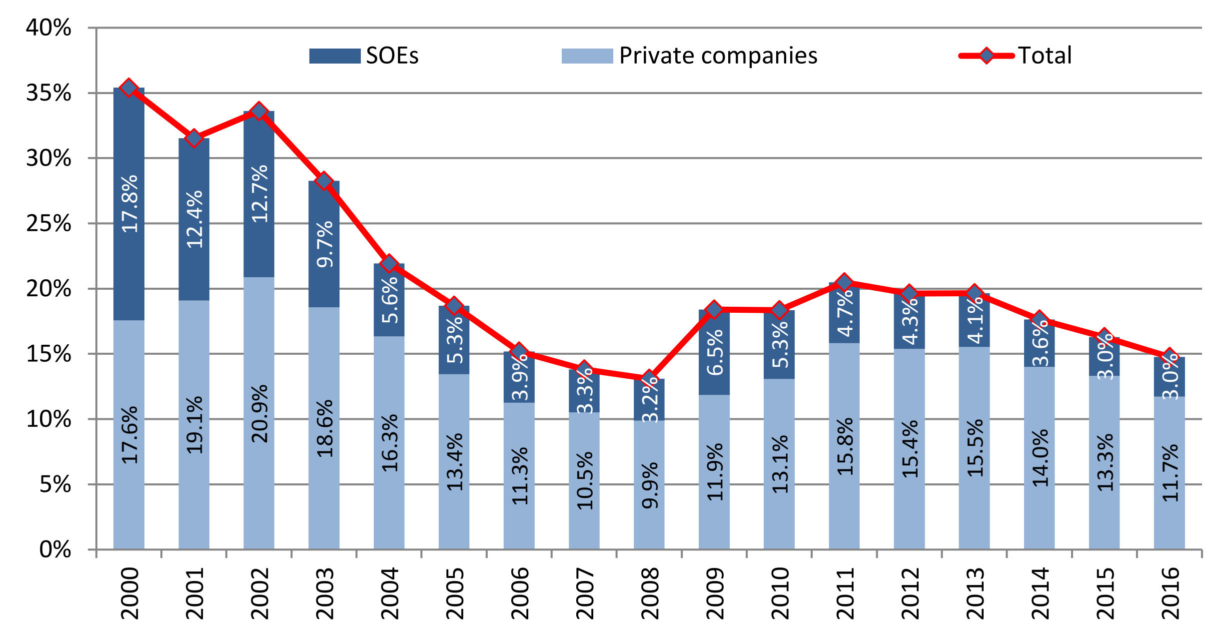
Since 2000, the share of the accumulated outstanding payments in the economy has considerably declined, from 35.4% of GDP in 2000 to 13.1% of GDP in 2008 (a reduction in nominal value amounting to 41.7 billion lei), but the financial crisis that started in 2008 led to their increase to a maximum value of 20.5% of GDP in 2011, followed by a downward trend, reaching 14.8% of GDP in 2016.

The arrears of the state-owned companies have registered a similar trend, with a decrease from 17.8% of GDP in 2000 to 3.0% in 2016, below the 2008 level (3.2% of GDP). But the year 2016 seems to signal a relaxation in the financial discipline, as the SOEs' arrears increased compared with the previous year.

In the state-owned sector, if in 2000 the outstanding payments represented 17.8% of GDP (practically half of total arrears in the economy), there was a continuous and consistent decrease until 2008 (up to 3.2% of GDP), but in 2009 they increased to 6.5% of GDP, then declining continuously, reaching 3.05% of GDP in 2016. Therefore, on the background of the measures[20] agreed with the international financial institutions (European Commission, IMF, World Bank), in the context of the two balance of payments agreements in the period 2011-2015, was reached the minimum value of the share of SOEs' arrears in GDP of 2.98% in 2015. However, the increase of the arrears by about 2 billion lei in 2016 compared to 2015, despite the significant drop in the number of companies included in the analysis and a nominal GDP growth by 7%, could indicate that, starting with 2016 we can observe a loosening in the financial discipline at the level of the SOEs, and the reversal of the tendency of reducing their arrears between 2011 and 2015.

[20] These measures aimed at framing the arrears in the quarterly indicative targets and included: budget transfers, placing SOEs into voluntary liquidation or insolvency or arrears' conversion into shares.

Figure 1: The evolution of SOEs' and private companies' arrears (% of GDP)

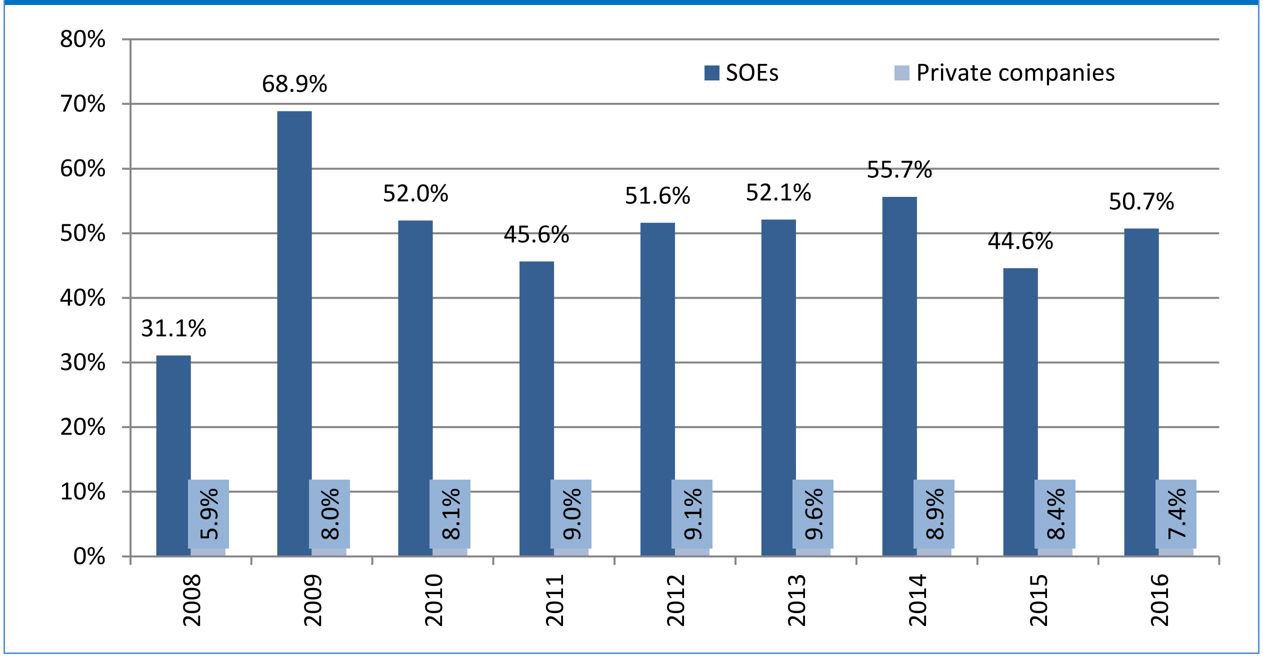


Source: MPF, based on balance sheets data submitted by the economic agents from non-financial sector

In the private sector the share of arrears reached a peak in 2002 (20.9% of GDP), since then being on a downward trend until 2008 (9.9% of GDP), but on the background of the economic and financial crisis, they increased up to 15.8% of GDP in 2011; starting with 2012 the arrears were again on a downward trend, reaching a level of 11.6% of GDP at the end of 2016.

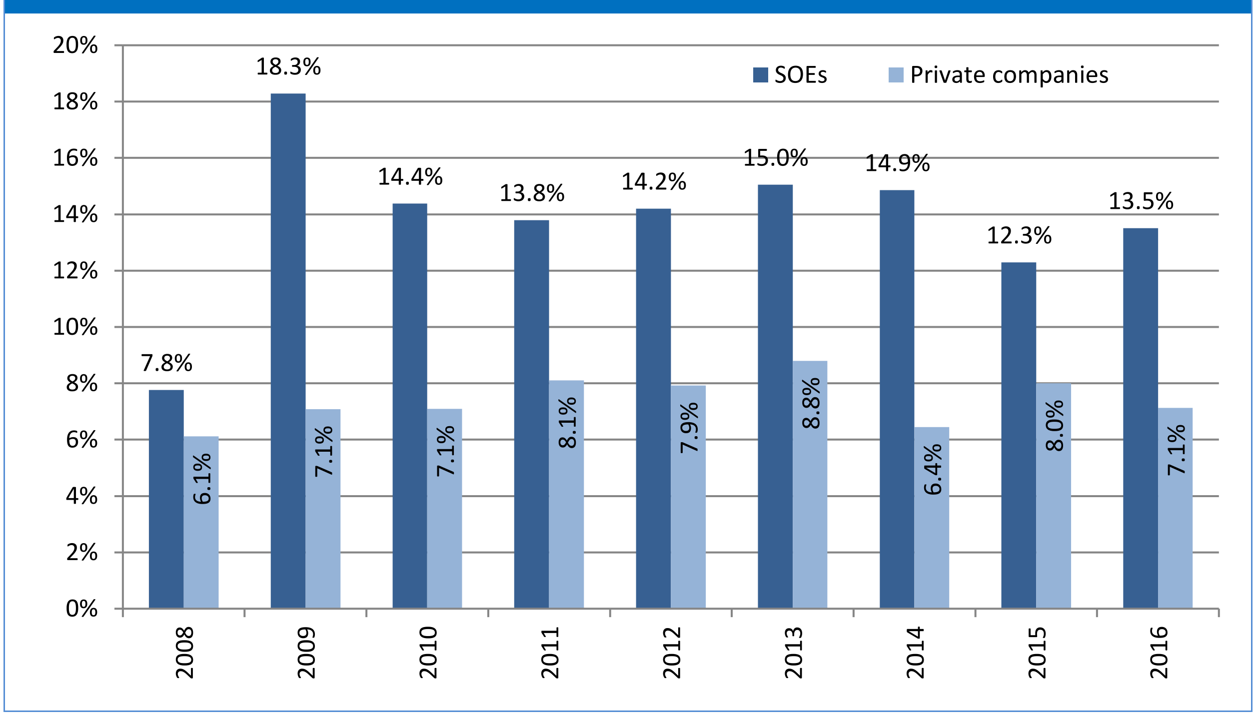
In the private sector the share of arrears in GDP recorded a peak in 2002 (20.9% compared to 17.6% in 2000), while during the 2003-2008 period of time it has been reduced significantly to 9.9% of GDP in 2008. The effects of the economic and financial crisis manifested starting 2008, led to the reversal of this trend, resulting a continuous accumulation of arrears in the 2009-2011 period of time (from 11.9% of GDP to 15.8% of GDP). Starting with 2012 the private companies succeeded to enter on a downward trend regarding the evolution of their arrears, being registered a level of 11.6% of GDP at the end of 2016. It should be noted that this result was achieved in the situation where, compared to 2015, the value of arrears of the private sector decreased by about 6% in 2016 compared to the previous year while the nominal value of GDP increased by 7%.

