Romania

Fiscal Council

Annual Report

2015

Note:

The Annual report for 2015 was approved by the Chairman of the Fiscal Council, according to article 56, paragraph (2), letter d) of Law no. 69/2010, after being adopted by the members of the Council through vote, on June 3, 2016.

The analysis of the financial performance of SOEs and that regarding the estimation of tax evasion in Romania will be completed later, as inputs become available. We estimate that for state-owned enterprises, the financial reports of Romanian companies for 2015 will be received by the Fiscal Council from the Ministry of Public Finance in the period June-July 2016, the raw data requiring further laborious processing to complete the Fiscal Council analyzes.

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List of abbreviations

CEE	Central and Eastern Europe
CF	Cohesion Fund
CPI	Consumer price index
EAFRD	European Agricultural Fund for Rural Development
EAGF	European Agricultural Guarantee Fund
EC	European Commission
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EMFF	European Maritime and Fisheries Fund
EMU	Economic and Monetary Union
ERDF	European Regional Development Fund
ESA 2010	European System of National and Regional Accounts 2010
ESA 95	European System of Accounts 1995
ESF	European Social Fund
EU	European Union
FC	Fiscal Council
FRL	Fiscal Responsibility Law No 69/2010
FS	Fiscal Strategy
FSu	Updated Fiscal Strategy
GCB	General consolidated budget
GDP	Gross Domestic Product
GEO	Government Emergency Ordinance
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
MEF	Ministry of European Funds
MPF	Ministry of Public Finance
MTO	Medium-term objective
NAE	National Agency for Employment
NAFA	National Agency for Fiscal Administration
NBR	National Bank of Romania
NCEF	National Commission for Economic Forecasting
NIS	National Institute of Statistics
NMS 10	New Member States from Central and Eastern Europe
NPISH	Non-profit institutions serving households
NREF	Non-reimbursable external funds
NRP	National Reform Programme

OECD	Organisation for Economic Co-operation and Development
OPFMA	Operational Programme for Fisheries and Maritime Affairs
pp	Percentage points
SGP	Stability and Growth Pact
SME	Small and Medium Enterprises
SOEs	State Owned Enterprises
SSC	Social Security Contribution
TFEU	Treaty on the Functioning of the European Union
TSCG	Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (The Fiscal Compact)
VAT	Value added tax
WB	World Bank

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I. Summary

The Fiscal Council (FC) is an independent authority established by the Fiscal Responsibility Law No. 69/2010 (FRL), which aims to support the Government and the Parliament in designing and implementing the fiscal policy and to promote the transparency and sustainability of public finances.

According to the FRL, the Fiscal Council has among its prerogatives to issue an Annual Report to analyze the conduct of the fiscal policy during the previous year against the framework set out in the Fiscal Strategy and the Annual Budget, to assess the macroeconomic and fiscal developments as well as the objectives, targets and indicators included in the Fiscal Strategy and the Annual Budget.

The year 2015 registered for the Romanian economy the highest annual rate of growth within the post-crisis period.

The economy advance in 2015 reached a level of 3.8%, a superior dynamic compared with the 2.5% anticipated in drafting the budget, representing the highest annual rate of growth in the post-crisis period, and higher than in the previous year (3%). Thus, the real GDP in 2015 is superior by 3.68%, to that registered in 2008, the year which marked the debut of the financial and economic crisis in Romania. The most important contribution to the real GDP growth was generated in 2015 by the household's final consumption expenditure (+3.7 pp), positive effects being also recorded at the level of gross fixed capital formation (+2.1 pp) and government consumption (+0.2 pp). Negative contributions were attributable to the net exports (-1.5 pp), due to a higher expansion in real terms of imports (+ 9.1%) compared to exports (+ 5.5%) and to the changes in inventories (-0.8 pp). Thus, also in 2015, the main driver of the economic advance was the domestic demand, which amplified its rhythm of growth. This development was joined by deteriorating the external position, as the current account deficit increased from 0.46% of GDP in 2014 to 1.14% of GDP in 2015, but being fully covered by the foreign direct investment.

Performance beyond expectations compared to the initial budget deficit targets based on over performance of the revenues, as the result of a combination of an economic growth significantly higher than the initial projection and an improvement in the collection efficiency, as a result of the NAFA's efforts and possibly due to pro-cyclical developments in terms of the taxpayers' compliance.

The budget for 2015 was based on a cash deficit target of 1.82% of GDP and 1.45% of GDP according to ESA 2010, corresponding to a structural deficit of 1% of GDP (respectively 1.25% of GDP including the adjustor of 0.25% of GDP for co-financing EU funds projects), but the final execution was well below according to both cash methodology, as the budget deficit registered 1.45% of GDP, and according to ESA 2010, given the deficit of 0.74% of GDP, corresponding to a structural deficit of 0.63% of GDP, being significantly lower compared to the initial target and to the level defined by the medium term objective (MTO).The main explanation for this development is given by the significant over performance of the budgetary revenues - registering a surplus of 6.96 billion lei, respectively 0.99 pp of GDP compared to the initial budget projection - as a result of a combination between a significantly higher than expected economic growth, with a composition favorable to higher tax revenues and an improvement in the collection efficiency, as a result of the efforts of the National Agency for Fiscal Administration (NAFA) and probably due to a pro-cyclical development of the taxpayers' compliance. This performance of revenues (surprising, given the amendments to the Fiscal Code applied during the year, which would have resulted in significant reduction in the value added tax (VAT) receipts), surpassed the successive increases operated on the budgetary expenditures on the occasion of the budget amendments - in amount of 4.3 billion lei, especially for the personnel and social assistance expenditure.

The efficiency of the tax collection recorded a notable improvement in 2015, but this development comes after a loss of efficiency in the previous year.

Romania has the second lowest share of total budgetary revenues in GDP among the European Union (EU)-fiscal and non-fiscal revenues-, these representing in 2015 only 34.8% of GDP, by 10.2 pp below the European average, while the ratio of the fiscal revenues to GDP (taxes and social contributions) was 28%, significantly lower than in similar economies such as Hungary (39.2%), Slovenia (36.9%), Czech Republic (34.7%) and Poland (33.4%).The fiscal revenues collected in 2015 were much higher than those projected in the draft budget, under the circumstances of a nominal GDP advance higher than anticipated. The level of the efficiency of taxation for VAT has significantly increased, also increasing for social security contributions (SSC), corporate and personal income tax, while the budgetary execution for the excise receipts indicates a contrary trend. Even if the improvement of the efficiency in the tax collection registered in 2015 is undoubtedly a positive element, it shall be signaled that in 2015 we can only notice a level equal to the one registered in 2013, and the sources of this inter-annual high volatility are not fully identifiable at this moment, as the reorganization process of the NAFA can be one of the factors.

The Fiscal Council appreciates an improvement in terms of efficiency and simplifying the tax collection administrative apparatus, both in terms of decreasing the number of financial administration, but also in terms of the ease of paying taxes. The reform initiated in Romania in this area seems to have led to some positive results but below the initial expectations. It is important to note that the World Bank (WB) evaluated in August 2015 the project started in cooperation with NAFA, assessing the overall progress of its implementation as moderately unsatisfactory and the risk of failure to complete the objectives as high. Therefore, the reform has the potential to lead to long-term positive effects, but we appreciate that further efforts are needed.

The financial position of the public pensions system has also deteriorated in 2015, the social security budget deficit reaching 2.48% of GDP and estimates for the coming years indicate a slight increase in 2016 (2.51%) and a reduction in 2017 (2.12%). The return

In 2015, the social security budget deficit reached 2.48% of GDP, significantly higher compared to the consolidated general budget (CGB) deficit, and the estimates for the future coming years indicate a slight increase in 2016 (2.51%) and a reduction in 2017 (2.12%), mentioning that these values appear to be undervalued given the macroeconomic projections underlying the pension point's indexation mechanism.

A significant part of the favorable dynamics of the revenue from contributions in the period preceding the financial crisis

to the special pensions system eliminated in 2010, and the emergence of new special pensions, in addition to the inequities created jeopardize the sustainability of the reforms previously initiated and generate supplementary pressure on the social security budget deficit.

proved to be cyclical, the further developments contradicting the optimistic forecasts on which the substantial increase of the pension point was based. In 2015 has been a major widening of the SSC deficit, respectively by 4.9 billion lei, due to the measure regarding the reduction of the social security contributions paid by the employer by 5 pp from October 1, 2014, despite the fast growth of wages and of the number of employees. In this context, the decision to increase some permanent expenses such as those related to pensions should take into account the trend of receipts from contributions and the forecasts for the ratio pensioners - employees, given the growing aging population effect. In addition, the return to the special pension system abolished in 2010 and the emergence of new special pension jeopardize the sustainability of the reforms previously initiated and generate additional pressure on the social security budget deficit. The Fiscal Council firmly appeals in the favor of maintaining the progresses made in the recent years, both in terms of the principles introduced (the exclusive use of the contribution principle in determining the pension benefits) and in terms of the strict compliance with the indexation mechanism introduced by the new pension law.

In 2015 it can be noticed an improvement in the use of the contingency reserve fund, signaling the return to the 2009-2013 behavior of reducing the total expenditure allocated and the number of Government decisions to allocate certain amounts from the contingency reserve fund. However, some measures in terms of legislative

The improvement revealed in 2015 occurred both in terms of the total expenditure allocated and the number of decisions adopted by the Government to allocate certain amounts from the contingency reserve fund, the latter being at the minimum of the analyzed period. Thus, in 2015, were allocated from the contingency reserve fund approximately 528.1 million lei (0.2% of the total expenditure), of which about 201.8 million lei to the central administration and 326.3 million lei to the local authorities. Compared to the initial estimates, the reserve fund was increased in 2015 by 527.5 million lei. Compared to the previous year, the allocations from the contingency reserve fund decreased by 1,217.8 million lei, by 69.75% respectively, mainly due to the reduction of the transfers to the central administration by

amendments are needed, by setting out the manner of the utilization for the contingency reserve fund.

about 901 million lei, while the amounts diverted to the local authorities were reduced by 316.7 million lei.

The Fiscal Council considers as absolutely necessary the implementation of urgent measures to amend the legislation which sets out the use of the contingency reserve fund, reiterating the recommendation on explicit identification of expenditures that can be allocated from the contingency reserve fund with a higher transparency, including through regular reporting to the Parliament regarding the manner and the level of utilization of the fund.

The public debt level decreased in 2015, in the period 2016-2018 the share of public debt in GDP being projected to be close to the level recorded in 2015, given that the recorded high growth rates will be offset by the high budgetary deficits, due to fiscal loosening measures contained in the new Fiscal Code, as well as other expenditure increases already taken.

The public debt decreased in 2015, its share in GDP reducing, according to ESA 2010 methodology, to 38.4% from 39.8% at the end of 2014, as a result of recording a primary balance surplus, a strong economic growth and a reduction in real terms of the interest paid for contracting loans. In addition, the buffer designed for protection against the manifestation of adverse conditions in the financial markets has also contributed to the decrease of the public debt as a share of GDP by 3.79 billion lei.

