

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 GCB 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:
 - o 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;
 - o 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;
 - o 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 assistance¹: + 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

¹ See Annex 1.

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.

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 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 15th November 2017.

15th November 2017

Chairman of the Fiscal Council,

IONUȚ 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

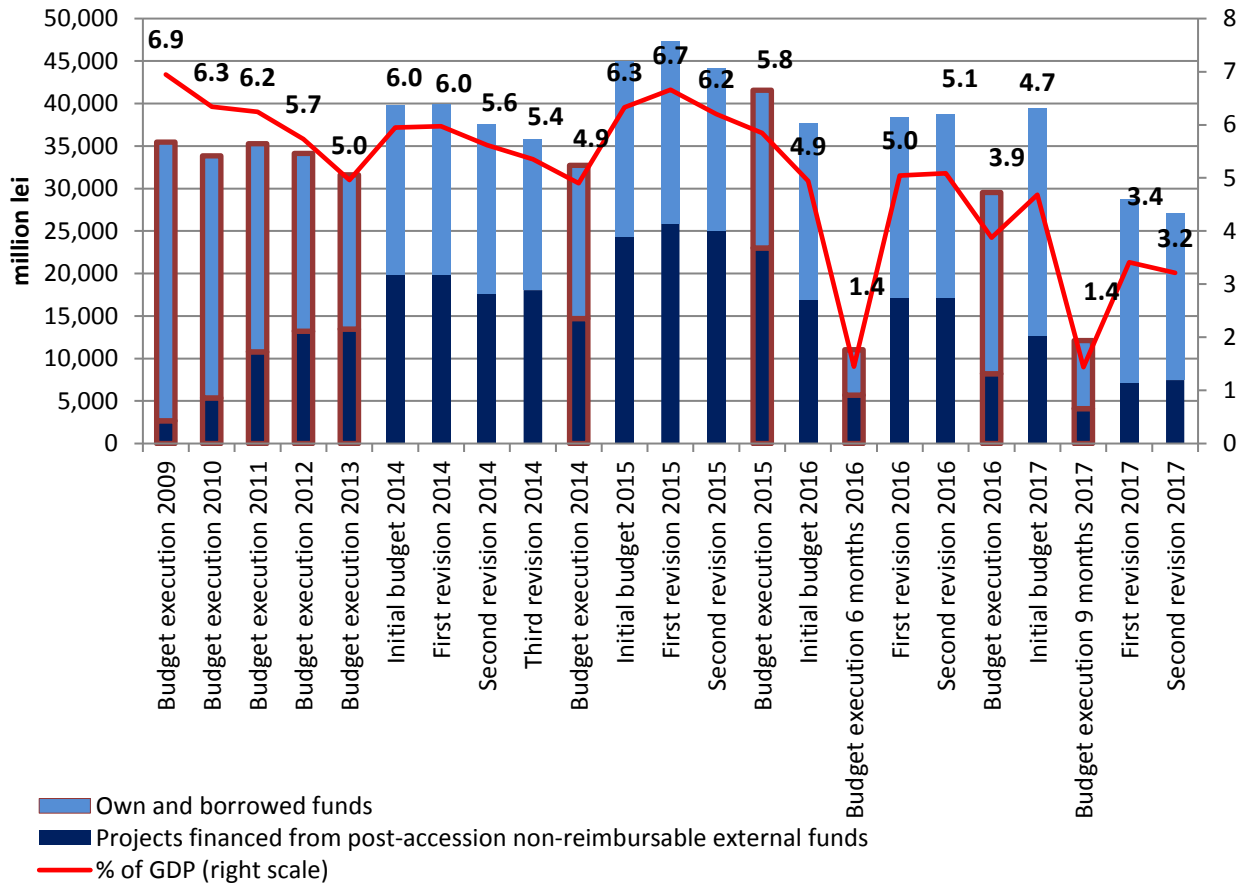
Source: Ministry of Public Finance, Fiscal Council's calculations