Figure 2: Arrears (% of turnover)



Source: MPF, based on balance sheets data submitted by the economic agents from non-financial sector

Figure 3: Arrears (% of total assets)



Source: MPF, based on balance sheets data submitted by the economic agents from non-financial sector

The development of the share of arrears in the turnover for state-owned companies registered a significant reduction from the peak of 68.9% in 2009 to 50.7% at the end of 2016, but still slightly increased compared to previous year (44.6%). The share of arrears in total assets had a similar development, that, after a peak of 18.3% in 2009 registered a significant reduction in the period 2010-2015, but also in 2016 this indicator has experienced a deterioration compared to the previous year.

Analyzing the development of the share of SOEs' arrears in the turnover (see *Figure2)*, it can be noticed a peak in 2009, as a result of the financial crisis, this indicator recording a significant jump of over 100% (from 31.1% in 2008 to 68.9% in 2009). After a significant drop in the share of arrears in turnover in 2010-2011 (up to 45.6% in 2011), this indicator registered an upward trend between 2012 and 2014, when arrears have reached a share of 55.7% in turnover, but then recorded a significant reduction (to 44.6% at the end of 2015). However, at the end of 2016, the share of the SOEs arrears in turnover increased by 6.1 pp compared to 2015 (respectively, a share of 50.7%). The evolution in the last two years can be explained by the accelerated reduction of the value of the SOEs' arrears (-12.9%), together with the increase in their turnover (+8.7%) in 2015 compared to the previous year, while in 2016 compared to 2015, the value of arrears increased by 9.4%[21] and the turnover decreased by 3.7%. Regarding the evolution of the share of arrears of SOEs in total assets (*Figure 3*), this indicator was about 2.4 times higher in 2009 compared to 2008 (18.3% from 7.8%), subsequently entering on a significant diminishing trend to 12.3% in 2015 but followed in 2016 by an increase to 13.5%.

In the private sector, the share of arrears in the turnover recorded an upward trend in 2009-2013, with values ranging between 8.0% and 9.6%, followed by a continued reduction, at the end of 2016 reaching a level of

From the perspective of the evolution of the share of the private companies' arrears in the turnover (*Figure 2*), a significant increase was observed in 2009 compared to the previous year, respectively, from 5,9% in 2008 to 8%. Over the period 2010-2013, this indicator recorded slight increases up to a peak of 9.6% in 2013, after which it entered a downward trajectory, reaching 7.4% at the end of 2016. It is worth mentioning that in 2016, unlike the state companies, the private companies have managed to reduce arrears by 5.8% compared to the precedent

[21] Although in 2016 the Memorandum on the measures to be taken into account when preparing the budgets for 2016 for the economic operators to which the provisions of Emergency Ordinance no. 26/2013 are applied was approved by E.O no. 26/2013 it was decided to reduce the outstanding payments by at least 15% by the end of 2016 compared to those scheduled for the end of 2015, including for the line ministries.

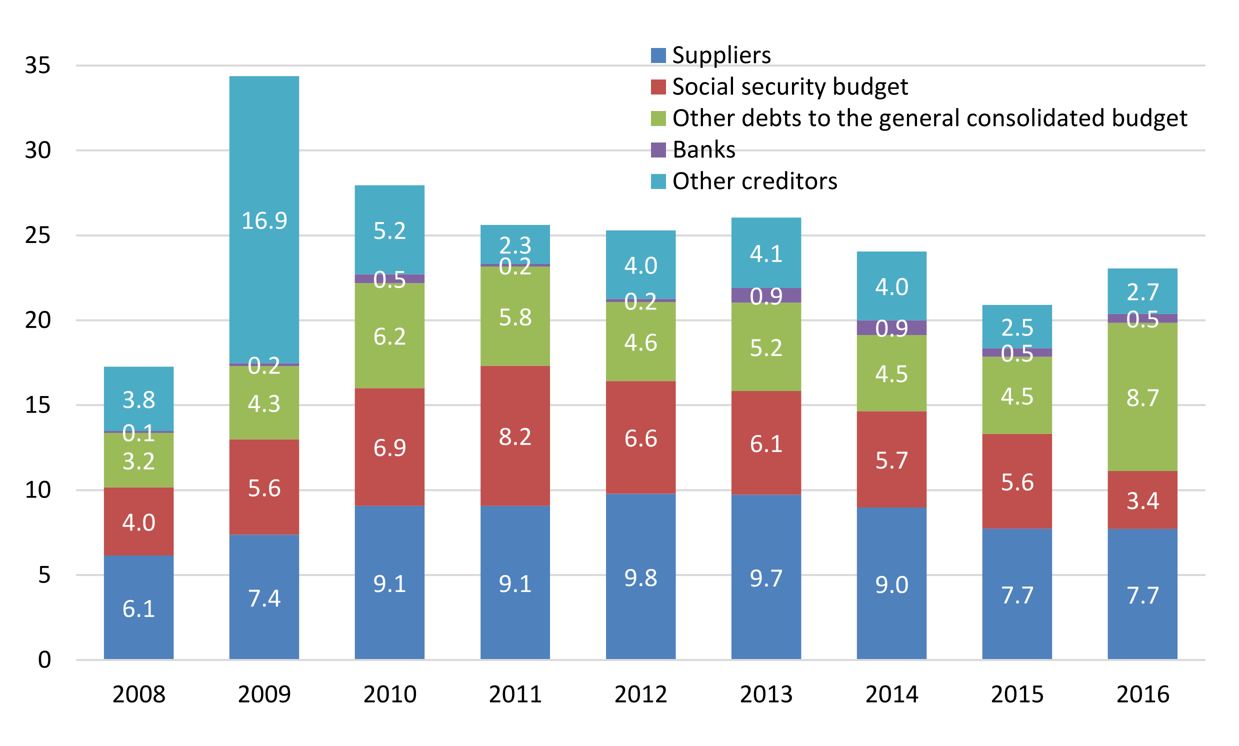
7.4%, being the first year in which this indicator was below the value of 2009. During the same period of time, the share of arrears in total assets for the private companies had a sinuous evolution, with values between 6.4% in 2014 and 8.8% in 2013, reaching a level of 7.1% at the end of 2016, similar to the 2009 level.

year, due to the increase of the turnover by 7.3%, so that the share of arrears in turnover decreased by 1 percentage point compared to 2015. Regarding the evolution of the share of the private companies' arrears in total assets (*Figure 3*), it can be noticed that the effect of the crisis was much less pronounced immediately after the economic and financial crisis started (an increase of the share from 6.1% in 2008 to 7.1% in 2009). Thereafter, this indicator had a sinuous evolution, from a maximum of 8.8% in 2013 to 6.4% in 2014 (the minimum of the 2009-2016 period), followed by an increase up to 8% in 2015, and then a reduction of almost 1 pp at the end of 2016, reaching the same level of the share of arrears of private sector companies in total assets as in 2009 (7.1%).

From the perspective of the structure by main creditors, in 2016 the state-owned companies recorded a share of 52% of total arrears to the general consolidated budget and 33% of the total arrears to suppliers. Compared to the previous year, the value of arrears of the state-owned companies to their creditors increased by over 2 billion lei, mainly to the consolidated general budget (by 20%).

The total outstanding payments of SOEs in December 2016 to the general consolidated budget amounted to 12.1 billion lei (1.6% of GDP, by 2 billion lei more compared to last year, respectively plus 0.2 percentage points of GDP), out of which 3.4 billion lei to the social security budgets (0.4% of GDP, practically a 50% reduction compared to 2015) and 8.7 billion lei to other budgets, which doubled compared to the previous year (4.5 billion lei in 2015). Suppliers ranked second among the creditors of SOEs, the amount due to them being 7.7 billion lei, and 1.0% of GDP, respectively. The structure of arrears of the SOEs is presented in *Figure 4*. Most of the SOEs' arrears in 2016 were to the general consolidated budget (52% of total arrears), of which the majority was represented by arrears to the other budgets (72%, almost double compared to the previous year) and 28% to the social security budget), followed by arrears to suppliers (accounting for 33% of total arrears, of which 77% late payments for more than 1 year). Compared to the previous year, the value of the arrears of the SOEs to suppliers remained constant at the level of 2016, while the arrears due to the consolidated general budget increased significantly (by 20%), so that on the whole, the increase of SOEs' arrears to their main creditors was over 2 billion lei.