In the period 2016-2018, according to the baseline scenario based on the Ministry of Public Finance’s forecasts envisaged in the Convergence Programme, the share of public debt in GDP is projected to be close to the level recorded at the end of 2015, the value of this indicator being forecasted to be 38.1% of GDP at the end of period, given that there are recorded high growth rates, respectively of about 4.4% in average per year, which will be offset by the high budgetary deficits (estimated by the MPF at 2.9% of GDP in 2016 and 2017, 2.3% of GDP in 2018 and 1.6% of GDP in 2019) due to the fiscal loosening measures contained in the new Fiscal Code, as well as other expenditure increases contained in the draft budget for 2016. It must be pointed out that, compared to the projections estimated previously to the adoption of the new Fiscal Code, the public debt is estimated to be significantly higher, the Fiscal Council considering that the next period corresponding with the upturn in the economic cycle should be used to reduce the indebtedness, as the current trajectory of the public debt development as share in GDP could lead to an excessive accumulation of vulnerabilities that would become fully visible in a future descending phase of the economic cycle.

Poor performance in attracting European funds for the financial framework 2007-2013, along with the inherent risk of automatic disengagement reflects a failure of public administration in this area. The slow start in the implementation of projects related to the 2014-2020 programming period and the difficulties found regarding the delays in designation of the management and control authorities and the achievement of ex ante conditionalities may affect the pace of economic growth.

Romania has the lowest performance in the EU, in terms of EU funds absorption for financial framework 2007-2013, with an absorption rate of only 69.9% in 2015, all the other new EU member states (excluding Croatia), having absorption rates between 84.7% and 95%. Even if in 2015, compared to previous year, there have been made progresses in terms of attracting European funds (respectively, an absorption rate increase with 13.6 pp) and special measures have been taken, given the deadline for attracting European funds allocated for the programming period 2007-2013, respectively December 31, 2015, the growth rate should have been a more accelerate one. To reduce the risk of disengagement for the European funds and to increase the absorption capacity, around 80 projects (50 of them being major projects) were identified for being rescheduled for the period 2014-2020 (the value of phased projects totaling 4 billion euro), which means that Romania can continue to partially implement in the current budgetary exercise also projects for the period 2007-2013. The second category of projects included in the programming period that is about to end, aiming to grow the absorption rate is represented by retrospective projects.

Regarding the absorption of the EU funds for financial framework 2014-2020, Romania is facing delays accrued in achieving ex ante conditionalities on public acquisition, health, waste management and transport. The Fiscal Council considers that accelerating the absorption pace is essential for sustaining economic growth in Romania, the timely preparation of projects and the increase in the administrative capacity for planning and managing the European funds being key factors for the implementation of projects financed through European funds to avoid the repetition of the poor performance in terms of the absorption of European funds from the previous financial year.

Romania's public finances sustainability measured by S0, S1, S2 indicators shows a comfortable level on short term, but on medium and long term there are high and medium risks.

The EC's report on fiscal sustainability, edition 2015, published on January 1, 2016, indicates that, in the short term, Romania does not pose a significant risk indicator, the indicator S0 – which is an "early detection indicator" - scoring a low level, below the EU average. The medium-term sustainability is analyzed based on the indicator S1 – it shows the additional adjustment required, in terms of a cumulated gradual improvement in the government structural primary balance over 5 years (2018-2022), to reach a 60% public debt-to-GDP ratio by 2030 – which highlights a medium level, as well as through debt sustainability analysis (DSA) which shows major risks, the level of public debt-to-GDP exceeding at the end of forecasting period, respectively in 2026, the level of 60% of GDP. The fiscal sustainability gap indicator S2 - it shows the upfront adjustment to the current SPB required to stabilize the debt-to-GDP ratio over the infinite horizon – indicates a medium risk on the long term for Romania.

The draft budget for 2016 and its associated medium term framework are characterized by a deliberate and large deviation from all fiscal rules imposed by both national legislation and the European treaties signed by Romania and induce a significant vulnerability for the position of the public finances. The balance of risks related to the proposed target for the

The Fiscal Council notes that the construction of the budgetary framework for the period 2016-2018 is in flagrant contradiction with the principles and rules established by the FRL and by the fiscal governance treaties at the European level at which Romania is a signatory. In the following years is foreseen a major budgetary slippage, generated by a mix of aggressive tax cuts, particularly on consumption, combined with significant increase in the budgetary expenditures, in particular on the personnel expenditure side. This slippage, which could be subsequently corrected through a fiscal consolidation in the downward phase of the economic cycle, is likely to generate economic and social costs that will exceed the positive short-term effects of the fiscal loosening. The Fiscal Council has repeatedly drawn attention to the fact that a major fiscal loosening passed under an output gap close to zero in 2016 and subsequently

budget deficit for this year is relatively equilibrated. For 2017, the country's risk of re-entering in excessive deficit procedure appears as being significant.

positive during the period 2017-2019 is totally counterproductive because the adopted measures accentuate the pro-cyclical nature of fiscal policy with a permanent negative impact on the budget deficit.

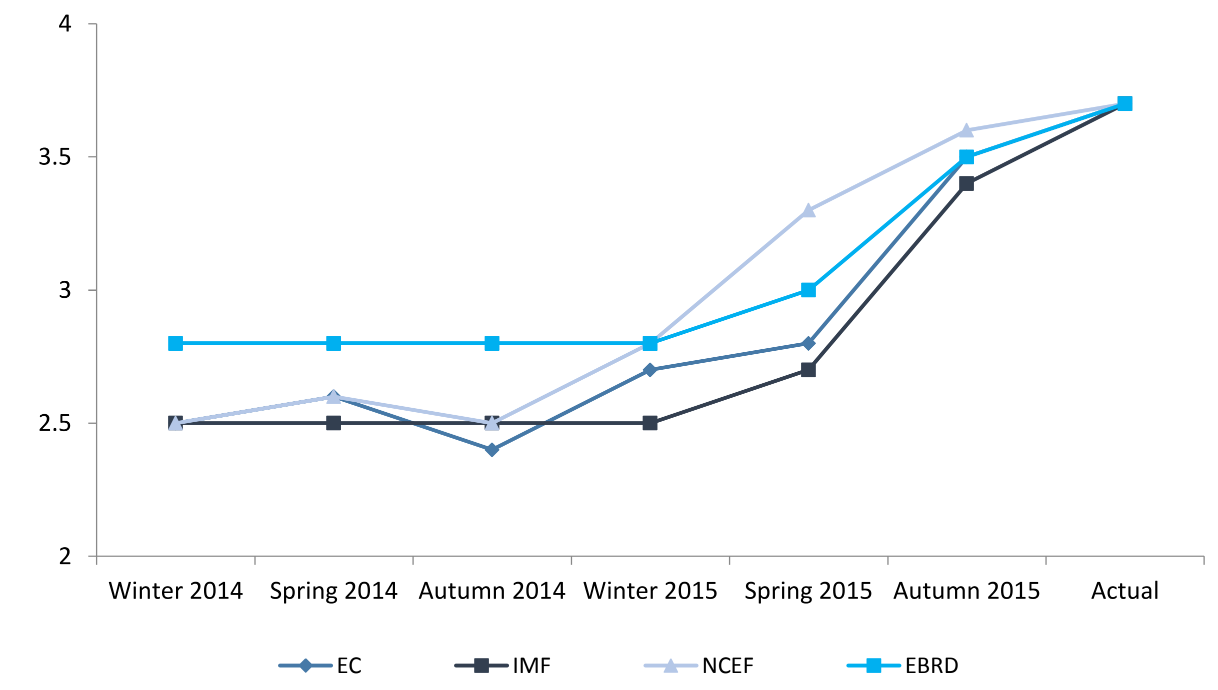
In the context of maintaining the current parameters of the fiscal policy, the balance of risks for 2016 appears to be equilibrated, the Fiscal Council considering that the budget deficit target for the current year is achievable.

In addition, the country's risk of re-entering in the excessive deficit procedure appears as significant, given that for 2017, the latest projections of the EC indicate a level of 3.4% of GDP for the headline deficit in both ESA 2010 standards and in structural terms. Again, we emphasize the idea according to which it would be sufficient to maintain a budget deficit below 3% of GDP is wrong; this level is not a "target", but rather a ceiling whose reach is allowed only under adverse cyclical conditions of deep recession, which obviously is not at all the case of Romania.

II. Macroeconomic framework in 2015

The year 2015 registered for Romanian economy the highest annual economic growth in the post-crisis period, the GDP growth reaching 3.8% in real terms, a higher dynamic compared to the level of 3% reached in 2014. After 5 years of positive developments (a cumulative growth of about 12.5%), the real GDP in 2015 is higher compared to 2008 by 3.68%. Compared to the initial forecasts considered in preparing the draft budget for 2015, and also to the forecasts of the European Commission (EC) and the National Commission for Economic Forecasting (NCEF), the economic growth was higher by approximately 1.3 pp, the above expectations development being attributable to the strengthening of the upward slope for the private consumption (+6.15%) and the advance recorded in investments (+8.8%).

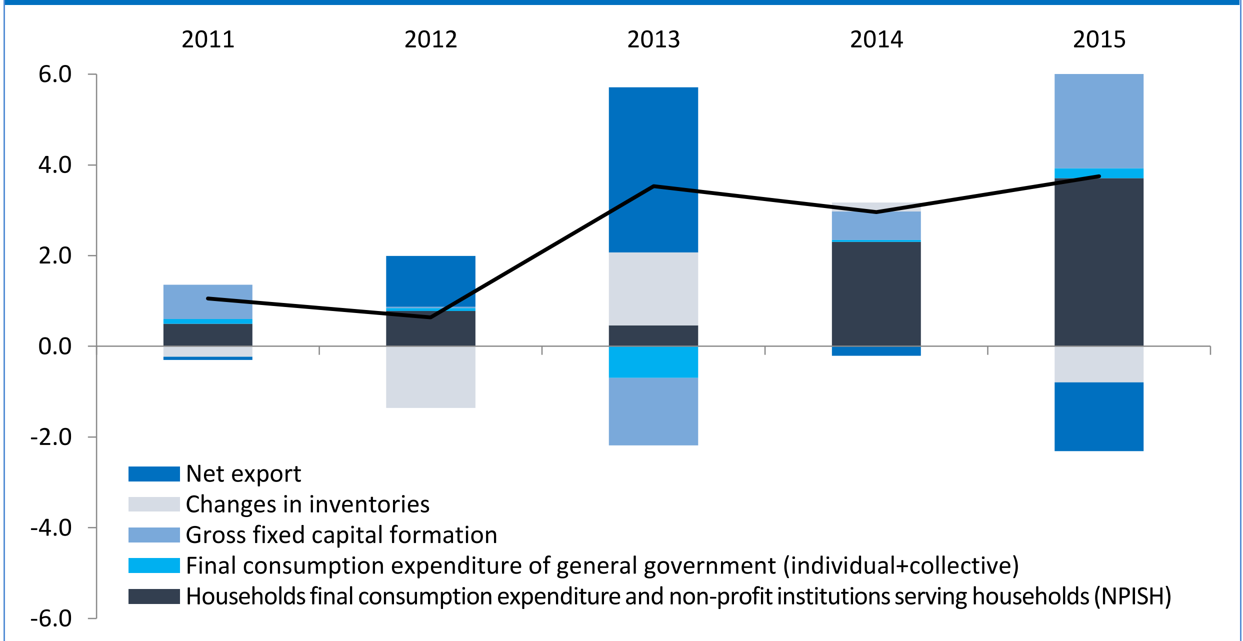
Figure 1: The evolution of economic growth forecasts for 2015



Source: EC, International Monetary Fund (IMF), NCEF, European Bank for Reconstruction and Development (EBRD)

From a GDP utilization point of view, the main contribution to the economic growth registered in 2015 came from the household final consumption expenditure (+3.7 pp), its increase in real terms being 6.1%, owed to the disposable income growth due to the decrease of the VAT rate for food products and restaurant services, to the real wage growth, a low inflation rate and an increased consumer confidence in the future economic perspectives. Moreover, the general government final consumption expenditure (+0.2 pp) and the gross fixed capital formation (+2.1 pp) had a positive contribution. In this context, public investments registered an increase by 23.9% in real terms, in the context of increasing absorption of the EU funds, especially in the field of financing the investment projects. This acceleration existed at the level of public investment was due to the fact that 2015 was the deadline by which funds could be attracted for the financial framework 2007-2013. Negative contributions could be find from the net exports (-1.5 pp), given that there was an expansion in real terms of imports (+9.1%) higher compared to exports (+5.5%) and changes in inventories (-0.8 pp). On the supply side, increases in the economic activity's volume were recorded in the majority of sectors, the most significant being recorded in information and communication (+11.9%), followed by construction (+8.8%), wholesale and retail trade, repair of motor vehicles and motorcycles, transport and storage, hotels and restaurants (+6.4%), net tax per product (+5.6%), professional, scientific and technical activities; administrative and support services (+4.9%), shows, culture and recreation activities; repair of household goods and other services (+4.4%), industry (+2%), public administration and defense, education, health and social assistance (+1.9%), financial intermediation and insurance sectors (+1.2%), while negative developments was recorded only by at the sector agriculture, forestry and fishing (-9.4%).

