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Fiscal Council

Fiscal Council's Opinions

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FISCAL COUNCIL
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I. Fiscal Council's opinion on the draft Government Emergency Ordinance amending art. 19 of Law no. 571/2003 regarding the Fiscal Code (profit tax exemption for reinvested profits)

On April 21st, 2014, the Fiscal Council received from the Ministry of Public Finances (MPF) the letter no. 668810/18.04.2014, requesting the opinion of the legislative proposal on profit tax exemption for reinvested profits. Meanwhile, the aforementioned legislative proposal was adopted at the meeting of the government on April 23rd, 2014, and subsequently published as G.E.O. no. 19/2014 in the Official Journal no. 308 of April 25th, 2014, without the Fiscal Council's endorsement, required under art. 13 of Law no. 69/2010 (FRL) as amended and supplemented. According to the article of the Fiscal Responsibility Law (FRL) mentioned above "*proposals for any legislation leading to a reduction of budgetary revenues must provide a financial statement according to article 15 of Law no. 500/2002, as amended and supplemented and meet at least one of the following conditions:*

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

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

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

Clearly, a Fiscal Council opinion on the legislative proposal in question could not be drawn up and adopted within the time frame available until discussion in the government meeting. The Fiscal Council notes that, despite its repeated requests (see *Fiscal Council's opinion on the State Budget law, Social Insurance Budget law for 2013 and the updated version of the 2013-2015 Fiscal Strategy, Fiscal Council's Opinion on the Half-Year Report Regarding the Economic and Budgetary Situation and Fiscal Council's Opinion on the Draft Budget Revision for 2013, Fiscal Council's opinion on the State Budget Law, Social Insurance Budget Law for 2014 and the updated version of the 2014-2016 Fiscal Strategy*) for a reasonable time to analyze the documents on which its endorsement/opinion is requested, the Ministry of Public Finance continues to treat the provisions of the FRL and the Fiscal Council's institution with insufficient consideration.

Brief description of the proposed legislation and of the impact on revenues estimates determined by MPF. General considerations

From a fiscal perspective, the recovery of investment in fixed assets such as technological equipment, in the absence of changes in the Tax Code introduced by the current legislative proposal, is realized by deducting the depreciation expenses from the taxable income, calculated either linear (equal tranches during the equipment's useful life) or accelerated - by deducting in the first year up to 50% from the asset's enter value. The legislative proposal regarding reinvested profit tax exemption for certain categories of fixed assets (technological equipment - machinery, technological equipment and work equipment, as specified in subgroup 2.1 of the Catalog regarding the classification and normal useful lives of fixed assets) equals, from a fiscal standpoint, with the complete recovery of eligible investments in the first year of utilization (limited to the accounting profit from that year); in addition, the depreciation will continue to be recognized as a deductible expense over the useful life of the equipment under the restriction of not applying the accelerated depreciation scheme. This legislative measure is temporary, being applicable to eligible investment made between July 1st, 2014 - December 31st, 2016. Over the long term, the measure appears as fiscally neutral (if we ignore the time value of money): the amount of profit that benefits from the tax exemption is allocated to reserves that become taxable upon their utilization in any form. Also, there is an obligation to keep the equipment for half of their life span, but not more than 5 years.

The legislative measure was well received by the business environment, as it is likely to improve the cash flow of the companies in a time when they are experiencing liquidity constraints. The Fiscal Council appreciates that the measure is appropriate from an economic point of view, but has reservations regarding the size of the budgetary impact on revenues assessed by the Ministry of Public Finances, during the period covered by this facility.

The explanatory note attached to the normative act sent by the Ministry of Public Finances to the Fiscal Council estimates marginal revenue losses (an annualized impact of 0.1% of GDP), of 137.5 million lei in 2014 (only one quarter of profit tax receipts would be affected in the case of the cash budgetary execution), 572.7 million lei in 2015, 604.1 million lei in 2016 and 153 million lei in 2017 (the receipts corresponding to the last quarter of 2016, the last year covered by the facility, are collected in the first quarter of 2017). The document does not explain in any way how the impact assessment was reached. The Fiscal Council's calculations (presented below) indicate the fact that the size of the revenue losses is most likely significantly underestimated.

The Ministry of Public Finances states in the same explanatory note that the budgetary revenue losses generated by the legislative measure will not lead to the increase of the budget deficit, as it will be covered according to the provisions of article 21 from the Law no. 500/2002. The cited article states that 10% of the budgetary credits[1] are retained from being spent and the utilization of this reserve is to be made in the second semester. Basically, in order to meet the budget deficit target, the Ministry of Public Finances intents to offset the identified budgetary revenue losses by reducing some expenses (the specific categories are not specified). However, the reference to the law article cited above does not mean that the authorities are exempted from the responsibility to explicitly identify the specific categories of expenditure to be reduced. Moreover, the bulk of the measure impact is expected not to materialize in the current year – for which the provisions of article 21 of Law no. 500/2002 are applicable, but in the next two years. A medium term fiscal projection which explicitly incorporates the negative impact on revenues and identifies the compensating spending cuts seems necessary and in its absence it is impossible for the Fiscal Council to endorse that the effects of the proposed measure do not affect the annual and medium term budgetary targets.

In addition, the current situation reflects a drawback in the way the medium term fiscal planning is realized: the programmatic documents are vague and not very transparent in terms of the discretionary fiscal policy measures to be adopted, lacking a commitment to a set of measures explicitly incorporated in the aggregate projections of revenues and expenditures. Thus, the Fiscal Strategy contains a simple statement of intent with respect to a set of fiscal policy measures to be adopted, lacking the impact quantification and the proposed implementation terms while the projected trajectories of the revenues and expenditures aggregates are not consistent with their adoption. Referring to the current case, the last iteration of the Fiscal Strategy has merely listed as a specific objective "the tax exemption, for a 5 year period of the dividends reinvested in machinery and technological equipment, research and development, which are increasing the social capital of the firms where they are shareholders, or are used at the participation to the social capital of other companies and which lead to the creation of new jobs".

An alternative assessment of the impact on budgetary receipts starting from the firms' balance sheets

The Fiscal Council interprets the legislative proposal as allowing the companies to deduct from a fiscal point of view the entire acquisition value of technological equipment in the first year of

[1] With the exception of personal, health and social insurance expenses, public debt expenditures, expenses arising from international obligations, amounts allocated from the Contingency Reserve Fund and from the Intervention Reserve Fund.

utilization, decreasing the corresponding taxable profit; considering both the way the fiscal facility is designed and the current economic situation – firms are characterized by liquidity constraints, it is expected that almost all companies which realize eligible investments and which are profitable to use this facility, even if it implies a temporary constraint upon their dividend policy.

In its' approach, the Fiscal Council starts from the companies' gross investments included in the F40 form "statement of fixed assets", taking into consideration the impact of the proposed legislative change on deductible expenses. The impact analysis is drawn *caeteris paribus*, considering an unchanged behavior of economic agents after this legislative change, respectively assuming that the same level of investment in technological equipment is achieved as before granting the fiscal facility.

Assuming that this behavior will change in the sense of bringing in the present some investments that should be made in the future, the loss of revenue would be higher than estimated[2].

The starting point of the assessment is the level of tangible assets at the end of 2012, for which are available the most recent reports; the revenue loss estimation starts as counterfactual at the level of 2012 (how much lower would have been the corporate income tax receipts if non-taxation of reinvested profit facility would have applied since that year), going to be brought forward at the level of the current year and extrapolated into the future based on a number of assumptions about the evolution of the amount of eligible investment. The database, containing the balance sheets of companies from Romania in 2012, was interrogated for fixed assets increases included in the category "Technical installations and machinery" (equivalent to gross investments) of the profitable companies from the following sectors: industry, agriculture and telecommunications – which by the nature of their activity are those that invest in eligible equipment from the fiscal facility point of view (subgroup 2.1 from the Catalogue regarding the classification and normal useful life of fixed assets) and for the amount of their accounting gross profit. Given that deductible expenses can only increase up to the limit represented by the accounting profit, we distinguish between companies whose accounting profit covers all

[2] Clearly, there are possible spillover effects if the planned investments for the period after the expiry of the facility are brought within the range covered by this, but not only they are difficult to quantify, but the net effect on the budgetary revenues would be even more unfavorable on the short term compared to the *caeteris paribus* scenario – deductible expenses would increase, taxable profit would decrease accordingly, with a partial and gradual mitigation on the medium and long term given the additional budgetary revenues due to an increase of the sales volume and the number of jobs that would occur more rapidly than it would have happened in the absence of granting temporary facility.

gross investment in technical installations and equipment and companies whose accounting profit is lower than the increases of relevant tangible assets. The table below summarizes the results of the query, for the first category of companies being reported the gross investments, while for the second category gross profit is reported as it represents the upper limit for deductibility under granting the fiscal facility:

Year 2012	Industry	Agriculture	Telecom	Total new investments that could benefit from the facility
Total tangible assets increases - technical installations and machinery (companies with gross profit > 0 and investments in technical installations and machinery <= gross profit)	13.399	2.342	0.642	16.383
Total gross profit (companies with gross profit > 0 and investments in technical installations and machinery > gross profit	1.38	0.219	0.106	1.705

Given that the analysis includes strictly those economic sectors at the level of which are located the eligible fixed assets in terms of the fiscal facility, it is reasonable to evaluate the amount of deductible expenses after the application of the facility as representing the amount of tangible assets in technical installations and machinery increases (acquisition value), within the limit of the gross profit reported by companies – according to the above table, this amount is 18,1 billion lei, to which is added the linear depreciation, that is mandatory applicable according to the normative act. To evaluate the counterfactual budgetary revenue loss from the application of the facility in 2012, a hypothesis on how the equipment in question are normally amortized is required: the baseline scenario is built on the assumption that, without the facility, half of the investments in technical installations and machinery are accelerated amortized (50% from their value in the first year and linear depreciation for the remaining value), and the rest are linearly amortized, assuming as above an equipment lifespan of 10 years; in addition, all investments are assumed to be made on day 1 of the year. Alternative scenarios from the perspective of this hypothesis are presented in the Annex: the baseline scenario corresponds to scenario II, scenario I assumes that the recourse to accelerated depreciation is generalized (the most favorable situation in terms of budgetary revenue losses following the application of the facility), and scenario III assumes that linear depreciation would have been applied to all companies for investments in eligible tangible assets (the worst situation from the same perspective).

The budgetary revenue loss as a result of granting the tax facility is by definition equal to the difference between the two deductible expenses aggregates multiplied by the tax rate of 16%. In the case of companies for which reported gross profits are in excess of the acquisition value of eligible new tangible assets, the difference is (16.383 + 0.1 x 16.383) – (0.5 x 0.5 x16.383 + 0.5 x 0.1 x 16.383) = 13.11 billion lei; the counterfactual revenue loss for the year 2012 is equal to the difference (13.11 billion lei x 0.16 = 2.09 billion lei), plus the entirely gross profit realized by companies with investments in eligible tangible assets higher than the amount of reported gross profit multiplied by the tax rate (their taxable profit becomes zero, and the revenue loss is 1.705 x 0.16 = 0.27 billion lei), resulting in a total of 2.37 billion lei revenue loss. Considering the alternative scenarios, the variation range of the revenue loss would be between a minimum of 1.85 billion lei (scenario I) and a maximum of 2.89 billion lei (scenario III).

Further we will try to bring the counterfactual estimated loss for the 2012 to the present, considering that in 2013 (for this year the data from the companies' balance sheet are not available yet) compared to 2012, the gross investments in eligible fixed assets varied with the index of gross fixed capital formation in the economy (0.9606 equivalent to a reduction of about 4%), and in 2014 their value would change, compared to the previous year, with the variation of nominal GDP from the latest government forecasts, recently published in the 2014-2017 Convergence Programme (increase of 5.4%); we assume that companies, which in 2012 made investments in eligible tangible assets higher than reported gross profit, will continue to be in this situation for the entire horizon of tax facility applicability and their profit margin will evolve in line with nominal GDP. In these conditions, the annualized loss for the year 2014 according to the baseline scenario would be 2.31 billion lei, which **corresponds to a quarterly average loss of about 607 million lei – equivalent to the shortfall of corporation tax receipts in the cash budget execution of this year in terms of applying the legislative measure from July 1st, 2014.** Continuing to extrapolate the volume of gross investments in eligible technological equipment using the nominal GDP variations from the 2014-2017 Convergence Programme (5.5% in 2015 and 5.5% in 2016), **the estimated budgetary loss under the same scenario would be 2.53 billion lei in 2015, 2.67 billion lei in 2016 and, respectively, 675 million lei in 2017. Considering the alternative scenarios, the budgetary revenue loss would be: (475, 740) million lei in 2014, (1.98, 3.08) billion lei in 2015, (2.08, 3.25) billion lei in 2016 and (528, 823) million lei in 2017. Depending on the scenario considered, the size of the estimated revenue loss is approximately 3.5 to 5.5 times higher than the amounts advanced by the Ministry of Public Finances.**

According to the Fiscal Council, the range described by the scenarios I (minimum revenue loss) and III (maximum revenue loss) accommodates different combinations of assumptions compared to those considered. The evidently exaggerated assumption, that substantiated the scenario I (accelerated depreciation preferred by all the companies for new investments before the introduction of the facility) produce so favorable effects on the size of assessed budgetary revenue loss that is unlikely that a combination of more plausible hypotheses (e.g. accelerated and linear depreciation combination without the facility – perhaps shifted in favor of linear depreciation, partial recourse to the facility and/or restricted behavior in the case of SOEs) to lead to a lower amount of this loss.

Given the large differences between its estimates and those made by MPF, the Fiscal Council invites the Ministry of Public Finances to present publicly the assumptions that substantiated the analysis and the manner of quantifying the impact of the reinvested profit non-taxation on budgetary revenue. Moreover, even in the absence of such differences, more transparency regarding the impact calculations would be welcomed.

Given all the above mentioned, the Fiscal Council cannot validate the fact that the impact of the proposed measure was properly reflected in the budgetary revenue projections. In the Fiscal Council's opinion the large revenue loss and the lack of explicit identification of the expenditure categories targeted by the compensatory reductions have the potential to compromise the achievement of budgetary targets in the medium term. The Fiscal Council does not dispute the appropriateness of granting the reinvested profit facility tax exemption, considering it adequate from the perspective of the economic situation and the business environment support, but its adoption should not be made by violating the law, both in terms of the Fiscal Council's opinion absence and in terms of compliance with the fiscal rules imposed by FRL.

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to Article 43, paragraph (2), letter d) of Law no 69/2010, based on the vote of the Fiscal Council members in the meeting on May 7th, 2014.

8th May 2014

Chairman of the Fiscal Council

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ANEXĂ:

General assumptions
The calculation is performed differentiated for companies with a gross profit higher than investments in technical installations and machinery, respectively for companies with a gross profit lower than investments in technical installations and machinery.
The revenue loss for 2013 was calculated as follows: for companies with a gross profit higher than the investments in technical installations and machinery the starting point is the amount recorded in 2012 adjusted with the GFCF growth (respectively 0.9606), and in the case of companies with a gross profit lower than the investments in technical installations and machinery the starting point is the amount recorded in 2012 adjusted with the nominal GDP growth.
The revenue loss for 2014, 2015, 2016, and 2017 was calculated starting from the amount recorded in 2013 adjusted with the nominal GDP growth from each year.
The collection of revenues from corporate income tax is done with a lag of one quarter. Thus, the revenue loss from 2014 is related to profits from QIII 2014, the revenue loss from 2015 is related to profits from QIV 2014 and QI-QIII 2015 and so on.
All the investments are carried on the first day of the year, so depreciation expenses correspond to the entire year.

Alternative scenarios to determine the loss of budgetary revenue due to non-taxation of reinvested profit	
Scenario I	Starting point: the total new investments that could receive tax exemption from industry, agriculture and telecom sectors in 2012. For companies whose investments in technical installations and machinery are lower than the gross profit was considered the value of gross investments in 2012. For companies whose investments in technical installations and machinery are higher than the gross profit, the latter was considered. Share of companies that use accelerated depreciation: 100%
Scenario II	Starting point: the total new investments that could receive tax exemption from industry, agriculture and telecom sectors in 2012. For companies whose investments in technical installations and machinery are lower than the gross profit was considered the value of gross investments in 2012. For companies whose investments in technical installations and machinery are higher than the gross profit, the latter was considered. Share of companies that use accelerated depreciation: 50%; share of companies that use linear depreciation: 50%.
Scenario III	Starting point: the total new investments that could receive tax exemption from industry, agriculture and telecom sectors in 2012. For companies whose investments in technical installations and machinery are lower than the gross profit was considered the value of gross investments in 2012. For companies whose investments in technical installations and machinery are higher than the gross profit, the latter was considered. Share of companies that use linear depreciation: 100%.

Table 1: The impact of non-taxation of reinvested profit on budget revenues in the year 2012 (bn. lei)				
	No.	Scenario I	Scenario II	Scenario III
New investments that could benefit from this facility - companies with a gross profit higher than investments in technical installations and machinery	1	16.38	16.3 8	16.38
Accelerated depreciation rate	2	0.50	0.50	0.50
The share of companies that use accelerated depreciation	3	1.00	0.50	0.00
The share of companies that use linear depreciation	4	0	0.50	1.00
Linear depreciation (compulsory applicable in the case of the non-taxation reinvested profit –an average useful life of 10 years)	5	1.64	1.64	1.64
Depreciation spending (accelerated and/or linear depreciation)	6=1x2x3 (Sc. I) or 6=1x2x3+4x5 (Sc. II, III)	8.19	4.91	1.64
Corporate income tax rate	7	0.16	0.16	0.16
Deductible amounts from corporate income tax in case of application of the proposed legislative measure	8=1+5	18.02	18.02	18.02
Deductible amounts from corporate income tax in case of non-application of the proposed legislative measure	9=6	8.19	4.91	1.64
Budgetary revenue loss compared to the non-application of the measure in the case of companies with a gross profit higher than investment in technical installations and machinery	10=7x(8-9)	1.57	2.10	2.62
New investments that could benefit from this facility - companies with a gross profit lower than investments in technical installations and machinery	11	1.71	1.71	1.71
Budgetary revenue loss compared to the non-application of the measure in the case of companies with a gross profit lower than investments in technical installations and machinery	12=11*7	0.27	0.27	0.27
Total budgetary revenue loss	13= 10+12	1.85	2.37	2.89

	Table 2: Scenarios for the budgetary revenue loss for the 2014 – 2017 interval				
		2014	**2015**	**2016**	**2017**
	PIB (bn. lei)	**662.3**	**698.6**	**736.9**	**778.2**
	Nominal GDP growth	5.4%	5.5%	5.5%	5.6%
Scenario I	**Budgetary revenue loss (bn. lei)**	0.475	1.975	2.084	0.528
	% of GDP	0.07%	0.28%	0.28%	0.07%
Scenario II	**Budgetary revenue loss (bn. lei)**	0.607	2.527	2.666	0.675
	% of GDP	0.09%	0.36%	0.36%	0.09%
Scenario III	**Budgetary revenue loss (bn. lei)**	0.740	3.079	3.248	0.823
	% of GDP	0.11%	0.44%	0.44%	0.11%

II. Fiscal Council's opinion on the draft Government Emergency Ordinance amending and supplementing the Law no. 571/2003 regarding the Fiscal Code (granting a special deduction to income tax calculation for restructured loans)

On June 10th, 2014, the Fiscal Council (FC) received by e-mail from the Ministry of Public Finance (MPF) the letter no. 41314 dated June 5, 2014, requesting the opinion on the draft emergency ordinance amending and supplementing the Law no. 571/2003 (regarding the introduction of a special deduction to income tax calculation for restructured loans) under article 40, paragraph (2), letter e) of the Fiscal Responsibility Law (FRL) no. 69/2010. On June 19th and 20th, 2014, the Ministry of Public Finance sent by e-mail to the Fiscal Council updated versions of the proposed ordinance, the evaluation of Fiscal Council considering only the latest form of the draft amendment to the Fiscal Code. According to the above mentioned article of the FRL, among the main tasks of the Fiscal Council are the "*preparation of cost estimates and issuing opinions on the budgetary impact of the normative ordinances, other than the ones mentioned on (d) and the amendments made on the annual budget law during the parliamentary debates*".

In addition, given the negative impact on the budget revenues involved by the above mentioned ordinance, the legislative proposal submitted to the Fiscal Council falls also under the article 13 of FRL which stipulates that: "*Proposals for any legislation leading to a reduction of budgetary revenues must provide a financial statement according to article 15 of Law no. 500/2002, as amended and supplemented and meet at least one of the following conditions:*

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

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

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

A brief description of the legislative proposal and of MFP estimates regarding the impact on revenues. General considerations

In the absence of the changes and amendments to the Fiscal Code introduced by the legislative proposal, individuals with incomes from salary or pension owe a personal income tax applied to a tax base equal to the gross income minus social security contributions. In the case of salary incomes, the computation base is the net income minus the personal deduction, union dues and any voluntary contributions to facultative pension funds up to 400 euros per year. The personal deduction of the employees depends on the number of their dependent persons and is granted to those with a gross monthly income up to 1000 lei, decreasing for those with incomes between 1001 and 3000 lei, while for incomes higher than 3001 lei there are not any deductions granted. For pension incomes, the computation base for the personal income tax is represented by the net income minus the monthly untaxable amount of 1000 lei. The legislative measure under review provides an additional monthly deduction for the personal income tax calculation corresponding to restructured loans of borrowers with a gross income less than or equal to 2200 lei, to be applicable during the period January 2016-December 2017.

The special deduction for loans is granted if the loan restructuring fulfills the following requirements:

a) is granted for credits with no payment delays or which are overdue for no more than 90 days;

b) leads to a decrease of at most by 35% of the debtor's monthly payment obligations, but no more than 900 lei, no matter if the loan was granted in lei or in foreign currency, for a period of maximum two years;

c) provides the extension of the initial credit period for which the payment obligations diminish, according to letter b);

d) the amount representing the reduction under letter b) and the corresponding financing price should be evenly distributed over a period equal to that which was given for the reduction of liabilities, starting with the date when the respective reduction no longer operates, under letter b);

e) the interest rate afferent to payment obligations during the extended period of the initial credit term scheduled under letter. c) cannot be greater than the interest rate stated in the contract at the date of credit restructuring request;

f) the lender does not increase the interest rate and other costs of financing and do not impose other charges otherwise than foreseen in the contract at the request of restructuring;

g) the restructuring scheme is achieved by January 1st, 2016.

The borrowers who opt for loan restructuring will be granted a special deduction from the personal income tax, **monthly, after the end of the period of rate reduction, equal to the new rate, but not more than 900 lei per month**. Also, the deduction is granted only within the period January 2016-December 2017. Consequently, a borrower who agreed with the credit institution a decrease of the rate during July 2014 - June 2016, respectively for the maximum period set by the legislative proposal will benefit from the application of an income tax deduction only during July 2016 - December 2017, respectively for 18 months.

The current legislative measure aims to support the borrowers with an income below and close to the average, having difficulties in the repayment of their debts to credit institutions and non-banking financial institutions, but also to stimulate consumption. The substantiation note attached to the regulatory document estimates a loss of budget revenues from the income tax in the amount of 725.5 million lei in 2016 and 757 million in 2017. Furthermore, the MPF states in the same substantiation note that the budgetary impact will be included in the Fiscal strategy for the period 2015-2017 and will be taken into account when drafting the budget law for 2016 and 2017. As a matter of fact, the budgetary impact of the application of the ordinance would have to be known with a high degree of preciseness at the time of elaborating the draft budget for 2016, given the fact that among the conditions for accessing the facility includes restructuring the loan until 1 January 2016.

The assessment of the budgetary impact of the proposed legislative measure

The starting point of the Fiscal Council's assessment is based on the data for loans to individuals ordered from the perspective of income installments, regarding the number of borrowers, the number of loans, the average residual maturity, the value of outstanding loans (total exposure), and the average interest rate. Considering the legislative proposal, the analysis focuses on loans granted to individuals whose gross incomes do not exceed 2,200 lei per month. The total exposure on loans granted to this category of borrowers is equal to 31.81 billion lei or 36.93% of the total loans to individuals, while the maximum number of borrowers covered by the proposed legislation is about 985,000, representing 48.84% of the total loans contracted to physical persons for real estate investment and consumption purposes.

In order to determine the budgetary impact of the proposed legislation, and also to illustrate the options available for an eligible debtor in the case of the loan restructuring, we use a numerical example for a loan characterized by the features placed on the average of the data considered (hereinafter "representative credit"). The opinion includes two versions of the reimbursement schedule for the representative credit, defined as having a residual value to be reimbursed of 26,651 lei, an average interest rate of 10.2% and a residual maturity of six years, one version corresponding to current conditions (without diminishing rate, rescheduling and additional tax deduction), and the second version given that the monthly payment is reduced by 35% for a period of two years (the maximum period permitted by the legislative proposal), while granting an extension for the maturity of 24 months; in the latter case, the new monthly installment payment after the expiry of the two years in which the rate is reduced will be recalculated taking into account the residual value to be reimbursed and the new repayment period of time.