Figure 4: Structure of arrears – SOEs (billion lei)

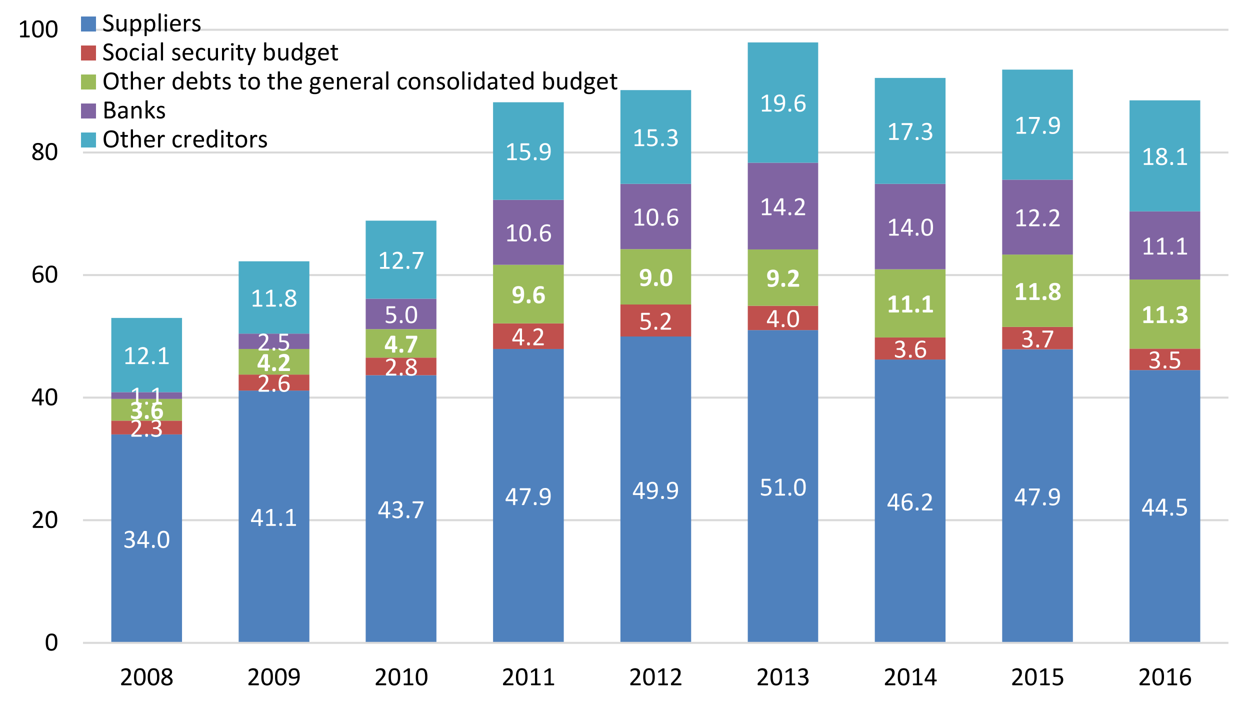


Source: MPF, based on balance sheets data submitted by the economic agents from non-financial sector

The private companies accounted for 50% of total arrears to suppliers and 16.5% for the general consolidated budget and managed to reduce arrears to their creditors by about 5 billion lei compared to 2015.

The private companies (*Figure 5*) accumulated arrears mostly to suppliers (44.5 billion lei, or 50% of the total arrears of the private sector). Of these, 59% were late payments for more than 1 year. The overdue payments to the general consolidated budget amounted to 14.8 billion lei (of which 76% represented arrears to the other budgets), respectively 16.5% of the total arrears. Compared to the previous year, the private sector's companies reduced their arrears to their creditors by about 5 billion lei, mainly to: suppliers with 3.4 billion lei (-7%), the general consolidated budget by 0.7 billion lei (-4.4%) and banks (by 1.1 billion lei, respectively - 9.3%).

Figure 5: Structure of arrears – private companies (billion lei)



Source: MPF, based on balance sheets data submitted by the economic agents from non-financial sector

The accumulation of outstanding payments by the companies in the public sector is concentrated in the following sectors: mining, distribution of heat and chemical industry and in a proportion of more than 67% is attributable to the first 10 SOEs ranked in terms of outstanding payments in total economy. Within the Top 10, the first 3 companies with the largest outstanding payments

Besides direct fiscal consequences generated by SOE's arrears – revenue shortfalls to the general consolidated budget - the accumulation of outstanding payments towards the private sector is likely to create liquidity problems and to hamper economic growth. The Top 10 companies in terms of outstanding payments account for over 67% of the total arrears of SOEs, the arrears being particularly high in the mining, distribution of heat and chemical sectors. Like in the previous years, the first five companies in the top are Compania Națională a Huilei, RADET București, Complexul Energetic Hunedoara S.A and S.C. Oltchim S.A. that together with the new entry in Top 5, Electrocentrale București S.A., have aggregate arrears representing over 81% of the Top 10's total arrears, or 54% of the total arrears of the public sector in 2016. Compared to the previous year, these 5 companies recorded significant increases in arrears, especially Electrocentrale Bucureşti (from 0.5 billion lei to over 1.4 billion

have accumulated over the past three years over 80% of the total arrears for the Top 10.

lei, due to the increase of RADET debts to them, causing the rapid accumulation of arrears to fuel suppliers).

The first 10 companies in the top of bad payers have accumulated at the end of 2016 about 80% of the total arrears of state owned companies towards the general consolidated budget, standing out Compania Națională a Huilei with over 56% of Top 10 arrears, respectively 45% of the total arrears of SOEs to the general consolidated budget and about a quarter (23%) of the total SOEs; arrears to the economy.

Table 4: Top 10 SOE's arrears

Top 10 arrears in Dec 2016

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

Top 10 arrears in Dec 2015

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

Top 10 arrears in Dec 2014

	Company name	Arrears (mil. lei)
1	COMPANIA NAȚIONALĂ A HUILEI S.A. ÎN LICHIDARE	4,865.05
2	S.C. OLTCHIM S.A.	3,397.19
3	RADET BUCUREȘTI	3,157.86
4	REGIA AUTONOMĂ PENTRU ACTIVITĂȚI NUCLEARE R.A.	1,097.06
5	COMPANIA NAȚIONALĂ A METALELOR PRETIOASE ȘI NEFEROASE REMIN S.A.	570.30
6	SOCIETATEA ROMÂNĂ DE TELEVIZIUNE	553.10
7	CENTRALA ELECTRICĂ DE TERMOFICARE IAȘI (C.E.T.) S.A.	545.38
8	SOCIETATEA NAȚIONALĂ A CĂRBUNELUI S.A.	518.77
9	FORTUS S.A.	405.21
10	CENTRALA ELECTRICĂ DE TERMOFICARE BRAȘOV S.A.	394.55
	% total	**63.62%**

Top 10 arrears to consolidated general budget in Dec 2015

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

Top 10 arrears to consolidated general budget in Dec 2015

	Company name	Arrears (mil. lei)
1	COMPANIA NAȚIONALĂ A HUILEI S.A. ÎN LICHIDARE	4,851.92
2	S.C. COMPLEXUL ENERGETIC HUNEDOARA S.A.	531.69
3	SOCIETATEA NAȚIONALĂ A CĂRBUNELUI S.A.	505.68
4	SOCIETATEA ROMÂNĂ DE TELEVIZIUNE	459.49
5	CENTRALA ELECTRICĂ DE TERMOFICARE IAȘI (C.E.T.) S.A	419.91
6	MOLDOMIN S.A.	261.41
7	SOCIETATEA NAȚIONALĂ A CĂILOR FERATE ROMÂNE R.A.	241.71
8	S.C. ELECTROCENTRALE CONSTANȚA	197.58
9	REGIA AUTONOMĂ PENTRU ACTIVITĂȚI NUCLEARE R.A.	174.39
10	AVERSA S.A.	160.93
	% total	**77.20%**

Top 10 arrears to consolidated general budget in Dec 2015

	Company name	Arrears (mil. lei)
1	COMPANIA NAȚIONALĂ A HUILEI S.A. ÎN LICHIDARE	4,851.92
2	SOCIETATEA NAȚIONALĂ A CĂRBUNELUI S.A.	505.66
3	SOCIETATEA ROMÂNĂ DE TELEVIZIUNE	454.51
4	CENTRALA ELECTRICĂ DE TERMOFICARE IAȘI (C.E.T.) S.A.	407.93
5	SC COMPLEXUL ENERGETIC HUNEDOARA S.A.	293.48
6	MOLDOMIN S.A.	260.77
7	SOCIETATEA NAȚIONALĂ A CĂILOR FERATE ROMÂNE R.A.	241.74
8	S.C. ELECTROCENTRALE CONSTANȚA	185.97
9	REGIA AUTONOMĂ PENTRU ACTIVITĂȚI NUCLEARE R.A.	175.80
10	INTERVENȚII FEROVIARE S.A.	175.01
	% total	**74.27%**