Figure 2: Contributions to economic growth



Source: Eurostat, Fiscal Council's calculations

The annual inflation rate registered at the end of 2015 was outside the target range (1.5% - 3.5%), reaching a level of -0.9%, significantly below the level projected in the Fiscal Strategy 2015-2017, respectively 2.9%, the main driver that led to this evolution being the VAT reduction for food from 24% to 9% starting with June 1st. Other factors that contributed to a lower inflation than the initial forecasts are represented by the persistence of the aggregated demand deficit, but also by the favorable dynamic of prices for imported goods. The inflation rate varied over the year between -1.9% and 1.2%, the average price growth in 2015 being -0.6%, placing itself below the level projected in the Fiscal Strategy (2.2%). In the first half on the analyzed interval, as a result of the price reduction for energy related products and the decrease in the price for raw materials, inflation was placed in a positive territory, but lower than 1%, while in the last month of the 2nd quarter the inflation entered in a negative territory, respectively -1.6%, as a result of extending the application scope of the reduced VAT rate of 9% for all food products, non-alcoholic beverages and restaurant services. The transitional first-round effects of the reduced VAT for food affected around 30% of the goods and services from the market basket of consumer goods and services and it was estimated that this had a transmission of around 80% from the maximum impact over the consumer price index (CPI) of 3.5 pp in the first month of application. In the 3rd quarter, the inflation deepened into negative territory (-1.7%) as the result of the base effect of the VAT reduction for food started to be seen, but also as a result of the continuing decline of the oil prices worldwide, which in August reached the minimum post-crisis level, while in the last quarter the annual inflation was by 0.8 pp over the level of the previous quarter, respectively -0.9%, as a result of the waning of the base effect generated by the decreased in the oil prices started which started at the end of 2014 and due the acceleration of the price growth for tobacco and alcoholic beverages.

In the context of a downward trajectory for inflation, but taking into account the high uncertainties associated to the developments in the external environment and the risks related to them, the central bank continued the easing of the monetary policy in 2015 by gradually reducing the monetary policy interest rate, from 2.5% to 1.75%, and the minimum reserve requirement ratio from 10% to 8% for the domestic currency denominated liabilities and for those denominated in foreign currencies at 14% over the course of 2015. Together with reducing the monetary policy rate, the central bank also narrowed the corridor for the permanent facilities' interest rate (from +/- 2.2 pp to +/- 1.5 pp), in order to reduce the interest rate volatility on the interbank market and to strengthen the transmission power of the monetary policy interest rate signal.

The price increases happening in the economy as a whole, measured by the GDP deflator registered 2.9% in 2015, in line with the forecasted level from the Fiscal Strategy for 2015-2017, respectively 2.7%, as the investments deflator and the one for exports were superior to the CPI, the latter one being also supported by the drop in imported good prices.

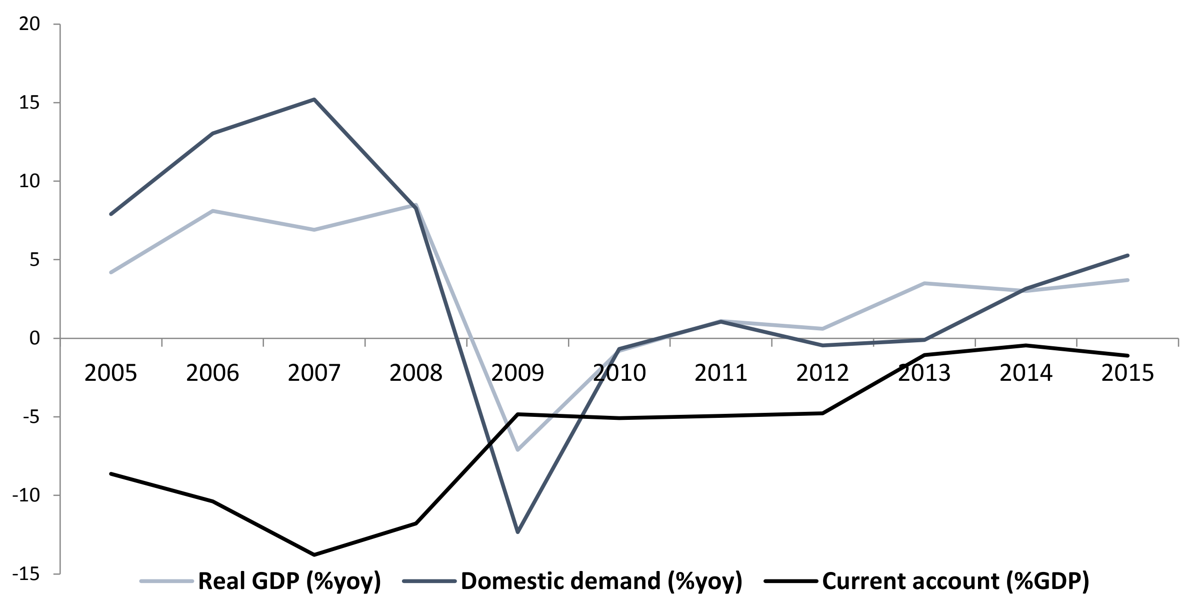
As regards the external position, 2015 marked the stoppage of the current account reduction trend, it growing by 1.14% of GDP, from 0.46% of GDP registered at the end of the last year, in the conditions of a growth of around 1.14 billion euro, but also an increase of GDP by approximately 6.7% considering values expressed in euro. The increase of current account deficit from 685 million euro in 2014 to 1,829 million euro in 2015 is, mainly attributable, to the increase of primary revenues deficit from -1,903 million euro in 2014 to -3,806 mil euro in 2015 (-1,903 mil euro). A negative contribution to the variation of the current account balance was generated by the worsening the goods and services balance from a deficit of 467 mil euro in 2014 to a deficit of 840 mil euro in 2015, exclusively based on the goods balance (-1,441 mil euro), while the amplification of secondary incomes balances surplus (+1,133 mil euro) had a positive contribution to the variation of the current account[1]. The exports of goods continued to grow in 2015 at a rate of approximately 6.4% (+3,969 million euro) in the context of improving the EU economic outlook, the main trading partner of Romania, the dynamic being similar to the one of imports that recorded an increase of about 7% (+4,348 million euro) in the context of amplifying domestic demand increase rate.

Analyzing the changes in the current account balance in terms of difference between the rate of saving and the rate of investment, it can be seen that the savings rate had a negative dynamic in 2015 compared to 2014, the latter decreasing by 0.34 pp of GDP, while the investment rate registered a growth of 0.34 pp of GDP, in this context of changes, the current account deficit widened from -0.46% to -1.14% of GDP. Considering the period 2008-2015, the current account deficit adjustment of 10.65 pp of GDP was realized by reducing investments by 7.85 pp of GDP, while the savings advanced by only 2.8 pp of GDP in the analyzed period.

The foreign direct investment registered a relatively similar level compared to the previous year, growing by 2.33% compared to 2014, their value amounting 2,765 mil euro, close to the average level of the last 5 years. Thus, it can be seen that in 2015 foreign direct investments financed entirely the current account deficit, but their value in absolute terms is much lower than in the period preceding the financial crisis (in the period 2007-2008, the annual average of FDI was 8,000 million euro).

[1] According to BPM6 standards (The balance of payments manual developed by IMF), the terminology of current account components changed. Thus, the primary income balance and the secondary income balance replace the income and transfers balance.

Figure 3: The evolution of the real GDP, domestic demand and current account, 2005-2015



Source: National Bank of Romania (NBR), Eurostat, Fiscal Council's calculations

The external debt of Romania decreased in nominal terms by 4.06% in 2015, compared to 2014, to a level of 90.90 billion euros, its share in GDP decreasing from 63.07% to 56.7%. The external debt decreased by 10 billion euro (-9.88%) in 2015 compared to the maximum level registered by this indicator, at the end of 2012, when it reached a level of 100.86 billion euro, its share in GDP being at that moment 70.96%. Regarding the medium and long-term external debt, it amounted 78.17% of total external debt at the end of the previous year, respectively 71.06 billion euro, its share being similar to the one from December 31st, 2014. The short-term external debt recorded an increase of 4.89% to a level of 19.84 billion euro (21.83% of total external debt).

Due to the repayments made, the debt to the IMF was lower at the end of 2015 compared to the same period of the precedent year by 1.30 billion euro, respectively reaching a level of 0.12 billion euro, the loan being repaid almost entirely. More precisely, there were decreases both in the level of the debt component for financing the budget deficit (-0.16 billion euro) and in that of the monetary authority (-1.46 billion euro). The downward trend of the external debt was as well due to the decrease of private external debt, especially in the context of deleveraging in the banking sector. In 2015, the external public debt decreased from 31.75 billion euro at the end of 2014 to 30.93 billion euro at the end of last year.

In 2015, the non-governmental loans dynamic re-entered in the positive territory after 3 years, managing a growth of 3.95% in real terms in December 2015 compared to the same period of last year and compared to a decrease of -4.22 in December 2014. The revival of private sector lending was exclusively driven by the increase of the balance of domestic currency denominated loans, having an increase of 19% in real terms, while the foreign currency denominated loans had a descending trajectory, decreasing by around 10% in euro equivalent in December 2015 compared to the same period in 2014. The reduction of households' indebtedness, the increase of their confidence (in the context of an improvement of their expectation about personal financial situation and economic policy in general, but also of reducing in concerns about rising unemployment), the reduced interest rates (especially the cost of the national currency denominated loans decreased to a level comparable to the cost of financing in euro) and easing lending requirements through a faster access to unsecured funding were the main factors that led to the expansion of lending activity. Other exogenous factors that favored the upward trend of lending dynamics are represented by conducting conversion operations in lei of loans denominated in Swiss francs and also by the acquisition of previously externalized credits by some banks. The level of non-performing loans continued its descending trajectory in the context of accelerating the balance sheets clean up, and also decreasing the deterioration rate of the portfolio quality. An improvement can be seen in the liquidity of the banking system, the loans/deposits ratio for non-governmental sector reducing below 100% since July, then continuing its downward trend, the registered level at the end of 2015 being around 85.74%, an adequate level from a macro prudential point of view.