According to the present situation, a representative individual borrower (physical person) pays a monthly rate of 496.42 lei for a period of 72 months, the average interest rate is 10.2% and the total interest paid is 9087.37 lei. Assuming a 35% rate reduction, the maximum allowed by the legislative proposal and in the conditions occurring while extending the maturity by 24 months, the monthly rate diminishes to 322.68 lei for the first two years and increases to 448.97 lei for the following 6 years (4 years related to the original maturity plus two years corresponding to the extension of the maturity); even with this increase, the monthly rate applicable to the period after the reduction by 35% expires, remains lower than the rate in the absence of the grant facility introduced by the legislative proposal. In this latter case, given that the total interest paid in 8 years amounts to 13,419 lei and that the borrower benefits also of a reduced income tax equivalent of savings of 1293.03 lei (corresponding to a monthly savings equal to the new rate of 448.97 * 0.16 = 71.84 lei for 18 months, given the application deadline facility is December 2017 and assuming that the loan restructuring would start from July 1st, 2014), the annual equivalent cost of the credit should be 9.62% per year. In principle, a representative borrower has to opt between a loan for six years at a cost of 10.2% per year and a loan for eight years at an annual equivalent cost of 9.62% per year, the total interest paid is obviously higher in the latter case, but with the State bearing a part of the supplementary costs. It is obvious that in practice, depending on the parameters agreed bilaterally for the loan restructuring (the period of time for which the annuity is reduced, and the moment of time when the restructuring agreement occurs), the equivalent annual cost of the loan may be different, but compared to the cost in the absence of restructuring, is lower.

It is difficult to quantify the share of borrowers who will be interested in this scheme, as it depends, among other things on the ability of the borrower to pay the debt service in the present, on his preference for extending the loan maturity given that at the end of the period he should pay a higher amount of money to the lending institution (even if the equivalent annual cost decreases slightly) and on the administrative form-filling imposed by appealing to the provisions of this legislative measure.

The decision on the restructuring of a loan also requires the approval of the lending institutions and it is difficult to assume *ex ante* that they will be interested to offer to all borrowers the possibility to pay their loans with restructuring plans, under the circumstances that the corresponding credits are not included as not performing loans. Therefore, the actual number of restructured loans can be found at the intersection of the preferences of debtors and creditors. However, it can be appreciated that there is a reasonable chance that the legislative proposal to be less attractive for borrowers who do not have payments delays (90% of total eligible borrowers have overdue payments for less than 15 days), provided they are not going to achieve additional indebtedness, and at the same time more attractive to those who already recorded significant delays in the debt service (but up to 90 days). Moreover, in the latter case there is the possibility of more interest from banks for the agreement on the loan restructuring.

Given the aforementioned uncertainties regarding the number of loans to be restructured and which would benefit from the fiscal facility, the assessment of the budgetary revenue loss should be presented as a range, whose ends correspond to some implausible assumptions, but however, with a non-zero probability of appearance. The lower edge of the range is obviously zero and corresponds to a highly unlikely scenario where either no debtor would be interested in the restructuring of loans or any financial institution would agree to a restructuring proposal. The upper edge corresponds to the situation also unlikely that all eligible borrowers opt for a 35% rate reduction for a period of two years, and the financial institutions will approve all the requests for restructuring: while the extension of the maturity for the representative credit will be 24 months and would occur on 1 July 2014, the budget revenue loss for the period January 2016 - December 2017 would be 448.97 (corresponding to the rate after the 2 years equivalent to additional tax deduction) * 18 months * 0.16 (income tax) * 1,193,670 (number of credits) = 1, 543 billion lei, corresponding to an annualized impact of -771.73 million lei in the revenues, a level close to the estimate included in the note accompanying the legislative proposal. Therefore, income tax receipts will be lower by an amount between 0 and 771.73 million lei per year (maximum representing about 0.1% of the projected GDP for 2016).

The Fiscal Council considers that there is a high probability that the net budgetary impact to be at the bottom of the aforementioned range. This is in line for the optional nature of the facility given that the attractiveness is potentially low for those borrowers who do not register arrears in their debt service (about 90% of those with less than 90 days overdue are overdue less than 15 days) and also for the possible positive effect on the economy during the reduction of the monthly payment due to the extra temporarily disposable income. Under the most optimistic assumption that all eligible borrowers would opt for and benefit from rescheduling, the disposable income would increase by a maximum of 5 billion lei[3] and the positive economic impact has the potential to be substantial given that the measure targets the consumers with incomes close to and below the average and therefore with high marginal propensity to consume in a period when there is a shortage of aggregate demand. The Fiscal Council considers that, however, the probability of a scenario close to these parameters is very low to materialize.

Under these conditions, the loss of revenue should be easily accommodated within the budget plan so that the annual and medium term targets are not affected. In addition, at the time of finalizing the draft budget for 2016, uncertainties relating to the size of the budget revenue loss will be clarified, and the amount of the budgetary revenue losses can be assessed accurately and appropriately compensated. In these circumstances, the Fiscal Council approves favorable the draft emergency ordinance amending and supplementing Law no. 571/2003 (regarding the introduction of a special deduction to income tax calculation for restructured loans).

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to Article 43, paragraph (2), letter d) of Law no 69/2010, based on the vote of the Fiscal Council members in the meeting 26th June 2014.

26th June 2014

Chairman of the Fiscal Council

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[3] 4.98 billion lei = (496.42 (representative credit rate before the restructuring) – 322.68 (representative credit rate during the reduction of the monthly payment)) x 24 months (the period in which the rates are reduced) x 1,193, 670 (number of eligible credits for restructuring).

ANNEX

Table 1: Information on Loans to Debtors with a Gross Monthly Income <=2,200 lei and with Less than 90 Days Overdue	
	Total (0-2,200]
Total exposure (lei)	Total exposure (lei)
No. of debtors	No. of debtors
No. of loans	No. of loans
Average residual maturity (years)	Average residual maturity (years)
Average initial maturity (years)	Average initial maturity (years)
Average annual interest rate (%)	Average annual interest rate (%)
Average monthly debt service (lei)	Average monthly debt service (lei)
Average value per debtor (lei)	Average value per debtor (lei)
Average loan value (lei)	Average loan value (lei)

Source: National Bank of Romania based on the information from the Central Credit Register, the Credit Bureau; NAFA

Table 2: Information on Loans to Debtors with Less than 90 Days Overdue	
Total exposure (lei)	Total exposure (lei)
No. of debtors	No. of debtors
No. of loans	No. of loans
Average residual maturity (years)	Average residual maturity (years)
Average initial maturity (years)	Average initial maturity (years)
Average annual interest rate (%)	Average annual interest rate (%)
Average value per debtor (lei)	Average value per debtor (lei)
Average loan value (lei)	Average loan value (lei)

Source: National Bank of Romania based on the information from the Central Credit Register, the Credit Bureau; NAFA

Table 3: The Repayment Schedule of a Loan in the Absence of the Proposed Legislative Measure (lei)

No. of months	Annuity	Interest	Principal	Residual Value
1	496.42	226.53	269.89	26,381.13
2	496.42	224.24	272.19	26,108.94
…	…	…	…	…
72	496.42	4.18	492.24	0
Total	35,246.15	9,087.37	26,158.78	-

Source: Fiscal Council's calculations based on Table 1 data

General Assumptions in the Context of Opting for the Fiscal Facility
1. It was considered the case of a debtor with a gross monthly income <=2,200 lei and with less than 90 days overdue, who has an ongoing credit (consumer or mortgage), the average value being equal to 26,651 lei, with an average residual maturity of 6 years (72 months), having an average interest rate of 10.2%.
2. It was assumed that he will choose to restructure the loan as follows: - he chooses to reduce its rate with the maximum of 35% provided in the legislative proposal, for 2 years (during July 2014-June 2016), along with the maturity extension; - the deduction is granted only within the period January 2016 - December 2017; therefore, a debtor who agreed with the creditor the rate reduction during July 2014- June 2016, respectively for the maximum period provided in the legislative proposal, will benefit of the deduction application at the calculation of income tax only during the period July 2016- December 2017.
3. When assessing the financial impact of the proposed legislative measure on the general consolidated budget for the years 2016 and 2017, it was considered the number of consumer credits and mortgages (1,193,670) and also the revenue loss from the income tax corresponding to the considered average credit for the application period (18 months): 1,193,670 * 71.84 lei * 18 months.

Table 4: The Repayment Schedule of a Representative Loan in the Context of the Proposed Legislative Measure (lei)

No. of months	Annuity	Interest	Principal	Residual Value	Deductio n	Saving from Personal Income Tax	Net Amount Paid
1	322.68	226.53	96.14	26,554.88	-	-	322.68
2	322.68	225.72	96.96	26,457.92	-	-	322.68
…	…	…	…	…	…	…	…
24	322.68	205.87	116.80	24,103.34	-	-	322.68
25	448.97	204.88	244.09	23,859.25	448.97	71.84	377.13
26	448.97	202.80	246.17	23,613.09	448.97	71.84	377.13
…	…	…	…	…	…	…	…
42	448.97	167.10	281.87	19,377.40	448.97	71.84	377.13
43	448.97	164.71	284.26	19,093.14	-	-	448.97
44	448.97	162.29	286.68	18,806.47	-	-	448.97
…	…	…	…	…	…	…	…
96	448.97	3.78	445.19	0.00	-	-	448.97
Total	40,070.02	13,419.00	26,651.02	-	8,081.45	1,293.03	38,776.99

Source: Fiscal Council's calculations based on Table no. 1 data

Table 5: The Cost of a Representative Restructured Credit vs. The Cost of a Representative Credit in the Absence of the Fiscal Facility	
Indicator	**Value**
Annual cost equivalent to the initial credit (% year)	10.20%
Annual cost equivalent to the restructured credit (% year)	9.62%
Overpaid interest (lei)	4,331.64
Saving from personal income tax (lei)	1,293.03
Difference (lei)	3,038.60

Source: Fiscal Council's calculations

III. Fiscal Council's opinion on the draft Government Emergency Ordinance amending Law no. 571/2003 regarding the Fiscal Code (the reduction of the employer's social security contribution by 5 pp)

On June 16th, 2014, the Fiscal Council received from the Ministry of Public Finances (MPF) the letter no. 669848, requesting the opinion on the draft emergency ordinance amending and supplementing Law no. 571/2003 (regarding the reduction of the employer's social security contribution by 5 pp) under article 40, paragraph (2), letter e) of the Fiscal Responsibility Law (FRL) no. 69/2010. According to the above mentioned article of the FRL, among the main tasks of the Fiscal Council are the "*the preparation of cost estimates and issuing opinions on the budgetary impact of the normative ordinances, other than the ones mentioned on (d) and the amendments made on the annual budget law during the parliamentary debates*".

In addition, given the negative impact on budget revenues involved by the above mentioned ordinance, the legislative proposal submitted to the Fiscal Council falls also under the article 13 of the FRL which stipulates that: "*Proposals for any legislation leading to a reduction of budgetary revenues must provide a financial statement according to article 15 of Law no. 500/2002, as amended and supplemented and meet at least one of the following conditions:*

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

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

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

Meanwhile, the legislative proposal has been approved by the Government on June 18th and subsequently adopted by the Senate on June 24th and by the Chamber of Deputies on July 2nd, without having the Fiscal Council's endorsement, required under article 13 of the FRL. Moreover, there is already a precedent for the infringement of the aforementioned article as the Government adopted on April 23th by emergency ordinance the profit tax exemption for reinvested profits without the endorsement of the Fiscal Council. Following the adoption of this emergency ordinance, the Fiscal Council (in the opinion from the 7th of May) has expressed serious reservations about the calculation provided by the MPF regarding the budgetary impact of this measure as it appeared largely underestimated and with the potential to significantly affect the medium term budgetary targets. As a result, the institution chose not to endorse this ordinance.

The ease with which the fiscal rules were repeatedly circumvented in the past and this year's violations of the provisions of article 13 of the FRL which stipulate as compulsory the Fiscal Council's endorsement on legislative measures that lead to reduced revenues, in the absence of other measures that increase budget revenue categories as required by the FRL, highlights the weakness of the constraints exerted by the provisions of the FRL. Given all these, there are serious concerns regarding the commitment to the fiscal policy rules that were established into the national law given the provisions of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the Fiscal Compact).

Brief description of the legislative proposal. General considerations

Currently, the social contributions for normal working conditions[4] paid by the employer and employee represent 44.35% of the gross wages being distributed as follows: 16.5% paid by the employee - 10.5% pension contributions, 5.5% health contributions, 0.5% unemployment contributions and 27.85% paid by the employer - 20.8% pension contributions, 5.2% health contributions, 0.5% unemployment contributions, 1.35% other contributions[5]. The legislative proposal intends to reduce the pension contribution of the employer by 5 pp., so the new rate envisaged for normal working conditions is 15.8%; the change will be operable starting from October 2014.

The promotion of the normative act is justified by "*the existence of a large labor tax burden associated with a high level of social security contributions that powers the pension system [...] that acts as a disincentive to employment, business stimulation and investments*." In this

[4] For special conditions of employment, the pension contributions are at higher levels with 5 and 10 pp compared to normal working conditions and the legislative proposal intends to reduce all these rates by 5 pp.

[5] The insurance contribution for work accidents and occupational diseases, the contribution to the guarantee fund for payment of salary debts (not paid by public institutions), contribution for medical leave and indemnities.

context, in the Fiscal Council's view, it would be of interest a regional perspective regarding the labor costs incurred by an employer through a brief comparative analysis in the New Member States from Central and Eastern Europe (NMS-CEE[6]). From the strict perspective of the level of contributions to the pension system, Romania indeed ranks first (from nine countries[7]) with a rate of 31.3% (a 20.8% share incurred by the employer and a share of 10.5% paid by the employee), at a distance of about 3 pp. from the following country (the Czech Republic); considering only the contributions to the pension system that fall on the employer, Romania continues to be within the top of the hierarchy, but behind countries such as Lithuania (a share of 23.3%) or the Czech Republic (a share of 21 5%). However, **in terms of the costs incurred by an employer with the labor force, the overall level of social contributions is relevant**, irrespective of their destination (for public pensions, health insurance, unemployment insurance or other purposes). From this perspective, considering the total contributions payable by the employee and the employer, Romania ranks fourth, their level being by around 4 pp lower than in the case of Slovakia, the country with the highest contributions and around 4 pp above the average; the relatively higher contributions' level for the pension system is partially offset by the relatively lower in terms of rates of contributions to health insurance, where Romania ranks 5 of 9 (with a level of contributions close to the average), but especially that of other social contributions (including unemployment insurance), where Romania ranks 8 out of 9, having a level of contributions significantly below the regional average. Moving the analysis towards the social contributions paid by the employer, Romania slightly exceeds the regional average being placed in the bottom of the hierarchy (6 out of 10). The upward deviation from the average is significantly higher in the contribution rates for employees; its position in these terms is the fourth, the same as in the case of aggregate social contributions.

In addition, it should be noted that in the case of Romania, unlike other countries in Central and Eastern Europe (see Table 1 in the Annex), social security contributions are not capped except the pension contribution and the ceiling is relatively high (5 average gross wages), which makes the tax burden on employment to be even higher in relative terms.

[6] The countries considered in the analysis are: Bulgaria, Estonia, Latvia, Lithuania, Poland, the Czech Republic, Romania, Slovakia, Slovenia and Hungary.

[7] In the case of Hungary the contributions cannot be broken down like other countries – separately on pensions, health and unemployment – due to the fact that, in this country, the employer pays an aggregate contribution of 27 pp, without their detailed breakdown of the three categories.

Table 1		
Total SSC		
1	SK	48.60%
2	HU	47.00%
3	CZ	45.28%
4	RO	44.35%
5	PL	42.09%
6	LT	39.98%
7	SI	38.20%
8	EE	36.00%
9	LV	34.09%
10	BG	31.00%
Average contribution rates		**40.66%**

Table 2		
Pensions contributions		
1	RO	31.30%
2	CZ	28.00%
3	LT	26.30%
4	PL	26.02%
5	LV	25.16%
6	SI	24.35%
7	EE	20.00%
8	SK	18.00%
9	BG	17.80%
10	HU	NA
Average contribution rates		**24.10%**

Table 3		
Health contributions		
1	SK	14.00%
2	CZ	13.50%
3	SI	13.45%
4	EE	13.00%
5	RO	10.70%
6	LT	9.00%
7	PL	9.00%
8	BG	8.00%
9	LV	0.00%
10	HU	NA
Average contribution rates		**10.07%**

Table 4		
Others		
1	SK	16.60%
2	LV	8.93%
3	PL	7.07%
4	BG	5.20%
5	LT	4.68%
6	CZ	3.78%
7	EE	3.00%
8	RO	2.35%
9	SI	4.00%
10	HU	NA
Average contribution rates		**6.18%**

Table 5		
Total SSC - employer		
1	SK	35.20%
2	CZ	34.28%
3	EE	34.00%
4	LT	30.98%
5	HU	28.50%
6	RO	27.35%
7	LV	23.59%
8	PL	19.38%
9	BG	18.10%
10	SI	16.10%
Average contribution rates		**26.75%**

Table 6		
Total SSC – employee		
1	PL	22.71%
2	SI	22.10%
3	HU	18.50%
4	RO	16.50%
5	SK	13.40%
6	BG	12.90%
7	CZ	11.00%
8	LV	10.50%
9	LT	9.00%
10	EE	2.00%
Average contribution rates		**13.86%**

Source: European Commission, Taxes in Europe Database, Taxation trends 2014

In conclusion, although the aggregate level of social contributions in Romania appears as high, Romania is not at all an extreme value in this respect; the status of outlier is rather associated to Bulgaria, which has much lower levels of contributions than the regional average. In addition, the level of pension contributions cannot be viewed separately from the costs which are intended to be financed through them, or, in Romania the spending pressures, especially those related to pensions and health insurance, appear to be high, both on short, medium and long term, also as a result of a very unfavorable support ratio.

Moreover, the tax burden borne by an employer with the labor force is given not only by the sum of different social contributions, but also by the share of personal income tax and from this last perspective Romania is placed at the bottom of the ranking. Defining the tax burden as the ratio between the total amount owed to the state for an employee (personal income tax and social contributions) and the total expenses with the employee (from the income statement account of a company), it appears that Romania is almost at the considered sample's average, the obligations owed to the state accounting for about 45% of the amount paid by the employer for each employee (see Annex 1). Except for Bulgaria (a very low level of tax burden), Slovakia, Slovenia and Hungary (a high level of tax burden), the rest of the NMS-CEE members are at levels very close to the sample's average.

The impact of the legislative proposal on the budgetary position and its compensation

The substantiation note attached to the legislative proposal estimates for the period 2014-2018 a loss in budgetary revenues from the social security contributions amounting to 1,120 million lei in 2014, 6,480 million lei in 2015, 6,826 million lei in 2016, 7,184 million lei in 2017 and 2018, concurrently with savings in personnel costs of 270 million lei in 2014 and 1620 million lei per year in the period 2015-2018, thus resulting an annualized net negative impact[8] of 850 million lei in 2014, 4,860 million lei in 2015, 5,206 million lei in 2016 and 5,564 million lei in 2017 and 2018.

The Fiscal Council's calculations indicate a level of the net budgetary impact (considering only the first-round effects) not significantly different from the one indicated by the MPF. Thus, starting from the projected revenues for the 2014 Social Security Budget, adjusted with the amounts transferred this year to the second pension[9] pillar (the result is labeled as gross revenues resulting from social contributions of the Social Security Budget), the annualized impact of reducing the pension contribution by 5 pp for the employer can be determined as: gross receipts from social contributions/ (the weighted average pension contribution rate *100)* 5. According to the information provided by the MPF to the Fiscal Council, the weighted

[8] The contributions for the public sector employees are recorded both on the revenue side, in the social security contributions item as well as within staff costs, and thus, reducing the latter is not equivalent to a reduction in the net wage received by the employees.

[9] In the budget execution, the amounts transferred to the second pension pillar appear as negative revenues, the consolidated budget figures being net of them. In order to determine the net impact of the measure, an estimate of these transfers is added to the reported levels of the social contributions projected revenues from the Social Security Budget.

average share for the pension contribution of the employer[10] is about 22%, a result which suggests that the majority of employees operate in normal working conditions, for which the related pension contribution is 20.8%. Under these conditions, the weighted average share of the pension contribution, relevant for the revenues collected to the Social Security Budget equals: 22% (pension contribution for employer) + 10.5% (pension contribution for employee) + 0.25% (employer's contribution to the insurance scheme for work accidents and occupational diseases) = 32.75%. So, the revenue loss from social security contributions is equal to 1.11 billion lei in 2014 (this year, given the intent of applying the measure from October 1st, the revenues are negatively affected in cash basis only for two months). Extrapolating the annualized impact in 2014 using National Prognosis Commission's (NCP) projections for the gross wage dynamics and for the number of employees, the revenue losses from social security contributions in the medium term are 7.02 billion lei in 2015, 7.4 billion lei in 2016 and 7.79 billion lei in 2017. In order to determine the net impact, it should be taken into account the personnel costs savings achieved through a reduction in the amounts owed by the state to itself regarding the related social contributions for which is responsible as an employer. In this respect, it is necessary to extract the gross wages from the personnel costs included in the latest version of the medium term fiscal strategy (dividing them by a factor of 1.288, determined by summing the pension contribution for employer – 22%, the health contribution for the employer – 5.2%, the employer's contribution for unemployment – 0.5%, the contribution for medical leave and other benefits – 0.85% and the contribution for insurance against accidents at work and occupational diseases - 0.25%) and multiplying the result by a rate of 5% corresponding to the pension contribution reduction introduced by the legislative proposal. Calculated in this way the expenditure savings are 0.31 billion lei in 2014 (for the two months affected in the cash execution), 1.94 billion lei in 2015, 2 billion lei in 2016 and 2.02 billion lei in 2017. The net impact determined by considering these two components (reduction of the revenues and cost savings) is about - 800 million lei in 2014 (-0.12% of GDP) -5.08 billion lei in 2015 (-0 73% of GDP) -5.4 billion lei in 2016 (-0.73% of GDP), respectively, -5.77 billion lei in 2017 (-0.74% of GDP).

In order to illustrate the impact of the pension contribution reduction on the costs incurred by an employer with the labor force, the Fiscal Council presents in the Annex an example considering a company that pays the average wage in the economy, assuming that employees are operating in normal working conditions. Thus, considering the average gross remuneration of 2,279 lei (similar to the projection of the NCP for 2014), the total amounts paid by the

[10] Calculated as a weighted average of the statutory rates for the employer's pension contribution, respectively 20.8%, 25.8%, 30.8%; the weights are represented by the ratio of the number of employees in each category in the total number of employees.

employer to the state (insurance contributions and personal income tax) represent in the current situation 1,315 lei and the total cost incurred by the employer is 2,914 lei. Assuming the reduced rate of 5 pp. for the employer, the total amount paid by the employer to the state is reduced by 114 lei, respectively by 8.66%, the new total cost to the employer necessary to pay the same net salary being 2,800 lei, respectively 3.91% lower.

The first round budgetary impact appears to be significant but the substantiation note accompanying the legislative proposal reaffirms the Government's commitment to the fiscal rules introduced by the Fiscal Compact and also contained in the national legislation, including the adjustment path towards the medium term objective for the structural budget balance. However, in the opinion of the Fiscal Council, the relevant elements on which one can conclude that the previously assumed targets will be met in the context of the proposed measure implementation are not provided. Thus, the substantiation note accompanying the draft legislation states that the fiscal space needed for the measure in the context of meeting the budget deficit targets for the coming years will be generated in 2014 from the supplementary income compared to the initial estimates related to the tax on special structures (1 billion lei, corresponding to the discrepancy between the tax returns submitted of 1.45 billion lei and the budgeted amount of 488 million), while in the subsequent years, it would be generated by the positive results on the budget revenues as a result of the tax system reform started in NAFA (the National Agency for Fiscal Administration), plus the second-round effects arising from increased investment and the new jobs created. The Fiscal Council will analyze the three sources of impact compensation listed in the substantiation note accompanying the legislative proposal.

Regarding the extra income from the tax on special structures, it must be stated that it is already exhausted by the three months postponement of the additional excise duty on fuel and by the decision to reimburse to the major carriers a part of this additional excise, the two measures having a cumulative negative budgetary impact of 923 million lei (570 million lei + 353 million lei), as the budget for the current year was built on the assumption that the fuel excise duty will be collected throughout the year (not from April as it happened) and not considering the last measure. Therefore, *caeteris paribus*, the fiscal space created by the difference between the effective revenues and the estimates has already been used and cannot act in the sense of compensating the impact of reducing the social security contribution rate. Nevertheless, this difference, under the assumption that the current tax will be maintained, will lower the net impact of reducing the pension contribution in the medium term, as the refund to the large carriers of a portion of the additional excise duty on fuel was not included in the medium-term fiscal projection and the three-month postponement of the introduction of the additional excise duty will affect only the budgetary revenues of the current year. The Fiscal

Council estimates that on the medium-term the fiscal space resulting from the difference between the estimates and actual receipts from the tax on special structures is approximately 600 million lei per year in the period 2015-2017.

Regarding the second-round effects, the substantiation note is limited to their enunciation without any quantification. Also, it is quite difficult to assess their value without performing some simulations based on a complete macroeconomic model able to capture the changes in the behavior of firms and consumers likely to generate favorable developments (compared to the baseline scenario) in the other revenue aggregates (social contributions, personal income tax, corporate income tax, VAT). The Fiscal Council considers that the second-round effects have the potential to be significant and could diminish the negative impact of the legislative proposal on the budget deficit (including the fiscal space created in the coming years by the favorable difference from the tax on special structures) compared to the first-round levels to around to 3-4 billion lei per year.