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

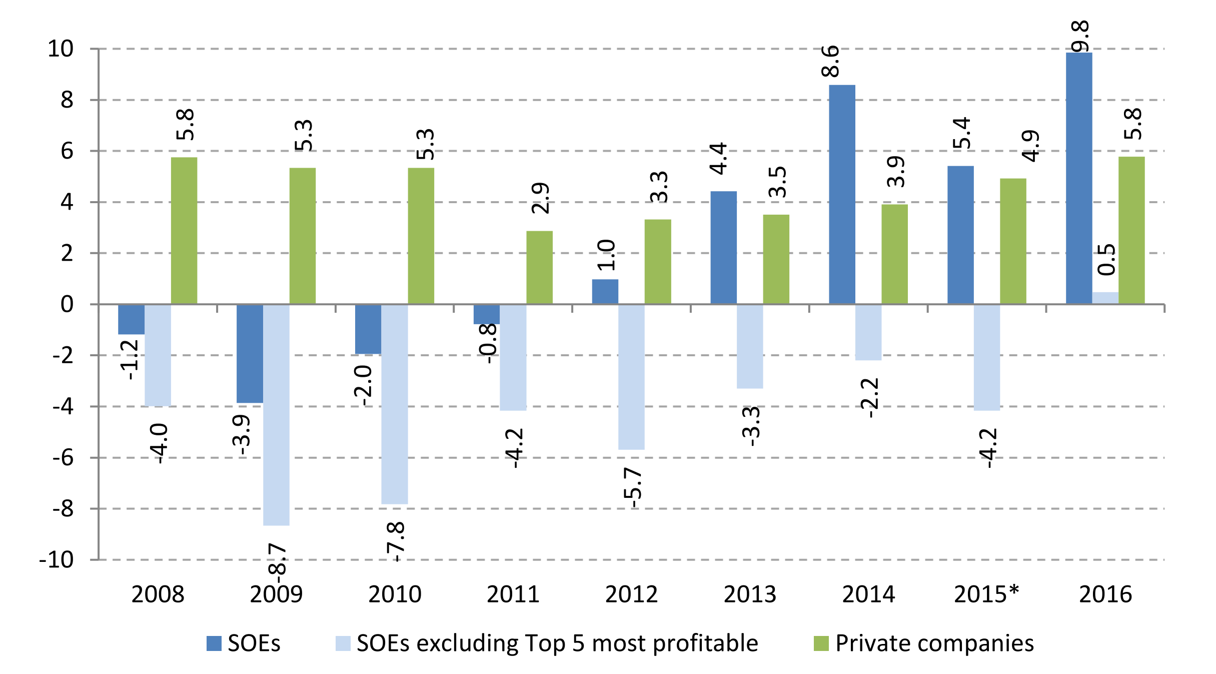
Table 5: SOEs arrears evolution by type of company (million lei)									
	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Autonomous administrations	1,130.70	1,411.14	2,019.32	3,153.75	3,662.52	4,541.85	5,515.00	5,110.99	5,198.17
Companies owned 100% by the state	6,802.97	8,102.41	9,648.19	7,670.87	5,605.94	6,341.70	5,378.51	5,174.00	5,532.35
National companies and societies	7,945.22	23,710.69	15,032.90	12,773.24	10,350.17	8,658.11	7,300.42	7,071.76	7,552.86
Other state – owned companies or majority-state – owned companies	77.60	184.32	298.81	769.32	879.87	1,484.98	1,187.36	914.92	924.64
State – owned companies, local and foreign state capital (state capital >= 50%)	5.52	1.05	0.26	46.28	3.27	0.81	1.76	2.60	1.51
State –owned companies, local and foreign private capital (state capital >=50%)	717.28	35.38	78.59	330.44	2,551.90	3,412.91	3,423.14	1,229.97	1,184.32
State –owned companies and with local private capital (state capital >=50%)	609.37	957.00	932.08	1,504.96	2,308.42	1,775.47	1,560.32	1,699.95	2,837.51
State –owned companies and with foreign private capital (state capital >=50%)	0.86	1.66	0.37	0.47	0.43	0.77	1.17	2.80	0.69
State –owned companies, privatized in the reporting year	4.81	1.38	1.79	2.06	0.62	0.51	1.80	19.30	0.00
TOTAL arrears	**17,294.33**	**34,405.02**	**28,012.31**	**26,251.39**	**25,363.13**	**26,217.11**	**24,369.48**	**21,226.29**	**23,232.05**

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

The operating margin of state-owned companies improved from 5.4% in 2015 to 9.8% in 2016, registering again a higher level than the one obtained by the private sector. Excluding the top five companies, the indicator has a value of just 0.5%, but it is worth mentioning that this is the only positive value recorded since 2008.

The year 2016 marked an improvement in the operating margin which measures the profitability of the core business activities by reporting earnings before interest and taxes to total revenues. In the case of SOEs, the indicator rose significantly from 5.4% in 2015 to 9.8% in 2016, exceeding by far the 5.8% recorded by private companies. This development was mainly driven by the increase of about 74% in operating earnings while total revenues declined by about 4%. Excluding the top five most profitable SOEs, the indicator is reduced to only 0.5%, but it is worth mentioning that this is the only positive value recorded since 2008. Excluding the top five companies, it is evidenced a sizeable gap, proving their high impact on SOEs' aggregate results. Therefore, the solid performance displayed by the top five companies is able to offset the poor results of the remaining companies, significantly improving the average of the entire SOEs' sector.

Figure 6: Operating margin (%)



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

*Note: Operating surplus (%)=Operating surplus/ Total income * 100*

**In 2015 at the level of SOEs was excluded the profit of S.C. Oltchim S.A. originated from the cancellation of a part of debt.*

*** The operating surplus does not include the interest expenses and those related to income taxes.*

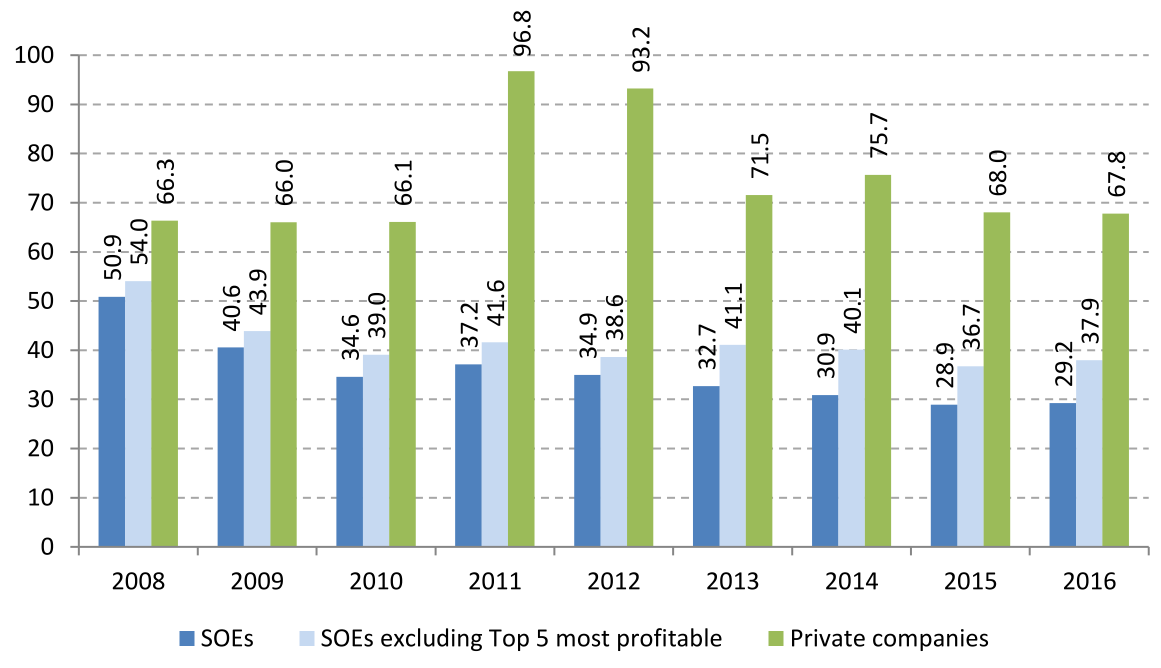
The ability of state-owned companies to cover their debt has not changed significantly since 2015, but indebtedness is distributed unevenly among them, with some companies having very small amounts of debt, while others are heavily indebted. Overall, in 2016, the share of debt in total assets of state-owned companies remained well below the level recorded by the private ones.

With regard to the solvency ratio of SOEs, reflected by the ability to cover their debt with their assets, it has undergone limited changes from 28.9% in 2015 to 29.2% in 2016. This result is justified by the fact that both the assets and the total debt of SOEs remained relatively stable with very small changes of less than 1%. The result is also influenced by the uneven distribution of debt across SOEs which include large firms with very low levels of indebtedness.

On the other hand, the indicator reflects a significantly higher indebtedness of private companies (67.8%), this level being very close to that recorded in 2015 (68%). Excluding the top five SOEs, the solvency ratio is 37.9%, which in turn is very close to the level recorded in 2015 (36.7%).

In conclusion, the solvency analysis for all categories of companies included in the study highlights the stability of the indicator, with no significant changes relative to 2015.