The revival of the lending activity in 2015 is attributable to the dynamics of households' loans (an advance in real terms of 6.68%), but the loans for companies also had a positive trend (+1.39% in real terms). For households' lending the advance came exclusively from the acceleration of the lei component (+32% in real terms), as a consequence of lower interest rates, of the ongoing governmental program "First Home" exclusively in domestic currency but also as a consequence of more simple procedures for verifying the incomes of applicants. For companies, the positive variation (+1.39 in real terms) was determined by the ascending evolution of the flux in new loans in local currency (+10% in real terms), the foreign currency component (denominated in euro) registering a negative dynamic (-9%).

Regarding the developments in the labor market, in 2015 it was favorable, the average number of employees continued to increase to a level of 4,545 thousand people[2], advancing by 2.8% compared to 2014, in the context of an increasing number of jobs created by the private sector (+3.3%) while the dynamic attributable to the public sector was +1.0%. In 2015, the average gross wage[3] per total economy was 2,560 lei, up with 8.5% from 2014, while net average wage was 1,848 lei, increasing by 8.3%, compared to 2014. Considering an average inflation of -0.6%,

[2] According to the data processed by the Fiscal Council on the basis of monthly data published by NIS.

[3] According to the data processed by the Fiscal Council on the basis of monthly data published by NIS.

the real wage increased by approximately 9%. The positive trend of the average salary was mainly driven by the growth of wages in the public sector (+10.1% in nominal terms), due to the increase in the minimum wage (from 900 lei in December 2014 to 975 in January 2015 and to 1,050 lei from July 1st) and by the increase in the teaching staff salaries by 5% from 1st of March 2015 and by another 5% from 1st of September 2015, by the increase of the local executive authorities salaries by 12% starting with 1st of August and from the healthcare system by 25% (starting with 1st of October). During the same period, average wages in the private sector[4] advanced in nominal terms by 8%, mainly due to the productivity gains.

Table 1: Macroeconomic indicators in 2015 (FS forecast versus effective)

	Revised Fiscal Strategy 2015-2017	Effective 2015
	- % yoy -	
GDP		
GDP (million lei)	709,681.0	712,832.3
Real GDP	2.5	3.8
GDP deflator	2.7	2.9
GDP components		
Final consumption	2.6	5.2
Private consumption expenditure	2.8	6.1
Government consumption expenditure	1.5	1.6
Gross fixed capital formation	4.0	8.8
Exports (volume)	5.9	5.5
Imports (volume)	6.9	9.1
Inflation rate		
December 2016	2.9	-0.9
Annual average	2.2	-0.6
Labor market		
Unemployment rate at the end of period	5.1	6.8
Average number of employees	1.6	2.8[5]
Gross average wage	4.5	8.5

Source: National Institute of Statistics (NIS), NCEF

[4] The private sector is approximated by removing public administration and defense sectors, education and health and social assistance.

[5] Regarding achievements, the reported dynamic refers to figures published in the monthly bulletins of NIS including only economic agents with more than 4 employees.

III. Fiscal policy

III.1. The assessment of objectives, targets and budgetary indicators

Under article 61, para. (2) of the FRL, the Fiscal Council's Annual Report must contain *"a discussion and analysis of the implementation of the fiscal policy set forth in the Fiscal Strategy and Annual Budget approved in the previous budget year"* and will include:

a) An ex post evaluation of the macroeconomic and budgetary forecasts set out in the Fiscal Strategy and the annual budget to which the Annual Report corresponds, including the reporting, where applicable, of any persistent deviations in the same direction of macroeconomic forecasts compared to actual data, which were recorded over a period of at least 4 consecutive years;

b) An assessment of progress against the fiscal policy objectives, targets, and indicators set out in the Fiscal Strategy and annual budget to which the Annual Report corresponds;

c) An assessment of the Government's compliance with the principles and rules of this law during the preceding budget year;

d) Recommendations and opinions of the Fiscal Council in improving the conduct of fiscal policy consistent with principles and rules of this law in the current budget year.

According to article 26, para. (1) of the FRL, until 31st of July each year, the Ministry of Finance is required to submit to the Government the Fiscal Strategy for the next 3 years accompanied by the draft law approving the ceilings specified in the fiscal framework. The Fiscal Strategy for the period 2015-2017 was drafted and approved in December 2014, at the same time with the draft budget proposal for 2015, which implies an identical fiscal framework for 2015 in both documents mentioned above. Under these circumstances, the obligation of the Fiscal Council to assess the Annual Report the compliance with the objectives, targets and indicators established through the Fiscal Strategy and the budget is reduced to an *ex post* analysis of the projections contained in the draft budget, the ex-ante assessment of the compliance with the rules regarding the limits defined for the budgetary indicators stipulated by the Law of ceilings being in this situation, irrelevant.

The general consolidated budget for 2015 was based on a macroeconomic forecast scenario with an economic growth estimated at 2.5% in real terms, while the deficit target was projected to 1.82% of GDP according to cash standards, respectively a budget deficit determined according to ESA 2010 methodology of 1.45% of GDP (including an adjustor[6] of 0.25% of GDP for co-financing expenses related to the projects financed from post-accession structural funds). This level of the ESA deficit has been designed in line with Romania's obligations according to the preventive arm of the Stability and Growth Pact and the Treaty on Stability (SGB), Coordination and Governance in the Economic and Monetary Union (the Fiscal Compact), namely reaching a level of the structural deficit according to the European Commission's methodology ("medium-term objective") of 1% of GDP. The estimation of a relatively large gap between the budget balances determined according to the national methodology (cash) and under the ESA 2010 methodology is due to the projected budget expenditures which, in accordance with the national methodology, included in 2015 payments of some enforceable titles already reflected in the previous years in the budget expenditures according to ESA 2010 and also due to the prepayments for the purchase of military equipment whose contribution in the budget spending according to ESA 2010 will be recorded thereafter, at the time of their reception.

The final budget execution recorded the achievement of the deficit target, both according to cash methodology as the budget deficit was 1.45% of GDP, or 10.36 billion lei (compared with a projection of 13.0 billion lei) and according to ESA 2010, given a deficit of 0.74% of GDP, or 5.3 billion lei. The effective gap between the budget balance in cash standards and according to the European methodology was higher than initial projections by 0.34 pp of GDP (the budget deficit in ESA 2010 standards was lower by 0.71 pp of GDP instead of 0.37 pp), mainly explained by the decision to increase by 0.21 pp of GDP the amounts paid regarding some salary related rights earned by court decisions, already recorded in the ESA 2010 execution in the previous years. The significant differences in terms of a lower budget deficit compared to the original targets by about 0.37 pp of GDP in cash standards and by 0.71 pp of GDP in European standards (i.e. a gap of 0.46 pp of GDP if we exclude the adjustor of 0.25% of GDP) are mainly explained by the outperforming revenues, as a result of a combination of economic growth significantly higher than originally projected, with a composition favorable to the growth in tax revenue receipts and an improvement in collection efficiency, both due the efforts of the National Agency for Fiscal Administration (NAFA) and probably due to a pro-cyclical development in the paying compliance from taxpayers[7]. This performance of the revenues (surprising in the context of amendments to the Fiscal Code made during the year, which would have resulted in significant reduction of VAT receipts), outclassed the successive increases operated on the budgetary

[6] This represents an allowed temporary deviation.

[7] The cost-benefit ratio for tax evasion decision varies in favor of perceived benefits during the recession and of the costs charged in the expansion phase. See Brondolo, J., 2009," Collecting Taxes during an Economic Crisis: Challenges and Policy Options", IMF Staff Position Note 09/17 and Pogoshyan T., 2011", Assessing the Variability of Tax Elasticity in Lithuania", IMF WP/11/270.

expenditures side with the occasion of the budget revisions (especially for the staff and social assistance).

In terms of fiscal policy rules, the nominal ceilings for the general government balance in 2015, its total expenses (excluding income from post-accession EU funds, pre-accession funds, and financial assistance from other donors) and personnel expenditure were established by Law no. 182/2014[8] (see *Table 2* below). The budget execution confirms the compliance with the ceilings only for the budget balance and the primary balance, in the case of the others indicators mentioned above being recorded significant deviations from the established ceilings. Thus, total expenses level (excluding income from post-accession EU funds, pre-accession funds, and financial assistance from other donors) at the end of the year exceeded the nominal ceiling established by the Law no. 182/2014 with 5,922.5 million lei, exceeding the limit of 31.3% of GDP by about 0.5 pp as a result of the successive iterations to increase budget expenditures (salary increases, doubling the child allowance, introduction of the service pension for certain categories of staff, increasing the pensions for special conditions, the prepayment of some salary related rights earned by court decisions, increasing the spending on goods and services, etc.) with the occasion of the two budget amendments, due to higher than expected revenues. In the case of the personnel expenses, the execution exceeded the nominal ceiling established by the Law no. 182/2014 with 3,652.2 million lei and the limit of 6.8% of GDP by about 0.5 pp, as a result of the decision to pay in advance instead of originally planned installment of some salary related rights earned by court decisions and due to the public sector wage increases made in the second half of the year.

Table 2: Nominal ceilings for GCB balance, total and personnel expenditure

	Law no. 182/2014			Budget execution 2015		
	GCB balance	Total expenditure*	of which: Personnel expenditure	GCB balance	Total expenditure*	of which: Personnel expenditure
million lei	**- 13,004.0**	**220,590.1**	**48,373.4**	**-10,361.3**	**226,512.6**	**52,025.6**
% of GDP	*-1.8%*	*31.3%*	*6.8%*	*-1.45%*	*31.78%*	*7.30%*

** Excluding financial assistance from the EU and other donors*

Source: MPF

The first budget revision, approved at the end of July 2015, significantly increased both general consolidated budget revenues and expenditure compared to the original approved budget with 6.92 billion lei, keeping the budget balance at the initially projected nominal level of -13.0 billion lei. Compared to the limits of the ceilings stipulated by Law no. 182/2014, only the limit

[8] Law approving ceilings for indicators specified in the Fiscal Strategy.

for the budget balance of GCB is respected, which was kept at the initially level, while the GCB primary balance[9], personnel expenses and total expenses, excluding financial assistance from the EU and other donors have exceeded the ceilings of the Law mentioned above[10], being inconsistent with the fiscal rules established by article 12, letter a), b) and c) of FRL, as well as article 17 para. (2), which prohibits the increase of personnel expenses during the budget amendments, article 24 which prohibits the increase of the total spending of the GCB during budget amendments other than for paying debt service and financial contribution of Romania to the EU budget and article 26 para. (5) which reaffirms the obligation of respecting the ceilings imposed by the law for the next budget year.

The failure to comply with the indicators mentioned above was the consequence of the deliberate increase in the budgetary expenses, namely the personnel expenses (in flagrant violation of article 17 para. (2) and article 24 of the FRL), in the context of the amendment to the Fiscal Code regarding the reduction in the VAT rate from 24% to 9% for food, restaurant and catering services from June 1st 2015, in this case being disregarded the principle enunciated by article 13 letter b) of the FRL, concerning the offset of the financial impact related to the revenue reduction “by increasing other budgetary revenues”.