Given the aforementioned arguments, even after taking into account the second round effects a large impact (about 0.5% of GDP) remains to be compensated in order to ensure the budget neutrality for which the only sources of revenues left consist of the hypothetical funds that could be generated by increasing the collection efficiency by NAFA. **In the opinion of the Fiscal Council, such an approach is into an evident contradiction with the principle of fiscal responsibility stipulated in the article 4 of the FRL, stating that** *"the Government has the obligation to carry out the fiscal and budgetary policy and to manage the budgetary resources, obligations and fiscal risks in a manner that ensures sustainability of the fiscal position in the medium and long term such that the Government is able to manage financial risks and unforeseen events in future periods without having to introduce economically or socially destabilizing expenditure or revenue adjustments".* Obviously a measure of fiscal loosening like the pension contribution reduction is not *per se* incompatible with this principle. However, it is similarly clear that to suppose certain pluses of revenues from the tax administration reform is not a prudent approach, especially if we consider the weak historical performance of NAFA in terms of improved revenue collection and the lower than expected revenues for the current year. Moreover, the Fiscal Council has indicated in several occasions that it is not prudent to assume an improved collection that will generate fiscal space (certainly possible - tax evasion is at a very high level in Romania) *ex ante*, and that a cautious approach requires the recognition of this improvement to be taken into account only *ex post*, respectively after this improvement is materialized, respectively only after at the end of the year the budget revenues will exceed the original estimates (which, *caeteris paribus*, would result in a lower budget deficit than the target) and that this increase was not attributable to more a favorable than expected developments of the relevant macroeconomic bases.

Considering the proposed measure in the context of the compliance commitment to the provisions of the Fiscal Compact and of the preventive arm of the Stability and Growth Pact, it should be noted that in the Convergence Programme 2014-2017, submitted by Romania in April 2014 to the European Commission, the Government reaffirms the obligation to achieve the medium-term objective, namely a structural deficit of 1% of GDP in 2015, while the significant slowdown in the pace of fiscal consolidation in 2014 is expected to be fully recovered in 2015. Thus, the budget deficit target for 2015 was set at 1.4% of GDP, both in the cash methodology and in ESA95 terms. Among the objectives for the fiscal policy on the medium-term proposed by the government in the Convergence Programme, is included "the reduction of the social security contributions rate, this reduction being made in a budget-neutral manner". Also, in the updated 2014-2016 Fiscal Strategy (adopted in November 2013) is envisaged a "significant reduction in the pension contribution by 5 pp beginning with July 2014 that, as a result of the measures that will be taken, will have a neutral budgetary impact". However, the budgetary projections for the two aforementioned programmatic documents are clearly built on the assumption of a no policy change scenario, as the revenue from social contributions are relatively unchanged as a percentage of GDP for the period 2014-2017 and perform in line with the projected growth of the average earnings and the number of employees in the economy.

The Fiscal Council had already expressed its reservations about the feasibility of achieving the structural adjustment envisaged for 2015 in the context of the opinion on the State Budget Law, Social Insurance Budget Law for 2014 and the updated version of the 2014-2016 Fiscal Strategy, in the absence of a specific set of measures able to produce such an adjustment. However, it should be noted that those reserves were expressed before the occurrence of the adverse effects on the fiscal position arising from the recently adopted measures, mainly those referring to the reinvested profit tax exemption (in which case the Fiscal Council's evaluation indicates revenue losses significantly higher than the one developed by the Government) and the reduction of pension contributions. Moreover, the doubts about the likelihood of the adjustment path envisaged, also before considering the impact of the fiscal measures outlined above, have been expressed recently by the European Commission too, whose assessment indicates for 2015 a risk of significant deviations from the required structural adjustment and foresees that in 2015 Romania will deviate from the reference expenditure criterion. Briefly, the European Commission considers that there are not sufficient tax measures envisaged that have the ability to generate a structural adjustment of 0.8 pp. of GDP necessary to ensure the achievement of the medium-term objective of structural deficit in 2015, according to the obligations arising from preventive arm of the Stability and Growth Pact. Thus, the forecasted budget deficit is around 0.5 pp. of GDP higher that the budget deficit target that would ensure the compliance with these obligations and the EC concludes that the program presents risks of a significant deviation from the requirements of the preventive arm in 2015. In this context, the

EC recommends to Romania, among others, to implement the fiscal strategy for the period 2014-2017, ***to significantly improve the fiscal effort in order to ensure the achievement of the medium-term objective in 2015 in accordance with the commitments under the balance of payments programme as reflected in the Convergence Programme for 2014-2017, in particular by specifying the measures to be undertaken for this purpose, and to comply with the medium-term objective in 2015 and in the subsequent period.***

Given the above, the Fiscal Council considers that the balance of risks regarding the conduct of the fiscal policy was already been titled on the downside for 2015 (a budget deficit higher than projected), even in the absence of the present legislative proposal, given both the proposed pace of fiscal consolidation (0.8 pp. of GDP according both to the cash and European methodology) which does not appear to be supported by the measures announced so far, and also the significantly underestimated level[11] of the negative impact on the corporate income tax receipts from the fiscal measures adopted***. If the legislative proposal would be adopted without compensation measures of the negative budgetary effects, not only that the achievement of the medium-term objective in 2015 appears as virtually impossible, but there would be a high risk of a major slippage in fiscal policy, which would dangerously close the budgetary position to the threshold for triggering the excessive deficit procedure (3% of GDP)***. Moreover, the favorable perception of the investors on the Romanian economy, reflected in the historical lows of the state financing costs, is founded on the assumption of continuing the fiscal consolidation in line with the commitments. A major slippage in 2015, as currently projected, would be likely to damage this perception, with adverse consequences on the financing costs.

In addition, the reduction of the pension contribution rate will have a significant impact on the financial position of the public pension system. Currently it is very precarious, characterized by a substantial structural deficit, as the budget expenditure on pensions are unsustainable in relation to the contributions received. In the Annex there is a graph that shows the evolution of the revenues and expenditures of the Social Security Budget for the period 2006-2013 and the projections for 2014-2017 corresponding to the application of the proposed legislative measure. In 2013, the public pension deficit was 11.7 billion lei (1.86% of GDP) and the projections for the period 2015-2017 are considering a deficit ranged between 19 and 21.1 billion lei given the reduction with 5 pp. of the pension contribution, with about 7 billion lei greater than with the current rates. Also, the support ratio in Romania is the second worst in the European Union, even below one, as it can be seen in the chart no. 2 from the Annex. The

[11] According to the Fiscal Council's estimates, the budgetary revenues losses implied by non-taxing the reinvested profit are, under the baseline scenario, 2.527 billion lei, which are significantly higher than those estimated by the Ministry of Public Finances, respectively 572.7 million lei.

measures taken in the recent years in order to improve the medium and long term financial position (such as those provided by the new pension law) would likely be entirely canceled under the application of the proposed legislative measure. Moreover, considering the effects of population ageing[12], the concerns on the medium and long term sustainability of the public pension system are likely to worsen.

Conclusions

The Fiscal Council cannot validate that the financial impact was taken into account in the forecast of the budgetary revenues and it does not affect the annual budgetary targets in the medium term, as required by article 13 of the FRL, the legislative proposal not being accompanied by an updated projection of the overall budget revenues and the compensation measures envisaged either are not accommodating the revenue losses related to all the fiscal measures envisaged (as it happens in 2014), or are not explicitly or credibly quantified (for the period 2015-2017), in a manner which is in obvious contradiction with the principle of fiscal responsibility included in the FRL. **The Fiscal Council warns that there are high risks of recording a major slippage in the conduct of the fiscal policy in 2015, given that even in the absence of the significant budgetary impact of this measure, the adjustment path to the medium-term objective appears as very ambitious, and the adoption of this legislative proposal could dangerously close the budget deficit to the threshold for triggering the excessive deficit procedure (3% of GDP). In addition, the manner of formulation and adoption of the legislative proposal indicates that the de facto commitment of the authorities to comply with fiscal rules and the other provisions of the Fiscal Responsibility Law is very weak.**

The Fiscal Council considers that the adoption of the legislative proposal regarding the reduction of the pension contribution rate for the employer by 5 pp, although desirable from the business environment point of view, is not possible under the commitment of pursuing the fiscal consolidation envisaged (derived from adopting the European treaties) without identifying equivalent compensatory measures (of significant amplitude) - increases/extensions in the tax base and/or expenditure cuts. In the Fiscal Council`s opinion, such a large decrease in the statutory pension contribution rates, which is beneficial considering the fiscal burden on labor, can be accomplished in a neutral way for the budget, if the significant differences in the fiscal treatment of various categories of taxpayers (wages, revenues from copyright, self-

[12] According to the “Fiscal Sustainability Report 2012” elaborated by the EC, in Romania the long-term costs of ageing are 3.6% of GDP, of which 2.4% of GDP are pensions expenditure and 1.3% of GDP are health system expenditure, costs that place Romania into the category of a medium risk to fiscal sustainability in the long-term under the assumption of unchanged policies compared to 2012.

employed, microenterprises) that discriminate the contributors, are reduced/eliminated. Also, the Fiscal Council reiterates its previous recommendation to consider the alternative of a firm commitment regarding the adoption of a multiannual trajectory for a gradually implementation of the reduction in the pension contribution rate that could be easily offset by equivalent discretionary measures or, eventually compensated ex-post via an improvement in the collection rate, reflected in bigger budgetary revenues (and corresponding, lower deficits compared to the targets). Such a multiannual plan has the advantage of anchoring the economic agents` expectations and, under the hypothesis of credibility accumulation, could generate favorable effects in the economy even before the effective implementation of the measures.

In addition, in the Fiscal Council`s opinion, a reduction in the pension contribution rate should be accompanied by a reform in the social contributions collection system starting from the principle of an equitable treatment for all the contributors, unrelatedly to the revenue category and also by the elaboration and implementation of a medium term strategy for the financial re-balance of the social security system, especially for the pension system. Such a strategy should aim at increasing the number of taxpayers, in particular by reducing the "illegal work", and at a total transparency of the budgetary spending as a whole, in order to stimulate the growth of the voluntary compliance for the taxes payment.

The reform of the tax collection system appears as an imperative in the current context characterized by a low efficiency of the tax system and the Fiscal Council is aware that this process has the potential to generate fiscal space in the medium term. However, making decisions about any tax cuts or increasing the expenses based on the potential efficiency gains must take place *ex post*, after the reform proves irreversible and capable of generating long-term results, especially since the proposed tax measure is a long-lasting one.

Given the above arguments, the Fiscal Council cannot endorse the legislative proposal of reducing the pension contribution rate for the employer by 5 pp, as it cannot validate that the current form of the proposal will not affect the medium-term deficit targets, which is a requirement of the FRL.

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to Article 43, paragraph (2), letter d) of Law no 69/2010, based on the vote of the Fiscal Council members in the meeting on July 3th, 2014.

3rd July 2014 ***Chairman of the Fiscal Council***

IONUȚ DUMITRU

ANNEX:

Table 1: Comparative analysis of social security contributions in the Central and Eastern Europe countries - 2013

	Bulgaria	Czech Republic	Estonia	Latvia	Lithuania	Hungary	Poland	Romania	Slovenia	Slovakia
SSC employees (%)	**12,9**	**11**	**2**	**10,5**	**9**	**18,5**	**22,71**	**16,5**	**22,1**	**13,4**
Pensions (%)	7,9	6,5	-	7,75	3	10	9,76	10,5	15,5	4
Health (%)	3,2	4,5	-		6	7	9	5,5	6,36	4
Unemployment (%)	0,4	-	2	0,5	-	1,5	-	0,5	0,14	1
Others (%)	1,4	-		2,25	-	0	3,95	0	0,1	4,4
Annual cap (national currency)	Monthly cap: 2.400 BGN	1.242.432 CZK	No cap	46.400 EUR	No cap	No cap	112.380 PLN	Pensions contributions capped at 5 average gross wages	No cap	Pensions contributions capped at 5 average gross wages
SSC employers (%)	**18,1**	**34,28**	**34**	**23,59**	**30,98**	**28,5**	**19,38**	**27,85**	**16,1**	**35,2**
Pensions (%)	9,9	21,5	20	17,41	23,3	27	16,26	20,8	8,85	14
Health (%)	4,8	9	13		3			5,2	7,09	10
Unemployment (%)	0,6	1,2	1	1,13	1,1			0,5	0,06	1
Others (%)	2,8	2,58	-	5,05	3,58	1,5	3,12	1,35	0,1	10,2
Annual cap (national currency)	Monthly cap: 2.400 BGN	1.242.432 CZK	50.043,6 EUR	46.400 EUR	No cap	No cap	112.380 PLN	Pensions contributions capped at the product of the number of insured employees and the value of 5 times the monthly average gross wage	No cap	Pensions contributions capped at 5 average gross wages
Observations	Cap applied to all types of insurance	Cap applied to all types of insurance	Cap applied to all types of insurance	Cap applied to all types of insurance	-	-	Employees health contributions are not capped	Cap applied only to pensions contributions, differentiated by employee and employer	-	Cap applied to all types of insurance except accident insurance
Total SSC (%)	**31**	**45,28**	**36**	**34,09**	**39,98**	**47**	**42,09**	**44,35**	**38,2**	**48,6**
Gross average monthly wage in national currency (2013)	799,00	25.128,00	949,00	716,00	2.224,80	230.664,00	3.650,06	2.240,80	917,72	912,00
Cap as number of average wages 2013	3,0	4,1	-	5,4	-	-	2,6	5,0	-	5,0

Sursa datelor: Comisia Europeană; United Nations Economic Commission for Europe Statistical Database

Table 2: Tax burden								
Country	Total cost	SSC employer	Gross income	SSC employee	Income before taxes	Personal income tax	Total PIT and SSC	Tax burden
SI	1161	161	1000	221	779	210	592	51.02%
SK	1352	352	1000	134	866	191	677	50.04%
HU	1285	285	1000	185	815	160	630	49.03%
PL	1179	179	1000	227	773	147	553	46.88%
RO	1279	279	1000	165	835	134	577	45.14%
LV	1236	236	1000	105	895	215	556	44.96%
CZ	1343	343	1000	110	890	150	603	44.89%
EE	1340	340	1000	20	980	206	566	42.22%
LT	1310	310	1000	90	910	137	536	40.95%
BG	1181	181	1000	129	871	87	397	33.62%
Average tax burden								**44,88%**

Source: European Commission, Fiscal Council's calculations

**The tax burden has been determined based on an illustrative example, having as starting point a gross wage of 1000 m.u.*

***Poland and Slovenia are the only countries in which is applied a progressive personal income tax rate. Poland applies two tax rates (18% and 32%), most taxpayers being included in the first tranche of taxation (annual ceiling of 85,528 PLN, equivalent to two average wages), and the rate taken into account being 19%. Slovenia applies four tax rates (16%, 27%, 41% and 50% temporary), the rate of 41% applying to annual incomes exceeding 18,960 EUR (1.7 average wages) and the relevant rate, from this perspective of analysis, was considered the average of 27%.*

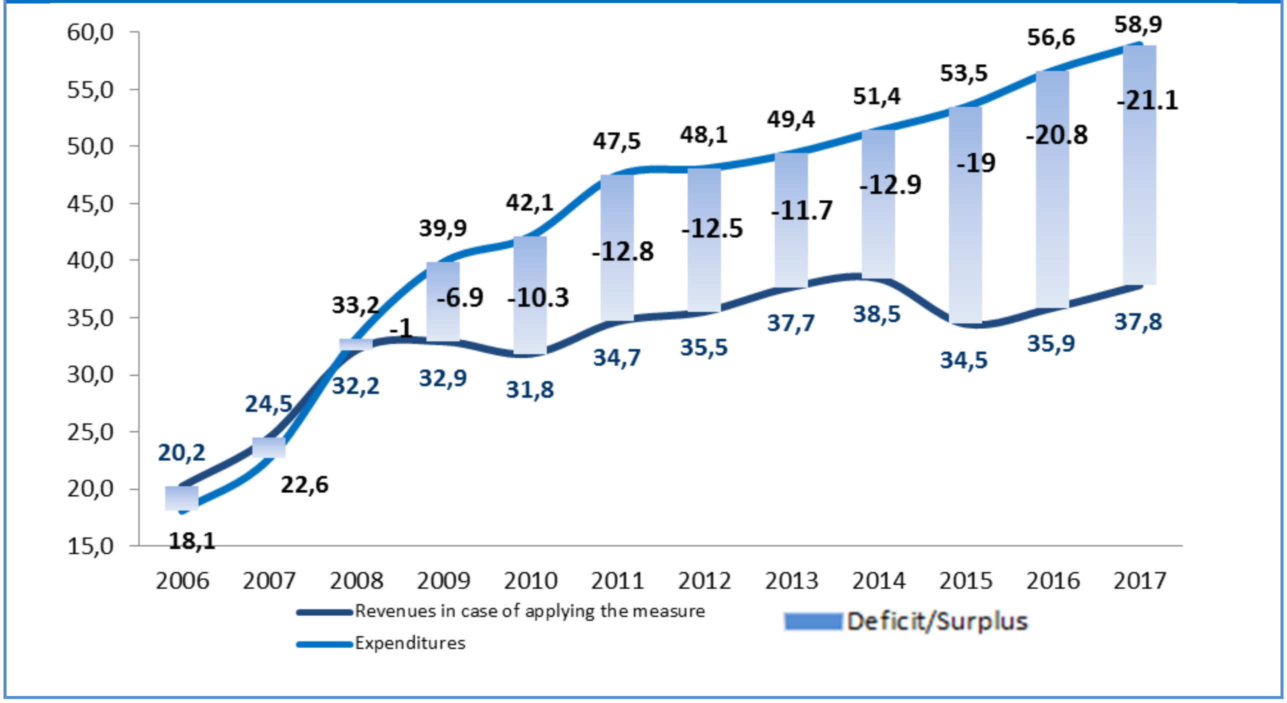
**** For Czech Republic and Hungary, in determining the personal income tax it was taken into account "the super grossing" – the personal income tax base is "compensation of employees", which includes social security contributions paid by employers.*

*****Personal income tax deductions have not been taken into account when calculating the personal income tax.*

Table 3: Illustrative example regarding the impact of the 5 pp employer's pension contribution rate reduction on the total cost of an employer with an employee		
	Actual situation	**Reduction of employer pension contribution rate by 5 pp**
Average gross income (lei)	2,279	2,279
SSC employer (lei)	635	521
SSC employee (lei)	376	376
Income before tax	1,903	1,903
Personal income tax (lei)	304	304
Total PIT and SSC (lei)	1,315	1,201
Total cost of an employer with an employee (lei)	2,914	2,800
Tax burden (%)	45.14%	42.91%
Budgetary revenues loss from social security contributions per employee (lei)	114.0	
Budgetary revenues loss from labor taxation (contributions + personal income tax) per employee (%)	8.66%	
Reduction in total cost of an employer with an employee (%)	3.91%	

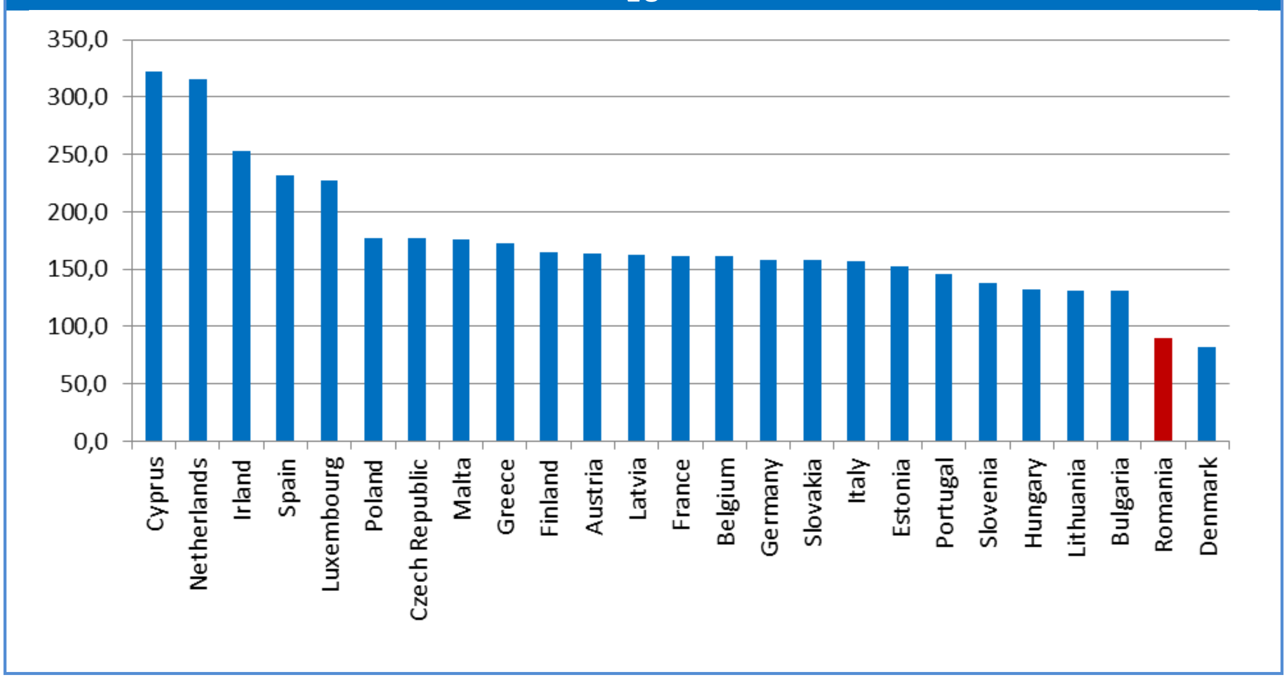
Source: Fiscal Council's calculations

Figure 1: Evolution of revenues and expenditures of social security budget in the case of reducing employer's pension contribution rate by 5 pp. from October 1st, 2014 (billion lei)



Source: Ministry of Public Finances, cash standard data

Figure 2: The number of contributors to the public pension system per 100 pensioners in the EU



Source: Ministry of Public Finances, cash standard data

General assumptions
1. The gross pension contributions revenues for the year 2014 have been determined by using the projected level in GCB plus the estimated contributions for Second Pension Pillar.
2. According to MPF, the average weighted pension contribution rate of the employer is 22%. This rate has been calculated based on the existing national data in 112 form - Declaration on obligations to pay social security contributions, personal income tax and the records of insured persons, as a ratio between the contribution **owed/paid** by the employer and the total income realized. Thus the total SSC rate **owed/paid** by the employer will be equal to 28.8%, and the employee and employer pension contribution rate will be 32.5% plus the 0.25% rate of work accidents and occupational diseases insurance, resulting in a rate of 32.75%.
3. The annualized impact of reducing the pension contribution rate on the budgetary revenues in 2014 has been determined as: gross receipts from social contributions / (the average weighted pension contribution rate * 100) * 5. The impact for the period 2015-2017 has been extrapolated from the estimated loss for the year 2014, which has been adjusted with the growth of the gross average wage and the number of employees projected by NCP.
4. To determine the net budgetary impact, the savings related to personnel state expenses have been also calculated based on the wage bill from the 2014 - 2016 Fiscal Strategy.

Table 4: Impact of the 5 pp pension contribution rate reduction on the social security contributions revenues

	2014	2015	2016	2017
Social security contributions (pensions) - gross series (billion lei)	43.41	-	-	-
Impact of the pension contribution rate reduction on the social security contributions revenues (billion lei)	-1.10	-7.02	-7.40	-7.79
Personnel expenses according to CGB (including employer's contribution) (billion lei)	47.79	49.97	51.53	51.96
Gross wages (billion. lei)	37.10	38.80	40.01	40.34
Impact of the 5 pp pension contribution rate reduction on the personnel expenses in the public sector (billion lei)	-0.31	-1.94	-2.00	-2.02
Net impact of the pension contribution rate reduction (billion lei)	-0.80	-5.08	-5.40	-5.77
Nominal GDP (billion lei)	662.3	698.6	736.9	778.2
Net impact of the pension contribution rate reduction (% of GDP)	-0.12%	-0.73%	-0.73%	-0.74%

Source: Fiscal Council's calculations

IV. Fiscal Council's Opinion on the Half-Year Report Regarding the Economic and Budgetary Situation and Fiscal Council's Opinion on the Draft Budget Revision for 2014

On July 29th 2014, the Fiscal Council received from the Ministry of Public Finances by letter no. 16086/29.07.2014 *The draft of the budget revision for 2014, The explanatory note and the Government Ordinance project regarding the draft of the budget revision for 2014,* as well as *The explanatory note and the Government Ordinance project regarding the draft of revised social security budget for 2014*, requesting the Fiscal Council's opinion under article 40, paragraph (2) of Law no. 69/2010. In addition, the Fiscal Council also received *The half-year report regarding the economic and budgetary situation* of which conclusions, alongside the Fiscal Council's opinion on it, should be taken into account in the construction of the budget revision proposal in accordance with article 15, paragraph (1) of the Fiscal Responsibility Law (FRL) as amended and supplemented.

1. The budget execution at the end of June 2014

Both revenues and expenditures were, at the end of June 2014, significantly below the semester program corresponding to the initial form of the general consolidated budget (GCB). Thus, according to the annexes *of the half-year report regarding the economic and budgetary situation*, the total revenues of the GCB were below the amount programmed by about 4.5 billion lei, and the expenditures by about 9.4 billion lei, generating a favorable impact at the level of the budget deficit (namely a deficit lower than the target set for the first semester) of 4.9 billion lei.

The largest contribution to the developments described above – more than half, was due to the underperformance of the European funds absorption whose ultimate beneficiary is the state (only these transit the consolidated general budget), which had an impact on both the revenue and expenditure side of the budget; thus, the reimbursement claims related to projects funded by external post-accession grants were lower by 2.8 billion lei compared to the amounts proposed in the initial budget, the failure to implement these projects also involving cost savings compared to the programmed level of about 4.4 billion lei[13].

There is also a significant underachievement compared to the initial program in the case of tax revenues, social security contributions receipts and non-tax revenues, of which the sources are detailed below.