Figure 7: Solvency ratio (%)



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

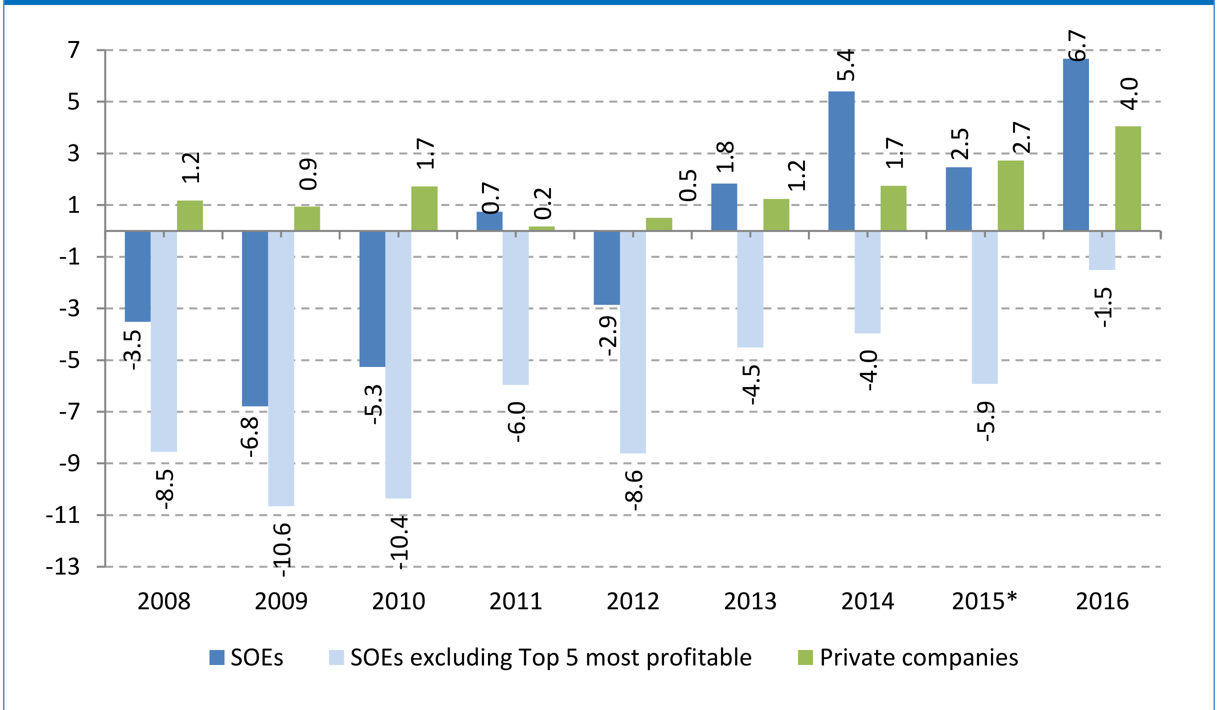
*Solvency ratio (%)=Total debt / Total assets * 100*

The profit margin of state-owned companies improved significantly from 2.5% in 2015 to 6.7% in 2016., exceeding the performance of private companies and being in line with the overall positive dynamics of economic activity.

The improvement of the operational efficiency of SOEs (attested by the operating margin) is also visible at the level of the profit margin, which increased significantly from 2.5% in 2015 to 6.7% in 2016. Moreover, SOEs' profit margin exceeded the one recorded by private companies (3.9%, also higher in comparison with 2.7% in 2015). Excluding the top five companies, the profit margin recorded negative values throughout the analyzed period, but there was a significant improvement in 2016 (-1.5% versus -5.9% in 2015). Although it remains negative, it is noteworthy that the -1.5% margin is the best result recorded since 2008.

The differences between the operating margin and the profit margin are explained by the fact that the latter takes into account the financial and extraordinary results. Thus, due to the negative impact of interest expenses on the net income, the profit margin recorded lower values relative to the operating margin.

Figure 8: Profit margin (%)



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

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

**In 2015 at the level of SOEs was excluded the profit of S.C. Oltchim S.A. originated from the cancellation of a part of debt.*

In 2016, the gross profit per 1,000 employees exhibited a spectacular growth for state-owned companies mainly due to a considerable increase of the gross profit. Excluding the top five companies, the gross profit remains negative, but the results are significantly improved relative to 2015.

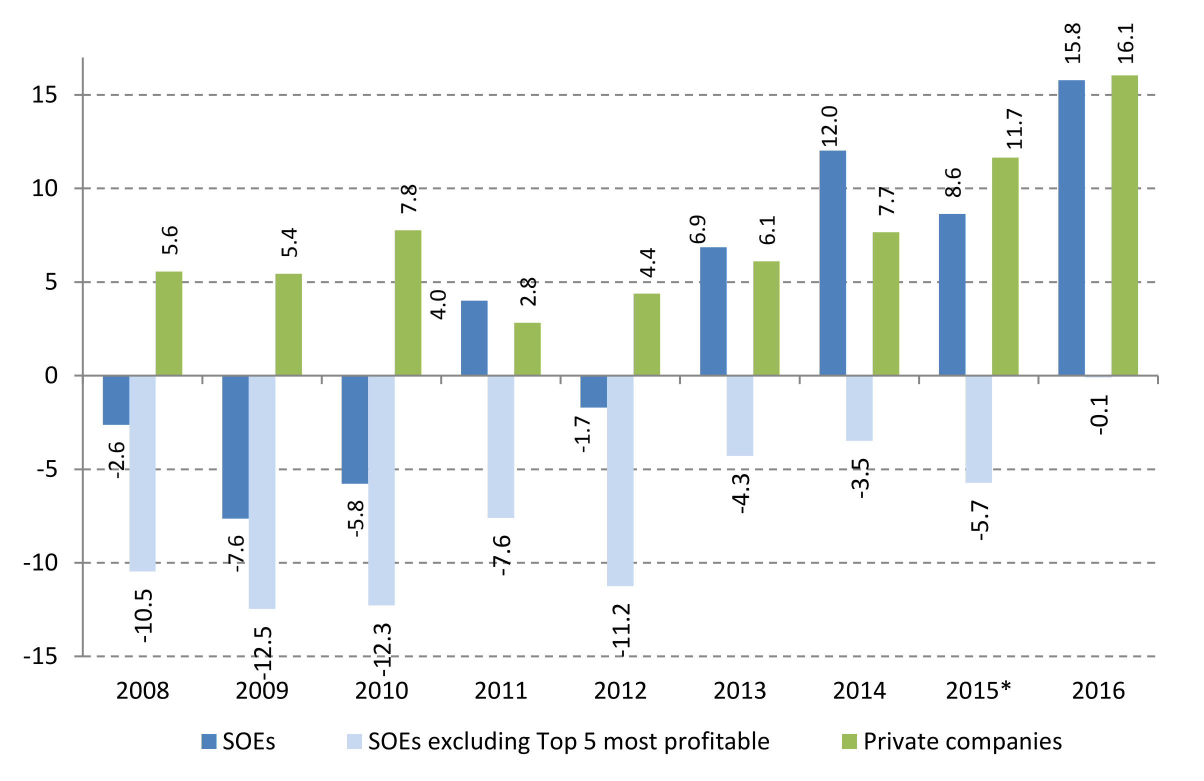
Private companies have continued the upward trend from previous years and, for all the categories of companies included in the study, 2016 marks the maximum values of the gross profit per 1,000 employees since 2008.

Gross profit per 1,000 employees is an indicator that measures the average profit generated by every 1,000 employees, assessing the company's effectiveness in using its own employees to maximize profits. For SOEs, the indicator recorded a spectacular growth of more than 80% compared to 2015, due to an important increase of the gross profit (by about 76%) and further sustained by a drop of about 4% in the number of employees.

It is worth noting that the strong dynamics of the indicator significantly reduced the gap towards private companies. However, the overall results of SOEs were substantially improved by the top five companies: in 2016 they registered a gross profit of 4,462 million lei, while the remaining SOEs recorded losses of 23 million lei. Therefore, the gap between the top five companies and the other SOEs is considerable, significantly influencing the overall results. Nevertheless, even when the top five companies are excluded, there is a significant improvement of the indicator: -0.1 million lei in 2016 compared to -5.7 million lei in 2015.

Positive developments are also registered by private companies: their gross profit per 1,000 employees increased from 11.7 million lei in 2015 to 16 million lei in 2016. It is important to note that, for all the categories of companies included in the study, in 2016 the maximum values of the indicator since 2008 were recorded.

Figure 9: Gross profit per 1,000 employees (million lei)



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

**In 2015 at the level of SOEs was excluded the profit of S.C. Oltchim S.A. originated from the cancellation of a part of debt.*

The return on equity generated by state-owned companies improved over the course of 2016 but continues to be significantly lower than the one obtained by private firms: 2.5% versus 12%.

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

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

In 2016, SOEs recorded an improvement in both rates of return, mainly driven by the net income growth of nearly 160%. Thus, ROE reached 2.5% while ROA increased to 1.8%, bothrepresenting the maximum values recorded by SOEs since 2008.