At the level of revenues, the budget revision envisaged an increase by 6.92 billion lei. The income aggregates to which, in the context of the execution at mid-year, were made increases compared to the original budget were: income from *non-reimbursable European funds*: (+1.98 billion lei), *social contributions* (+1.8 billion lei), *non-tax revenues* (+1.5 billion lei as a result of the additional revenue expected to be collected from the sale of *emission allowances for greenhouse gases* and amounts recovered following the decision of incompatibility of some state aids), *corporate income tax* (+817 million lei) and *personal income tax* (+784 million lei), while the downward revisions of the projection occurred at the level of *the property taxes* (-579 million lei, given the absence in the initial budget of the special construction tax reduction from 1.5% to 1%) and *VAT* (-253 million lei in the context of the enlargement of the applicability of the reduced VAT rate for food, restaurant and catering services from June 1st 2015, partially offset by a significant performance on the collection in relation to the original program, recorded in the first half of the year).

At the level of the budgetary expenditures, the increase of 6.92 billion lei was determined by

[9] Due to a downward revision in *interest expenditure*, the GCB primary balance was scheduled to exceed by 204.5 million lei the ceiling defined by the Law no. 182/2014.

[10] Overruns of the ceilings by +1.5 billion lei for personnel expenses and by 4.9 billion lei for *total expenditure excluding financial assistance from the EU and other donors*.

the increase in the *expenditure related to projects financed from post-accession non-reimbursable funds* (+1.9 billion de lei, countertrading the upward revision of the program regarding the amounts received from the EU), *personnel expenditure* (+1.5 billion lei, mainly due to the inclusion of new amounts paid regarding some salary related rights earned by court decisions), *goods and services expenditure* (+1.2 billion lei), *social assistance expenditure* (+1.12 billion lei, as a result of doubling the child allowance and reintroduction of the service pension for aviation personnel and judicial courts' auxiliary specialized personnel). There were also increased *capital expenditure* (+0.9 billion lei) and *other expenditure* (+0.6 billion lei, for ECHR decisions, restoring the religious units, etc.).

Compared with the approved parameters in the context of the first budget revision, the second budget revision realized in October envisaged an increase of the estimated general government revenues and expenses by 3 billion lei, while keeping the budget deficit target at the initially projected level (13.0 billion lei). Similar to the first budget amendment, there were violated (by derogation) the rules regarding the budget revisions stated by article 12 letter b) [11] and c) [12], as well as those stated by article 17 para. (2), article 24 and article 26 para. (5) of the FRL.

The GCB revenues were revised upward by 3.0 billion lei compared to the level programmed by the first budget revision, but excluding the part related to a new compensation scheme of outstanding obligations to GCB (+688.7 mil. lei), the net increase in the budgetary revenues was 2.3 billion lei. The income aggregates which have changed compared to the values projected during the first budget revision, considering the values net of the swap, are: *VAT*, with +1.2 billion lei (by incorporating the collection's outperformance from the first six months of the year), *non-tax revenue* (+0.6 billion lei, as a result of the additional revenue expected to be collected from the sale of *emission allowances for greenhouse gases* and those received over the initial program), *taxes on using goods, authorization on using goods or carrying out activities* (+0.4 billion lei due to additional revenue from *taxes on the income from prizes and gambling*), *excises* (+0.36 billion lei), *social contributions* (+0.2 billion lei), *corporate income tax* (+0.16 billion lei) and *personal income tax* (+0.12 billion lei), increases in the latter two categories being caused by decision to pay in advance instead of originally planned installment of some salary related rights earned by court decisions and due to the public sector wage increases.

[11] The second amendment resulted in the overrun of the primary deficit ceiling by 213 million lei.

[12] I.e., additional overruns of the ceilings to those made at the first amendment in the case of *personnel expenditure* by an extra 2.4 billion lei and *total expenditure excluding financial assistance from the EU and other donors* with a further 3.8 billion lei.

Major downward revisions were made at the level of the revenue estimation for the *amounts from the EU for the payments made and pre-funding* (-0.8 billion lei), as a result of the developments under the first amendment's forecast.

Eliminating the influence of the compensation schemes for the budgetary arrears, the increase in the budgetary expenditures by 2.3 billion lei was located at the level of the following categories: *personnel expenditure*, with +2.14 billion lei (as a result of the decision to pay in advance instead of originally planned installment of some salary related rights earned by court decisions, the increase in the health sector salary by 25% from October 1st, as well as in the local executive authorities' staff by 12% from August 1st and the increase in the food norm in the defense and public order sector); *subsidies* (+1.4 billion lei, as compensation for agricultural producers, increase in the subsidy for diesel); *goods and services expenditure* (+0.9 billion lei, for the defense sector) and *social assistance expenditure* (+0.4 billion lei). Have been reviewed negatively the allocations for *total investment expenditure* (-3.16 billion lei, in line with the massive under execution from the first 8 months of the year), being diminished the *capital expenditure* (-2.8 billion lei) and the *projects funded by external non-reimbursable grants* (-0.9 billion lei). Basically, compared with the levels programmed in the first budget amendment, on the budgetary expenditure side were significantly increased the *current expenditure (personnel, goods and services, subsidies)* concomitantly with the massive reduction in the *investment expenditure*.

Regarding the relevance of the budgetary rules and the commitment to compliance with the fiscal discipline, can be appreciated that, since the development of the FRL in 2010 and up to date, the national fiscal rules have exerted a weak constraint on the fiscal policy makers, which resulted in:

- the lack of compliance with the annual ceilings set for the general government deficit, the primary deficit, the total expenditure and personnel expenditure, these being often violated *ex post*;
- the frequent violation of the ban on increasing the total expenditure and personnel expenditure during the budget amendments;
- the Fiscal Strategy has not been developed on time (July, 31);
- usually, the measures to reduce taxes are not accompanied by coherent compensation measures (such as increasing the tax base/growing other taxes or reducing expenditures);
- the structural deficit rule is flagrantly violated since 2016 following the implementation of the new Fiscal Code, as well as the other enacted expenditure increases.

It should be mentioned that during 2015, the draft normative acts stipulated exemptions from the fiscal rules by redefining the ceilings of Law. 182/2014 according to the budgetary aggregates’ levels from the proposal for rectification, except the budget deficit. The systematic recourse to the exemption from fiscal rules that do not concern the GCB balance confirms the existence of two classes of fiscal rules - one of "strong" rules (rules concerning the GCB balance), and one of "weak" rules (rules concerning the mandatory ceilings for all other elements relevant from the law’s perspective – the primary balance, the personnel expenditure, the total expenditure excluding financial assistance from the EU and other donors, strengthened by the prohibition of increasing the total expenditure and personnel expenditure during budget revisions), despite the fact that such a distinction is not prescribed by law and derogations can be operate with the same ease in all indicators. In the view of the Fiscal Council, the "weak" rules complement the budget deficit rule in terms of respecting the principles of transparency and stability established by the FRL, and their relevance lies in the following reasons:

- In the context of transition to structural benchmarks regarding the budget balance, the rule concerning the prohibition of increasing the total expenditure during the year also allows the *ex post* compliance with the structural deficit target and not just the *ex-ante* one, because, in the context of an economic growth higher than anticipated, the existence of the total expenditure ceiling has the potential to provide in real time the alignment with the structural benchmark instead of generating a necessary structural fiscal consolidation during the next budgetary iteration;
- The mandatory ceilings related to total expenditure, personnel expenditure and primary balance appear as relevant in terms of ensuring the predictability of budgetary parameters, motivating the authorities to include the entire relevant information in the initial budgetary construction and promoting the commitment to a particular set of budgetary parameters.

The Fiscal Council points out that the *de facto* inoperability of the fiscal rules set related to those concerning the budget deficit level, highlighted by its irrelevance in terms of constraining the authorities' behavior in accordance with the legislature's intention, requires either strengthening the law enforcement by limiting the possibility of derogation to an accurate defined set of circumstances and the introduction of motivating penalties for non-compliance with the fiscal rules (optimal solution), or bringing to an agreement *de jure* situation with *de facto* situation by asserting the supremacy of the budget deficit rule (according to the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union) and formal renunciation of the related set of rules. Such an approach is even more necessary given the budget construction process for 2016, which provides a deliberately and major slippage both in terms of structural deficit and budget deficit, in flagrant contradiction with the principles and rules established both by national legislation and

European treaties[13], increasing the risk for Romania to remain in the trap of a pro-cyclical fiscal policy, pressing the accelerator in the expansion phase of the economic cycle and risking to be forced to implement measures of structural adjustment in an inevitable future phase of recession.

The evolution of the key budgetary aggregates during 2015 according to cash standards is presented in *Table 3*.

Table 3: The evolution of the main budgetary aggregates during 2015 (billion lei)

	Initial budget	First revision	Second revision	Budget execution 2015
Total revenues	**225.5**	**232.4**	**234.7**	**232.5**
Fiscal revenue	132.5	134.3	136.5	138.0
Social contributions	55.3	57.0	57.2	57.3
EU Funds	18.8	20.8	20.0	17.4
Total expenditure, of which :	**238.5**	**245.4**	**247.7**	**242.8**
Current expenditure, of which	220.1	226.1	231.3	226.1
Projects from EU funds	24.6	26.2	24.8	24.6
Capital expenditure	18.39	19.31	16.48	17.7
Budget deficit	**-13.00**	**-13.00**	**-13.00**	**-10.4**

Source: MPF

Note: Amounts without the compensation schemes

The results of the budget execution in the fiscal year 2015 were higher than the forecasts of the initial program, the revenues recording developments above expectations, even in the context of the operated tax cuts (VAT), simultaneously with successive increases in the budgetary expenditures during budget revisions. Thus, compared to the fiscal policy coordinates considered in preparing the draft budget, the Government adopted during the year an emergency ordinance aimed at expanding the scope of the reduced VAT rate of 9% for all food, restaurant and catering services since June, 1st 2015, the Parliament decided to double the monthly allowance for children (from 42 to 84 lei) starting with the second half of 2015 and, additionally, were made salaries increases for certain categories of budgetary personnel (+12% from August, 1st in the case of the local executive authorities' staff and +25% for the employees in the health sector, starting with October 1st), were introduced service pensions for the civil

[13] The flexibility of the Stability and Growth Pact approved in February 2016 is available in three clear instances, in which Romania does not fall (i.e.: structural reforms, economic cycle, investments).

aeronautical flying staff (from May, 21) and were increased pensions for special working conditions from June 25, 2015.

On the budgetary revenue side, net of the swap impact, the difference from the estimated amount to be received was +6.95 billion lei, mainly due to the good performance of the *tax revenues* (+5.5 billion lei, mainly as a result of the higher than expected receipts from *VAT* collection +1.3 billion lei, *personal income tax* collection +1.2 billion lei, *corporate income tax* collection +1.1 billion lei), the *social contributions* (+2 billion lei) and the *non-tax revenues* (+0.9 billion lei), which also offset the weaker evolution of the absorption of *EU funds*[14] (-1.8 billion lei compared to the level estimated in the initial budget).

As regards the expenditure, their amount has increased by 4.3 billion lei compared to the initial estimated value, the main categories among which were recorded increases being: *personnel expenditure* (+3.7 billion lei), *goods and services expenditure* (+1.1 billion lei), *social assistance expenditure* (+1.7 billion lei), and developments below expectations had: the *interest expenditure* and *other transfers*, each by -1.1 billion lei, *capital expenditure* (-0.7 billion lei). *The expenditure for projects funded by external non-reimbursable grants* were at the same level as the initial estimated one (24.6 billion lei) and close to that considered in the second budget revision, but below the estimates related to the first budget amendment, which were more optimistic by 1.6 billion lei. Thus, the budget deficit in cash standards recorded at the end of the year was by 2.6 billion lei (approximately 0.4% of GDP) lower than the original estimated level.