At the level of tax revenues, the gap between the program for the first semester and the actual revenues is about -954 million lei, and the sources are as follows:

- **An achievement rate of only 96.4% of the revenue program in the case of personal income tax, which resulted in a revenue shortfall of 426 million lei.** Thus, the receipts related to this category of revenues increased by only 0.6% compared to the revenues recorded in the first 6 months of the previous year (compared with a programmed dynamic of 4.4%), while the number of employees increased, during January-May 2014, compared to the same period of previous year, by 0.8%, and the annual growth of the gross salary for the same period was 4.95%. This evolution raises questions especially if it is considered in correlation with the dynamics of the social security contributions receipts, which have mostly the same tax base, and at the level of which the unfavorable differences from the initial program are substantially lower. We consider that the unfavorable evolution of the personal income tax revenues reflects a significant decrease in the effectiveness of collection, but there are some signs of revenues recovery in the last month of the semester (in June, the revenue flows exceeded those registered in June 2013 by 8.9%).

- **An achievement rate of only 94.3% of the revenue program in the case of VAT, materialized in a receipts gap of -1.49 billion lei, corresponding to an annual growth of only 1.9% compared with a programmed one of 8.1%.** We also consider that this development reflects a significant decrease in the effectiveness of collection, especially given the high annual growth rate of retail sales volume (8.2% in the period January-May 2014 in real terms), even if the underperformance of the program is explained in some extent by: a) the execution of the compensation scheme which led to the clearing of budgetary overdue payments, which generated revenues of 257.2 million lei compared to a programmed level of 425 million lei (negative impact of 168 million lei at the level of VAT receipts); b) the three months postponement of the excise duties

[13] The failure to implement an investment project draws cost savings greater than the revenue loss from the amounts reimbursed by EU – therefore this will have a diminishing impact on the budget deficit, since the cost of the investment objectives include both the co-financing supported by the Romanian state and the ineligible expenses for reimbursement from the EU (e.g.. compensation for expropriation).

increase on fuel (excise falls under the tax base of VAT), which generated a revenue gap of -164 million lei on the VAT receipts. Moreover, the substantial underachievement of the investment expenditures compared to the program[14] was likely to generate a VAT receipts shortfall compared to the program – it has the potential to be significant, given the amounts involved, but its precise quantification is impossible in the absence of relevant information regarding the size of intermediate consumption implied by these investment projects: the underperformance of these expenditures generates, on one hand, minuses to the collected VAT (of about 1.26 billion lei, given the differences of the investment expenditures from the program), but also minuses to the deductible VAT (unquantifiable in the absence of data regarding the size of intermediate consumption), and the VAT revenues in the budget execution are registered on a net basis, representing the difference of the two aggregates. Under the conditions in which the investment expenditure is accelerating in the second semester of the year so that their volume to converge to the annual programmed levels, it is expected that the VAT revenue losses recorded in the first semester to be recovered to a certain extent in the second part of the year. The information included in the text of the Half-Year Report regarding the annual evolution of the VAT revenues – respectively the diminishing receipts from penalties for delay and the increasing VAT refunds – are not relevant, in the Fiscal Council's opinion, for explaining the deviations from the program: the receipts reduction from penalties for delay was generated by their amount change from July 1st, 2013, and have already produced effects in the second half of the previous year and have been therefore anticipated in the first year budgetary programming, while the VAT refunds increase did not exceed the growth rate of VAT collected, being only the effect of the increase in annual terms of the economic activity volume.

- **An achievement rate of only 97.4% of the revenue program in the case of excises, which resulted in a receipts gap of -301 million lei.** Given that the excises revenue program had as hypothesis the fuel excise increase from January 1st, 2014, and the actual receipts occurred while the measure in question was delayed by three months (the revenue losses, entirely reflected in the first half year budget execution, represent 683 million lei), to this postponement being added the reimbursement measure of a part of the additional excise to the large carriers, we consider that the execution reflects a better than programmed excise collection, whose maintenance in the second half of

[14] At the end of June, capital expenditures represented only 69.3% of the half-year program – lower by 2.13 billion lei than the programmed expenditures and by 2.34 billion lei compared to the capital expenditures recorded in the first semester of 2013, the projects funded by external post-accession grants accounted only 51% of the programmed level – lower by 4.4 billion lei, and the expenditures related to the projects funded from reimbursable funds represented 81.5% of the programmed level – lower by 54.4 million lei.

the year would be likely to compensate the negative impact of the discretionary measures above mentioned and thus would not lead to the reduction of excise revenues for the entire year compared to the initial annual program.

The unfavorable evolutions above mentioned in the case of tax revenues were partially offset by higher than programmed receipts as follows: a) the corporate income tax (+261 million lei); b) the property taxes (+507 million lei) – caused by higher than initially estimated special structures receipts (as it was in fact predictable, according to the Fiscal Council's estimates[15]); c) other taxes on goods and services (+431.5 million lei) – caused by higher than programmed receipts from the clawback tax and from the additional income tax as a result of the natural gas prices deregulation.

In the case of the social security contributions, the receipts program was achieved in a proportion of 98.3%, the revenues being lower than programmed by about 478 million lei. The 5.6% annual growth rate recorded, appears as consistent with the annual growth of the number of employees and of the average salary (0.8%, respectively 4.95%, during January-May 2014), but as the reporting basis, in the present case the receipts of the first semester of 2013, continued to be affected by the staggered repayments of the unconstitutional health contributions receipts from the period January 2012-April 2013 recorded as negative revenues, the annual growth rate appears as artificially increased in terms of economic interpretation. After the adjustment related to the receipts of the first semester of 2013, it is also noticeable a collection efficiency loss (the adjusted annual growth rate of the revenues being only approximately 3.4%, compared with an annual increase of the wage bill of about 5.8%), which, however appears to be lower than in the case of the personal income tax receipts.

Compared to the programmed level, the non-tax revenues accounted 94.1%, being lower by 478 million lei. The Ministry of Public Finances explains this difference by cashing dividends from state-owned companies that were initially planned in the first semester, in July 2014, which means that the underachievement of the revenues in the first half of the year should not negatively affect the receipts over the entire year.

On the expenditure side, all the expenditure categories, except the personnel spending – which was higher than programmed by 107 million lei, registered below programmed levels at the end of the first semester. More than half of the 9.4 billion lei deviation of the total expenditures

[15] The Fiscal Council expressed its reservations regarding the size estimated by MPF of the special structures tax impact in the Fiscal Council's Opinion on State Budget Law, Social Insurance Budget Law for 2014 and the updated version of the 2014-2016 Fiscal Strategy (http://www.fiscalcouncil.ro/Fiscal_Councils_opinion_14_11_2013.pdf).

compared to the half-year program target was recorded by the projects funded by external post-accession grants already mentioned, also a major deviation being registered in capital expenditures, whose achievement ratio is only 69.3% of the half-year program (-2.13 million lei). An underperformance of lower magnitude compared to the program can be observed in the case of expenditures related to: goods and services (96% of the program, e.g. -740.3 million lei), transfers for public entities (49.2% of the program, e.g. -518 million lei), social assistance (98.6% of the program, e.g. -503.7 million lei), subsidies (achievement degree of the program of 96.7%, e.g. -110 million lei) and interest (98% of the program, e.g. -131 million lei).

In conclusion, the budget execution at the end of the first half of the current year reveals an underperformance of about 1.2 billion lei at the level of the budgetary revenues, excluding the EU funds absorption below estimates, as well as the underachievement of the non-tax revenue program, given that this was caused by the postponement of the dividends receipts compared to the initial program. The underperformance of the budgetary revenues was more than compensated by significant cost savings compared to the program, which resulted in a significantly lower level of the budget deficit, both compared to the previous year and to the half-year program.

The Fiscal Council recommends to the Ministry of Public Finances to include in the text of the report on budget execution relevant explanations regarding the reasons that caused the non-compliance of the half-year revenue program for each affected category and not only to limit to state or explain the variations compared to the situation recorded in the previous year. Such explanations, along with proposals to remedy the deficiencies noted, are even more necessary as these deviations from the program have not been caused by significant variations of the macroeconomic bases with respect to the scenario considered in the construction of the initial budget; quite the contrary, the macroeconomic bases developments have been significantly more favorable. Moreover, the Fiscal Council's recommendation merely enunciates the obligations of the MPF according to the provisions of article 30, letter j) of the Fiscal Responsibility Law, under which *the half-year report regarding the economic and budgetary situation* should include "explanation for any failure to collect the forecasted revenues, indicating the measures taken and planned to improve the collection".

2. The draft budget revision for 2014

Compared to the original approved budget, the draft budget revision increases revenue by 1.54 billion lei and expenditure by 1.81 billion lei, while the upward revision of the deficit is 270 million lei. If the budget deficit and that of personnel expenses, both expressed as percentage of GDP, remain at 2.2% and 7.3% of GDP, as defined by the Law no. 355/2013 regarding the approval of ceilings for some indicators specified in the fiscal framework for 2014, thus ensuring the fiscal rule established by article 6 letter a) of FRL, the proposed nominal levels of the GCB deficit, the GCB primary deficit, the personnel expenses and the total expenses excluding the financial assistance from the EU and other donors exceed the thresholds of the above mentioned Law no. 355/2013[16], this being inconsistent with the fiscal rules imposed by article 6 letters b) and c) of FRL, article 9 paragraph 2 which prohibits increasing the personnel expenses during the budgetary revisions, article 16 which prohibits increasing total expenditure of the GCB during revisions otherwise than to pay the debt service and Romania's contribution to the EU budget and article 18 paragraph 4 which reaffirms the mandatory limits established by law for the next budgetary year. Moreover, the draft budget revision uses again derogation from the above mentioned articles, having negative effects on the credibility of the fiscal rules stated by the FRL, given that the derogation itself tends to become a rule rather than an exception as it would be normal.

However, the exceedances, except the one corresponding to total expenditure, are minor. In the case of the total expenditure increase, it is exclusively due to the introduction of a new swap scheme in order to clear the outstanding obligations to the GCB, having a symmetric impact on revenue and expenditure, equal to 748 million (a neutral impact on the budget deficit), to which is added the impact of a change in the accounting treatment of the sale transactions from the state reserves in order to harmonize with the Regulation no. 966/2012 *regarding the financial rules, applicable to the general budget*: thus, if until now, these operations were highlighted in net terms in the budget[17], the regulation quoted above requires all income and expenses to be registered without any adjustment against each other, which leads to higher income and expenditure of 917.2 million lei (the capital revenues and expenses are affected).

At the level of revenues, the budget revision envisages their increase by 1.54 billion lei, but after adjusting for the impact of the swap scheme (with impact on VAT and social contributions) and the changes in the accounting treatment of sale operations of goods from the state reserves (with impact on the capital income) that artificially increased revenues by 1.66 billion lei, the earnings appear to be adjusted slightly negative, i.e. by 128 million lei. The income aggregates to the level of which are identifiable failures to fulfill the program targets due to lower collection efficiency in the context of the midterm-execution, are negatively reviewed, as the low collection efficiency is extrapolated to the full year where appropriate. Thus:

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[16] The thresholds are exceeded by 50 million lei by the GCB deficit, by 166 million lei by the primary deficit, by 85 million lei the personnel expenses and by 1.59 billion lei by the total expenditure excluding the financial assistance the UE funds and other donors.

[17] For instance the difference between the amounts received from selling stocks and the amounts used for purchase products for the state reserve stocks.

- The estimates of receipts from the personal income tax are lowered by 1.274 billion lei compared to the initial budget (at the end of the first semester they were below the target with 426 million lei),

- The VAT receipts estimates, excluding the impact of the newly introduced compensation scheme (692 million lei), have been revised downward by 1.75 billion lei. At the end of the first semester they were below the scheduled level by 1.54 billion lei, but part of this deviation is explained by the difference between the assumed and the actual execution of the original compensation scheme in amount of 850 million lei (168 million lei), as well as the three-month postponement of the introduction of the additional excise on fuel (164 million lei), factors that will not generate similar deviations in the second semester. In addition, as shown in the section related to the budget execution at the end of the first semester, the underperformance of the investment expenses and their presumed acceleration in the second half of the year towards the convergence to the annual budgeted amounts are likely to generate acceleration at the level of VAT receipts corresponding to this period.

- The social contributions receipts estimates, without the impact of the newly introduced compensation scheme (56 million lei), are expected to be lower than those from the initial budget by 504 million lei, accommodating an underperformance of 478 million lei. **It should be noted that the social contributions revenue projection for 2014 does not include the negative impact of the measure already approved by the Parliament to reduce the employer's social security contribution by 5 pp. starting from October 1st, 2014 (estimated at about 1.1 billion lei at the level of income and 850 million lei at the level of budget deficit).**

In contrast, other categories of budgetary revenues have been significantly increased, reflecting the developments already manifested at the end of the first semester, and the developments that are very likely in the second semester, as well:

- The estimates on the corporate income tax have been revised upward by 423 million lei, reflecting the extrapolation of the positive deviation from the level scheduled at the end of the first semester (261 million lei), but also a revenue loss due to the introduction of the profit tax exemption for reinvested profits, estimated by the MPF at 137.5 million lei. However, **as stated in its opinion from May 8th, 2014[18], the Fiscal Council does not support the MPF's impact estimation on the introduction of the profit tax exemption for reinvested profits which it considers undervalued, estimating a negative impact of**

[18] http://www.fiscalcouncil.ro/Opinion_Fiscal_Council_tax_exemption_reinvested_profits.pdf

at least 475 million lei for 2014 (so a revenue loss by 338 million lei higher than the one considered by the MPF);

- The estimates on property taxes have been revised upward by 1.26 billion lei, mainly due to the difference between the initial estimates on tax receipts from special constructions (488 million lei) and the tax declarations submitted by the taxpayers showing revenues of about 1.5 billion lei. Moreover, the scheduled level for this category of income corresponding to the first semester was exceeded by 500 million lei by the actual receipts;

- The revised estimates on excise revenue confirm the initial ones, given that the negative deviation from the program which reflects the postponement of the introduction of the additional excise on fuel is expected to be fully recovered in the second semester considering unchanged the positive difference between the actual receipts and those from the program registered in the first semester;

- The estimates on receipts from other taxes on goods and services have been revised upwards by 808 million lei (the surplus over the semester program was 431.5 million lei), given the extra revenues estimated to be received from the tax on additional revenues resulting from the deregulation of the natural gas prices (432.4 million lei) and the clawback tax from the health sector (350 million lei);

- The estimates of non-tax revenues have been revised upwards by 707.83 million lei due to the additional revenues estimated to be received by the Ministry of Economy from the sale of emission allowances for greenhouse gases (726.0 million lei);

- The capital income estimates have been revised upward by 1.08 billion lei, of which 917 million lei come from the change in the accounting treatment of transactions which imply the sale of goods from the state reserve above mentioned.

At the level of the budgetary expenditures, the increase of 1.81 billion lei is also explained largely by the impact of the swap scheme meant to clear the obligations due towards the GCB[19], plus the impact of the change in the accounting treatment of sale and purchase operations from the state reserve (with impact on capital expenditure of 917.2 million lei), without which the increase would have been only 142 million lei. The categories of expenditures have been revised compared to the initial allocations, as follow:

[19] The impact on expenditure is also 748 million lei, of which 400 million lei for the capital expenditures, 224 million lei in goods and services, 60 million lei other transfers, 41 million lei social assistance and 15 million lei personnel expenses.

1. The personnel expenses have been revised upward, excluding the newly introduced compensation scheme (15 million lei), by 289 million lei, without explaining the reasons of this change;

2. The expenses with goods and services have been revised upward, excluding the newly introduced compensation scheme (224 million lei), by 830 million lei;

3. The transfers between the public administration's units have been revised upward by 251 million lei;

4. The contingency reserve fund has been increased by 292 million lei;

5. The interest expenses have been revised downward by 116 million lei;

6. The subsidies have been revised downward by 250 million lei;

7. The capital expenses, adjusted for the newly introduced compensation scheme impact (400 million lei), but also for the impact of the change in the accounting treatment regarding the sale and purchase operations from the state reserve (917 million lei), have been revised downward by 1.15 billion lei.

Despite the significant failure to absorb the European funds, whose final beneficiary is the state – compared to the program for the first semester, the revenue achievement degree is 49%, while the expenditure achievement degree is 51% - the budgetary revision does not modify the initial estimates regarding these categories. In the Fiscal Council's opinion, the estimates from the draft budget appear unlikely to materialize[20]. Although this underperformance should not lead to an increase in the deficit, but on the contrary, given that the failure to implement investment projects involves both lower reimbursement requests and savings in terms of co-financing and ineligible expenses, the failure to absorb European funds is obviously not desirable, given the costs on economic growth both in terms of direct effects and those propagated, but also the major risks associated with the disengagement of these funds.

Also, the Fiscal Council recalls that the proposed budget amendment does not include the impact of the reduction with 5 pp of the employer's social security contribution starting from October 1st, 2014, a law which was approved by the Parliament, but not yet signed by the President. Since the explanatory memorandum attached to the proposal for amending the Tax Code above mentioned indicates that the source of coverage for the current year's

[20] Moreover, the projections from the first revision have an obvious tendency to overestimate the performance from the end of the year, as shown in the table from Annex 2, despite the fact that every time the amounts scheduled after the first semester were realized less than half .

impact is represented by the additional revenues from the tax on special constructions, and the latter ones already exist in the current form of the revised budget without leading to a reduction in the budget deficit, the Fiscal Council notes that any legislative proposal implemented at the initially envisaged deadline has no coverage in the current budget, so the compliance with the deficit target would likely involve a significant further reduction in public spending.

The Fiscal Council considers the current budget revenue projections as generally realistic, while formulating reservations about the European funds and the profit tax forecasted revenues, in the latter case in the context of the significant differences between its impact assessment and the one of the MPF, exposed in the Opinion from 8th of May 2014.

Finally, the **Fiscal Council notes that the negative revisions of the budgetary revenues estimates are concentrated at the level of some aggregates whose current year level is likely to influence their projections in the coming years, and the compensatory increases in revenues are in a significant extent temporary** – the additional legislation on supplementary taxation of income from liberalizing gas prices expires at the end of the current year, and revenues from the sale of emission allowances for greenhouse gas are by definition temporary (one-off). **This phenomenon is likely to create additional pressure on the budget construction in the coming years in order to meet the deficit targets, especially if we take into account the adverse impact on the budget revenue which is expected to be generated by the discretionary measures on which the Fiscal Council has recently expressed its view (in this case the exemption of reinvested profits and the reduction of the employer's social security contribution). In addition, the first semester budget execution and the draft budget revision contain very few elements that can lead to optimism about the possibility of covering the revenue minuses generated by the above mentioned legislative changes only on the account of improving the collection efficiency.**

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to article 43, paragraph (2), letter d) of Law no. 69/2010, as amended and supplemented, after being approved by the Council members through vote, on 31st July 2014.

31st July 2014

Chairman of the Fiscal Council

IONUȚ DUMITRU

ANNEX I – budget execution semester I 2014 vs. the half-year program	The half-year program 2014 with *swap* (mil. lei)	Budget execution semester I 2014 with *swap* (mil. lei)	Delta *swap*	The half-year program 2014 without *swap* (mil. lei)	Budget execution semester I 2014 without *swap* (mil. lei)	Sem. 1 2014/ Sem. 1 2013 without *swap*	Differences from the half-year program 2014 without *swap* (mil. lei)	The achievement degree of the half-year program without *swap* (%)	Differences from the half-year program 2014 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	**104,892.19**	**100,383.60**	**425**	**104,467.19**	**100,126.40**	**2.91%**	**-4,340.79**	**95.8%**	**-4,508.6**	**95.7%**
Current revenue	99,042.50	97,099.74	425	98,617.50	96,842.54	2.75%	-1,774.96	98.2%	-1,942.8	98.0%
Tax revenue	61,842.45	60,888.13	425	61,417.45	60,630.93	3.71%	-786.52	98.7%	-954.3	98.5%
Taxes on profit, wages, income and capital gains	18,197.07	18,191.78		18,197.07	18,191.78	5.37%	-5.28	100.0%	-5.3	100.0%
Profit	5,838.27	6,099.01		5,838.27	6,099.01	12.75%	260.74	104.5%	260.7	104.5%
Personal income tax	11,846.75	11,420.68		11,846.75	11,420.68	0.62%	-426.08	96.4%	-426.1	96.4%
Other taxes on income, profit and capital gains	512.05	672.10		512.05	672.10	33.33%	160.06	131.3%	160.1	131.3%
Property tax	3,188.51	3,695.11		3,188.51	3,695.11	34.99%	506.60	115.9%	506.6	115.9%
Taxes on goods and services	39,919.17	38,480.13		39,919.17	38,480.13	1.44%	-1,439.04	96.4%	-1,439.0	96.4%
VAT	26,166.64	24,675.09	425	25,741.64	24,417.89	1.86%	-1,323.75	94.9%	-1,491.6	94.3%
Excises	11,356.53	11,055.73		11,356.53	11,055.73	10.90%	-300.80	97.4%	-300.8	97.4%
Other taxes on goods and services	855.56	1,287.10		855.56	1,287.10	84.32%	431.54	150.4%	431.5	150.4%
Taxes on using goods, authorizing the use of goods or on carrying activities	1,540.45	1,462.20		1,540.45	1,462.20	-55.62%	-78.24	94.9%	-78.2	94.9%
Tax on foreign trade and international transactions (customs duty)	311.11	313.02		311.11	313.02	0.10%	1.91	100.6%	1.9	100.6%
Other tax revenue	226.59	208.09		226.59	208.09	-3.89%	-18.50	91.8%	-18.5	91.8%
Social security contributions	28,558.67	28,080.78		28,558.67	28,080.78	5.55%	-477.88	98.3%	-477.9	98.3%
Nontax revenue	8,641.39	8,130.83		8,641.39	8,130.83	-11.49%	-510.56	94.1%	-510.6	94.1%
Capital revenues	306.63	391.71		306.63	391.71	36.87%	85.08	127.7%	85.1	127.7%
Grants	11.53	170.06		11.53	170.06	253.55%	158.53	1474.9%	158.5	1474.9%
Amounts received from the EU in the account of payments made and prefinancing	5,531.53	2,711.09		5,531.53	2,711.09	-10.78%	-2,820.44	49.0%	-2,820.4	49.0%
Financial operations	-	-		-	-				0.0	
Amounts collected in the single account(State budget)		11.01							11.0	

ANNEX I – budget execution semester I 2014 vs. the half-year program	The half-year program 2014 with *swap* (mil. lei)	Budget execution semester I 2014 with *swap* (mil. lei)	Delta *swap*	The half-year program 2014 without *swap* (mil. lei)	Budget execution semester I 2014 without *swap* (mil. lei)	Sem. 1 2014/ Sem. 1 2013 without *swap*	Differences from the half-year program 2014 without *swap* (mil. lei)	The achievement degree of the half-year program without *swap* (%)	Differences from the half-year program 2014 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 EXPENDITURE	**113,293.71**	**103,859.29**	**425.0**	**112,868.71**	**103,602.09**	**-0.31%**	**-9,266.62**	**91.8%**	**-9,434.4**	**91.7%**
Current expenditure	106,358.36	99,539.85	425	105,933.36	99,282.65	2.25%	-6,650.71	93.7%	-6,818.5	93.6%
Personnel	23,781.32	23,888.71		23,781.32	23,888.71	3.43%	107.39	100.5%	107.4	100.5%
Goods and services	18,286.45	17,546.18		18,286.45	17,546.18	5.66%	-740.27	96.0%	-740.3	96.0%
Interest	6,395.25	6,264.37		6,395.25	6,264.37	-0.95%	-130.88	98.0%	-130.9	98.0%
Subsidies	3,287.89	3,178.39		3,287.89	3,178.39	-4.69%	-109.50	96.7%	-109.5	96.7%
Total Transfers	54,313.88	48,423.04	425	53,888.88	48,165.84	1.86%	-5,723.04	89.4%	-5,890.8	89.2%
Transfers for public entities	1,018.89	500.95	425	593.89	243.75	14.96%	-350.14	41.0%	-517.9	49.2%
Other transfers	7,002.52	6,582.05		7,002.52	6,582.05	3.72%	-420.47	94.0%	-420.5	94.0%
Projects funded by external post-accession grants	8,902.88	4,530.35		8,902.88	4,530.35	-12.97%	-4,372.54	50.9%	-4,372.5	50.9%
Social assistance	35,701.66	35,197.98		35,701.66	35,197.98	3.40%	-503.68	98.6%	-503.7	98.6%
Other expenditure	1,687.92	1,611.71		1,687.92	1,611.71	8.80%	-76.21	95.5%	-76.2	95.5%
Expenditure funded from reimbursable funds	293.56	239.15		293.56	239.15	-46.22%	-54.41	81.5%	-54.4	81.5%
Reserve funds	0.02	-		0.02	-		-0.02	0.0%	-0.0	0.0%
Capital expenditure	6,935.35	4,807.34		6,935.35	4,807.34	-32.78%	-2,128.02	69.3%	-2,128.0	69.3%
Financial operations	-	-		-	-		0.00		0.0	
Payments made in previous years	-	-487.89		-	-487.89	53.86%	-487.89		-487.9	
EXCEDENT(+) / DEFICIT(-)	**-8,401.52**	**-3,475.69**		**-8,401.52**	**-3,475.69**	**-47.57%**	**4,925.83**	**41.4%**	**4,925.8**	**41.4%**

