Fiscal Council of Romania

Fiscal Council's preliminary Opinion on the draft of the second budget revision for 2021

On November 24th, 2021, the Ministry of Finance (MF) sent to the Fiscal Council (FC), by address no. 467362/24.11.2021, the draft revision of the general consolidated budget for 2021, the explanatory note and the draft of the Government Emergency Ordinance on the revision of the state budget for 2021, as well as the explanatory note and the draft of the Government Emergency Ordinance for the revision of the social security budget for 2021, requesting, under art. 53, para. (2) of the Fiscal Responsibility Law (no. 69/2010, republished, hereafter referred to as FRL), the opinion of the Fiscal Council.

According to art. 53, para. (4) of the FRL, the Government and the Parliament have the obligation to analyze the opinions and recommendations of the Fiscal Council when they elaborate the Fiscal Strategy, the annual budgetary laws, as well as other measures determined by the implementation of this law and, and also prior to their appropriation/approval.

Given the Government's intention to approve the above-mentioned documents at the meeting announced for Friday, November 26th 2021 – which is a very short time frame for drafting a full opinion – and for reasons related to clarifying the necessary information on the budget revision, the Fiscal Council decided to elaborate a preliminary opinion.

The preliminary opinion makes a brief assessment of the macroeconomic framework underlying the second budget rectification in 2021, of the updated coordinates of budget revenues and expenditures proposed in the draft rectification, of the compliance with fiscal rules, while the full opinion will be drafted in the coming period.

The macroeconomic framework underlying the second budget revision for 2021

The Fiscal Council assesses the plausibility of the changes in the current revision, the second of this year, starting from the internal and external macroeconomic framework underlying them. The considerations take into account, among others, the revised forecast published by the National Commission for Strategy and Prognosis (NCSP), on November 15th 2021 and the associated accompanying note.

The anticipated economic recovery materialized at the level of almost all economic indicators. This recovery – which in some cases brought the indicators back to pre-pandemic values or even higher than them – benefited from a strong, unrepeatable base effect, determined by the negative economic effects of the pandemic and its restrictions, especially during 2020. This reality shapes an economic trajectory, after the more alert dynamics of 2021, which will return, in the coming years, to values close to the historical average, even in conditions of intense absorption of European funds (through the Multiannual Financial Framework - MFF and the National Recovery and Resilience Plan – NRRP).

The updated NCSP projection maintains the pace of real economic growth at 7% in 2021, but revises the GDP deflator from 4% to 5.4%, thus incorporating the inflationary shock caused mainly by rising electricity and gas prices, as well as that of fuels. On the other hand, the new forecast shows an accelerated dynamic of the "Agriculture, forestry, fishing" sector – marked by a very good harvest this year – and a rapid evolution, similar to the one previously forecasted, of the "Services" sector and, on the other hand, slowdowns in the dynamics for "Industry" and, in particular, for "Construction".

These developments correspond to the information revealed by the high frequency data on the mentioned sectors, recently published by the National Institute of Statistics (NIS). However, this partial translation of the center of gravity of economic growth may also mean a less generous composition of GDP in taxes, and the current evolution marked by additional fiscal revenues (including from the payment of deferred taxes from 2020), may return to a dynamic closer to historical developments. Moreover, the "signal" data on GDP, published by the NIS on 16th of November, show, on the one hand, that the cumulative, real increase in GDP in the first three quarters of 2021 of 7.2% compared to the same period in 2020, is, therefore, closer to the annual forecast for this indicator; on the other hand, revised GDP data indicate a steady slowdown in real economic growth in recent quarters (from +5.7% in Q3 compared to Q2 2020 to +0.3% in Q3 compared to Q2 2021).

If the signal data for Q3 2021 for the recent dynamics (quarter by quarter) of GDP (+0.3%) are correlated with the evolution of the agricultural sector we can conclude that the rest of the sectors suffer a loss of pace. Given that the following quarters are marked, due to the seasonality of agricultural production, by a much lower contribution of this sector to GDP, data for Q4 and early 2022 could explain the genesis of this syncope in the evolution of non-agricultural sectors. All this information, although partially validating the economic growth forecast for 2021, show that uncertainty about the evolution of future macroeconomic aggregates is growing and, with it, the uncertainty about maintaining budget revenues on the recent rapid growth trend.