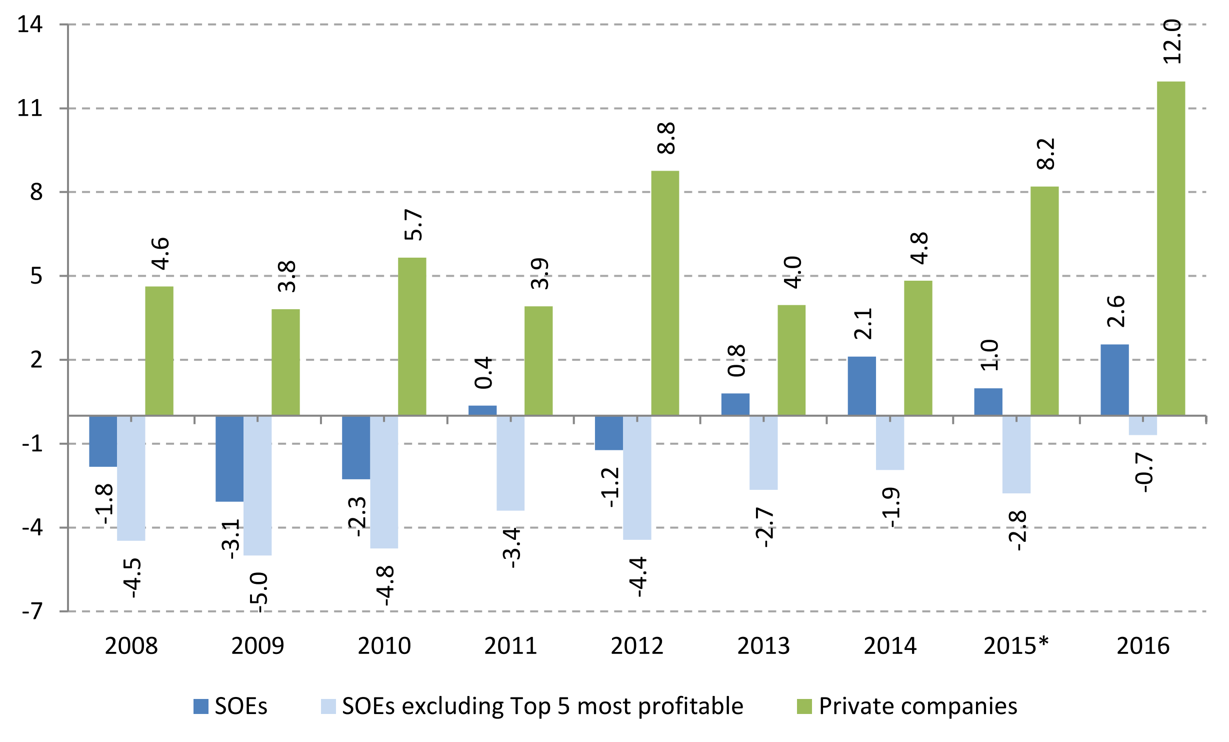
Thus, the ability of state-owned companies to generate value for their shareholders is rather poor. The return on assets exhibited a similar trend: state-owned companies rose from 0.7% in 2015 to 1.8% in 2016. During the same period, the return on assets of private firms increased from 2.6% to 3.8%.

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

Excluding the top five companies, both rates of return continue to register negative values (-0.7% for ROE and -0.4% for ROA). However, once again there is a clear improvement, with ROE and ROA reaching the maximum levels throughout the analyzed period.

With regard to private firms, the upward trend from previous years continues in 2016, being sustained by a net income growth of more than 50%. Thus, ROE rose to 12% from 8.2% in 2015 while ROA increased to 3.8% from 2.6% in 2015.

Figure 10: ROE (%)

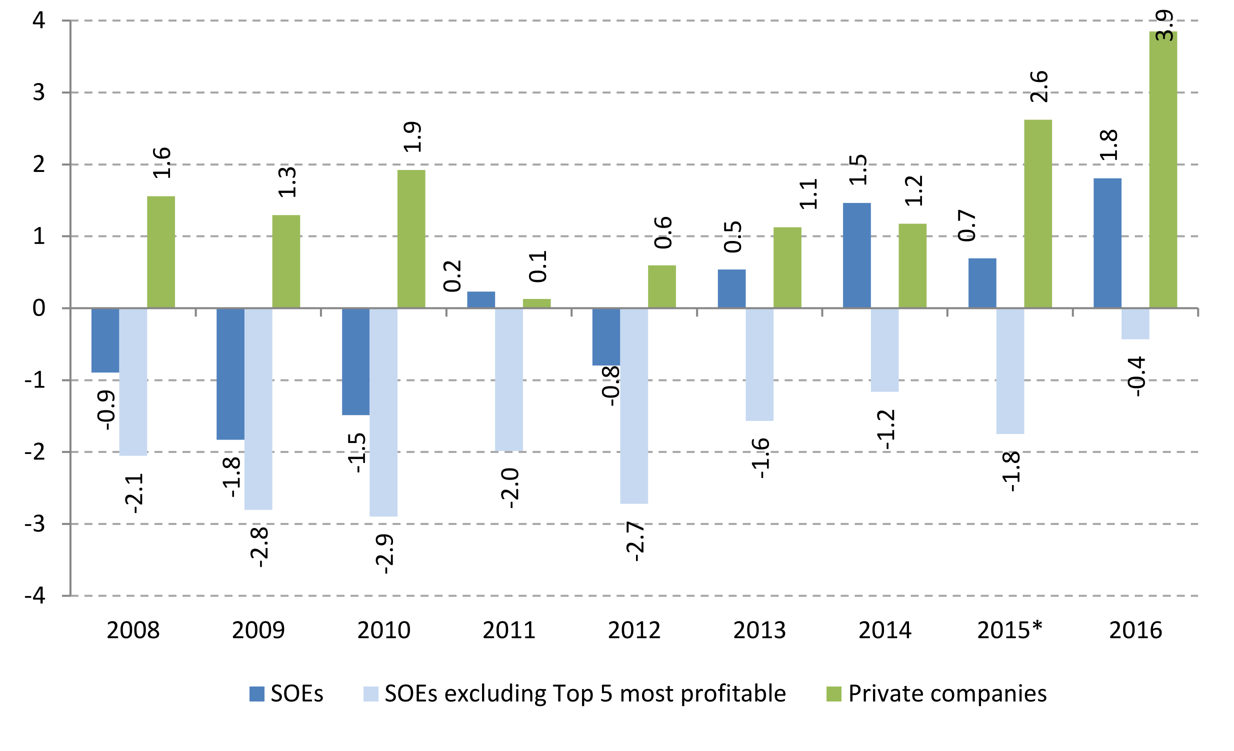


Source: MPF, based on the balance sheets submitted by the economic agents from non-financial sector

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

**In 2015 at the level of SOEs was excluded the profit of S.C. Oltchim S.A. originated from the cancellation of a part of debt.*

Figure 11: ROA (%)



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

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

**In 2015 at the level of SOEs was excluded the profit of S.C. Oltchim S.A. originated from the cancellation of a part of debt.*

The interest coverage ratio of state-owned companies continued the upward trend from previous years, but after the considerable increase between 2014 and 2015, the pace of growth in 2016 was slower. However, this indicator should be interpreted with caution because its values are largely influenced by the top five companies in terms of profitability.

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

After a considerable increase between 2014 and 2015 (from 3.2 to 13.1), the interest coverage ratio of SOEs continued to grow in 2016, but at a slower pace, reaching the value of 17.6. This evolution should be interpreted with caution because the indicator is strongly influenced by the top five companies in

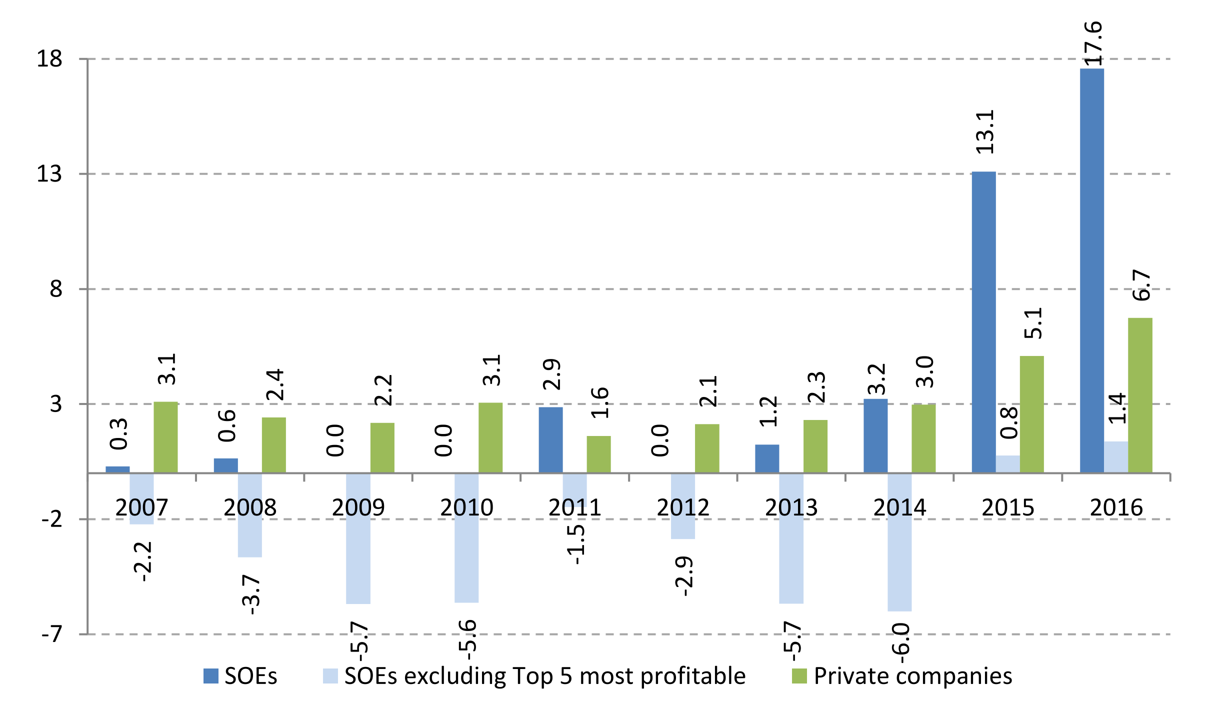
Private firms continued the upward trend in terms of the ability to repay interest expenses. Although the pace of growth was moderate, it is expected that the trend will be sustainable, being supported by significant increases in the operating and net profits.

terms of profitability. Thus, on one hand, they recorded large operating profits and, on the other hand, they reported low interest expenses or even equal to 0 in the case of S.N.T.G.N. Transgaz S.A. Consequently, their interest coverage ratios are very high (reaching a maximum of 90,384.8 in the case of S.N.G.N. Romgaz S.A.) and the important weight of the top five companies, relative to all SOEs, influences significantly the results of the indicator for the entire category.

