Fiscal Council opinion on the State Budget law, Social Insurance Budget law for 2013 and the updated version of the 2013-2015 Fiscal Strategy

On January 21st, 2013, the Fiscal Council received from the Ministry of Finance the letter no. 350.147, requesting, under Art. 40, paragraph (2) of Law no. 69/2010, in the shortest time possible, opinions on the draft budget law for 2013, the report on the macroeconomic situation for 2013 and projections for the years 2014-2016, the draft budget law for the 2013 social security budget and the revised fiscal strategy for 2013-2015. However, the complete set of documents required for the elaboration of the Fiscal Council's opinion (specifically the report on the macroeconomic situation in 2013 and projection for the period 2013-2016, respectively the updated version of the Fiscal Strategy for 2013-2015) was not received until the date of January 23rd, 2013, while the first document was submitted to the Fiscal Council at 6pm on Tuesday, 22nd of January, and the updated strategy at 10.30 on Wednesday, 23rd of January.

Given the Government's intention to approve the above documents at the meeting on 23.01.2013, the time is obviously insufficient for their thorough review and the Fiscal Council. Despite the fact that the urgency for the 2013 budget approval is understandable, the legislative procedure should respect the principle of transparency stated in law no. 69/2010, which provides that "the Government and the local authorities have the obligation to make public and to 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". In this context, the Fiscal Council recommends a period of at least one week between the sending of the documentation by the Ministry of Public Finance and the time of adopting the relevant legislation, this interval being the minimum necessary in order to perform a rigorous analysis. In addition, the draft budget contains a package of amendments to the Tax Code which will come into effect starting with the 1st of February 2013, without being subject to public debate for a reasonable time, contrary to the spirit of Article 4.1 of the Tax Code which states that "the code is amended only by law, promoted, usually 6 months before the date of entry into force."

Under article 40, paragraph (2), letter d) of the fiscal responsibility law, the Council has the legal attribution to "analyze and issue opinions and recommendations, both before Government approval, and before submission to Parliament, on the annual budget laws." Thus, given its mandate in accordance with the law 69/2010, the Fiscal Council issues the following opinions and recommendations on the budget projection for 2013:

The consolidated budget for 2013 (and therefore the medium-term budgetary projection) is based on a significantly more unfavorable scenario regarding the macroeconomic developments compared to the one taken into account in developing the Fiscal Strategy for 2013-2015 adopted by the Government in June 2012. According to the updated macroeconomic projections, the economic growth in 2013 is estimated to reach the value of 1.6% in real terms, compared with a forecasted growth of 3.1% used in the Fiscal Strategy from June 2012. Moreover, the nominal GDP for 2013, relevant for determining the budgetary aggregates' share of GDP is substantially revised downwards as a result of the statistical review for nominal GDP in 2011 (-21.9 billion, or -3.8%) and the lower than expected economic advance during 2012 (the updated projection of National Commission of Prognosis is indicating a growth of only 0.2%, compared with a forecast of 1.7% envisaged in the Fiscal Strategy 2013-2015 as adopted by the Government in June 2012). Moreover, the projection of economic growth in 2013 is lower than the latest assessment of the European Commission from November 2012 (2.2%). The updated projections for economic growth are lower than the potential GDP growth rates for both 2012 and 2013 (assessed by the latest European Commission forecast at 2.1% and 2.4%), which implies a widening of the output gap in the economy and hence worse cyclical component of the budget balance. This means that reducing the headline deficit to 2.3% of GDP at the end of 2012 involved a structural adjustment effort higher than initially envisaged. At the same time, maintaining the 2013 proposed structural adjustment in accordance with the commitment for achieving the medium-term objective of a structural deficit of 1% of GDP in 2014 will result in a higher effective deficit.

The Fiscal Council considers the macroeconomic scenario implemented in the budget construction to be realistic, assessing the balance of risks to be relatively balanced. On the one hand, amid persistent sovereign debt crisis, major uncertainties remain regarding the economic growth in the euro area, which imply the existence of adverse risks to the realization of the economic growth forecast. On the other hand, the good performance of Romania so far in terms of adjusting budgetary imbalances and the relatively low level of public debt compared to the euro area and to the Central and Eastern Europe are expected to have a favorable effect on the investor sentiment, which could be strengthened as well by further progress in structural reforms and by the projected exit from the excessive deficit procedure this year.