Table 4: The development of budgetary expenditure and revenue according to ESA 2010

	2009	2010	2011	2012	2013	2014	2015	Changes 2015 to 2014	Changes 2015 to 2009
Total revenue (% of GDP)	**31.5**	**32.7**	**33.7**	**33.4**	**33.1**	**33.5**	**34.8**	**1.3**	**3.3**
Fiscal revenue	16.8	17.5	19.0	19.0	18.7	19.0	19.9	0.9	3.1
Indirect taxes, out of which:	10.7	11.8	13.0	13.2	12.8	12.8	13.2	0.5	2.6
VAT	6.5	7.5	8.6	8.4	8.3	7.8	8.2	0.4	1.6
Excises*	3.1	3	3.1	3.1	3.1	3.3	:	:	0.2
Direct taxes, out of which:	6.2	5.7	6.0	5.9	6.0	6.3	6.7	0.4	0.5
PIT	3.6	3.4	3.4	3.6	3.5	3.6	3.7	0.1	0.1
CIT	2.4	1.8	1.8	1.7	1.7	1.8	2.0	0.1	-0.4

[14] Including amounts corresponding to the financial framework 2014-2020.

SSC	10.0	9.3	9.0	8.8	8.7	8.6	8.1	-0.4	-1.9
Other current revenue	1.6	2.7	2.3	1.9	1.7	1.8	1.9	0.1	0.3
Total expenditure (% of GDP)	**40.9**	**39.6**	**39.1**	**37.1**	**35.2**	**34.3**	**35.5**	**1.2**	**-5.4**
Intermediate consumption	6.3	5.4	5.7	6.0	5.7	5.7	5.6	-0.02	-0.6
Compensation of employees	10.7	9.5	7.8	7.8	8.1	7.7	7.6	-0.1	-3.1
Interest payments	1.5	1.5	1.6	1.8	1.7	1.7	1.6	0.0	0.1
Social assistance	13.2	13.7	13.1	12.1	11.7	11.5	11.5	0.0	-1.7
Subsidies	1.1	1.0	0.9	0.7	0.5	0.5	0.5	0.0	-0.6
Other current expenditure	1.8	1.9	2.1	2.5	1.9	2.3	2.4	0.1	0.6
Gross fixed capital formation	6.0	5.7	5.4	4.8	4.5	4.3	5.1	0.8	-0.9
Budget deficit (% of GDP)	**-9.5**	**-6.9**	**-5.4**	**-3.7**	**-2.1**	**-0.9**	**-0.7**	**0.2**	**8.8**

Source: Eurostat

*Note: *for 2015 data are not available yet, the difference 2015-2009 refers to 2014-2009.*

The fiscal consolidation initiated in 2010 in order to correct the existing major imbalances regarding the public finances position, was characterized by an alert pace, Romania succeeding in a relatively short period of time a significant budget deficit reduction, expressed according to ESA 2010 standards, from 9.5% of GDP in 2009 to 0.7% of GDP in 2015. The fiscal adjustment of 8.8 pp of GDP considering ESA 2010 standards was performed by cutting budgetary expenditure by 5.4 pp of GDP and increasing budgetary revenues by 3.3 pp of GDP.

The categories of budgetary revenues that recorded a positive development in this period were: *tax revenues*[15] (+3.1 pp of GDP), due to higher receipts from *indirect taxes* (+2.6 pp of GDP), *direct taxes* (+0.5 pp of GDP), negative developments being registered at the level of *social contributions* (-1.9 pp of GDP, due to reducing social contribution quota for the employer by 5 pp from October 1, 2014[16] and due to increasing the amounts transferred to Pillar II[17]).

[15] Within this category stands out the VAT receipts higher by +1.6 pp of GDP due to the increase in the VAT rate from 19% to 24% starting with July 1, 2010.

[16] From February 1, 2009 the social security contributions quota for the employer was 20.8%, reaching 15.8% from October 1, 2014.

The adjustment in the budgetary expenditure was made at the level of *intermediate consumption* (-0.6 pp of GDP), *gross fixed capital formation* (-0.9 pp of GDP), *social assistance expenditure* (-1.7 pp of GDP) and *personnel expenditure* (-3.1 pp of GDP), the last two categories being affected by the application of restrictive policies in 2010-2012, namely: wage cuts, the rule of hiring a person to 7 departures in the public sector, freezing the pension point, etc.

The categories of expenditure that recorded increases in this period are: *other current expenses* (+0.6 pp of GDP) and *interest expenditure* (+0.1 pp of GDP, as a result of the increase in the public debt stock, partially attenuated by the downward trend in the interest rate from the last 2 years).

Table 5: The development of budgetary revenue and expenditure according to cash methodology (% of GDP)

	2009	2010	2011	2012	2013	2014	Initial budget 2015	Execution 2015	Changes execution to initial budget 2015 to 2014	Changes 2015 to 2014	Changes 2015 to 2009
Total revenue	**30.8**	**31.6**	**32.1**	**32.4**	**31.4**	**32.0**	**31.6**	**32.6**	**-0.3**	**0.7**	**1.8**
Fiscal revenue	17.1	17.4	18.5	19.2	18.7	18.6	18.6	19.4	0.0	0.7	2.3
PIT	2.1	1.9	1.8	1.8	1.7	1.8	1.8	1.9	0.0	0.1	-0.2
CIT	3.6	3.4	3.4	3.5	3.6	1.8	3.6	3.7	0.0	0.2	0.1
Property tax	0.7	0.7	0.7	0.7	0.7	0.9	0.9	0.8	0.0	-0.1	0.1
VAT	6.7	7.4	8.5	8.5	8.1	7.6	7.7	8.0	0.1	0.4	1.3
Excises	3.1	3.3	3.4	3.4	3.3	3.6	3.6	3.6	0.0	0.0	0.5
SSC	9.4	8.6	9	8.7	8.5	8.6	7.8	8.0	-0.8	-0.5	-1.4
Non fiscal revenue	3.3	3.7	3.2	3.1	2.7	2.6	2.5	2.7	-0.1	0.1	-0.6
Donations	0.6	0.8	0.1	0.1	0	0.0	0.0	0.0	0.0	0.0	-0.6
Amounts received from the EU for payments made	0.4	1.0	1.1	1.3	1.4	1.7	2.6	2.4	0.9	0.7	2.0
Total expenditure	**38.0**	**37.8**	**36.3**	**34.9**	**33.9**	**33.7**	**33.5**	**34.1**	**-0.2**	**0.4**	**-3.9**
Personal expenditure	9.2	8	6.8	6.9	7.3	7.5	6.8	7.3	-0.8	-0.2	-1.9
Goods and services	5.5	5.6	5.6	5.8	6.1	5.8	5.6	5.7	-0.3	-0.1	0.2

[17] They increased by 0.5 pp per year from 2% of gross wage in 2009 to 5% in 2015.

Interest payments	1.2	1.4	1.6	1.8	1.7	1.5	1.5	1.3	0.0	-0.2	0.1
Subsidies	1.4	1.3	1.1	1.0	0.8	0.9	0.7	0.9	-0.2	0.0	-0.5
Projects financed from post-accession grants	0.5	1.4	1.9	2.2	2.2	2.2	3.3	3.4	1.1	1.2	2.9
Social protection	12.5	12.8	12	11.3	10.7	10.7	10.4	10.7	-0.2	0.0	-1.8
Capital expenditure	4.3	3.6	4.1	3.2	2.8	2.6	2.6	2.5	0.0	-0.1	-1.8
Budget deficit	**-7.2**	**-6.2**	**-4.2**	**-2.5**	**-2.5**	**-1.7**	**-1.8**	**-1.5**	**-0.1**	**0.3**	**5.7**

Source: MPF

Note: Amounts without the compensation schemes.

From the cash methodology perspective, compared to the previous year, in 2015 was recorded an improvement in the budget deficit of 0.37 pp of GDP, budgetary revenues increasing by 0.7 pp of GDP, higher than the budgetary expenditure (+0.4 pp of GDP). Compared to 2014, the main categories of budgetary revenues had a favorable evolution, standing out *amounts received from the EU for the payments made* (+0.7 pp of GDP, however, these standing below the program by 0.25% of GDP), *VAT* receipts (+0.4 pp of GDP, even in the context of expanding the scope of the reduced VAT rate of 9% for all food, restaurant and catering services since June 1, 2015), *personal income tax* receipts (+0.2 pp of GDP) and *corporate income tax* receipts (+0.1 pp of GDP), while significant negative developments recorded *social contributions* receipts (-0.5 pp of GDP) and *taxes on property* (-0.1 pp of GDP). On the expenditure side, compared to the previous year, have decreased *personnel expenditure, other transfers and interest expenditure* (by 0.2 pp of GDP each), *goods and services expenditure* and *capital expenditure* (-0.1 pp of GDP), offsetting the increase in the *expenditures for projects funded by external non-reimbursable grants* (+1.2 pp of GDP) and in the *transfers between public administration units* (+0.2 pp of GDP). Considering the period 2009-2014, the fiscal adjustment in cash standards was performed by reducing the budgetary expenditure by 3.9 pp of GDP and increasing the budgetary revenues by 1.8 pp of GDP.

Further, this chapter will include an analysis of the structural budget balance in Romania given that the fiscal targets are defined primarily in terms of structural deficit followed by a detailed examination on the developments of the main budgetary revenue and expenditure aggregates, and pursued by an assessment of the public debt dynamics and its determinants based on a medium term projection.

III.2. The structural budget balance in Romania

The signing and ratification by Romania of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union in 2012 stipulates a fiscal framework based on rules, with a benchmark in the case of Romania of a structural deficit target of maximum 1% of GDP[18]. The TSCG's provisions and the one of Directive no. 85/2011 were incorporated into the national law by amending the Fiscal Responsibility Law no. 69/2010 in December 2013, so the medium-term budgetary planning is constrained by the new rule for the budget deficit enforced by the TSCG, starting with 2015.

Thus, the draft budget for 2015 targeted a structural deficit of 1% of GDP (respectively 1.25% of GDP including the adjustor of 0.25% of GDP for co-financing projects supported by EU funds), which is equivalent to a structural adjustment pace of 0.6 pp of GDP compared to the estimated level for 2014 from that time (December 2014), respectively of 1.6% of GDP. However, the budget execution for 2014[19] indicated a level of the headline deficit according to the European methodology of only 1.4% of GDP, so that compliance with the deficit target for 2015 would have been equivalent to a deterioration of the structural budget balance, the medium term objective being already achieved. Moreover, in 2016 there was a new revision of GCB balance for the years 2012 and 2014, according to the decision to fully record the sums derived from the rental of frequency bands by mobile telephony operators at the level of 2014, so that the headline deficit in this year has been revised to 0.9% of GDP, which corresponds to a structural deficit of 0.2% of GDP.

The budget execution for 2015 published in May of the current year by Eurostat indicates a level of the headline deficit according to the European methodology of only 0.74% of GDP, corresponding to a structural deficit of 0.63% of GDP, which is significantly lower as compared both to the initial target and the medium term objective level, mainly due to outperforming revenues, as a result of a combination of a significantly higher economic growth than initially expected and an improvement in collection efficiency. It is noteworthy the NCP's different assessment from that of the EC for the structural deficit in 2015, i.e. 0.3% of GDP, explained by the fact that the EC's estimation incorporates an additional element of temporary and exceptional measures nature (one-off) at the level of the budgetary revenues estimated at 0.3% of GDP, which is not found in the NCP's estimation.