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

ANNEX II	Initial budget 2014	*Swap* program 2014	Initial budget 2014 without *swap*	First budget revision (R1) 2014	Additional *swap*	First budget revision 2014 without *swap*	R1 - Initial budget 2014 with *swap*	R1 - Initial budget 2014 without *swap*	Budget execution semester I 2014/ Budget execution semester I 2013 with *swap*	R1 2014/ Budget execution 2013 without *swap*
	1	2	3=1-2	4	5	6=4-5	7=4-1	8=6-3	9	10
TOTAL REVENUE	**216,808.3**	**850.0**	**215,958.3**	**218,346.0**	**748.0**	**217,598.0**	**1,537.6**	**1,639.6**	**2.91%**	**9.32%**
Current revenue	201,331.2	850.0	200,481.2	201,788.8	748.0	201,040.8	457.5	559.5	2.75%	6.00%
Tax revenue	126,162.2	850.0	125,312.2	126,359.5	748.0	125,611.5	197.3	299.3	3.71%	6.26%
Taxes on profit, wages, income and capital gains	36,724.9		36,724.9	35,873.5		35,873.5	-851.5	-851.5	5.37%	2.75%
Profit	11,378.0		11,378.0	11,800.5		11,800.5	422.5	422.5	12.75%	8.09%
Personal income tax	24,000.9		24,000.9	22,726.9		22,726.9	-1,274.0	-1,274.0	0.62%	-0.02%
Other taxes on income, profit and capital gains	1,346.0		1,346.0	1,346.0		1,346.0	0.0	0.0	33.33%	6.40%
Property tax	5,040.7		5,040.7	6,299.9		6,299.9	1,259.2	1,259.2	34.99%	43.08%
Taxes on goods and services	83,362.6	850.0	82,512.6	83,178.1	692.0	82,486.1	-184.5	-26.5	0.79%	5.86%
VAT	54,621.6	850.0	53,771.6	53,563.0	692.0	52,871.0	-1,058.6	-900.6	1.90%	3.72%
Excises	24,102.0		24,102.0	24,114.1		24,114.1	12.1	12.1	10.90%	14.25%
Other taxes on goods and services	1,807.1		1,807.1	2,615.0		2,615.0	808.0	808.0	84.32%	71.89%
Taxes on using goods, authorizing the use of goods or on carrying activities	2,831.9		2,831.9	2,886.1		2,886.1	54.1	54.1	-55.62%	-33.20%
Tax on foreign trade and international transactions (customs duty)	623.0		623.0	626.0		626.0	3.0	3.0	0.10%	0.97%
Other tax revenue	411.0		411.0	382.0		382.0	-29.0	-29.0	-3.89%	-0.78%
Social security contributions	57,779.0		57,779.0	57,331.4	56.0	57,275.4	-447.6	-503.6	5.55%	5.39%
Nontax revenue	17,390.0		17,390.0	18,097.8		18,097.8	707.8	707.8	-11.49%	6.07%
Capital revenues	621.0		621.0	1,701.2		1,701.2	1,080.2	1,080.2	36.87%	161.85%

ANNEX II	Initial budget 2014	*Swap* program 2014	Initial budget 2014 without *swap*	First budget revision (R1) 2014	Additional *swap*	First budget revision 2014 without *swap*	R1 - Initial budget 2014 with *swap*	R1 - Initial budget 2014 without *swap*	Budget execution semester I 2014/ Budget execution semester I 2013 with *swap*	R1 2014/ Budget execution 2013 without *swap*
	1	2	3=1-2	4	5	6=4-5	7=4-1	8=6-3	9	10
Grants	14.6		14.6	24.6		24.6	10.0	10.0	253.55%	-87.74%
Amounts received from the EU in the account of payments made and prefinancing	14,841.5		14,841.5	14,831.4		14,831.4	-10.1	-10.1	-10.78%	66.43%
Financial operations	0.0		0.0	0.0		0.0	0.0	0.0		
Amounts collected in the single account(State budget)									-103.36%	
TOTAL EXPENDITURE	**231,298.4**	**850.0**	**230,448.4**	**233,105.9**	**748.0**	**232,357.9**	**1,807.5**	**1,909.5**	**-0.30%**	**8.16%**
Current expenditure	213,514.3	850.0	212,664.3	215,150.4	348.0	214,802.4	1,636.1	2,138.1	2.26%	8.29%
Personnel	47,786.2		47,786.2	48,090.7	15.0	48,075.7	304.5	289.5	3.43%	3.84%
Goods and services	39,363.7		39,363.7	40,417.3	224.0	40,193.3	1,053.6	829.6	5.66%	4.95%
Interest	11,223.5		11,223.5	11,107.9		11,107.9	-115.6	-115.6	-0.95%	3.27%
Subsidies	5,732.7		5,732.7	5,483.2		5,483.2	-249.5	-249.5	-4.69%	6.47%
Total Transfers	108,139.7	850.0	107,289.7	108,540.3	109.0	108,431.3	400.6	1,141.6	1.88%	11.79%
Transfers for public entities	1,399.9	850.0	549.9	1,650.9		1,650.9	251.0	1,101.0	16.74%	127.08%
Other transfers	11,816.7		11,816.7	11,934.7	68.0	11,866.7	118.0	50.0	3.27%	11.16%
Projects funded by external post-accession grants	20,250.9		20,250.9	20,251.0		20,251.0	0.0	0.0	-12.97%	44.71%
Social assistance	71,512.7		71,512.7	71,553.5	41.0	71,512.5	40.8	-0.2	3.40%	4.58%
Other expenditure	3,159.5		3,159.5	3,150.3		3,150.3	-9.2	-9.2	8.80%	-2.13%
Expenditure funded from reimbursable funds	1,100.2		1,100.2	1,043.7		1,043.7	-56.5	-56.5	-46.22%	20.10%
Reserve funds	168.3		168.3	467.3		467.3	299.0	299.0		
Capital expenditure	17,784.1		17,784.1	17,955.6	400.0	17,555.6	171.5	-228.5	-32.78%	0.57%
Financial operations	0.0		0.0	0.0		0.0	0.0	0.0		
Payments made in previous years	0.0		0.0	0.0		0.0	0.0	0.0	53.86%	-100.00%
EXCEDENT(+) / DEFICIT(-)	**-14,490.0**		**-14,490.0**	**-14,760.0**		**-14,760.0**	**-269.9**	**-269.9**	**-47.57%**	**-6.41%**

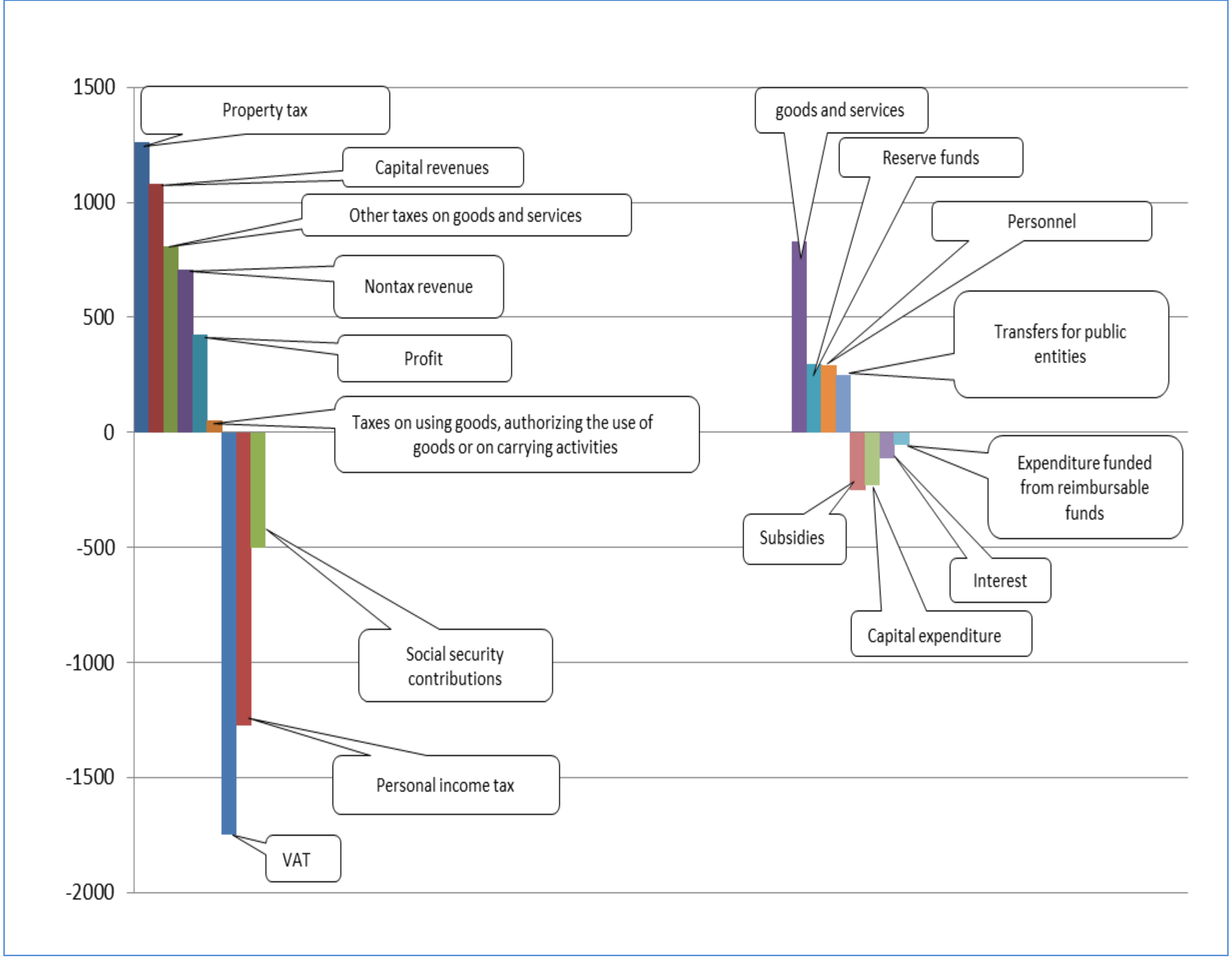
Source: Ministry of Public Finance, Fiscal Council's calculations

Annex 3 - Evolution of the EU funds absorption in the first six months and the first revised budget amounts for this category versus the full year drawn amounts

	Initial budget	Half-year program	Budget execution - semester I			Proposed amounts at first budget revision	Final budget execution		
			Execution	% half-year program	% initial budget		Execution	% first budget revision	% initial program
2011									
Revenue									
Amounts received from the EU for the payments made and prefinancing	7,810.00	-	1,943.60	-	24.89	7,810.10	6,112.00	78.25	78.26
Grants	1,450.00	-	340.40	-	23.48	1,324.20	766.00	57.84	52.83
Expenditure									
Projects funded by external post-accession grants	9,108.00	-	4,358.60	-	47.85	9,002.80	10,787.00	119.81	118.43
Expenditure funded from reimbursable funds	2,356.00	-	852.90	-	36.20	2,337.70	2,111.00	90.30	89.60
2012									
Revenue									
Amounts received from the EU for the payments made and prefinancing	12532	6,408.90	3,072.30	47.94	24.52	10,673.00	7,979.10	74.76	63.67
Grants	972	751.30	88.50	11.78	9.10	1,081.00	442.80	40.96	45.56
Expenditure									
Projects funded by external post-accession grants	11641	6,685.00	6,373.60	95.34	54.75	10,869.00	13,217.90	121.61	113.55
Expenditure funded from reimbursable funds	2424	1,380.20	704.40	51.04	29.06	2,008.00	1,614.50	80.40	66.60
2013									
Revenue									
Amounts received from the EU for the payments made and prefinancing	11,220.20	6,385.87	3,038.83	47.59	27.08	12,153.80	8,911.48	73.32	79.42
Grants	629.90	308.20	48.12	15.61	7.64	630.70	200.60	31.81	31.85
Expenditure									
Projects funded by external post-accession grants	17,311.20	7,086.42	5,205.40	73.46	30.07	16,845.70	13,994.07	83.07	80.84
Expenditure funded from reimbursable funds	782.90	574.80	444.67	77.36	56.80	976.80	869.03	88.97	111.00
2014									
Revenue									
Amounts received from the EU for the payments made and prefinancing	14,841.46	5,531.53	2,711.09	49.01	18.27	14,831.42	-	-	-
Grants	14.60	11.53	170.06	1,474.89	1,164.76	24.60	-	-	-
Expenditure									
Projects funded by external post-accession grants	20,250.94	8,902.88	4,530.35	50.89	22.37	20,250.97	-	-	-
Expenditure funded from reimbursable funds	1,080.10	293.56	239.15	81.47	22.14	1,100.18	-	-	-

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

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



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

V. Fiscal Council's Opinion on the Draft Second Supplementary Budget for 2014

On September 26th, 2014, at 6:57 PM, the Ministry of Finance sent by letter no. 19836/26.09.2014 to the Fiscal Council, the second supplementary budget draft for 2014, the explanatory note and the Government Ordinance project regarding the draft of the budget revision for 2014, as well as the explanatory note and the Government Ordinance project regarding the draft of revised social security budget for 2014, requesting the Fiscal Council's opinion under the article 40, paragraph (2) of Law no. 69/2010. Given the Government's intention to approve the above documents on the meeting of September 30th, 2014, the Fiscal Council is seen again in the position of having available only one working day to draft and approve its opinion. In addition, it is difficult to imagine how the Government can accomplish the legal requirement derived from article 40, paragraph (4) of the Fiscal Responsibility Law and subsequent amendments (FRL), to analyze during the budget revision process approval the Fiscal Council 's opinion other than in a purely formal manner. The Fiscal Council is thus obliged to reiterate the previous recommendations addressed to the Government to prepare the draft laws and provide the necessary documents to the Fiscal Council at least one week before the adoption of the relevant legislation during the Government meeting, allowing both the Fiscal Council and the Government, a reasonable time for drafting opinions, respectively for analyzing and eventually adopting the Fiscal Council's recommendations in the Government meeting dedicated to the approval of these legislative acts. Moreover, the article 4, paragraph (1), point 1 of Law no. 69/2010 indicates that „the Government and the local authorities have the obligation to make public and maintain in public debate, for a reasonable period of time, all the information necessary to allow the assessment of the implementation of fiscal and budgetary policies, the respective outcomes and the stance of central and local public finances".

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

Compared with the budget approved on the occasion of the first budget amendment, the general consolidated budget (GCB) revenue decrease by 1.32 billion lei, the expenditure by 1.37 billion lei, so that the budget deficit is projected to slightly diminish (by 48 million lei); considering the reduction in interest spending by 572 million lei, the primary deficit is projected to increase by 524 million lei. Personnel spending decrease marginally compared to the level projected in the first budget amendment, respectively by 22 million lei. Article 6 letters b) and c), article 16 and article 18 paragraph (4) of the FRL state as mandatory the ceilings established by the Fiscal Strategy and by the accompanying law regarding the thresholds for the nominal levels of the GCB deficit, the GCB primary deficit, the total spending excluding the financial assistance from the EU and other donors and also for the personnel spending, limiting the possibility of increasing total expenditure of the GCB during revisions exclusively for paying the debt service and Romania's contribution to the EU budget. The first budget amendment already projected minor breaches of the above mentioned mandatory ceilings for the GCB budget deficit (by 50 million lei), the GCB primary budget deficit (by 166 million lei) and personnel spending (by 85 million lei), but a larger increase (by 1.59 billion lei) compared to the ceiling corresponded to the total spending excluding the financial assistance from the EU and other donors, solely due to the introduction of a new swap scheme in order to clear the outstanding obligations and a change in the accounting treatment of the sale transactions from the state reserves, both measures having a neutral impact on the budget deficit. The changes introduced by the project of the second budget amendment significantly reduce the size of these thresholds overruns in the case of GCB deficit (the breach is only 2 million lei), in the case of total expenses excluding financial assistance from the EU and other donors (the related overrun is reduced at only 523 million lei) and in the case of personnel expenses (the breach is reduced at 62 million lei), but generate a large increase in the size of these thresholds overruns in the case of the primary deficit (up to 689 million lei), given the fact that the savings recorded at the level of interest expenses are not used for reducing the budget deficit, as the rule concerning the primary balance, stated in the Law no. 69/2010 would have required. Moreover, the draft law provides again the already usual exemption from the above described fiscal rules, diminishing their credibility.

The Coordinates of the second budget revision - budgetary revenues

GCB revenues are downwardly revised by 1.32 billion lei compared to the programmed level from the first budget revision. A small part of this review is due to the reevaluation of the swap compensation scheme already approved, whose amount decrease by 250 million lei (from 1,598 million lei to 1,348 million lei), plus a newly approved scheme of 59 million lei, so that the aggregate impact is of -191 million lei, both at the level of budgetary revenues and expenditures. The most part of the revenues revision comes from incorporating in the budgetary projection the impact of reducing from October the 1st, 2014 the employer's social security contribution (by 5 pp), that generates a gross impact at the level of revenues from social security contributions evaluated at -1 billion lei, given its incidence only on two months of the cash-based execution for this year. A significant large downward revisions is made at the level of revenues (without the aforementioned swaps) regarding "nontax revenues" (-451 million lei), "amounts received from the EU in the account of payments made and prefinancing"

(-300 million lei) and “taxes on using goods, authorizing the use of goods or on carrying activities” (-101.6 million lei). These negative revisions at the level of certain categories other than social contributions are, however, almost entirely compensated by the ascending changes (without swaps) operated in the revenue estimations regarding “VAT” (+544.8 million lei) and “corporate income tax” (+ 190.5 million lei).

The Fiscal Council has serious reservations regarding the proposed upward revision for the projection of VAT receipts, given that the income flows for the two months of the budget execution available after the first budget revision – namely July and August – are not at all likely to generate optimism regarding the future receipts from this tax which, consequently, makes the proposed ascending revision at the level of budgetary revenues estimate for this category to appear as implausible. Specifically, the aggregated VAT receipts at the level of the aforementioned months are lower than those from the previous year by 1.3% (-114 million lei), a phenomenon partly explained by the base effect related to the VAT reduction on flour and bakery products implemented starting with September 1st, 2013 that, according to NAFA data, generated monthly reduced revenues on average by 32.1 million lei during September 2013-July 2014 compared to the same period of the previous year. Moreover, according to NAFA data obtained by the Fiscal Council, the annualized impact on budget revenues from VAT of the aforementioned measure, evaluated according to the available reports at the end of July 2014 (10 months of implementation), was of -386.7 million lei decrease compared to the same period of the previous year (-55.1% during September 2013-July 2014 compared to the same period of the previous year), a level that not seems to indicate a materialization of the expectations of an increase in the payment voluntary compliance[21].

Moreover, the projected evolution of VAT receipts appears as inconsistent with the proposals to revise the budgetary spending, their level, itself generator of VAT revenues, being lower than the one projected in the context of the first budget revision. A simple calculation shows that the monthly average revenue over the last four months should be increased by about 20% compared to that corresponding to the last 8 months from the preceding budget execution,

[21] A *caeteris paribus* evaluation would most likely indicate revenue losses higher than the above, given that realized revenues after the VAT reduction also include the favorable effect that occurs during years with rich crops. In these years, the reduction of prices regarding the agricultural raw materials is not accompanied, according to historical data, by decreases of the final price net of taxes, which tend to remain relatively fixed, a phenomenon likely to generate more added value and therefore VAT receipts. Moreover, NAFA data also shows a decrease in the number of average monthly VAT documents filed by companies with activities related to NACE codes 1061 and 1071 targeted by the VAT reduction, from 2481 during September 2012-July 2013 to 2382 during September 2013-July 2014 (-4.0%), which also seems to indicate the absence of a voluntary compliance increase in the payment behavior.

after both the compared levels have been adjusted for the way in which the compensation schemes are distributed at an intra-annual level. The Fiscal Council admits that the uneven investment expenditure execution, the budgeted annual amounts being scheduled to be spent in a proportion of 62,4% over the last four months of the year (i.e. 23.4 billion lei from 37.5 billion lei) is likely to lead to symmetric distortions at the level of the monthly VAT returns. However, its assessments indicate that, even taking into account the massive acceleration of the investment spending in the last four months of the year according to the proposed schedule, it appears as prudent to revise downward the annual VAT returns estimates by at least 800 million lei, depending on the assumptions about the size of the intermediate consumption related to investment projects.

Also, the Fiscal Council reiterates its reservations already mentioned on the occasion of the first budget revision regarding the estimated inflows from the post-accession EU funds of which the ultimate beneficiary is the public sector. The reductions of the revenue estimates at this chapter by only 300 million lei appears as inadequate in terms of ensuring the verisimilitude of the annual projected level, given that in order to converge to it, the average monthly inflows in the last four months of this year should be about 2.46 billion lei, a level which is almost double to the best performance from this year, respectively that from August; moreover, achieving the estimated annual level would be a first in terms of historical estimates on this chapter of income in Romania and is less credible as the gap between the achievements from the 8 months execution and the annual estimates is higher than the ones from the previous years. The Fiscal Council will return to the EU funds topic during the current opinion in the context of the budget expenditure.

The coordinates of the second budgetary revision – budget expenditure

Compared to the programmed public spending in accordance with the first budget amendment, the current review indicates a reduction of around 1.36 billion lei, of which 191 million lei are due to the impact of the revaluation of the swaps described above. The spending reduction is mainly located on three categories, namely, projects funded by external post-accession grants (-2,455 million lei), interest expenses (-572 million lei) and expenditure funded from reimbursable funds (-451 million lei). The allocations within the following categories increase significantly: expenditures on goods and services (+933 million lei, excluding the impact of the swap scheme), capital expenses (+370 million lei, excluding the impact of the swap scheme) and the contingency reserve fund (+377 million lei). In essence, compared to the programmed levels in the first budget revision, the allocations for investment expenditure are revised negatively (-2,381 million lei), the amounts being partially used to supplement some categories of current expenses, mainly those on goods and services of the local budgets; while the difference, to which are added the savings on interest expenses, is used to offset the impact of the social security contribution reduction on budgetary revenue, in order to ensure the convergence to the deficit target.

The Fiscal Council appreciates as inconsistent the assumptions regarding the estimates on revenues from post-accession funds and the expected significant reduction on the expenses related to projects funded from non-reimbursable funds. Assuming a bottom up elaborated budget, starting from concrete projects, as it should be the case especially with regard to investment objectives with European funding, it should be impossible to attract such a volume of European funds without adequate co-financing costs, including here both the standard co-financing required by the European Commission and the ineligible outlays whose amount varies on the nature of each investment objective. In the case of the current proposal to revise the GCB, the estimated European inflows are expected to record a relatively small reduction (-300 million lei), while the aggregate expenditure counterpart undergoes a downward revision of an entirely different order of magnitude (-2.455 billion lei), which is likely to lead to a significant contribution to a downward revision of the budget deficit. From the Fiscal Council's perspective, there are two possible explanations for this. The first explanation is that the reduction in revenues recorded in the case of the post-accession funds corresponds to the abandonment of investment projects for which the amount of ineligible expenditure represents approximately 87% of the project, which, although theoretically possible, it seems unlikely. A second possible explanation would be that the reduction in expenditure is the result of using an expenditure buffer included in the initial budget construction in order to comply with the deficit target in the event of unforeseen events which, although it is a proof of caution, it appears as undesirable from the perspective of building a transparent budget. Given the above mentioned, the Fiscal Council considers appropriate a clarification from the Ministry of Public Finances.

The Fiscal Council also considers that the reallocations made within the investment spending category – in the sense of abandoning the investment projects funded by external post-accession grants or funded from reimbursable funds, as well as reducing the spending on road infrastructure works of CNADR simultaneously with the supplementation of capital expenditure allocations to local budgets – are not in accordance with the principle of resources allocation to priority projects, characterized by a favorable cost-benefit ratio and with a high economic impact, especially considering the results of the evaluation exercise of the investment works portfolio in terms of these criteria achieved in the previous years.

In addition, it would have been expected that the reduction of social security contribution to generate, in return to the negative impact on the revenues related to this categories, also a reduction in the aggregate expenditure plan, which includes the contribution owed by the employer (the amount would be of about 270 million lei). The figures from the rectification proposal indicate though a marginal reduction in the wage bill of only 22 million lei, which means that the expected reduction was accompanied by additional spending allocations within the same category.

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to article 43, paragraph (2), letter d) of Law no. 69/2010, as amended and supplemented, after being approved by the Council members through vote, on 30 September, 2014.