The significant revision of the macroeconomic framework implies that the Fiscal Strategy for 2013-2015 as adopted by the Government in June 2012 is no longer valid. In fact, that version of the fiscal strategy and the associated law approving ceilings for certain indicators specified in the budgetary framework had not undergone a complete legislative process (the latter has only passed in the Senate) and from a strictly legal point of view, one of the consequences of the installation of a new government is the fact that it is not bound by the provisions of the fiscal strategy. Although the Government has developed an updated Fiscal Strategy, it is desirable that it goes through the full legislative approval before the elaboration of the next year's budget, making it able to anchor the fiscal policy parameters for the medium term and to assess compliance with the fiscal rules stipulated by Law no. 69/2010. At this time, the Fiscal Council is unable to comment on the updated form of the Fiscal Strategy for 2013-2015 given the very short notice (the document reached the institution on January 23rd, 2013, 10:30 AM).

The draft budget for 2013 foresees a deficit target of 13.394 billion lei, or 2.15% of GDP, higher by 1.7 billion (or 0.35 pp. of GDP, of which 0.1pp. as a result of the revision of nominal GDP assumption due to the reasons previously mentioned) than the proposed threshold following the adoption of the Fiscal Strategy for 2013-2015 by the government in June 2012. The upward revision of the deficit target reflects, on the one hand, the worsening growth prospects in 2013 and, on the other hand, the partially accommodated additional costs resulting from the Government's acceptance in December 2012 of financial corrections (valued at 3.11 billion lei) proposed by the European Commission in order to prevent de-commitment of the 2007-2013 allocation of grants for those operational programs for which major weaknesses in procurement procedures were discovered, following audits. Given the foregoing, the Fiscal Council considers that the proposed target is consistent with the structural adjustment path (according to the ESA95 deficit) required to achieve the 2014 the medium term objective of a 1% structural deficit (which would ensure compliance with the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union ratified by Romania in June 2012).

Total general government revenues are estimated to reach a level of 209.285 billion lei (33.6% of GDP), registering an increase of 15.586 billion lei (8.05%) compared to the preliminary execution at the end of 2012, a significant portion of the revenue increase being attributable to larger inflows from post-accession grants (+3.08 billion lei, respectively 37%). The projected revenues include an extraordinary component (*one-off*) valued at 3.16 billion lei, coming from the rest of 2.1 billion due by the mobile operators for renting frequency bands (910 million were already paid in 2012) and the implementation of a new compensation (swap) scheme designed to clear outstanding obligations to the state budget (1 billion impact both on revenues and on expenditures). In addition, beyond the already announced fiscal policy measures (oil and tobacco excise indexation according to the calendar, increase in the share of social contributions transferred to the second pension pillar), the draft budget includes a package of measures on the revenue side of which the estimated impact is 2.98 billion lei (the detailed list of discretionary measures and their impact is presented in Annex 1). A consistency assessment has been undergone by the Fiscal Council (included in Annex 2), indicating that the revenue projection for the year 2013 is realistic, being in line with the expected evolution of the relevant macroeconomic base and the impact of discretionary measures (which also appears as correctly evaluated).

General government expenditures are valued at 222.68 billion lei (35.7% of GDP), up by 15.3 billion (or 0.3 pp. of GDP) compared to the level recorded at the end of last year according to the preliminary execution. Adjusting for inflows related to the financial assistance from the EU and other donors (pre-accession and post-accession funds and other donations), the increase is lower than the one of nominal GDP and as a result the expenditures decrease as a share of GDP (compared with adjusted level from 2012) with 0.2 percentage points (from 34.9% of GDP to 34.7% of GDP). Thus, the dynamics of spending respects the spirit of the fiscal rule stated in article 6, letters d) of Law no. 69/2010, which provides that "until the consolidated general budget balance is in surplus in the previous year, the annual rate of growth in the forecasted consolidated general budget expenditures will be maintained below the annual rate of growth of the forecasted nominal GDP for the three-year period of the fiscal strategy". Beyond the financial correction applicable to certain EU funds operational programs, the level of expenditures accommodates 0.9 billion lei corresponding with the payment of an installment of 10% of final court rulings regarding outstanding wages to certain categories of public sector employees (included in personnel costs) and about 3.5 billion lei at the expense of goods and services for the implementation of the EU directive on combating late payment in commercial transactions. Since both the above expenses have been recorded in the previous years in the ESA95 accrual system, this should contribute to a significant narrowing of cash and ESA95 deficits in 2013, which is likely to cause a significant adjustment of the latter in comparison with its cash counterpart, sufficient from the perspective of the necessary structural adjustment step.