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 calculations

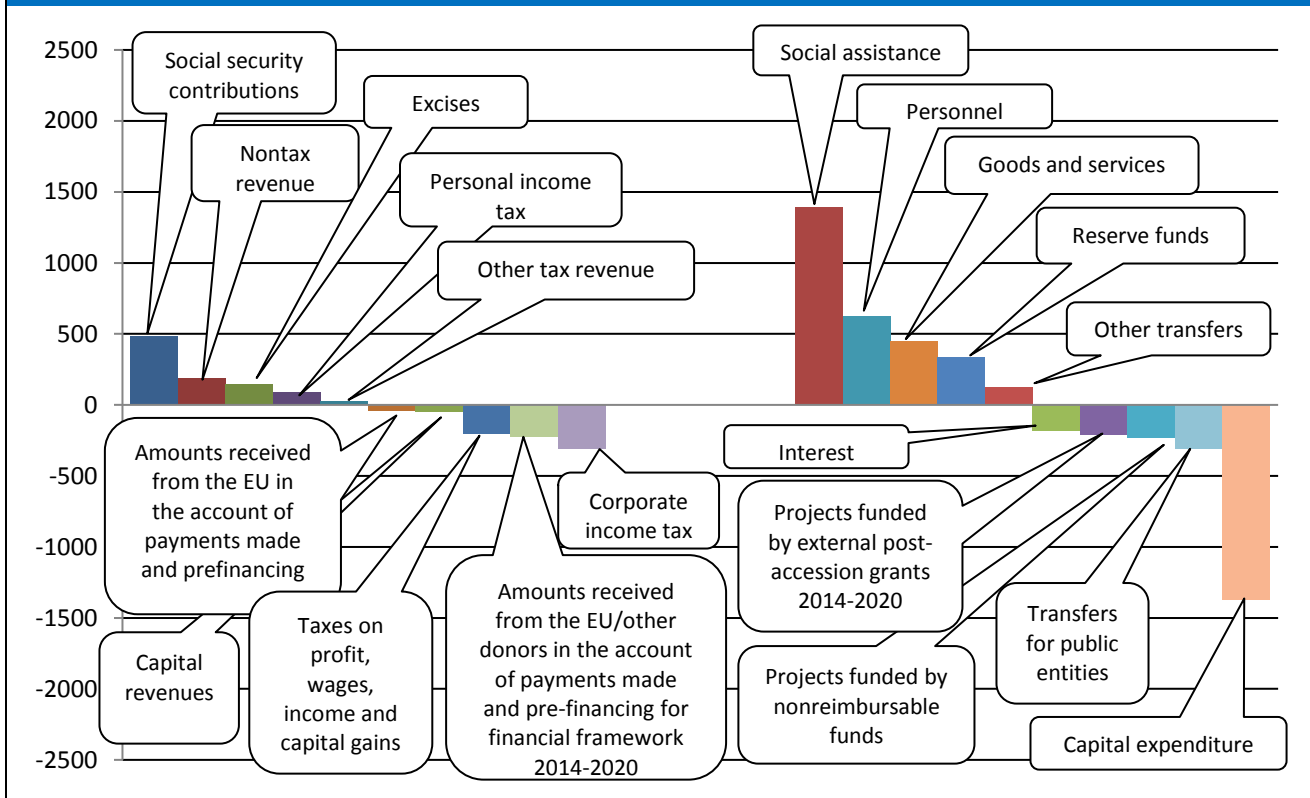
Figure 1: Evolution of the investment expenditure in the period 2009-2017

- planned vs. execution, million lei



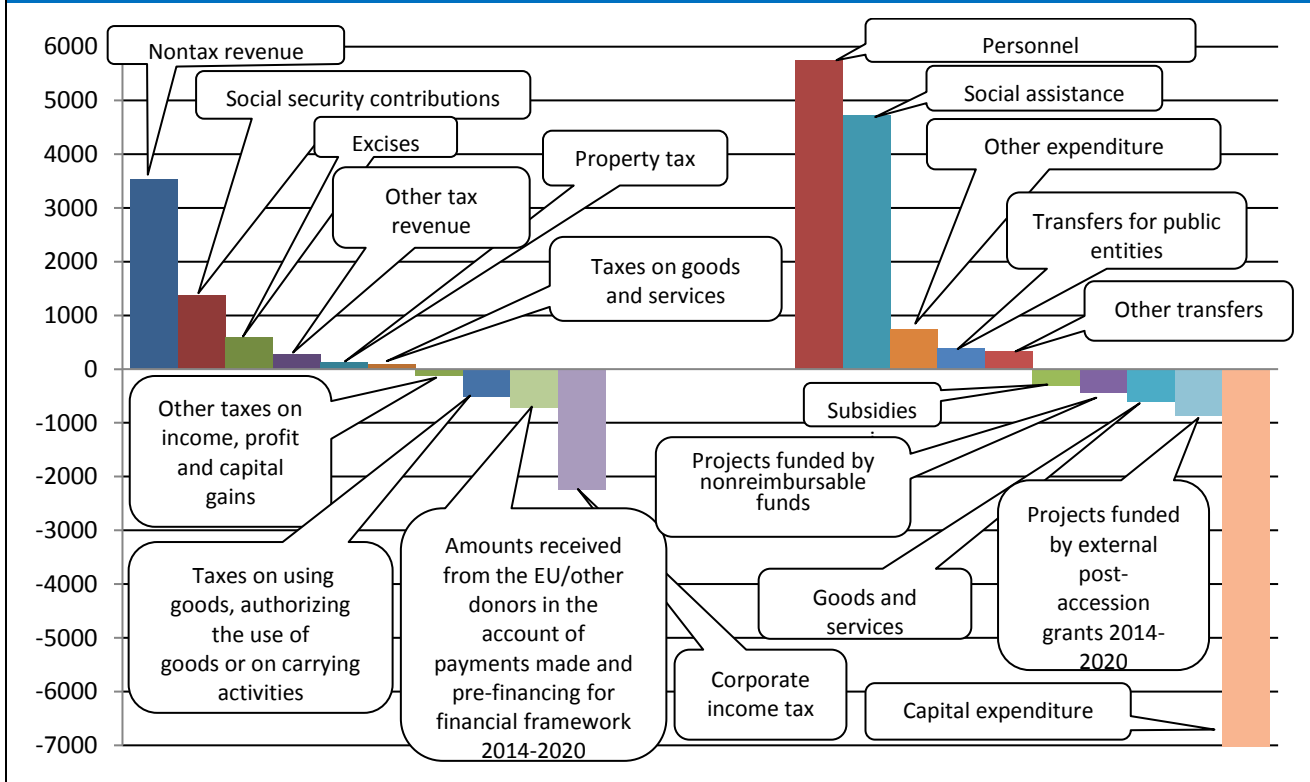
Source: Ministry of Public Finance, Fiscal Council's calculations

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