30th September 2014

Chairman of the Fiscal Council

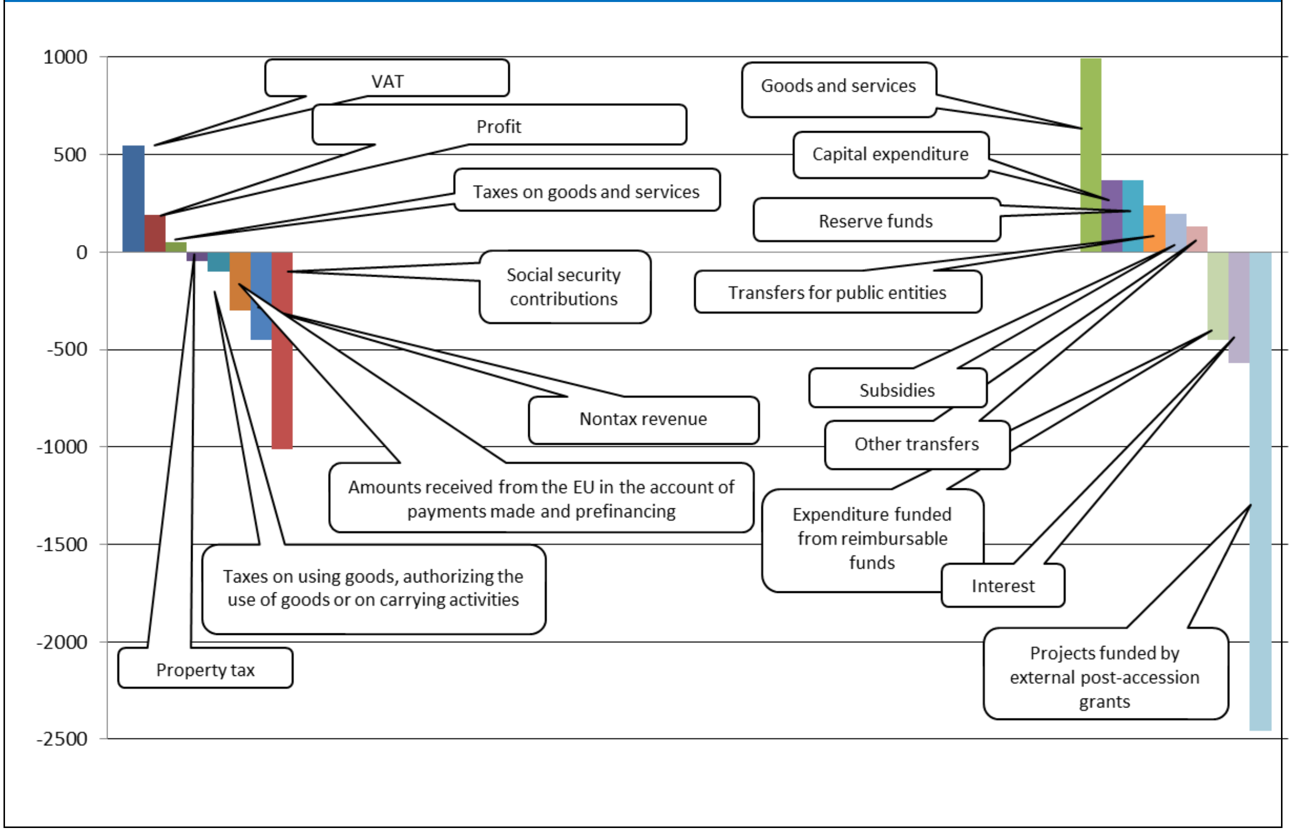
IONUȚ DUMITRU

ANNEX I	Initial budget 2014	Swap program 2014	Initial budget 2014 without *swap*	First budget revision (R1) 2014	Swap	R1 without swap	R2	Swap	R2 without swap	R1 - Initial budget	R2 - Initial budget	R2 - R1
										Adjusted values for swap impact		
	1	2	3=1-2	4	5	6=4-5	7	8	9=7-8	10=6-3	11=9-3	12=9-6
TOTAL REVENUE	216,808.3	850	215,958.3	218,346.0	1598.0	216,748.0	217,029.5	1407.0	215,622.5	789.6	-335.8	-1,125.5
Current revenue	201,331.2	850	200,481.2	201,788.8	1598.0	200,190.8	200,772.2	1407.0	199,365.3	-290.5	-1,116.0	-825.5
Tax revenue	126,162.2	850	125,312.2	126,359.5	1598.0	124,761.5	126,804.4	1407.0	125,397.4	-550.7	85.2	635.9
Taxes on profit, wages, income and capital gains	36,724.9		36,724.9	35,873.5	0.0	35,873.5	36,063.9	0.0	36,063.9	-851.5	-661.0	190.5
Profit	11,378.0		11,378.0	11,800.5	0.0	11,800.5	11,991.0	0.0	11,991.0	422.5	613.0	190.5
Personal income tax	24,000.9		24,000.9	22,726.9	0.0	22,726.9	22,726.9	0.0	22,726.9	-1,274.0	-1,274.0	0.0
Other taxes on income, profit and capital gains	1,346.0		1,346.0	1,346.0	0.0	1,346.0	1,346.0	0.0	1,346.0	0.0	0.0	0.0
Property tax	5,040.7		5,040.7	6,299.9	0.0	6,299.9	6,251.0	0.0	6,251.0	1,259.2	1,210.3	-48.9
Taxes on goods and services	83,362.6	850	82,512.6	83,178.1	1542.0	81,636.1	83,480.5	1351.2	82,129.3	-876.5	-383.3	493.1
VAT	54,621.6	850	53,771.6	53,563.0	1542.0	52,021.0	53,917.0	1351.2	52,565.8	-1,750.6	-1,205.8	544.8
Excises	24,102.0		24,102.0	24,114.1	0.0	24,114.1	24,114.0	0.0	24,114.0	12.1	12.0	-0.1
Other taxes on goods and services	1,807.1		1,807.1	2,615.0	0.0	2,615.0	2,665.0	0.0	2,665.0	808.0	858.0	50.0
Taxes on using goods, authorizing the use of goods or on carrying activities	2,831.9		2,831.9	2,886.1	0.0	2,886.1	2,784.5	0.0	2,784.5	54.1	-47.5	-101.6
Tax on foreign trade and international transactions (customs	623.0		623.0	626.0	0.0	626.0	626.0	0.0	626.0	3.0	3.0	0.0
Other tax revenue	411.0		411.0	382.0	0.0	382.0	383.0	0.0	383.0	-29.0	-28.0	1.0
Social security contributions	57,779.0		57,779.0	57,331.4	56.0	57,275.4	56,321.6	55.8	56,265.9	-503.6	-1,513.2	-1,009.5
Nontax revenue	17,390.0		17,390.0	18,097.8	0.0	18,097.8	17,646.2	0.0	17,646.2	707.8	256.2	-451.6
Capital revenues	621.0		621.0	1,701.2	0.0	1,701.2	1,701.2	0.0	1,701.2	1,080.2	1,080.2	0.0
Grants	14.6		14.6	24.6	0.0	24.6	24.6	0.0	24.6	10.0	10.0	0.0
Amounts received from the EU in the account of payments made and prefinancing	14,841.5		14,841.5	14,831.4	0.0	14,831.4	14,531.5	0.0	14,531.5	-10.1	-310.0	-300.0
Financial operations	0.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

ANNEX I	Initial budget 2014	Swap program 2014	Initial budget 2014 without *swap*	First budget revision (R1) 2014	Swap	R1 without swap	R2	Swap	R2 without swap	R1 - Initial budget	R2 - Initial budget	R2 - R1
										Adjusted values for swap impact		
	1	2	3=1-2	4	5	6=4-5	7	8	9=7-8	10=6-3	11=9-3	12=9-6
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	0.0
TOTAL EXPENDITURE	231,298.4	850	230,448.4	233,105.9	1598.0	231,507.9	231,741.5	1407.0	230,334.5	1,059.5	-113.9	-1,173.5
Current expenditure	213,514.3	850	212,664.3	215,150.4	1198.0	213,952.4	213,416.0	1007.0	212,409.0	1,288.1	-255.3	-1,543.4
Personnel	47,786.2		47,786.2	48,090.7	15.0	48,075.7	48,068.2	14.8	48,053.4	289.5	267.2	-22.3
Goods and services	39,363.7		39,363.7	40,417.3	224.0	40,193.3	41,468.7	282.8	41,185.9	829.6	1,822.2	992.6
Interest	11,223.5		11,223.5	11,107.9	0.0	11,107.9	10,535.6	0.0	10,535.6	-115.6	-687.9	-572.3
Subsidies	5,732.7		5,732.7	5,483.2	0.0	5,483.2	5,678.4	0.0	5,678.4	-249.5	-54.3	195.2
Total Transfers	108,139.7	850	107,289.7	108,540.3	959.0	107,581.3	106,238.2	709.4	105,528.8	291.6	-1,760.9	-2,052.5
Transfers for public entities	1,399.9	850	549.9	1,650.9	850.0	800.9	1,642.0	600.0	1,042.0	251.0	492.1	241.1
Other transfers	11,816.7		11,816.7	11,934.7	68.0	11,866.7	12,067.6	68.4	11,999.2	50.0	182.5	132.5
Projects funded by external post-accession grants	20,250.9		20,250.9	20,251.0	0.0	20,251.0	17,795.5	0.0	17,795.5	0.0	-2,455.5	-2,455.5
Social assistance	71,512.7		71,512.7	71,553.5	41.0	71,512.5	71,494.2	41.0	71,453.2	-0.2	-59.5	-59.3
Other expenditure	3,159.5		3,159.5	3,150.3	0.0	3,150.3	3,238.9	0.0	3,238.9	-9.2	79.4	88.6
Reserve funds	168.3		168.3	467.3	0.0	467.3	834.3	0.0	834.3	299.0	666.0	367.1
Expenditure funded from reimbursable funds	1,100.2		1,100.2	1,043.7	0.0	1,043.7	592.5	0.0	592.5	-56.5	-507.7	-451.2
Capital expenditure	17,784.1		17,784.1	17,955.6	400.0	17,555.6	18,325.5	400.0	17,925.5	-228.5	141.4	369.9
Financial operations	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	0.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EXCEDENT(+) / DEFICIT(-)	-14,490.0		-14,490.0	-14,760.0	0.0	-14,760.0	-14,712.0	0.0	-14,712.0	-269.9	-222.0	47.9

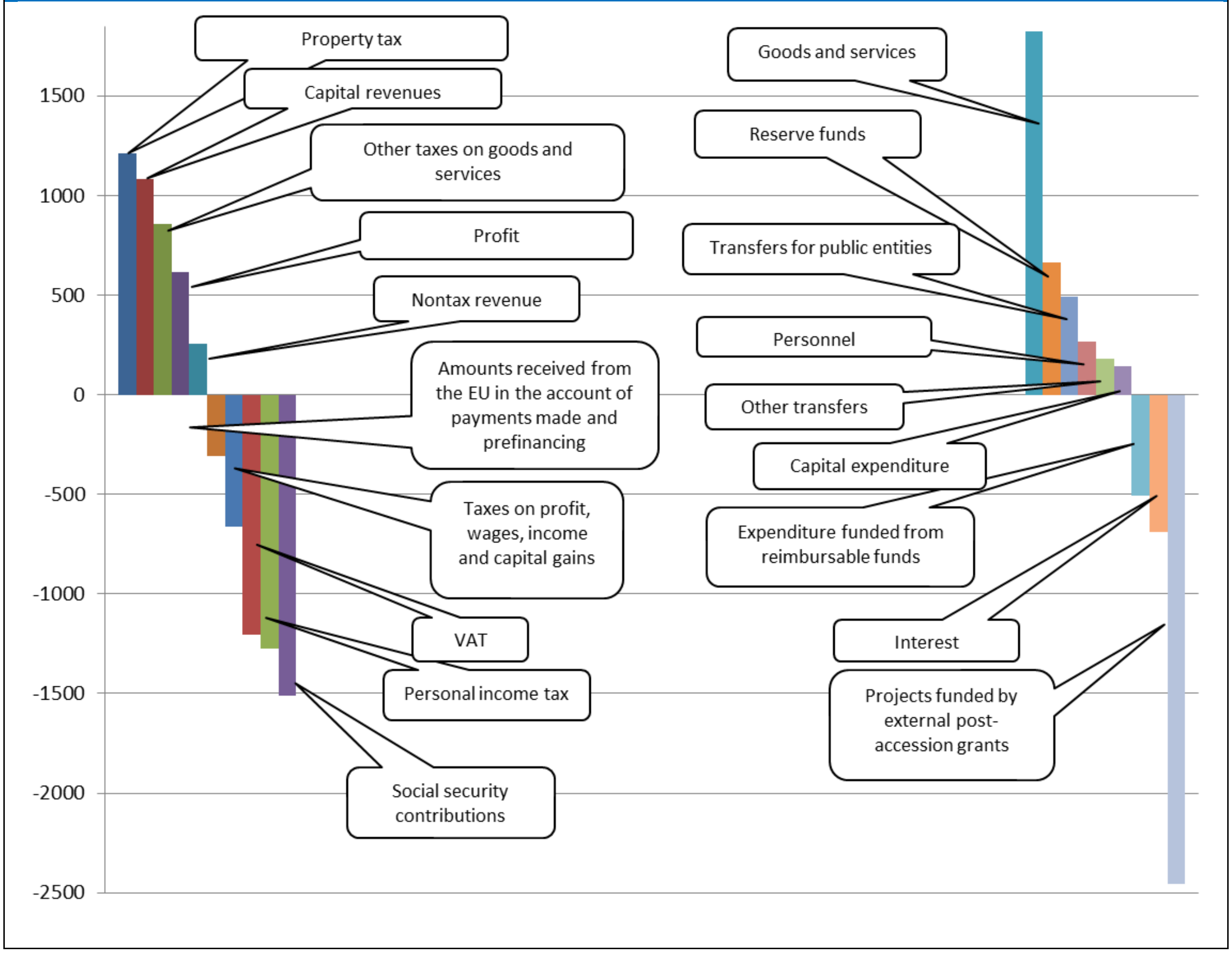
Source: Ministry of Public Finance, Fiscal Council's calculations

Figure 1: 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 2: The main changes in expenditures and revenues compared to the initial budget (without the impact of swap schemes), million lei



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

VI. The Fiscal Council's Opinion on the Third Supplementary Budget Draft for 2014

On the 28th of November 2014, at 19:00, the Ministry of Public Finance (MPF) sent via e-mail to the Fiscal Council, by letter no. 20348 from the 27th of November 2014, a third supplementary budget draft for 2014, the explanatory note and the Government Ordinance project regarding the budget revision draft for 2014, as well as the explanatory note and the Government Ordinance project regarding the draft of the revised social security budget for 2014, requesting the Fiscal Council's opinion under the article 40, paragraph (2) of the Law no. 69/2010. The Government's intention is to adopt the above mentioned documents during the meeting from the 3rd of December 2014, so the Fiscal Council is put again in the position of having available only one working day to analyse, elaborate and approve the requested opinion. *Although the Fiscal Council repeatedly asked the Government to provide a reasonable time to fulfil its obligations according to the law, the persistence of this behavior shows a lack of consideration for the fiscal responsibility law in general and for the institution of the Fiscal Council in particular.*

To the aforementioned documents is added a draft Emergency Ordinance approving distinctively temporary exemptions (effective for the current year) from the Public Finance Law no. 500/2002 and from the Fiscal Responsibility Law no. 69/2010 regarding prohibitions to promote, in the first case, a budget revision after the 30th of November and to approve more than two budget amendments during a year, in the second case. The justification for the temporary suspension of these two laws' provisions, according to the preamble of the enactment, consists mainly of "the surplus recorded at 10 months, as a result of an increased budgetary revenue collection compared to the estimates and given the favorable situation in terms of framing in the general government budget ceiling approved for 2014". The argument is obviously false, **as the existence of a surplus after 10 months of budget execution is not due to budgetary revenues that substantially exceed estimates[22], but simply because of the investment expenditure underachievement**: at the end of October 2014, the investment

[22] According to the reports on the MFP's website, the total budgetary revenues from the third quarter represented about 95.7% of the program, respectively 2476 million lei below the estimates, almost entirely because of lower than expected post-accession EU funds by 2446 million lei. (http://discutii.mfinante.ro/static/10/Mfp/trezorerie/AnexeraporttrimIII2014_31102014.xls)

expenses were by 2.3 billion lei lower than the ones from the previous year while for the entire year the programmed level of investment expenses is by 5.8 billion lei higher than in 2013. **From the Fiscal Council's point of view, the situation is far from reflecting a good public finance management and a good budget execution; on the contrary, it is testimony of an obvious inability at the level of the public investment projects portfolio management, likely to induce an unnecessary negative fiscal impulse in the economy**[23]. This statement is confirmed by the changes proposed by the third budget revision, given that the public investment program recorded a further reduction of 1.3 billion lei, compared to the level of the second budget revision, the more that the latter one is very recent, taking place at the end of September. In essence, the third budget revision for 2014 uses the fiscal space created by the substantial underachievement of investment spending to pay in advance, compared to the timing established by law, some salary related rights earned by court decisions and also other arrears, with favorable impact on the cash deficit in 2015. However, given that a significant proportion of these outstanding remuneration and other arrears, that the Government intends to pay, has already been included in the execution on an accrual basis (ESA95 / ESA2010) in 2011 - for the first category, or in that from the current year in the case of the second category, it is very unlikely that this inter-annual reallocation would generate a reduction in the existing pressures on the general consolidated budget (GCB) deficit in 2014, determined in accordance to the European standards, relevant from the perspective of Romania's commitments as a member of the European Union and from the perspective of compliance with the preventive arm of the Stability and Growth Pact and the Treaty on Stability, Coordination and governance in the Economic and Monetary Union. In other words, the payment of those sums could have been done just as well, for example in January 2015, under the approved budget for 2015, without this adversely affecting the size of the budget deficit according to European standards and without the need to appeal to many violations of the fiscal rules stipulated by laws and consequently undermining their credibility. In addition, the reduction of investment expenditures in 2014 to a minimum in the last few years and/or their postponement would rather put pressure on the budget deficit in the coming years both in cash and accrual standards (ESA95 / ESA 2010).

According to the Fiscal Council, the systematic recourse to exemptions from laws (especially the Law no. 69/2010) and the ease with which they occur, highlight major weaknesses in the

[23] According to the latest data available on Eurostat, the gross fixed capital formation (investment) in the public sector from the national accounts (by accrual standards) decreased in nominal terms during January-June 2014 by 35.6% compared to the same period of 2013, this being the main factor that led to lower real GDP in the second quarter from 2014 compared to the previous quarter. At the same time, in the budget execution according to cash standards during January-October 2014, this particular item decreased by 10% over the same period of 2013.

implementation of a rule-based framework in the conduct of the fiscal policy, the legal provisions failing to induce significant constraints in the behavior of the relevant authorities, as intended. It is obvious that stipulating the fiscal rules in the law is not enough and the establishment of functional rules requires them to be legislated at the constitutional level.

The compliance with the fiscal rules

Compared to the budget approved on the occasion of the second budget amendment, the GCB revenues increase by 1,796.6 million lei, the expenditure by 1,797.5 million lei, so that the budget deficit is projected to increase marginally by 1 million lei. The GCB primary deficit increases by 211 million lei, due to the downward revision of the interest spending (-210.3 million lei). Taking into account the above mentioned figures and the affected expenditures categories, the budget revision proposal implicates multiple infringements of the fiscal rules stated by Law no 69/2010 (FRL) with further amendments:

1. It violates the provisions of article 15 paragraph (2) of the FRL according to which in one year, maximum two budget amendments can be approved;
2. It violates the provisions of article 6 letter b) according to which the GCB balance and the GCB primary balance may not exceed the ceilings established by the Fiscal Strategy accompanying law (namely, the Law no 355/2013). Thus, even if the breach of the ceiling for the GCB balance is marginally (3 million lei, corresponding to a deficit ceiling of 14,710 million lei and a programmed level for the GCB balance of 14,713 million lei), the existent gap to the ceiling for the GCB primary balance is increased by 901.1 million lei (the programmed level for primary balance is now 4,387.6 million lei compared to a ceiling of 3,486.5 million lei);
3. It violates the provisions of article 6 letter a) according to which the personnel spending as a share in GDP cannot exceed the ceiling established by the Fiscal Strategy accompanying law (namely, the Law no. 355/2013). Thus, the proposed amendment indicates personnel spending of 7.5% of GDP, compared to a ceiling of 7.3% of GDP (a significantly higher level compared to the lowest level reached during 2011-2012, namely 6.8% of GDP[24]), as the personnel expenses were increased by 2.406 million lei compared to the second budget revision due to an early payment of the installment for 2015 of some salary rights earned by court decisions, which payment was staggered over five years;
4. It violates the provisions of article 6 letter c) according to which the total spending excluding the financial assistance from the EU and other donors and also the personnel spending cannot exceed the ceiling established by the accompanying law of the Fiscal Strategy (the Law no 355/2013). The personnel spending proposed growth involves the

[24] The highest level of the personnel spending in the last 10 years was reached in 2009 – 9.4% of GDP

increase of the existent marginal gap (62 million lei) compared to the stated ceiling of 48,006 million lei up to a gap of 2,468.2 million lei. Moreover, the budget amendment involves the increase of the gap to the ceiling for the total spending from 523 million lei up to 2.068 million lei as the growth in the personnel spending is partially offset by the capital spending reduction (-1,797 million lei).

5. It violates the provisions of article 9 paragraph (2) according to which the total personnel spending cannot be increased during the fiscal year on the occasion of budget revisions;
6. It violates the provisions of article 6, letter g) according to which during the budgetary year, the commitment appropriations and the approved budget that are not used for capital expenditure cannot be transferred and used for current expenses, given that the current expenses proposed increase is offset by the reduction of the capital spending in order to meet the deficit target.

Consequently, the proposed amendment induces either new violations of the fiscal rules or an increase in the size of the existing violations, so that the Government evades the responsibility of their observance by recourse to derogations from almost all the legal provisions which establish fiscal rules.

The coordinates of the Third Supplementary Budget Draft– budgetary revenue and spending

Essentially, the main change introduced by this third budget revision is the use of the fiscal space created by the reduction of about 1.8 billion lei for capital spending to pay in advance, compared to the initial programmed rescheduling for certain salary rights earned by court decisions, increasing the personnel spending by 2.4 billion lei compared to the level targeted by the second budget revision at the end of September.

The payment of these rights generates additional revenue for the personal income tax (307.3 million lei) and social contributions (1.091,4 million lei), these income categories thus explaining almost all the increase for the total budget revenue. There are minor increases for nontax revenue (145.3 million lei), anticipated EU funds (234.7 million lei) and donations (18.8 million lei), while other revenue categories remain unchanged compared to the previous estimates.

For total budget spending, excluding the two above mentioned categories, in addition there are 1.1 billion lei of supplementary spending for current expenses. The increases are located at the chapters: goods and services spending, other expenses, transfers between government units and projects funded by external non reimbursable funds and are partial offset by the reduction of the estimates for the interest spending and the use of the budget reserve fund allocations[25].

The Fiscal Council maintains his reservations already formulated in the context of the second budget amendment regarding the extremely optimistic levels for the projection of VAT receipts and for the estimated inflows from the post-accession EU funds, the two additional months of budget execution available at this time being likely to strengthen his opinions. However, the Fiscal Council assess as unlikely that the underachievement in these income categories would generate an increase in the budget deficit, given that they are likely to be offset by the underachievement of investment expenditure and possible by slightly increased revenue for personal income tax and social contributions. With regard to the investment expenditure it is difficult to understand how, from a level of 20.3 billion lei at the end of October, the investment expenditure will reach 37.5 billion lei at the end of this year, since it would involve levels of spending in November and December comparable in size with the accumulated spending during the first ten months of the year.

In conclusion, the Fiscal Council considers that the Government's decision to operate a third budget revision, obviously violating the provisions of the relevant laws (temporarily suspended by an emergency ordinance), is the evidence of a noticeable administrative incapacity of budgetary programming and budget execution, particularly for investment spending. In addition, it is difficult to understand the opportunity of advance payments for the outstanding wages compared to the originally scheduled by appealing a multitude of violations of fiscal rules stipulated by laws, given that it appears to be unlikely to facilitate the construction of the budget for 2015 in terms of ESA 2010, relevant for the commitments stemming out from the perspective of membership of the European Union and the provisions of the Growth and Stability Pact and of the Fiscal Compact.

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to article 43, paragraph (2), letter d) of Law no. 69/2010, as amended and supplemented, after being approved by the Council members through vote, on 2nd of December, 2014.

2nd December 2014

Chairman of the Fiscal Council

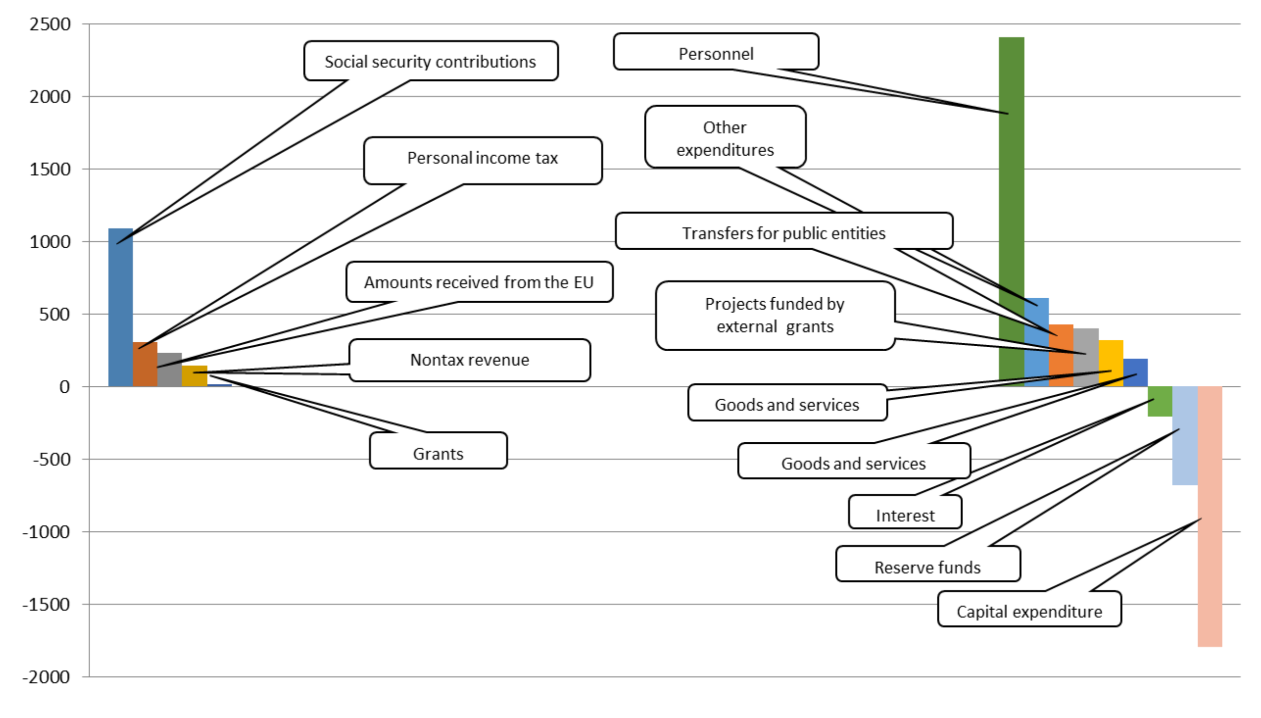
IONUȚ DUMITRU

[25] It is worth to mention that until 14 November 2014, the reserve fund allocations sum up 956.7 million lei, increasing by 567% compared to the same period of 2013.