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 January 23rd, 2013.

January 23rd, 2013

President of the Fiscal Council

IONUT DUMITRU

Annex I	Budgetary impact	Revenue category - million RON
I. Fiscal policy measures, of which	2280.3	
Monthly ceiling of RON 18,000 for deductibility of depreciation expenses incurred for vehicles	168.8	**Profit tax**
Solidarity tax for increasing the price of gas (gas profit)	335.0	**Taxes on using goods, authorizing the use of goods or on carrying activities**
Gradual liberalization of gas and electricity prices	297.0	**Total impact on revenue, of which:**
	103.4	**Profit tax**
	193.6	**VAT**
Special fee for exploitation of mineral resources (other than natural gas)	106.9	**Taxes on using goods, authorizing the use of goods or on carrying activities**
Fee for transportation of gas and electricity	205.0	**Taxes on using goods, authorizing the use of goods or on carrying activities**
Establishing the standard notional income for income from agricultural activities	413.3	**Personal income tax**
The inclusion in the tax base of allowances	30.0	**Total impact on revenue, of which:**
	6.8	**Personal income tax**
	23.3	**Social security contributions**
The increase of excise duty on cigarettes, of which:	311.8	**Total impact on revenue, of which:**
- indexation from 1 July according with the previous schedule	157.2	**Excises**
- increasing the excise duty on April 1 instead of July 1	94.3	**Excises**
- indexation from 1 July according with the previous schedule	37.7	**VAT**
- increasing the excise duty on April 1 instead of July 1	22.6	**VAT**
The increase of excise duty on diesel fuel from January 1, 2013	402.5	**Total impact on revenue, of which:**
	324.6	**Excises**
	77.9	**VAT**

I. Fiscal policy measures (cont.)		
The increase of excise duty on beer	79.7	**Total impact on revenue, of which:**
	64.3	**Excises**
	15.4	**VAT**
The increase of minimum gross salary	328.0	**Total impact on revenue, of which:**
	93.00	Personal income tax
	310.00	Social security contributions
	-75.00	Profit tax
Environmental tax for registration of vehicles	100.0	**Taxes on using goods, authorizing the use of goods or on carrying activities**
The increase of deduction ceiling for research and development expenditure	-5.4	**Profit tax**
Property tax increase for local authorities with arrears	285.0	**Property tax**
The introduction of the 3% tax on turnover for micro-enterprises with annual revenues of maximum EUR 65,000	457.0	**Capital gains and other taxes**
Supplementary transfer to the second pension pillar (+0.5 pp. of pension contribution paid by employee)	-500.0	**Social security contributions**
Reimbursement to retirees of health contributions collected during the period 1 January 2011 - 30 April 2012 under a provision declared unconstitutional	-796.0	**Social security contributions**
The increase of natural gas royalties	61.7	**Nontax revenue**
II Extraordinary revenue, of which:		
The impact of SWAP schemes for clearing outstanding payments for 20131	1000.0	**VAT**
Income from renting frequency bands by mobile operators	2159	**Taxes on using goods, authorizing the use of goods or on carrying activities**