It is clear that the economic recovery of 2021 is not repeatable in terms of GDP growth in the next years.

The coordinates of the labor market – a determining component of the evolution of budget revenues, especially in terms of payroll tax, but also social contributions – were also revised in the latest NCSP forecast. According to it, the average number of employees is projected to increase in 2021 also by 1.4%, but following a slower dynamic in 2022 (+2.0% compared to +2.3% previously). The dynamics of average gross earnings is more accelerated both in 2021 in the last projection (+7.6% from +6.9% previously) and in 2022 (+8.7% from +6.7% previously). The evolution of 2021 will have a direct effect on the budget execution this year, and the one projected for 2022, as it reflects the expectations of households and companies and, implicitly, their decisions, also influencing the current evolution of the economy. The forecast for the unemployment rate is marginally modified in 2021 (registered unemployment standing at 3%, compared to 3.3% in the previous projection, and unemployment calculated according to the methodology of the International Labor Office is 5.3%, compared to 4.8 % previously). These data indicate a plausible projection of labor market aggregates, marked only by a slight overestimation of the relevant dynamics.

Updated coordinates of budget revenues and expenditures

Compared to the previously approved budgetary parameters, the draft of the second budget rectification includes a new increase in both the total revenues of the general consolidated budget (GCB thereafter) (+4.4 billion lei) and the total budgetary expenditures (+5.52 billion lei), the budget deficit standing at 1.1 billion lei over the previous projection. Expressed as a percentage of GDP, the forecasted level of the budget deficit is maintained at 7.13% of GDP amid the increase in the nominal GDP projection by 15.4 billion lei.

The Fiscal Council maintains its view that in a year with such a sharp increase in budget revenues, the budget deficit should not have been increased in absolute terms, even if additional expenditures were needed to combat the COVID-19 pandemic and, respectively, of the energy crisis.

By categories of budget revenues, positive revisions of the initial estimates occur in almost all revenues dependent on nominal GDP dynamics, opposite trends being recorded in the case of amounts from European funds and those based on renting 5G frequency bands. In essence, the upward revision of budget revenues can be attributed to the considerable increase over the initial GDP forecast, the increase in prices throughout the economy (reflected in the GDP deflator) and the behavior of firms that have reimbursed in a considerable proportion deferred taxes from the previous year.

By income categories, more significant differences compared to the estimates from the first revision occur at VAT (+5.02 billion lei), corporate income tax (+1.75 billion lei), social contributions (+1.07 billion lei), personal income tax (+0.55 billion lei), while lower revenues are forecasted for the tax on the use of goods, the authorization of the use of goods or on the development of activities (-2.07 billion lei as following the non-collection of the amounts from the 5G frequency band rental) and for the amounts received from the EU/other donors on account of the payments made and pre-financings related to the financial year 2014-2020 (-3.24 billion lei).

In this phase of the analysis, the Fiscal Council appreciates the proposed new level of budget revenues as realistic.

On the side of budget expenditures, there is a new increase compared to the parameters approved at the first budget revision, the main causes being the supplements of current expenditures, partially offset by the decrease of investment expenditures. Thus, important additions take place at the level of social assistance expenditures (+3.57 billion lei), goods and services (+3.09 billion lei), interest (+1.37 billion lei), personnel (+1.1 billion lei), subsidies (+0.9 billion lei), other expenses (+0.67 billion lei) while significant reductions are recorded at the level of projects financed from non-reimbursable post-accession 2014-2020 funds (-3.48 billion lei), capital expenditures (-1.48 billion lei), other transfers (-1.05 billion lei).

The evolution of budgetary expenditures confirms the evaluations formulated by the FC on the occasion of the first budgetary revision regarding the additional necessary resources at the level of social assistance expenditures in the amount of 3.5 billion lei and the risks of exceeding the envelope at the level of personnel and goods and services expenditures. In the case of the last two categories of expenditures, however, the magnitude of the exceedances is above the one previously anticipated by the FC, additional allocations proving necessary at the level of other categories of expenditures. Even if these developments can be partly attributed to the evolution of the COVID-19 pandemic, or the need to react to the situation on the energy market, the projected exceedances of expenditure ceilings show a lack of adequate control over them. Moreover, the overruns take place at the level of certain categories of permanent expenses, the compensation coming partly from the decrease of investment expenses.