ANNEX I	Initial budget 2014	Swap program 2014	Initial budget 2014 without *swap*	Second budget revision (R2) 2014	Updated Swap	R2 without swap	R3	Updated Swap	R3 without swap	R2 - Initial budget	R3 - Initial budget	R3 – R2
										Adjusted values for swap impact		
	1	2	3=1-2	4	5	6=4-5	7	8	9=7-8	10=6-3	11=9-3	12=9-6
TOTAL REVENUE	216,808.3	850	215,958.3	217,029.5	1407.0	215,622.5	218,827.0	1407.9	217,419.1	-335.84	1,460.72	1,796.56
Current revenue	201,331.2	850	200,481.2	200,772.2	1407.0	199,365.3	202,316.2	1407.9	200,908.3	-1,115.98	427.07	1,543.05
Tax revenue	126,162.2	850	125,312.2	126,804.4	1407.0	125,397.4	127,111.7	1407.9	125,703.8	85.22	391.56	306.34
Taxes on profit, wages, income and capital	36,724.9		36,724.9	36,063.9	0.0	36,063.9	36,371.3		36,371.3	-661.00	-353.69	307.31
Profit	11,378.0		11,378.0	11,991.0	0.0	11,991.0	11,991.0		11,991.0	613.00	613.00	0.00
Personal income tax	24,000.9		24,000.9	22,726.9	0.0	22,726.9	23,034.2		23,034.2	-1,274.00	-966.69	307.31
Other taxes on income, profit and capital	1,346.0		1,346.0	1,346.0	0.0	1,346.0	1,346.0		1,346.0	0.00	0.00	0.00
Property tax	5,040.7		5,040.7	6,251.0	0.0	6,251.0	6,251.0		6,251.0	1,210.30	1,210.30	0.00
Taxes on goods and services	83,362.6	850	82,512.6	83,480.5	1351.2	82,129.3	83,480.5	1352.2	82,128.3	-383.32	-384.30	-0.98
VAT	54,621.6	850	53,771.6	53,917.0	1351.2	52,565.8	53,917.0	1352.2	52,564.8	-1,205.82	-1,206.80	-0.99
Excises	24,102.0		24,102.0	24,114.0	0.0	24,114.0	24,114.0		24,114.0	12.01	12.01	0.00
Other taxes on goods and services	1,807.1		1,807.1	2,665.0	0.0	2,665.0	2,665.0		2,665.0	857.96	857.96	0.00
Taxes on using goods, authorizing the use of goods or on carrying activities	2,831.9		2,831.9	2,784.5	0.0	2,784.5	2,784.5		2,784.5	-47.48	-47.48	0.00
Tax on foreign trade and international transactions (customs duty)	623.0		623.0	626.0	0.0	626.0	626.0		626.0	3.00	3.00	0.00
Other tax revenue	411.0		411.0	383.0	0.0	383.0	383.0		383.0	-28.01	-28.05	-0.04
Social security contributions	57,779.0		57,779.0	56,321.6	55.8	56,265.9	57,413.0	55.8	57,357.3	-1,513.17	-421.77	1,091.40
Nontax revenue	17,390.0		17,390.0	17,646.2	0.0	17,646.2	17,791.5		17,791.5	256.21	401.52	145.31
Capital revenues	621.0		621.0	1,701.2	0.0	1,701.2	1,701.2		1,701.2	1,080.20	1,080.20	0.00
Grants	14.6		14.6	24.6	0.0	24.6	43.4		43.4	10.00	28.80	18.80
Amounts received from the EU in the account of payments made and	14,841.5		14,841.5	14,531.5	0.0	14,531.5	14,766.2		14,766.2	-310.04	-75.34	234.71

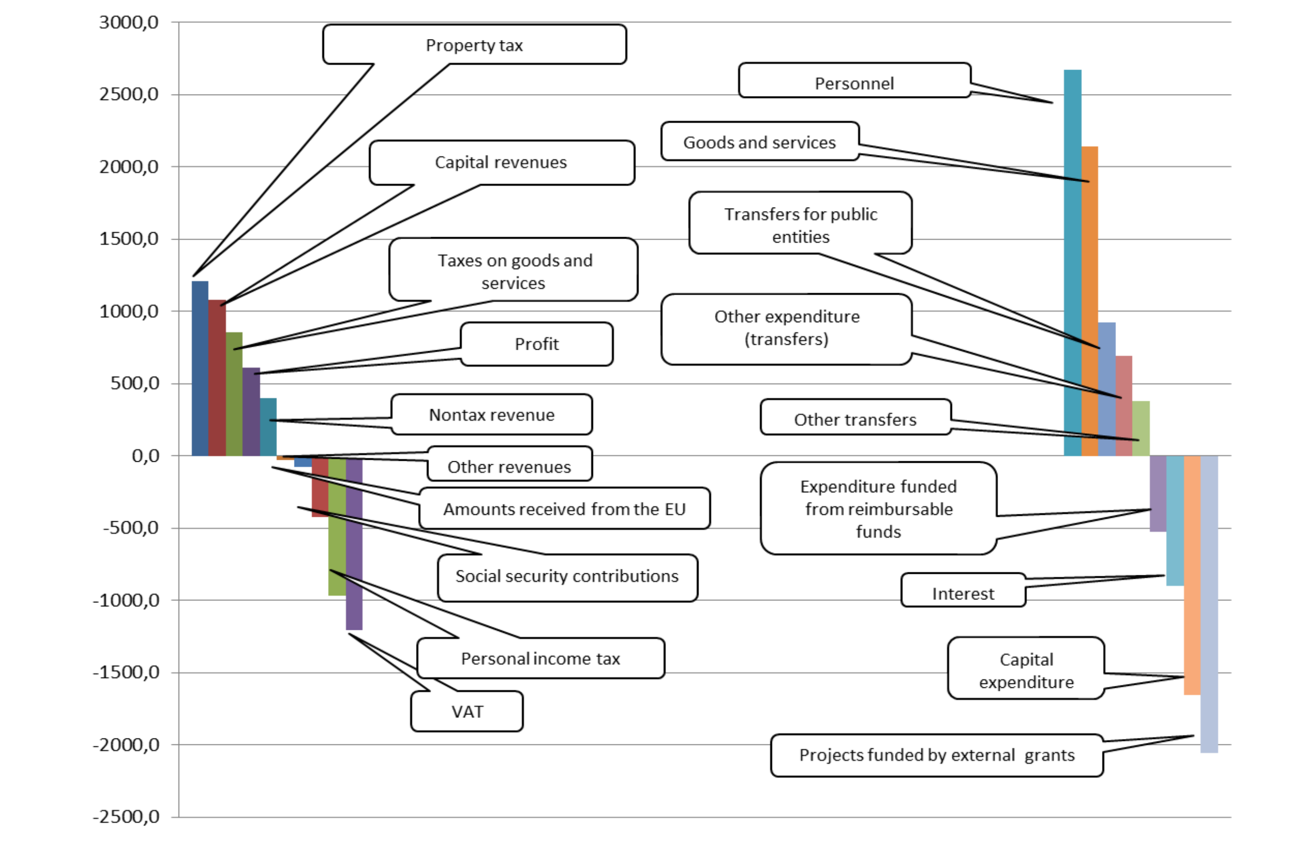
ANNEX I	Initial budget 2014	Swap program 2014	Initial budget 2014 without *swap*	Second budget revision (R2) 2014	Updated Swap	R2 without swap	R3	Updated Swap	R3 without swap	R2 - Initial budget	R3 - Initial budget	R3 – R2
										Adjusted values for swap impact		
	1	2	3=1-2	4	5	6=4-5	7	8	9=7-8	10=6-3	11=9-3	12=9-6
Financial operations	0.0		0.0	0.0	0.0	0.0	0.0		0.0	0.00	0.00	0.00
Amounts collected in the single account (State	0.0		0.0	0.0	0.0	0.0	0.0		0.0	0.00	0.00	0.00
TOTAL EXPENDITURE	231,298.4	850	230,448.4	231,741.5	1407.0	230,334.5	233,539.9	1407.9	232,132.0	-113.93	1,683.61	1,797.55
Current expenditure	213,514.3	850	212,664.3	213,416.0	1007.0	212,409.0	217,011.4	1007.9	216,003.5	-255.31	3,339.23	3,594.54
Personnel	47,786.2		47,786.2	48,068.2	14.8	48,053.4	50,474.2	14.8	50,459.4	267.19	2,673.20	2,406.01
Goods and services	39,363.7		39,363.7	41,468.7	282.8	41,185.9	41,786.4	283.8	41,502.6	1,822.23	2,138.89	316.66
Interest	11,223.5		11,223.5	10,535.6	0.0	10,535.6	10,325.3		10,325.3	-687.90	-898.18	-210.27
Subsidies	5,732.7		5,732.7	5,678.4	0.0	5,678.4	5,708.2		5,708.2	-54.30	-24.47	29.82
Total Transfers	108,139.7	850	107,289.7	106,238.2	709.4	105,528.8	107,920.7	709.3	107,211.4	-1,760.90	-78.34	1,682.55
Transfers for public entities	1,399.9	850	549.9	1,642.0	600.0	1,042.0	2,071.9	600.0	1,471.9	492.15	921.98	429.84
Other transfers	11,816.7		11,816.7	12,067.6	68.4	11,999.2	12,261.4	68.4	12,193.0	182.53	376.26	193.73
Projects funded by external grants	20,250.9		20,250.9	17,795.5	0.0	17,795.5	18,193.2		18,193.2	-2,455.48	-2,057.78	397.70
Social assistance	71,512.7		71,512.7	71,494.2	41.0	71,453.2	71,543.7	41.0	71,502.7	-59.51	-9.96	49.55
Projects funded by external post-accession grants 2014-2020							64.5		64.5	0.00	64.45	64.45
Other expenditure	3,159.5		3,159.5	3,238.9	0.0	3,238.9	3,850.6		3,850.6	79.42	691.06	611.64
Reserve funds	168.3		168.3	834.3	0.0	834.3	155.4		155.4	666.04	-12.90	-678.94
Expenditure funded from reimbursable funds	1,100.2		1,100.2	592.5	0.0	592.5	576.8		576.8	-507.68	-523.42	-15.74
Capital expenditure	17,784.1		17,784.1	18,325.5	400.0	17,925.5	16,528.5	400.0	16,128.5	141.38	-1,655.58	-1,796.96
Financial operations	0.0		0.0	0.0	0.0	0.0	0.0		0.0	0.00	0.00	0.00
Payments made in previous years	0.0		0.0	0.0	0.0	0.0	0.0		0.0	0.00	0.00	0.00
EXCEDENT(+) / DEFICIT(-)	-14,490.0		-14,490.0	-14,712.0	0.0	-14,712.0	-14,713.0		-14,713.0	-222.0	-222.9	-1.0

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



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

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



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

VII. Fiscal Council's preliminary opinion on the State Budget Law and Social Insurance Budget Law for 2015

On December 11, 2014, the Fiscal Council received from the Ministry of Public Finances (MPF) the letter no. 56371 dated to December 10, 2014, requesting under art. 40, paragraph (2) of the Fiscal Responsibility Law no. 69/2010 as amended and supplemented (FRL), the opinions on the draft of the Budget Law for 2015, the draft of the Social Insurance Budget Law for 2015, the Report on the macroeconomic situation for 2015 and the projection for the period 2016-2018, the Fiscal Strategy for 2015-2017 and the corresponding explanatory note and the draft of the ceilings law of certain indicators specified in the fiscal framework for the year 2015. However, the complete set of documents necessary for the elaboration of the Fiscal Council's opinion (especially the Fiscal Strategy for 2015-2017), and also the requested additional clarifications during the day of December 11 regarding the forecast substantiation of the budgetary aggregates and the transmitted documents were not received at the time of writing this opinion.

Under the article 40, 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 12.12.2014, 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. Moreover, the Fiscal Council repeatedly asked publicly to the Government[26] to offer a reasonable period from the time of submission of the required documents by the MPF and the moment of adopting the relevant legislation in the Government

[26]See The Fiscal Council's Opinion on the Third Supplementary Budget Draft for 2014, Fiscal Council's Opinion on the Draft Second Supplementary Budget for 2014, Fiscal Council's opinion on the draft Government Emergency Ordinance amending art. 19 of Law no. 571/2003 regarding the Fiscal Code (profit tax exemption for reinvested profits), Fiscal Council's opinion on the State Budget Law, Social Insurance Budget Law for 2014 and the updated version of the 2014-2016 Fiscal Strategy, Fiscal Council's Opinion on the Half-Year Report Regarding the Economic and Budgetary Situation and Fiscal Council's Opinion on the Draft Budget Revision for 2013, Fiscal Council's Opinion on the Draft Budget Revision for 2013, Fiscal Council opinion on the State Budget law, Social Insurance Budget law for 2013 and the updated version of the 2013-2015 Fiscal Strategy.

meeting. Beyond the Executive's obligation to consider the opinion of the Fiscal Council before approving the fiscal strategy and the annual budget laws, according to the transparency principle stated in the FRL "the Government and the local authorities have the obligation to make public and maintain in public debate, for a reasonable period of time, all information necessary to allow the assessment of the implementation of fiscal and budgetary policies, the respective outcomes and the stance of central and local public finances."

Also, according to article 18 of the FRL, until 31 July, 2014 the MPF should have submitted to the Government the Fiscal Strategy for the period 2015-2017 and the accompanying law of the Fiscal Strategy approving the limits specified in the fiscal-budgetary framework that serve to anchor the medium-term fiscal policy coordinates, representing a reference in the construction of the draft budget for 2015 and for the assessment of the fiscal rules established by FRL related to the annual budget laws. Given that the draft law that establishes the limits for some indicators specified in the 2015 fiscal framework was prepared simultaneously with the draft budget, monitoring ex-ante the compliance with the fiscal rules becomes irrelevant.

The draft budget for 2015 aims the achievement of the medium-term objective (MTO) in 2015, in line with the commitments reconfirmed by the Government in the 2014-2017 Convergence Programme submitted in April this year, the structural adjustment effort for 2015 being around 0.6 pp of GDP, significantly higher than the 0.1 pp of GDP achieved in 2014. This target corresponds to an actual deficit according to European standards ESA2010 of 1.2% of GDP whereas the cyclical component of the budget balance for 2015 was reviewed by the European Commission from -0.41% of GDP (accordingly to the 2013 Winter Forecast) to -0.27% of GDP (accordingly to the 2014 Autumn Forecast), due to a higher output gap than the initial projections, respectively, of -0.8% of GDP from -1.2% of GDP. Thus, the initial deficit target for 2015 according to ESA2010 standards of 1.4% of GDP, which would have ensured reaching the MTO in 2015, was revised downward to 1.2% of GDP.

This target corresponds to a deficit in cash standards of about 1.6% of GDP, the spread between the two methodologies being explained mainly by paying in advance, compared to the initial programmed rescheduling of certain salary rights earned by court decisions, which were, for the most part, already recorded in the budget execution according to ESA2010 standards in 2011. Thus, in 2015, significant parts of the installment for 2016 will be paid in advance (about 3.5 billion lei according to the information available at this moment), while the installment for 2015 has already been included in this year budget execution. To this deficit target for 2015 is added an adjustor of 0.25 pp of GDP for co-financing the projects sustained by EU funds, so that after including this adjustor, the budget deficit targets become 1.45% of GDP according to ESA2010, respectively, 1.83% of GDP according to the cash methodology (if the absorption of EU funds does not meet the estimates, the deficit targets remain at 1.2% of GDP in ESA2010 standards respectively, 1.6% of GDP according to cash methodology). Thus, the draft budget envisages a deficit reduction of about 0.8 pp of GDP (its estimated level for 2014 is 2% of GDP) – based on ESA standards and about 0.6 pp of GDP according to the cash methodology without taking into account the adjustor of about 0.25 pp of GDP for co-financing the projects sustained by EU funds.

On a preliminary analysis of the budgetary aggregates contained in the draft budget, based on the data available at this time, the Fiscal Council expresses some reservations about the forecasted revenues for the categories "personal income tax", "social contributions", "corporate income tax ", "property taxes" which are expected to advance more rapidly than it have been justified by the projected dynamics of the relevant macroeconomic bases and by the fiscal policy measures taken. Also, on the expenditure side, a number of categories – “personnel expenses”, “good and services expenses”, “social assistance” – appear to be slightly undervalued given the measures taken, as well as the budget execution from 2014.

The adjustment of the budget deficit in 2015 from the projected level for 2014 seems to be achieved mainly by reducing the goods and services expenses (by 0.6 pp of GDP) but the information available at this time is not indicating a concrete way by which this is to be done. In addition, the increased investment spending forecast is mostly based on a spectacular projected increase (almost doubling compared to the 2014 budget execution) of the EU funds absorption that, although desirable, seems very unlikely to be achieved, while capital expenditure financed from own sources are projected to increase compared to the very low level recorded in 2014 (however, they significantly decrease as a percentage of GDP compared to 2010-2013). Under these circumstances, the investment expenses could continue the downward trend in the execution and therefore, according to the Fiscal Council, their prioritization is absolutely necessary in order to improve and maximize the multiplier effect in the economy.

The Fiscal Council reserves its right to intervene later (during the next week, until the discussion and approval of the budget by the Parliament) to complement the opinion requested by the MPF, according to the Law no. 69/2010, as it will receive the full documentation and the clarifications requested and after a rigorous analysis of the proposed fiscal policy coordinates for the draft of the Budget Law for 2015 and the Fiscal Strategy for 2015-2017.

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to article 43, paragraph (2), letter d) of Law no. 69/2010, as amended and supplemented, after being approved by the Council members through vote, on December 11, 2014.

11th December 2014 **_Chairman of the Fiscal Council_**

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VIII. Addendum to the Fiscal Council's opinion on the State Budget Law, the Social Insurance Budget Law for 2015 and the Fiscal Strategy for 2015-2017

On December 11th, 2014, the Fiscal Council (FC) received from the Ministry of Public Finances (MPF) the letter no. 56371, dated 10 December 2014, requesting, under art. 40, paragraph (2) of the Law no. 69/2010 as amended and supplemented (FRL), the opinions on the draft Budget Law for 2015, the Report on the macroeconomic situation for 2015 and the projections for the years 2016-2018, the draft of the Social Insurance Budget Law for 2015 and the corresponding explanatory note, and also the Fiscal Strategy for 2015-2017, the explanatory note and the associated ceilings law of certain indicators specified in the fiscal framework. Given the insufficient time available to assess the relevant documents and the absence of the complete set of documents necessary for the Fiscal Council's opinion preparation (namely the Fiscal Strategy for the period 2015-2017) and of the requested additional clarifications, the FC issued a preliminary view on the draft budget on 11th December, 2014. This document is intended to complement the preliminary assessment mentioned above.

The construction of the budget for the next year aims to achieve a cash deficit of 1.83% of GDP, which would have a corresponding ESA2010 deficit of 1.45% of GDP. This level of the ESA deficit would ensure the fulfillment of Romania's obligations under the preventive arm of the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the Fiscal Compact), namely achieving a structural deficit measured according to the methodology of the European Commission of 1% of GDP (the so-called "medium-term objective"), with the inclusion of an adjuster (an allowed temporary deviation) of 0.25% of GDP for co-financing expenditures related to the projects funded from post-accession structural funds. According to the information received by the Fiscal Council so far, the realization of a such unusual gap both in terms of dimension and sign – given the historical patterns - between the budget balances under the national methodology (cash) and the one according to ESA2010 is explained by the fact that the projection of spending in according to the national methodology includes in 2015 consistent payments related to certain salary rights earned in court that were already reflected in the previous years' budgetary expenditures according to ESA2010 and also by the advances paid for the purchase of military equipment which will be reflected in the budgetary expenditure according to ESA2010 later, respectively at the time of their receipt. The Fiscal Council requests publicly to the Ministry of Public Finances, in accordance with the principle of transparency stated by the Law no. 69/2010 as amended and supplemented, the inclusion in the Report on the macroeconomic situation for 2015 and the projections for the years 2016 to 2018 of a separate subsection detailing the transition from the cash balance to the ESA2010 based budgetary balance, all the more that this explanation will be included in the context of the notification to Eurostat under the excessive deficit procedure in the spring of the next year.

According to the draft budget, the fiscal consolidation from an estimated cash deficit for 2014 of 2.2% of GDP (in line with the recently approved third budget revision for 2014) to 1.8% of GDP in 2015, is realized in the conditions of a revenue reduction as a percentage of GDP (-0.47% of GDP) surpassed by the decrease in the projected budget level of budgetary expenditures (-0.82% of GDP). The Fiscal Council will comment on the dynamics of the individual categories of revenues and expenditures corrected for the impact of the compensation schemes for clearing outstanding budgetary obligations implemented in 2014 and projected for 2015. It is to be mentioned that if we exclude the temporary expenditures and revenues for 2014 and 2015[27], the cash-based budget deficit adjustment planned for 2015 amounts only to 0.13% of GDP (from a deficit of 1.55% of GDP in 2014[28] to 1.42% of GDP in 2015).

The descendent dynamics of the budgetary revenue/GDP ratio is determined almost entirely by the impact of the employer's social security contributions reduction (the social security contributions /GDP ratio is being reduced as a result of this measure by 0.7 pp of GDP) to which is added a fall in the non-tax revenue/GDP ratio, as the revenue estimate for the year 2014 includes some temporary income (in amount of 726 million lei) from the sale of greenhouse gas emissions certificates; an opposite influence is recorded in the personal income tax revenues given a greater growth of the tax base than the projected nominal GDP dynamics, due to an increase in the number of employees and in the average wage, in the latter case based on the legislated increases of the minimum wages and those from education and health. Also, the post-accession EU grants estimate considers a considerable absorption improvement, from 14.8 billion lei in 2014[29] up to 18.8 billion lei in 2015 (+0.46% of GDP).

At the level of budgetary spending, consistent reductions will occur at the level of personnel spending (by 0.67% of GDP) and of the goods and services spending (by 0.56% of GDP).

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[27] The personal expenses related to the enforceable titles paid in 2014 and 2015, the elections expenses and the equipment for police officers, the ANRP compensations for 2014 and 2015 and a number of social security contributions in 2014.

[28] The actual deficit in 2014 could be even less than 2.2% of GDP given the underachievement of investment expenses planned for the last 2 months of the year according to the third budget amendment.

[29] The Fiscal Council has already expressed serious reservations about this estimate in its opinions regarding the second and the third budget amendment.

In the first case, the reduction in budgetary spending, amounting to 2.09 billion lei follows the estimated execution for 2014 that includes temporary spending of 5.137 billion lei[30], while the programmed budget for 2015 includes only temporary spending of 2.6 billion lei due to the payment of the enforceable titles, and also the employer's social security contribution reduction implies personnel costs savings of 1.62 billion lei[31], offsetting the projected impact on the level of the public sector wage bill (1.4 billion lei) determined by the increase of the minimum wage and of the salaries in health and education. In the second case, the reduction of expenditures represents 1.8 billion lei, partly explained by the fact that the execution for the year 2014 included temporary spending of 440 million lei occasioned by to the implementation of EU Directive no 7/2011 on combating late payments for commercial transactions.

The draft budget for 2015 includes again a compensation scheme for clearing the outstanding payments to the budget (swap scheme) with symmetric impact on the budgetary revenue and expenditure, in amount of 850 million lei. This swap scheme is persistent: beginning with 2011, the cumulative amounts for 2011-2014 are around 7.6 billion lei. It is difficult to understand the rationale behind the perpetuation of this procedure, which reflects, in the Fiscal Council's opinion, leaving unresolved structural problems (particularly the inefficiency of the state owned enterprises) that cause an abnormal behavior in terms of financial discipline. The Fiscal Council asks to the public authorities to disclose the specific details on the manner in which these compensation schemes are reflected in the financial statements of the entities involved, and their explicit identification, together with an action plan to halt this practice and to solve the underlying problem – mainly, the inefficiency of the state owned enterprises and their financial indiscipline.

According to its initial opinion, the Fiscal Council expressed preliminary reservations on the projected evolution for certain categories of budgetary revenue. Following the review of revenue projections and the additional information received from the Ministry of Public Finances, the Fiscal Council validates the MPF estimates for the discretionary measures' impact, but maintains its prior formulated reservations regarding the projected levels of the budgetary revenue aggregates, as follows (see Appendix III):

- The corporate income tax - the Fiscal Council considers that the projected level is over-estimated by about 300 million lei. The Fiscal Council admits that this revenue aggregate is usually very difficult to be accurately predicted, but the difference in question occurs even under the assumption that we admit an entirely reflection in the firms gross profit of the increased revenue determined by reducing the employer's social security

[30] The enforceable titles in amount of 4.7 billion lei (2.4 billion related to the instalment initially scheduled for 2014 and 2.3 billion related to the advance payment of the instalment initially scheduled for 2015), temporary expenditure for the policemen equipment of 270.5 million lei and temporary expenses related to the presidential election of 167 million lei.

[31] It is related to the difference between the annualized impact of 1.89 billion lei and the impact already produced in 2014 as a result of application for two months according to the cash execution (270 million lei).

contributions (an unlikely event, however). The Fiscal Council maintains also a much higher estimate compared to the MPF regarding the budgetary revenue loss due to the temporary profit tax exemption for reinvested profits: the resumption of the estimation algorithm presented in its opinion of May 2014, using the data available from the companies' balance sheets at the end of 2013 and the data on gross fixed capital formation for 2014, determine a downward re-evaluation of the minimum loss by about 400 million lei (up to 1.6 billion lei), but even this is superior by 1 billion lei to the estimated revenue loss calculated by MPF (550 million lei).