ANNEX II	2012			2013						
	2012 preliminary budget execution	The influence of the two compensation schemes	2012 preliminary budget execution excluding schemes effect	The influence of compensation scheme in 2013	Fiscal policy measures in 2013 according with Annex I	Explanations	Relevant macroeconomic basis*	Revenue projection 2013 FC	CGB revenues states by the budget draft 2013	Differences
	1	2	3 = 1-2	4	5	6	7	8=3*7+4+5	9	10=9-8
TOTAL REVENUE	193698.2	2211.9	191486.3	1000.0	4432.7			208961.4	209285.0	-323.6
Current revenue	184386.8	2211.9	182174.9	1000.0	4432.7			196422.4	196747.7	-325.3
Tax revenue	113980.4	2143.9	111836.5	1000.0	4915.5			122619.4	122937.8	-318.4
Corporate income tax	11784.4	95.0	11689.4		648.7			13099.1	13200.7	-101.6
Profit	10826.8	95.0	10731.8		191.7		Nominal GDP (+6,51%)	11622.2	11721.7	-99.5
Capital gains and other taxes	957.6		957.6		457.0		Nominal GDP (+6,51%)	1476.9	1479.0	-2.1
Personal income tax	20893.8	67.1	20826.7		513.1			22998.0	23159.1	-161.1
Wages, dividends, capital gain	20880.8	67.1	20813.7		513.1		The average number of employees (+0,9%) Average gross earning (+7%)	22984.2	23146.2	-162.0
Other (local) taxes	13.0		13.0				Nominal GDP (+6,51%)	13.8	12.9	0.9
Property tax	4059.0		4059.0		285.0		Indexation with cumulative inflation rate over the past three years (16.9%), assuming that 80% of local authorities which don't have arrears and for which indexation is not binding will chose indexation	4480.9	4466.3	14.6
Taxes on goods and services	76163.6	1574.2	74589.4		3468.7			80897.2	80980.9	-83.7
VAT	50517.4	1570.9	48946.5	1000.0	562.8	Although the excise increases and the liberalization of electricity and natural gas prices (which implies price increases) generate additional revenue from VAT, their impact should be included in the deflator's projection for the relevant macroeconomic base considered. The calculation reported here reflect only changes in nominal consumption without separately adding additional revenues for these measures.	Household's final consumption expenditure excluding own account consumption and the related market (+6,3%)	53026.0	52948.8	77.2
Excises	20269.6	3.3	20266.3		0.0		Household's final consumption expenditure excluding own account consumption and the related market, in real terms (+2.1%) Variation of the reference exchange rate for excises (+5.17%)	22241.4	22363.2	-121.8
Other taxes on goods and services	2110.8		2110.8			The budget revenues for 2012 include about 1.8 mld. lei from clawback tax. The revenue projection for 2013 does not include revenue from this tax.	Household's final consumption expenditure excluding own account consumption and the related market (+6,3%)	330.4	320.4	10.0
Taxes on using goods, authorizing the use of goods or on carrying activities	3265.8		3265.8		2905.9	The starting point of extrapolation (the revenues from 2012 preliminary budget execution) is adjusted excluding the extraordinary income from renting frequency bands by mobile operators during 2012 (910 million).	Real GDP (+1.6%)	5299.4	5348.4	-49.1
Tax on foreign trade and international transactions	707.4		707.4				Imports of goods and services (+5.7%)	747.7	741.8	5.9
Other tax revenue	372.2		372.2				Nominal GDP (+6,51%)	396.4	389.0	7.4
Social security contributions	51648.6	407.6	51241.0		-544.5	The starting point of extrapolation (the revenues from 2012 preliminary budget execution excluding the compensation schemes implemented in 2012) is adjusted excluding health contributions colected from pensioneers durring the period 1 January 2011 - 30 April 2012 under a provision declared unconstitutional (413 million) and adding compensatory transfers to affected persons begining with 1 June 201, which were recorded as negative revenues (619 million)	The average number of employees (+0,9%) Average gross earning (+7%)	54247.9	54355.2	-107.3
Nontax revenue	18757.8	68.0	18689.8		61.7		The average rate of inflation forecasted in 2013 (4,3%)	19555.2	19454.7	100.5
Capital revenues	660.4		660.4				The average rate of inflation forecasted in 2013 (4,3%)	688.8	687.1	1.7
Subsidies	0.0		0.0					0.0	0.0	0.0
Grants	365.0		365.0			according with the projection of Ministry of Public Finance		629.9	629.9	0.0
Amounts received from the EU	8139.3		8139.3			according with the projection of Ministry of Public Finance		11220.3	11220.3	0.0