Recurrent exceedances of permanent expenditures, which contribute to their unsustainable levels, weaken the overall budget and complicate the fiscal consolidation process.

In this phase of the analysis, the FC appreciates that the budget execution can be framed in the new projected level of budget expenditures.

In view of the above, the target level of the budget deficit (7.13% of GDP) for the current year seems feasible, given that the increase over expectations in current expenditure is covered by the additional revenue obtained as a result of increasing the nominal GDP projection and by decreasing investment expenditures.

As the FC's opinion pointed out at the previous revision, in a year with GDP growth is well above the forecast and also with a higher deflator, it was contraindicated for the deficit to increase in absolute terms.

From a broader perspective, considering the implementation of the general consolidated budget for 2021, it records the largest upward revision of budget revenues in the history of budget constructions assessed by the Fiscal Council, without these developments leading to a reduction of the budget deficit, all the additional amounts being allocated for expenses. This situation is sub-optimal, all the more so as part of the additional revenues collected in the current year are cyclical or temporary (the latter having as main source deferred taxes in the previous year), while a part even more significant of the increase in expenditures was generated by increases in permanent expenditures.

The construction of the budget for 2022 will be a severe test given the need to reconcile the management of very difficult situations facing Romania (health crisis, energy price shock, effects of tensions on international markets), which require adequate resources, with the need budgetary consolidation, visible reduction of the budget deficit.

In this context, and in view of the above-mentioned desideratum, the Fiscal Council reiterates that it is mandatory that a rigorous control of the expenditure of public money, public expenditures to ensure basic public goods for citizens (health, education, etc.) and at the same time account of the constraints imposed by the budgetary consolidation, to be combined with the increase of fiscal revenues. Without a substantial increase in tax revenues, it will be virtually impossible to meet current and future challenges faced by the envelope public budget and the Romanian society.

Compliance with fiscal rules

The draft of the second budgetary revision is characterized by the modification of the ceilings in nominal terms of the indicators specified in the budgetary framework for 2021 (initially established by Law no. 14/2021 and then amended on the occasion of the first budgetary rectification by GEO no. 97/2021) as follows:

- the nominal ceiling of the GCB primary deficit is reduced by 0.3 billion lei to the level of 66.7 billion lei;
- the nominal ceiling of the GCB deficit is increased by 1.1 billion lei to the level of 84.9 billion lei;
- the nominal ceiling of GCB's personnel expenses is increased by 1.1 billion lei to the level of 112.3 billion lei;

- the nominal ceiling of the total expenditures of GCB, excluding financial assistance from the EU and other donors, is increased by 8.7 billion lei to the level of 425.4 billion lei.

This repeated increase over the years by derogating from the ceilings for some of the indicators specified in the budgetary framework, operated on most budget revisions, show the persistence of major weaknesses in the construction of public budgets in Romania, the arbitrary in reorienting of expenditures, fiscal rules which can be easily circumvented, thus limiting the role they should play in guiding the conduct of fiscal policy.

Regarding the indicators expressed as a share in GDP, it is found that they have remained within the limits initially provided by Law no. 14/2021 (7.16% of GDP in case of GCB deficit, respectively 9.8% of GDP in case of GCB personnel costs), as a result of the increase of the nominal GDP projection by 15.4 billion lei compared to the estimate from the first revision.

The draft Government Ordinance on the revision of the state budget for 2021 stipulates the necessary derogations from the fiscal rules established by the FRL and redefines the ceilings of the budgetary aggregates in accordance with the levels provided in the revision proposal.

The opinions and recommendations formulated above by the FC were approved by the President of the Fiscal Council, according to the provisions of art. 56, para. (2), lit. d) of Law no. 69/2010 republished, following their approval by the Council members, through vote, in the meeting of November 26th, 2021.

26th November 2021

Chairman of the Fiscal Council
Professor Daniel Dăianu