Excluding the top five companies, the interest coverage ratio for the remaining SOEs has a moderate value of just 1.4. It should be noted that, for the first time throughout the analyzed period, the interest coverage ratio is above the critical threshold of 1, continuing the favorable trend from 2015 when it returned to positive values. This increase could indicate a real improvement in the solvency of SOEs, as 2016 also exhibited positive values for the operating result.

Private firms continued the upward trend in terms of the ability to repay interest expenses, with the indicator rising from 5.1 in 2015 to 6.7 in 2016. Although this is not a major development, it is expected to be sustainable, being supported by significant increases in the operating and net profits.

Figure 12: Interest coverage ratio



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

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

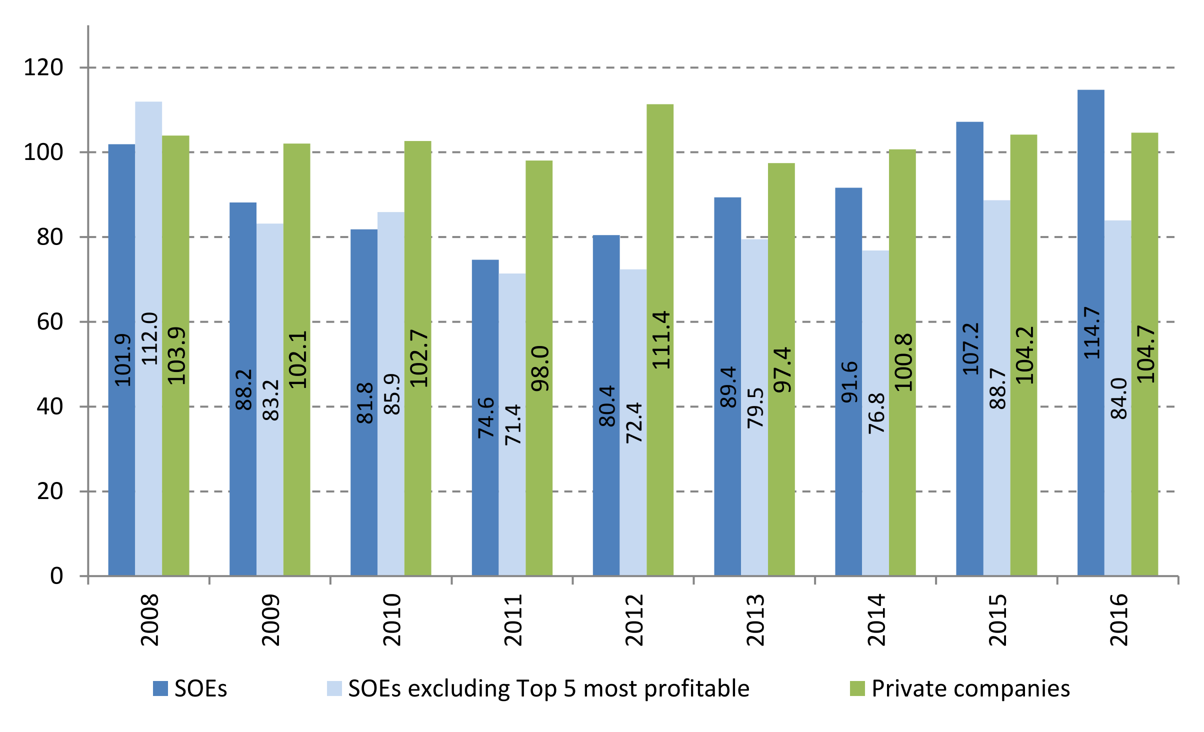
In 2016, the liquidity ratio of state-owned companies continued to evolve on an upward trend, exceeding the value recorded by private firms.

Excluding the top five state-owned companies, the liquidity ratio suffered a deterioration of nearly 5 pp and continues to be well below the recommended threshold.

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

In 2016, the liquidity ratio of SOEs continued to evolve on an upward trend, reaching 114.7%. This level is superior to the liquidity ratio recorded by private firms which stabilized around 104%. Thus, both categories of companies exhibited liquidity ratios that can be considered adequate. However, excluding the top five SOEs, there is a worsening in liquidity from 88.7% to 84%, this value being well below the aggregate level and the recommended threshold of 100%.

Figure 13: Liquidity ratio (%)



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

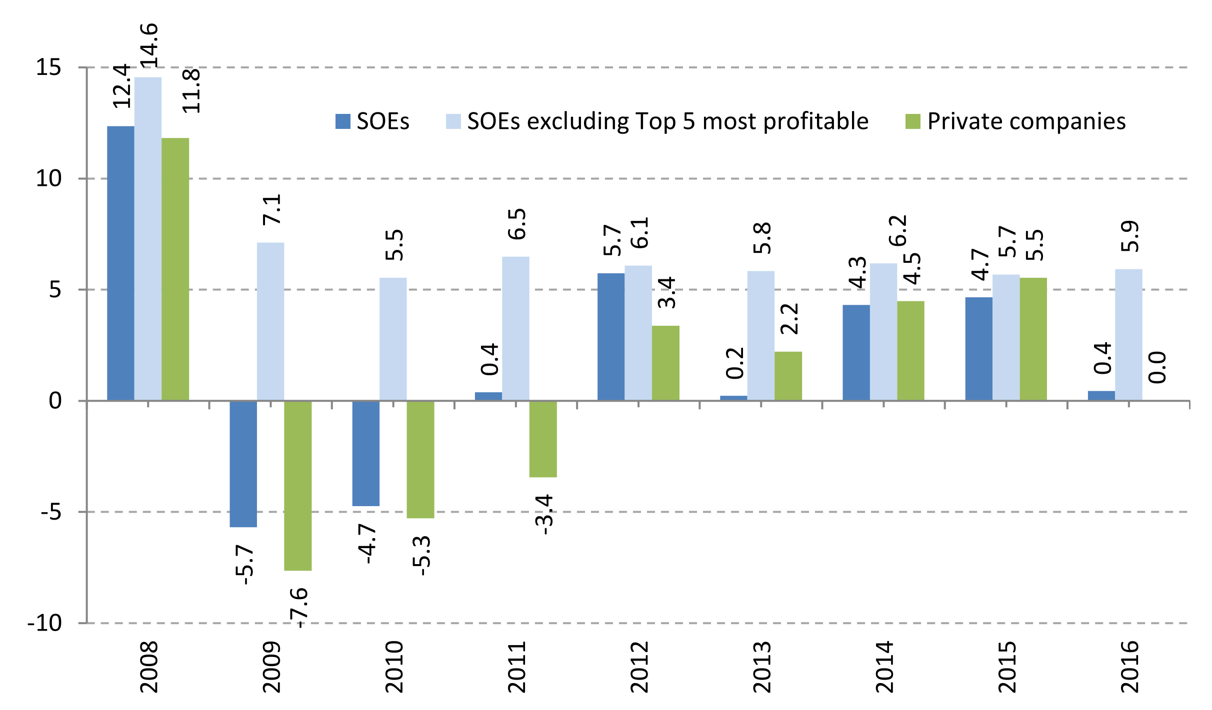
*Note: Liquidity ratio (%) = Current assets / Short term debts *100*

2016 marked a significant drop in the ratio of new investments for state-owned companies, both in aggregate levels and excluding the top five companies.

On the other hand, the indicator has recorded a slight increase for private firms, while continuing to fluctuate around 6%.

While between 2014 and 2015 the new investments conducted by SOEs stabilized around 4.5% of total assets, in 2016 they suffered a drastic reduction to 0.4%. Excluding the top five SOEs, the decrease is even more pronounced, with the new investment ratio reaching close to 0. Thus, the results confirm that this indicator exhibits a high volatility in the case of SOEs, with sudden evolutions from one period to the next. On the other hand, in the case of private firms the ratio of new investments has grown moderately from 5.7% to 5.9%, thus, remaining around 6% for the entire 2010-2016 interval. At the same time, it should be noted that, for all the companies included in the analysis, the ratio of new investments is still considerably lower than its pre-crisis levels.