[18] The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union requires the contracting parties to ensure convergence towards country-specific MTO, imposing a structural deficit limit of 0.5% of GDP, respectively 1% for the member states with a public debt significant below 60% of GDP. In the case of Romania, the structural deficit has to be maximum 1% of GDP.

[19] Published in May 2015.

Basically, once the achievement of MTO was met in 2014, the fiscal consolidation process initiated in Romania in 2010 could be considered completed, other fiscal adjustments not being necessary. However, it should be taken into account the fact that defining the target in terms of structural deficit implies a target for the headline deficit appropriately adjusted according to the economic cycle. Thus, given that the output gap in 2016-2017 is projected to enter on positive territory, compliance with the structural deficit target of 1% of GDP will be equivalent to the registration of headline deficit levels lower than this level (the cyclical component of the budget balance will be positive).

The fiscal consolidation process conducted over the period 2010-2015 was partly reversed in an abrupt manner since 2016 following the entry into force of the new Fiscal Code which involves a broad fiscal relaxation[20] while simultaneously enacting significant spending increases, especially salary related. This is **in flagrant contradiction with the principles**[21] **and rules established by the FRL, as well as fiscal governance treaties at the European level at which Romania adhered.**

Thus, according to the EC forecast, since 2016 are estimated significant deviations from the medium term budgetary objective, namely, **structural balance levels of -2.8% of GDP in 2016 and -3.4% of GDP in 2017**[22]. Moreover, there is a paradigm shift in conducting the fiscal policy in the medium term between the Fiscal Strategy 2015-2017 (related to the budgetary construction for 2015) which provided the following guidelines: *"macroeconomic prudency and fiscal responsibility"* by maintaining the MTO to -1% of GDP and the Fiscal Strategy 2016-2018 which is based on *"a firm commitment to support the change that would stimulate economic growth"* and which confirms the deviation from the MTO in 2016-2019 and the return to a path of convergence towards the MTO from 2018.

In this context, it is relevant to highlight that the rating agencies mentioned in their recent press releases that the assessments are conditional on further progress as regards the

[20] The main measures in terms of the budgetary impact refers to: extending the scope of the reduced VAT rate of 9% for all food, restaurant and catering services, reducing the standard VAT rate at 20% in 2016 and 19% in 2017, reducing the special constructions tax to 1% in 2016 and its elimination in 2017, decreasing at 5% the tax on dividends since 2016 and eliminating the fuel supraexcise since 2017.

[21] The principle of fiscal responsibility stated by article 4 of the FRL requires the government *"to manage fiscal policy prudently".*

[22] According to the Convergence Programme 2016-2019, the MPF forecasts for the structural balance values of -2.7% of GDP in 2016 and -2.9% of GDP in 2017 (due to different estimates of the EC on the production gap level and the headline budget balance for 2017).

structural position of public finances[23]. It is worth reminding Bulgaria's recent experience, which, in the context of the considerable widening of the budget deficit at the end of 2014 (from 0.4% in 2013 to 5.4% of GDP in 2014) was faced with a leap of about 100 basis points of the risk premium and hence with a significant increase in the financing costs.

The structural budget balance, despite the fact that it better reflects the fiscal position of an economy, presents also a number of disadvantages, the most important being related to the uncertainties associated with its estimates. Thus, the value of the structural balance depends on the level of output gap, itself depending on potential GDP, an unobservable variable that is often subject to more or less significant revisions according to the review of statistical data and methodology used. Compared to the previous version of the Annual Report of the Fiscal Council, the output gap was revised only marginally by the EC, in the sense of an aggregate demand gap during 2013-2015 lower by about 0.2 pp compared to previous estimates, which implies a contribution of less than 0.1 pp in the re-evaluation of the structural deficit in this period.

In 2009-2014, the structural deficit was reduced from 8.8% of GDP to 0.2%, the average rate of adjustment of 1.72 pp per year being extremely fast (see *Figure 4*); at the same time, we have to remember that the starting level was high, which required a rapid adoption of decisive measures to ensure the sustainability of the fiscal policy. It should be noted that this adjustment was made mostly in 2010 and 2011, when the structural deficit was reduced on average by 2.9 pp per year, the fiscal consolidation being achieved mainly on the expenditure side through reforms in the public wages, in the pension system and in the budgetary programming. At the same time, on the revenue side, the most important measure was the increase in the standard VAT rate from 19% to 24% since July 2010.

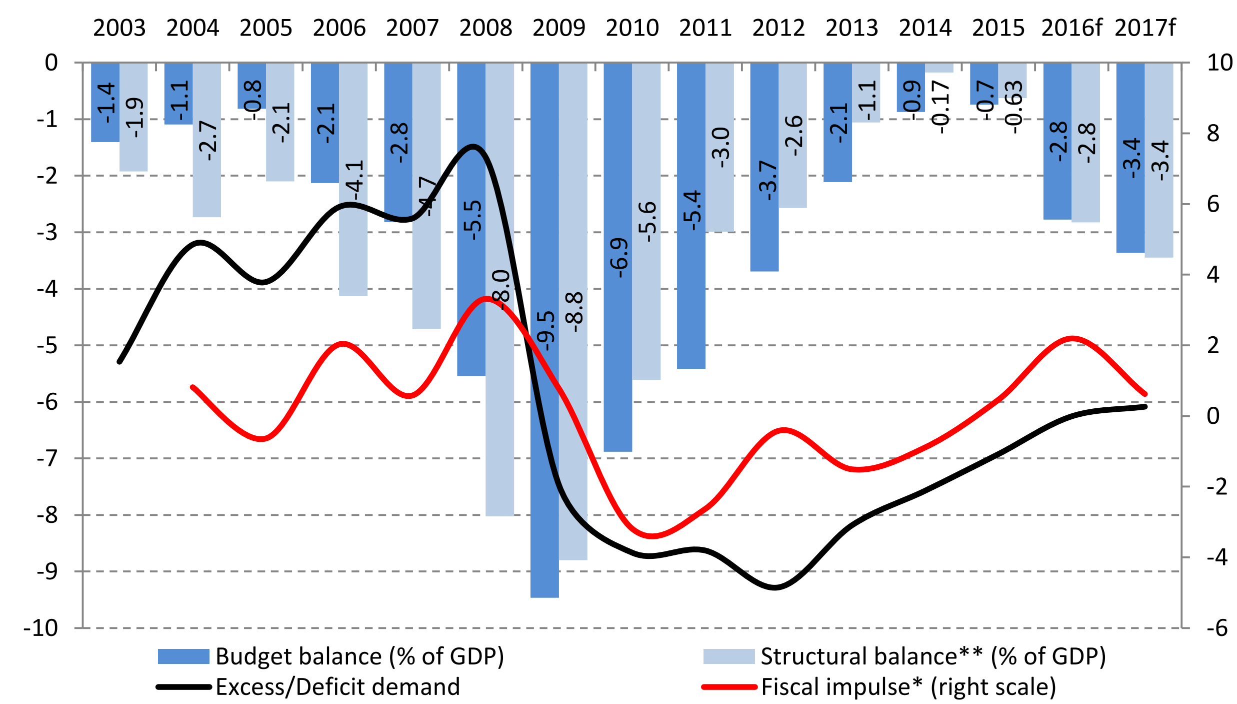
By contrast, in 2015 the fiscal policy's stance was simulative, the fiscal impulse being positive, totaling 0.5 pp of GDP, without exceeding the limits imposed by the compliance with the MTO. **During the period 2016-2017, the fiscal policy amplifies its expansionary nature, the fiscal impulse being about 2.2% of GDP in 2016 and about 0.6% of GDP in 2017, even if that entails exceeding by more than 2 pp of GDP the structural deficit level permitted by the MTO. In addition, in 2017 the EC's projections indicate the re-entry under the excessive deficit procedure, in the context of a headline deficit above 3% of GDP.** It should be mentioned that the MPF's projection that was included in the Convergence Programme 2016-2019 differs from

[23] The Fitch's, Standard & Poor's and Moody's press releases from the second half of 2015 explicitly mentioned among the factors that could cause a negative review of the rating of Romania a major fiscal relaxation affecting the stability of public finances.

that of the EC, being anticipated deficits slightly below 3% of GDP for the period 2016-2017, without being detailed the measures contributing to a deficit of 2.9% of GDP in 2017, in the context of applying the last stage of tax cuts envisaged by the new Fiscal Code.

Romania practiced in the period 2006-2014 a significant pro-cyclical fiscal policy, stimulating strongly but useless and counterproductive the economy in times of economic expansion (2004-2008) and slowing the economy when it was operating below potential (2010-2014), contributing to the exacerbation of business cycle fluctuations and to deepening the accumulated imbalances in the economy (*Figure 4*). Basically, the pro-cyclicality of the fiscal policy during the pre-crisis economic boom has exhausted the required fiscal space to stimulate the economy during the recession that followed, the need to reduce the budget deficit during the crisis (primarily due to funding constraints) therefore implying, inevitably, maintaining the pro-cyclicality of the fiscal policy. Consequently, the automatic, beneficial and stabilizing action of the cyclically deficit (the automatic stabilizers) was canceled by the pro-cyclical discretionary policy.

Figure 4: Structural deficit, fiscal impulse and excess demand



*Defined as variation in the structural balance (% of GDP) (+ stimulus effect ,- contractionary effect)

** For the period 2003-2009, the data refer to the cyclically adjusted budget balance

Source: AMECO, Fiscal Council`s calculations

Further, the application of fiscal relaxation since 2016 in the context of an output gap close to

zero will only help maintaining the pro-cyclicality of the fiscal policy and exposing the public finances' position to shocks, not being excluded the need for corrections in difficult economic times due to the depletion of the fiscal space. Moreover, considering the placement of government debt level at the end of 2015, a significantly higher level than in 2007, i.e. 38.4% compared to 13.2% of GDP, it is difficult to imagine the existence of a fiscal space to stimulate the economy in times of recession, existing risks even for the sustainability of the public debt. Furthermore, such a policy is in flagrant contradiction with the rules established by the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and the FRL, the compliance with the structural deficit target in the period 2016-2018 being abandoned. Additionally, the adjustment path towards the MTO is not appropriate, the automatic correction mechanism envisaged by the law not being currently functional *de facto*.

III.3. Budgetary revenues

The revenues of the general consolidated budget, without the impact of the compensation schemes, increased by approximately 9% in 2015 compared to the previous year, up to 232.46 billion lei, respectively 32.6% of GDP. Compared to 2014, the share of budgetary revenues in GDP increased by 0.66 pp of GDP, the growth being localized at the following categories of revenues: *amounts received from the EU in the account of payments made and prefinancing of the financial framework 2007-2013* (+0.68 pp din PIB), 2015 representing in fact the deadline for attracting the funds related to that financial year and at the level of *tax revenues* category (+0.74 pp of GDP).

In the case of the latter, the most significant increases in the share of GDP were: *VAT receipts* (+0.44 pp, even in conditions of extended the scope of the reduced VAT rate of 9% to food and restaurant services from June 1, 2015), revenues from *income tax* (+0.19 pp), *corporate tax* (+0.11 pp) and *excises* (+0.04 pp). Instead, the *social insurance contributions* have declined by 0.53 percentage points as a share of GDP, due to the decision to reduce it by 5 percentage points since October 1, 2014 and the increase of the share transferred to Pillar II pension by 0,5 pp, at 5%, *amounts received from the EU for operational programs financed under the Convergence objective*, a new subchapter in the implementation of the budget for the year 2014 that no longer appeared at the level of 2015 (which is equivalent to a negative impact of 0.25 percentage points of GDP in the level of revenues), while taxes on property decreased their share in GDP by 0.12 pp due to the decrease of special construction tax from 1.5% in 2014 to 1% in 2015.