- Personal income tax – even given an upward revision of the estimated revenues for 2014 included in the third budget amendment (about 600 million lei), the extrapolation of the income aggregate with the relevant macroeconomic basis (number of employees and average wage according to the National Commission of Prognosis' projection from November 2014) to which is added the impact of the minimum wage increase and also the wage growth from education and health, indicates a minus of revenues compared to the estimated from the draft budget for 2015 of about 280 million lei.
- Property taxes - even if the Report on the macroeconomic situation for 2015 and its projections for the years 2015-2017 has explicitly mentioned a negative impact of 550 million lei corresponding to a tax rate reduction on special constructions from 1.5% to 1%, the impact of this measure does not seem to be reflected in the actual projection of this revenue aggregate. This is projected to increase by 103 million lei, while the differentiated determination of the property tax owed by individuals, according to the destination (residential or non-residential), would produce additional revenues estimated at 132 million lei. Consequently, the Fiscal Council considers that at the level of this category it is identifiable a revenue minus compared to the budget projection in an amount equal to the impact of the above mentioned measure, namely 550 million lei.
- VAT – Starting from a level of VAT revenues estimated at 51.6 billion lei in 2014, by about 1 billion lower than the level from the third budget revision, a level which appears to be more plausible in light of the budgetary execution so far (the Fiscal Council has already expressed twice its reservations about the projected VAT revenues for 2014) and extrapolating it with the nominal consumption projected evolution, the Fiscal Council considers that the level of this revenue category is overestimated by about 630 million lei.
- Social security contributions – The Fiscal Council's calculations, using as a starting point the estimation for this category from the third budget revision, extrapolated to the relevant macroeconomic basis dynamics and adjusted with the impact of the adopted fiscal measures, indicate revenue minus of about 420 million lei.

At an aggregate level, the fiscal revenues appear as potentially overvalued by about 2.35 billion lei (0.33% of GDP), given that the MPF probably takes into account in the revenue projection the favorable impact of an improved revenue collection. The Fiscal Council reiterates its earlier opinion according to which the earnings of an improved revenue collection are impossible to be assessed *ex ante* and a cautious approach, otherwise specifically required by the Fiscal Responsibility Law, requires the consideration of any income pluses only *ex post*.

According to its preliminary opinion, the Fiscal Council has expressed reservations about the projected of the following expenditure aggregates: goods and services, personal and social costs, but considering the additional information received, it withdraws those related to the last two categories. In terms of expenditure on goods and services, their reduction is the main adjustment instrument towards the convergence to the structural deficit target. The Fiscal Council considers, in principle, that this manner of adjustment has a low distortionary potential, as far as the projected reduction of the intermediate consumption amount should be based on eliminating some unproductive expenditure. However, determining the nature of these spending reductions is impossible given that none of the explanatory documents related to the draft budget contains relevant information regarding the specific sources that would generate savings in this expenditure category in 2015. Furthermore, historically, the aggregate expense on goods and services appears to be one that is by excellence extremely difficult to control: thus, in the period 2011-2014, the amount of spending on goods and services recorded constantly in the execution higher levels than those originally budgeted or even those already upward revised during the budgetary adjustments, beyond what could be explained by the impact of the compensation schemes or by the additional receipts from the clawback[32] tax, and that given that the initial budgets from these years contained higher allocations (in nominal terms) compared to the previous year execution, which is not the case in the current budget draft.

The investment expenses are projected to grow consistently in 2015 (+8.6 billion lei), both at the level of the component related to projects funded by European post accession grants (+6.2 billion lei), but also at the level of the exclusively domestic funding component (+2.3 billion lei).

Note that the above increases are compared to the estimates of budgetary expenditure from the third supplementary budget for 2014 which, in the Fiscal Council's opinion, are extremely unlikely to materialize at the indicated level. As in the case of goods and services expenses, the past budget executions constantly recorded considerable deviations from the initial budgeted amounts in the case of investment expenditure, but of opposite sign, meaning that the execution results are invariably lower than the estimates from the initial and supplementary budgets, recording even reductions in nominal terms from one budget execution to another (see *Figure 1*). Regarding the projected amount of EU funds absorption, it is understandable taking into account in the initial

[32] Compared to the original approved budget, the amount of spending on goods and services (net of the impact of so-called swaps) was higher by 3 billion lei in 2011, 2.3 billion lei in 2012, 1.05 billion lei in 2013 and, respectively, 1.9 billion lei in 2014 (the third budget amendment compared to the initial budget).

budget such a steep increase of performance, given that 2015 is the last year of contracting funds for the financial exercise 2007-2013 and the budget allocations must prevent the disengagement of funds.

Considering the above, the Fiscal Council has serious reservations regarding the possibility of meeting the deficit target while maintaining the budgetary expenditure within the parameters of the draft budget, given the identified significant overestimation of the tax revenues. Moreover, in the Fiscal Council's opinion, framing in the envelope of good and services expenditure – which is the main factor of the programmed structural adjustment – appears as uncertain in terms of historical evolutions, especially since it is not clear which are the specific sources of the planned expenditure savings.

Regarding the 2015-2017 Fiscal Strategy, the Fiscal Council can only note again that the manner of elaborating it at the end of the year, simultaneously with the draft budget, is not at all consistent not only with the legal terms but also with the objective of anchoring economic agents' expectations by providing a predictable fiscal framework. As in the previous years, the authorities attention appears to be exclusively focused on the short term (the next year), ignoring to focus on the medium-term budgetary projections.

Illustrative in this respect is the incomprehensible manner in which the deficit decreases from the programmed level of 1.8% of GDP in 2015 to the level of 1.1% of GDP envisaged for 2016: the adjustment occurs almost exclusively on behalf of a massive increase of post - accession EU funds inflows (+7.3 billion lei or by 0.83% of GDP), while the expenditure related to projects funded by external grants decrease by 788 million lei (by 0.29% of GDP). Moreover, the same trend from a qualitative point of view was presented as an adjustment source for the year 2015 compared to 2014 in the previous version of the Fiscal Strategy, in sharp contrast with the concrete manner in which the deficit reduction is projected to occur in the current version of the draft budget for 2015.

The Fiscal Council considers that an appropriate strategy to anchor the fiscal policy's coordinates in the medium term should not be limited only to announce deficit targets and simple fiscal measures objectives, but to include a coherent and realistic projection of the revenue and expenditure aggregates, that should contain a transparent presentation of the underlying assumptions, whether we refer to Tax Code changes with the related impact analysis or to the underlying parameters for the expenditure development (such as, the evolution of the number of employees and of the average wages in the public sector).

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to article 43, paragraph (2), letter d) of Law no. 69/2010, as amended and supplemented, after being approved by the Council members through vote, on the 19th of December, 2014.

19th December 2014

Chairman of the Fiscal Council
IONUȚ DUMITRU

ANNEX I	Budgetary impact	Revenue item
Fiscal policy measures - Revenue	-4226.7	- million lei
The 5 pp reduction of the employer's social security contributions	**-6,600.0**	**Social security contributions**
The reduction of special construction tax (awaiting approval in Parliament) from 1.5% to 1%	**-549.8**	**Property tax**
The exemption of reinvested profit *	**-550.0**	**Profit tax**
Extension of the period of charging the tax on additional revenue due to the deregulation of natural gas prices and electricity	**1,103.0**	**Other taxes on goods and services**
The increase of the minimum wage by 75 lei/semester (from 900 lei to 1,050 lei)	**549.0**	**Total impact on revenue, of which:**
	140.0	**Personal income**
	409.0	**Social security contributions**
The payment of certain salary rights of public sector personnel, earned in court	**1,507.8**	**Total impact on revenue, of which:**
	350.7	**Personal income**
	1,157.1	**Social security contributions**
The increase of the base salaries of the personnel from the public health system and the public social assistance system	**114.8**	**Total impact on revenue, of which:**
	28.5	**Personal income**
	86.3	**Social security contributions**
The increase in salaries of employees in education by 5% from March 1st, 2015 and by another 5% from September 1st, 2015	**198.5**	**Total impact on revenue, of which:**
	50.0	**Personal income**
	148.5	**Social security contributions**
	Budgetary impact	**Expenditure item**
Fiscal policy measures - Expenditure	4,944.9	- million lei
The increase of the allowance for institutionalized children	**253.5**	**Social assistance**
The increase of the allowance for family support	**244.8**	**Social assistance**
The increase of the social allowance for pensioners	**171.0**	**Social assistance**
The increase of the allowance for disabled persons	**281.0**	**Social assistance**
The increase in salaries of employees in education by 5% from March 1st, 2015 and by another 5% from September 1st, 2015	**470.6**	**Personnel expenditure**
The increase of the base salaries of personnel from the public health system and the public social assistance system	**269.7**	**Personnel expenditure**
The increase of the minimum wage by 75 lei/semester (from 900 lei to 1,050 lei)	**654.3**	**Personnel expenditure**
The payment of certain salary rights of public sector personnel, earned in court	**2,600.0**	**Personnel expenditure**

* According to Fiscal Council's estimations, the impact of the tax exemption for reinvested profit is –1.6 bn. lei.

Source: the Ministry of Public Finances

ANNEX II	Third rectification 2014 (R3)	The influence of the compensation scheme 2014	R3 without *swap*	Budget 2015	Swap planned for 2015	Budget 2015 without swap	Budget 2015-R3	Budget 2015 - R3	Budget 2015/R3	Budget 2015/R3	R3	Buget 2015	Budget 2015 - R3
								withput swap		without swap	without swap % PIB		
	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	218,827.0	1,407.9	217,419.1	226,360.5	850.0	225,510.5	7,533.5	8,091.4	3.44%	3.72%	32.24%	31.78%	-0.47%
Current revenue	202,316.2	1,407.9	200,908.3	206,732.3	850.0	205,882.3	4,416.0	4,973.9	2.18%	2.48%	29.80%	29.01%	-0.79%
Tax revenue	127,111.7	1,407.9	125,703.8	133,391.8	850.0	132,541.8	6,280.1	6,838.0	4.94%	5.44%	18.64%	18.68%	0.03%
Corporate income tax	36,371.3		36,371.3	39,567.7		39,567.7	3,196.4	3,196.4	8.79%	8.79%	5.39%	5.58%	0.18%
Profit	11,991.0		11,991.0	12,670.0		12,670.0	679.0	679.0	5.66%	5.66%	1.78%	1.79%	0.01%
Wages and income tax	23,034.2		23,034.2	25,314.7		25,314.7	2,280.5	2,280.5	9.90%	9.90%	3.42%	3.57%	0.15%
Other taxes on income, profit and capital gains	1,346.0		1,346.0	1,583.0		1,583.0	237.0	237.0	17.60%	17.60%	0.20%	0.22%	0.02%
Property tax	6,251.0		6,251.0	6,354.0		6,354.0	103.0	103.0	1.65%	1.65%	0.93%	0.90%	-0.03%
Taxes on goods and services	83,480.5	1,352.2	82,128.3	86,402.1	850.0	85,552.1	2,921.6	3,423.8	3.50%	4.17%	12.18%	12.05%	-0.13%
VAT	53,917.0	1,352.2	52,564.8	55,537.2	850.0	54,687.2	1,620.2	2,122.4	3.00%	4.04%	7.80%	7.71%	-0.09%
Excises	24,114.0		24,114.0	25,531.0		25,531.0	1,417.0	1,417.0	5.88%	5.88%	3.58%	3.60%	0.02%
Other taxes on goods and services	2,665.0		2,665.0	2,738.4		2,738.4	73.4	73.4	2.75%	2.75%	0.40%	0.39%	-0.01%
Taxes on using goods, authorizing the use of goods or on carrying activities	2,784.5		2,784.5	2,595.5		2,595.5	-189.0	-189.0	-6.79%	-6.79%	0.41%	0.37%	-0.05%
Tax on foreign trade and international transactions	626.0		626.0	675.0		675.0	49.0	49.0	7.83%	7.83%	0.09%	0.10%	0.00%
Other tax revenue	383.0		383.0	393.0		393.0	10.1	10.1	2.62%	2.62%	0.06%	0.06%	0.00%
Social security contributions	57,413.0	55.8	57,357.3	55,311.0		55,311.0	- 2,102.1	-2,046.3	-3.66%	-3.57%	8.51%	7.79%	-0.71%
Non-tax revenue	17,791.5		17,791.5	18,029.5		18,029.5	238.0	238.0	1.34%	1.34%	2.64%	2.54%	-0.10%
Capital revenue	1,701.2		1,701.2	853.8		853.8	-847.4	-847.4	-49.81%	-49.81%	0.25%	0.12%	-0.13%
Grants	43.4		43.4	2.3		2.3	-41.1	-41.1	-94.70%	-94.70%	0.01%	0.00%	-0.01%

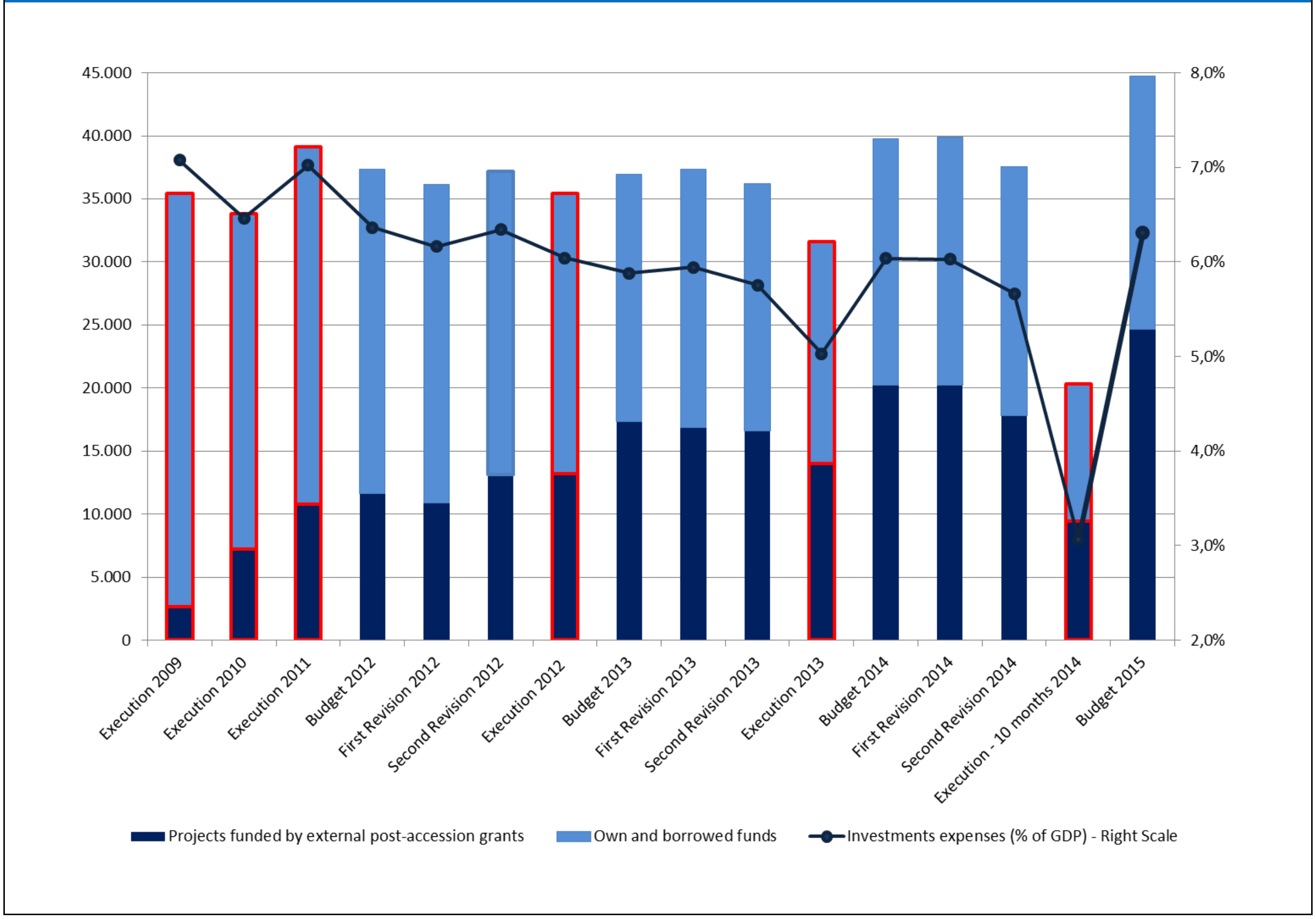
Amounts received from EU	14,766.2		14,766.2	18,772.1		18,772.1	4,005.9	4,005.9	27.13%	27.13%	2.19%	2.65%	0.46%
Financial operations	-		-	-		-	-	-	-	-	-	-	-
Amounts collected from the state budget	-		-	-		-	-	-	-	-	-	-	-
TOTAL EXPENDITURE	233,539.9	1,407.9	232,132.0	239,364.4	850.0	238,514.4	5,824.5	6,382.4	2.49%	2.75%	34.43%	33.61%	-0.82%
Current expenditure	217,011.4	1,007.9	216,003.5	220,978.1	850.0	220,128.1	3,966.6	4,124.5	1.83%	1.91%	32.03%	31.02%	-1.02%
Personnel	50,474.2	14.8	50,459.4	48,373.4		48,373.4	- 2,100.8	-2,086.0	-4.16%	-4.13%	7.48%	6.82%	-0.67%
Goods and services	41,786.4	283.8	41,502.6	39,714.6		39,714.6	- 2,071.8	-1,788.0	-4.96%	-4.31%	6.15%	5.60%	-0.56%
Interest	10,325.3		10,325.3	10,715.2		10,715.2	389.9	389.9	3.78%	3.78%	1.53%	1.51%	-0.02%
Subsidies	5,708.2		5,708.2	5,337.6		5,337.6	- 370.6	- 370.6	-6.49%	-6.49%	0.85%	0.75%	-0.09%
Total transfers	107,920.7	709.3	107,211.4	116,032.3	850.0	115,182.3	8,111.6	7,970.9	7.52%	7.43%	15.90%	16.23%	0.33%
Transfers for public entities	2,071.9	600.0	1,471.9	1,358.5	850.0	508.5	- 713.4	- 963.4	-34.43%	-65.45%	0.22%	0.07%	-0.15%
Other transfers	12,261.4	68.4	12,193.0	12,410.3		12,410.3	148.9	217.3	1.21%	1.78%	1.81%	1.75%	-0.06%
Projects funded by external post-accesion grants	18,193.2		18,193.2	23,836.7		23,836.7	5,643.5	5,643.5	31.02%	31.02%	2.70%	3.36%	0.66%
Social assistance	71,543.7	41.0	71,502.7	74,262.3		74,262.3	2,718.6	2,759.6	3.80%	3.86%	10.60%	10.46%	-0.14%
Projects funded by external post-accesion grants 2014-2020	64.5		64.5	800.0		800.0	735.5	735.5	1141.20%	1141.20%	0.01%	0.11%	0.10%
Other expenditure	3,850.6		3,850.6	3,364.5		3,364.5	- 486.1	- 486.1	-12.62%	-12.62%	0.57%	0.47%	-0.10%
Reserve fund	155.4		155.4	8.6		8.6	- 146.8	- 146.8	-94.47%	-94.47%	0.02%	0.00%	-0.02%
Expenditure funded from reimbursable funds	576.8		576.8	796.4		796.4	219.6	219.6	38.08%	38.08%	0.09%	0.11%	0.03%
Capital expenditure	16,528.5	400.0	16,128.5	18,386.4		18,386.4	1,857.9	2,257.9	11.24%	14.00%	2.39%	2.59%	0.20%
Financial opreations	-		-	-		-	-	-	-	-	0.00%	0.00%	0.00%
Payments made in previous years and recovered during current year	-		-	-		-	-	-	-	-	0.00%	0.00%	0.00%
EXCEDENT(+) / DEFICIT(-)	-14,713.0		-14,713.0	-13,004.0		-13,004.0	1,709.0	1,709.0	-11.62%	-11.62%	-2.18%	-1.83%	0.35%

Annex III	2014			2015					
	2014 Budget after the third rectification	The influence of the compensation schemes in 2014	2014 Budget after the third rectification excluding schemes effect	The influence of the compensation schemes in 2015	Explanations	The growth of the relevant macroeconomic basis	The revenue projection 2015 of the Fiscal Council (FC)	CGB revenues according to the 2015 budget draft	Differences
TOTAL REVENUE	**218,827.0**	**1,407.9**	**217,419.1**	**850**			**224,117.7**	**226,360.5**	**-2,242.8**
Current revenue	202,316.2	1,407.9	200,908.3	850			204,541.9	206,732.3	-2,190.4
Tax revenue	127,111.7	1,407.9	125,703.8	850			131,622.6	133,391.8	-1,769.2
Corporate income tax	12,867.3		12,867.3				13,275.6	13,708.0	-432.4
Profit	11,991.0		11,991.0		(The starting point of extrapolation is represented by the level projected in the third budget revision)*The growth of the macroeconomic base; the result is adjusted by the impact difference between FC's estimates and the ones of MPF regarding the tax exemption on reinvested profits (estimated at about -1000 mil. RON), plus the estimated positive impact of the 5 pp employer's social security contribution reduction on the corporate income tax (approximately 732.8 mil. lei).	Nominal GDP (+5.25%)	12,353.3	12,670.0	-316.7
Other corporate taxes on profits, income and capital gains	876.3		876.3			Nominal GDP (+5.25%)	922.3	1,038.0	-115.7
Personal income tax	23,504.0		23,504.0				25,525.7	25,859.7	-334.0
Wage and income tax	23,034.2		23,034.2		(The starting point of extrapolation – represented by the projection of the FC given the budget execution at 10 months and the other information available – eliminating the additional revenues from the payment of certain salary rights earned in court in 2014, estimated at 494.6 mil. RON)*The growth of relevant macroeconomic basis, plus additional revenues from the payment of certain salary rights earned in court in 2015 (estimated at 283.6 mil. lei) and from the fiscal measures implemented in 2015 (about 218.5 mil. RON).	The average number of employees (+1.42%) Average gross earnings (+4.52%)	25,031.3	25,314.7	-283.4
Other taxes on income, profits and capital gains	469.7		469.7			Nominal GDP (+5.25%)	494.4	545.0	-50.6
Property tax	6,251.0		6,251.0		The special structures tax reduction from 1.5% to 1% is estimated to have a negative impact on revenue of approx. 550 mil. RON.		5,804.0	6,354.0	-550.0
Taxes on goods and services	83,480.5	1,352.2	82,128.3	850			85,950.0	86,402.1	-452.1
VAT	53,917.0	1,352.2	52,564.8	850	(The starting point of extrapolation – represented by the projection of the FC given the budget execution at 10 months and the other information available – excluding swap schemes effect for 2014)*The growth of macroeconomic base, plus the swap for 2015 and the negative impact of VAT decrease on "all inclusive" services from 24% to 9% (estimated at around 300 mil. RON in 2015, and the positive impact on 3 months in 2015 of the 7	Household's final consumption expenditure excluding self-consumption and related market (+5.21%)	54,909.5	55,537.2	-627.7

					eurocents excise on fuel (estimated at about 110 mil. RON)				
Excises	24,114.0		24,114.0		(The starting point of extrapolation is represented by the level projected in the third budget revision, plus the impact of the 3 months application of the 7 eurocents excise, of about 342.33 mil. RON)*The growth of macroeconomic base, plus the impact of higher excise duty on cigarettes according to the schedule.	Household's final consumption expenditure excluding self-consumption and related market in real terms (+2.72%)	25,382.7	25,531.0	-148.3
Other taxes on goods and services	2,665.0		2,665.0			Household's final consumption expenditure excluding self-consumption and related market (+5.21%)	2,803.8	2,738.4	65.4
Taxes on using goods, authorizing the use of goods or on carrying activities	2,784.5		2,784.5			Real GDP (+2.5%)	2,854.1	2,595.5	258.6
Taxes on foreign trade and international transactions	626.0		626.0			Imports of goods and services (+6.1%)	664.2	675.0	-10.8
Other tax revenue	383.0		383.0			Nominal GDP (+5.25%)	403.1	393.0	10.1
Social security contributions	57,413.0	55.8	57,357.3		(The starting point of extrapolation is represented by the level projected in the third budget revision, plus the amounts estimated to be transferred to the Second Pension Pillar in 2014, minus the impact of social security contributions derived from the payment of certain salary rights earned in court in 2014 (total=initial rectification III) of 1,508.6 mil. RON and the impact of the 5 pp employer's social security contribution reduction in 2014 estimated at 1,120 mil. RON by the MPF)*The growth of macroeconomic basis minus the amounts estimated to be transferred to the Second Pension Pillar in 2015 and the impact of the 5 pp employer's social security contribution reduction in 2015 estimated at 6,480 mil. RON by the MPF, and adding the impact of social security contributions derived from the payment of certain salary rights earned in court in 2015 of about 827.8 mil. RON and) and the impact of the fiscal measures implemented in 2015 (643.8 mil. RON).	The average number of employees (+1.42%) Average gross earnings (+4.52%)	54,889.8	55,311.0	-421.2
Nontax revenue	17,791.5		17,791.5		According to the projection of the Ministry of Public Finances		18,029.5	18,029.5	0.0
Capital revenue	1,701.2		1,701.2		It is eliminated the impact of the state reserve amounting to 917 mil. RON in 2014 (one-off).	The average rate of inflation forecasted for 2015 (2.2%)	801.5	853.8	-52.4
Grants	43.4		43.4		According to the projection of the Ministry of Public Finances		2.3	2.3	0.0
Amounts received from EU	14,766.2		14,766.2		According to the projection of the Ministry of Public Finances		18,772.1	18,772.1	0.0
Financial operations	0.0		0.0				0.0	0.0	0.0
Amounts collected for the state budget	0.0		0.0				0.0	0.0	0.0

Source: the Ministry of Public Finances, Fiscal Council's calculations

Figure 1: The evolution of investment expenses between 2009-2015 – planned level vs. execution (million lei)



Source: Ministry of Public Finances