Figure 14: New investments (% of total assets)



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

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

With the entry into force of the Emergency Ordinance no. 109/2011 on the corporate governance of public enterprises, there has been a visible progress in increasing the transparency and monitoring of the activity of state-owned companies. Despite the recommendations of the international financial institutions to consolidate

The improvement of SOEs' performance was also supported by the legislative reforms embodied by the enforcement of the Emergency Ordinance no. 109/2011 regarding corporate governance of public enterprises. This represented a major step in the implementation of the best corporate governance practices and aimed at depoliticizing and professionalizing the management of SOEs, both regarding the selection, appointment and functioning of the Board of Directors and managers, and in terms of increasing transparency and providing information in order to increase the public companies' accountability. The overall performance of SOEs has improved also due to the entry in liquidation procedure of the National Coal Company, Termoelectrica and Oltchim S.A[22]. In the year 2016, new regulations were formally

[22] Its entry into the voluntary liquidation procedure was stipulated in the Memorandum sent to the IMF in 2013. In 2015 the reorganization plan was approved, stipulating the debts cancellation amounting to 2.4 billion lei (registered as scriptic income of this period of time, thus influencing the financial outcome for 2015 compared to the previous year).

the progress and bring the financial performance of state-owned enterprises to a level comparable to that of the private sector, the latest amendments made in 2016-2017 to Emergency Ordinance no. 109/2011 on Corporate Governance of Public Enterprises practically abolishes the implementation of good corporate governance practices in the state-owned companies.

introduced to promote corporate governance: Law no. 111/2016 with implementing rules (Government Decision no. 722/2016), the establishment of a specialized department within the Ministry of Public Finance for overseeing the implementation of the provisions of GEO no. 109/2011, monitoring the activity of public enterprises with the obligation to report some performance indicators on the basis of which MFP draws up an annual report on the activity of public enterprises, and so on. Thus, in 2016, according to the Annual Report on the Public Enterprises Activity elaborated by the Ministry of Public Finance, regarding the fulfillment of indicators according to the mandate contracts, it is shown that the corporate governance indicators had the highest degree of non-compliance, respectively 6 out of 7 indicators, against financial indicators (1 out of 73) or non-financial ones (3 out of 20). Among the performance indicators on corporate governance, it includes: developing executive management evaluation models and implementing the valuation process and remuneration policies of the CEO; implementing the code of ethics, the corporate governance code, and ensuring transparency in relation to public information; setting, reviewing and pursuing the performance indicators at the level of the public enterprise. The report also shows that those SOEs that implemented the corporate governance system and have selected professional administrators, performed better in terms of optimizing their financial and operational efficiency. Nevertheless, and despite the recommendations of the international financial institutions aiming to consolidate the progress made and bring the financial performance of the SOEs to a level comparable to that of the private sector's companies, following the publication of the Law no. 111/2016 approving the Emergency Ordinance no. 109/2011 (which brought a number of changes that were difficult to apply in practice[23]), a number of legislative changes were proposed that led to the *de facto* non-application of the initial provisions aimed at strengthening corporate governance for SOEs. Thus,

[23] Even the reporting procedures were amended several times during 2016 and 2017 by Orders of the Minister of Public Finance (OMPF no. 41/2014 was repealed by OMPF no. 2873/2016 and amended by OMPF no. 768/2017).

according to the legislative proposal approved by the Chamber of Deputies in December 2017, there were exempted from the applicability of the provisions of GEO no. 109/2011 dozens of companies and institutions[24], most of them in the field of defense sector, energy sector, chemical industry, road infrastructure, etc. Practically, at the entry into force of the law thus amended, the provisions of GEO no. 109/2011 on corporate governance will no longer apply to most SOEs.

The impact of state companies on the budget balance in European standards ESA10 was positive in 2013-2016, the contribution of the companies consolidated in central government sector (the first 20 companies) and local sector being between 0.5% of GDP in 2014 and 0.2% of GDP in 2015-2016. Regarding the state-owned companies consolidated in the local government the contribution was mainly negative (except 2015), but of small amplitude.

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

According to the Eurostat methodology for accrual accounting (ESA10), several SOEs have been reclassified in the government sector. The 309 SOEs consolidated in central government sector had a positive influence on the general consolidated budget balance in ESA10 standards in 2013-2016. The table below shows the contribution to consolidated budget balance in ESA10 standards of the first 20 state owned companies included in the central government; they had positive contribution accounting 1428.5 million lei (0.2% of GDP) in 2016, slightly above 2015 level. Regarding the SOEs consolidated in the local government, in 2016 they had a negative contribution to the consolidated balance in ESA10 standards (-70.6 million lei), similarly to the 2013-2014 period of time. Cumulatively, the

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

contribution of these consolidated state companies to the central and local government sector in 2016 accounted for around 0.2% of GDP.

Table 6: Contribution of state companies included in the public sector to the consolidated budget balance (million lei), ESA10 standards				
	2013	2014	2015	2016
1. Total companies at central level	**2,861.3**	**3,498.4**	**1,344.8**	**1,428.5**
C.N. de Căi Ferate CFR S.A.	225.5	501.8	424.5	524.4
C.N. de Autostrăzi şi Drumuri Naţionale	2,171.6	2,244.2	341.0	463.6
CFR Călători S.A.	95.5	473.0	308.0	-4.8
Compania națională de investiţii S.A.	44.5	85.3	229.9	-13.9
S.N. Radiocomunicaţii S.A.	138.3	102.4	72.0	63.2
Societatea de administrare a participațiilor în energie S.A.	0.0	-1.7	68.1	29.3
Societatea română de televiziune	56.3	-5.0	51.3	51.0
Societatea română de radiodifuziune	24.1	15.2	25.9	25.1
S.N. Aeroportul Internațional Mihail Kogălniceanu	0.3	3.2	1.0	-0.4
C.N. Administrația Canalelor Navigabile Constanţa S.A.	13.2	-19.0	-33.8	83.7
Administrația fluvială Dunărea de Jos Galați	25.6	2.4	18.0	18.7
Fondul Proprietatea	0.0	0.0	0.0	0.0
Institutul Național de Cercetare-Dezvoltare pentru Chimie și Petrochimie	-0.1	-1.1	-8.2	-1.7
S.N. Închideri Mine Valea Jiului S.A.	14.2	11.2	10.7	10.4
S.C. Electrocentrale Grup S.A.	-55.9	11.2	-9.9	-0.1
R.A. Tehnologii pentru energie nucleară	21.7	0.6	-1.1	1.3
S.C. CONVERSIM S.A.	-2.5	61.0	-2.2	-1.5
S.N. CFR R.A	-1.0	-0.6	-42.6	-0.2
C.N. Administraţia Canalelor Navigabile Constanța S.A.	13.2	-19.0	-33.8	83.7
Metrorex	76.8	33.3	-74.0	96.6
2. Total companies at local level	**-235.2**	**-20.8**	**43.5**	**-70.6**
Local airports	-11.3	-19.1	13.1	-53.3
Heating stations with local subordination	-66.5	-23.9	-5.2	-23.1
Other local units	-157.5	22.2	35.6	5.8
3. Total SOEs	**2,626.1**	**3,477.6**	**1,388.3**	**1,357.9**
% of GDP	**0.41%**	**0.52%**	**0.19%**	**0.18%**

Source: NIS

Most economic and financial indicators of SOEs have improved during 2016 and this evolution reflects an increase in the efficiency of these companies. However, it is also a direct consequence of the position within the economic cycle, improvements and positive results being recorded throughout the entire economy. At the same time, it is important to note that the level of financial performance is not uniformly distributed among SOEs, as there are some particularly profitable companies that positively influence the average of the entire sector, but also many companies that experience problems concerning arrears and profitability. Moreover, as mentioned in the introduction of this study, since the sample of SOEs included in the analysis is smaller, the results indicate their overall performance, but they are not fully comparable to those obtained in the previous years and should be interpreted with caution.

On the other hand, the financial discipline of SOEs seemed to deteriorate during 2016. While the contribution of SOEs to economic activity is constantly decreasing, reaching in 2016 the minimum level for the entire period under review, the share of their arrears in total arrears is significantly higher and increased relative to 2015. Although the arrears of SOEs are partially the result of historical developments, this deterioration is in contradiction with the declining trend of outstanding payments in the private sector.

An overview of the main economic and financial indicators highlights a significant increase of the operating and net profits, also reflected in the improvement of ROE and ROA. However, the profitability gap between SOEs and private firms remained significant, indicating the lower efficiency of the public sector. The results of the main solvency and liquidity indicators did not highlight pressing issues concerning the "health" of SOEs, but an in-depth analysis showed that the values of the indicators are strongly influenced by the top five companies in terms of profitability. When their impact was eliminated, a deterioration of the liquidity ratio could be noticed, all the more worrying given that, since 2009, the values of the indicator remained below the threshold recommended in financial literature. Another negative signal is given by the ratio of new investments to total assets: it continued to be highly volatile in the case of SOEs – attested by a drastic decline in 2016 – while the new investments of private firms remained relatively constant in recent years. An important aspect, with potential negative consequences for future economic growth, is that for all the companies included in the analysis, the ratio of new investments is still considerably lower relative to its pre-crisis levels.

In the post-crisis period, the improvement of the economic and financial performance of SOEs was also supported by the legislative reforms materialized through the enactment of the Government Emergency Ordinance no. 109/2011 on Corporate Governance of Public Enterprises. However, its modification during the 2016-2017 period, which allowed a significant number of companies and institutions to be excepted from applying this ordinance, is practically abolishing the implementation of good corporate governance practices in most SOEs. Consequently, there is a significant risk that the progress made in recent years will be reversed.