Compared to the initial budget, the budget revenues were by 0.98 pp of GDP higher, due to the development above the expectations of the whole economy compared to initial projections, the favorable composition of the budget revenue growth (tax rich), but also due to an improvement in collection efficiency, especially at the level of *VAT receipts*. Thus, higher levels than initially estimated had registered: the *VAT receipts* (0.32 pp of GDP, i.e. an additionally 2.3 billion lei), even under the circumstances of the reduction of the standard VAT rate for food and restaurant services since June 1, 2015 which had not been included in the initial budget, the revenues from *income tax* (+0.17 pp of GDP), *social security contributions* (+0.28 pp), the latter two categories benefiting from the advance of the number of employees by 2.8% and the average gross salary by 8.5%, higher values than initial forecasts. An extra income was recorded at the revenues from *corporate income tax* (+0.16 pp), attributable to a higher elasticity of this budgetary aggregate to GDP growth. A negative gap compared to the initial projection was noted as always in the aggregate: *amounts received from the EU in the account of payments made and prefinancing* (-0.25 pp), absorption targets being systematically missed, but it should be noted that in 2015 the distance with respect to the target was significantly lower than in 2014 by -0.56 pp of GDP.

In this context, it is of interest conducting an analysis regarding the evolution of the collection efficiency in the period 2014-2015, while the budgetary executions suggest a significant increase in it in 2015 and an opposite trend in 2014. This analysis carries some challenges induced by the decisions to amend certain taxes in this period which must be considered. The reasoning used in the table below is to determine the collected revenue adjusted with the impact of fiscal policy measures (at the actual revenue level we must add/ subtract the estimated impact of reductions/increases in taxes) from which are subsequently deducted the receipts which would have been achieved in the absence of fiscal policy measures and taking into account actual data on the evolution of appropriate macroeconomic bases. In other words, it is computed the difference between what was actually collected and what should have been collected, a positive difference representing an increase in collection efficiency while a negative difference means a downside of it.

Thus, it is noticed a maintaining in the collection efficiency relatively constant over the years 2014-2015, but it was carried out in the conditions of decreasing by about 1 percentage point of GDP in 2014, which has been recovered in the next year. It can be seen that, indeed, in 2015 were collected about 7 billion lei more than what would have been justified by the macroeconomic dynamics bases mainly as a result of the added revenue recorded in the VAT (+5.67 billion lei) and social security contributions (+1.08 billion. lei), the situation for the year 2014 being opposite respectively significant drawbacks in the collection efficiency located mainly in the VAT (-3.31 billion lei) and social security contributions (-2.37 billion lei). Even if improving the collection efficiency in year 2015 is undoubtedly a positive element, it should be emphasized that at this time it can be noticed only a maintaining at the level of the year 2013 and the sources of this high inter-annual volatility are not completely identifiable at this time, as the reorganization of NAFA could be one of the factors.

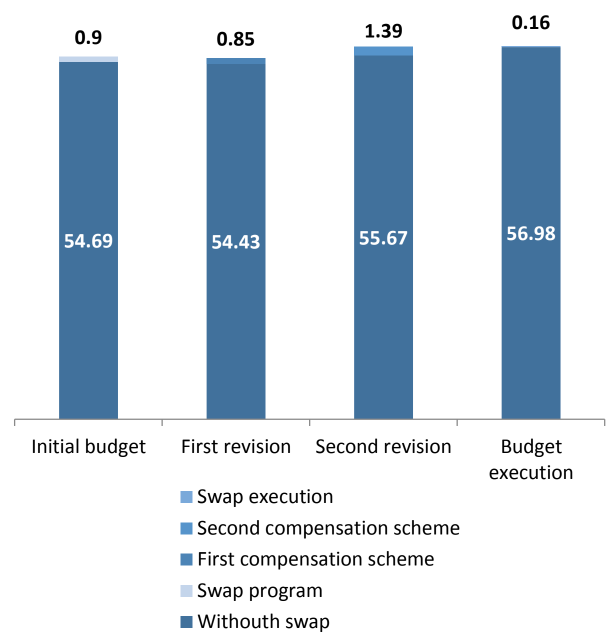
Table 6: Ex-post budgetary revenues in the period 2014-2015 versus actual execution																		
Categories of budgetary revenues	Budgetary revenues			Fiscal measures			Budgetary revenues adjusted with fiscal measures and *swap*			Macroeconomic base			Elasticity	Budgetary revenues' projection based on elasticities			
	2013	**2014**	**2015**	**2013**	**2014**	**2015**	**2013**	**2014**	**2015**	**2013**	**2014**	**2015**		**2014**	**2015**	**Difference 2014**	**Difference 2015**
Total	**173,489**	**182,586**	**195,906**	**-424**	**4,529**	**-3,356**	**172,655**	**176,289**	**197,875**					**182,985**	**190,923**	**-6,696.2**	**6,951.77**
CIT	12,190.8	13,684.3	15,451				12,182	13,627.1	15,422.6	362,329	374,382	397,305	1.81	12,915.5	15,137.3	711.58	285.255
PIT	22,735.9	23,691.8	26,640	86	453	429	22,646.6	23,149.9	26,124.2	166,376	179,705	194,030	1.36	25,114.2	25,659.6	-1,964.2	464.607
VAT	51,827	50,878.5	57,132	0	383	-2,248	50,855.4	50,022.4	59,222.8	388,722	408,233	437,981	0.97	53,331.5	53,558.1	-3,309	5,664.7
Excises	21,106	24,094.8	26,018	0	1,594	2,391	21,106	22,500.6	23,627	388,722	408,233	437,981	0.97	22,133.6	24,091	367.014	-464.02
Custom duties	620	643	815.87				620	643	815.872	258,322	277,234	296,672	1	665.39	688.082	-22.39	127.79
Social contributions	54,378.9	57,612	57,604	-510	414	-5,063	54,857.8	56,840.9	62,402.1	166,376	179,705	194,030	0.99	59,208.8	61,326.5	-2,367.9	1,075.61
Property tax	4,403.2	6,185.1	5,737.99	0	1,685	1,135	4,403.2	4,500.1	4,602.99	637,456	667,577	712,832	1	4,611.26	4,805.16	-111.16	-202.17
Other taxes	6,226.8	5,796.5	6,507.13	243	792	850	5,983.8	5,004.5	5,657.13					5,004.5	5,657.13	0	0

Source: MPF, Fiscal Council`s calculations

III.3.1. VAT and excises

The **VAT** receipts, without the impact of the compensation schemes, recorded in 2015 a level of 56.97 billion lei, respectively 8% of GDP, significantly above the amount envisaged in the draft budget by about 2.3 billion lei, despite the reduction in the standard VAT rate for food and restaurant services since June, 1st 2015 was not included in the initial budget. This result arises from the advance of the relevant macroeconomic base (final consumption of households and NPISH[24]) of 7.3% compared to 5.3%, the value taken into account in the draft budget for 2015. Moreover, the difference between the actual registered level of VAT receipts, adjusted for the estimated impact of extending the application scope of the reduced VAT rate on food, and the level that would have been achieved according to the macroeconomic framework is 5.7 billion lei, which indicates a significant increase in collection efficiency.

Figure 5: VAT revenues in 2015 (billion lei)



Source: MPF

Along with an improvement in collection efficiency, the significant outperformance of this category of budget revenues can be explained by the lower VAT refunds in 2015 (-1.6 billion lei, respectively 7.98% below the level recorded in 2014), but also by the increased of investment from EU funds given that 2015 was the last year in which funds corresponding to the financial period 2007-2013 could be drawn.

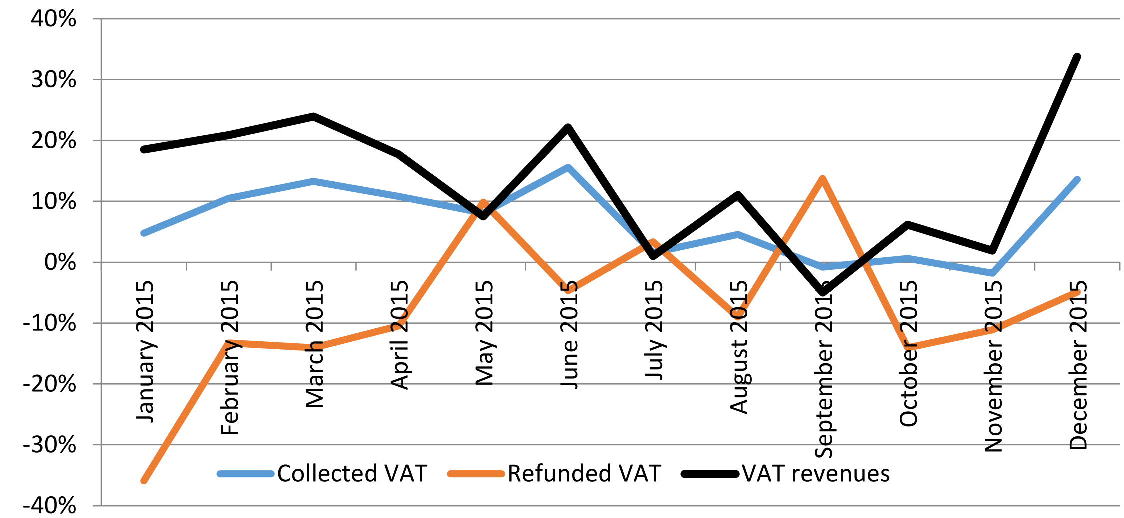
It should be noted that in the draft budget for 2015, the compensation scheme that would affect the VAT revenue, was projected at 0.9 billion lei. Subsequently, through the three budgetary revisions, this amount was increased up to 1.4 billion lei, but this rise was not reflected at the level of the final execution, as the VAT receipts corresponding to the swap scheme totaled only 0.16 billion lei.

In terms of observable impact at the level of VAT receipts of the extending the application scope of the reduced VAT rate on food and restaurant services, the impact of the first-round

[24] Non-profit institutions serving households.

appears to be in line with the originally estimated (about 5.5 billion lei per year). Thus, as can be seen in *Figure 6*, in the first 6 months the average annual growth rate of monthly collected flows of VAT amounted to about 10% whereas in the period from July to December it dropped to about 2.97%, suggesting a monthly impact of the measure of about 500 million lei. If we analyze the values of VAT receivable (most noticeable in the monthly budget execution, which are equal to the VAT collected less VAT refunded are, being influenced also by the dynamic of the reimbursements that can undergo meaningful monthly variation), the average growth rate in the first 6 months of over 18% experienced a significant slowdown to about 8%, being likely to lead to a similar conclusion, namely a monthly impact of the measure concerned of about 400-500 million lei.

Figure 6: VAT increasing rate, compared to the same period of the previous year



	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15
Collected VAT	4.76%	10.52%	13.29%	10.82%	8.10%	15.60%	1.59%	4.56%	-0.79%	0.63%	-1.79%	13.62%
Refunded VAT	-35.94%	-13.26%	-14.03%	-10.46%	9.84%	-4.67%	3.33%	-9.01%	13.76%	-14.05%	-11.11%	-4.88%
VAT revenues	18.54%	20.89%	23.95%	17.74%	7.52%	22.13%	1.03%	11.03%	-4.98%	6.19%	1.91%	33.76%

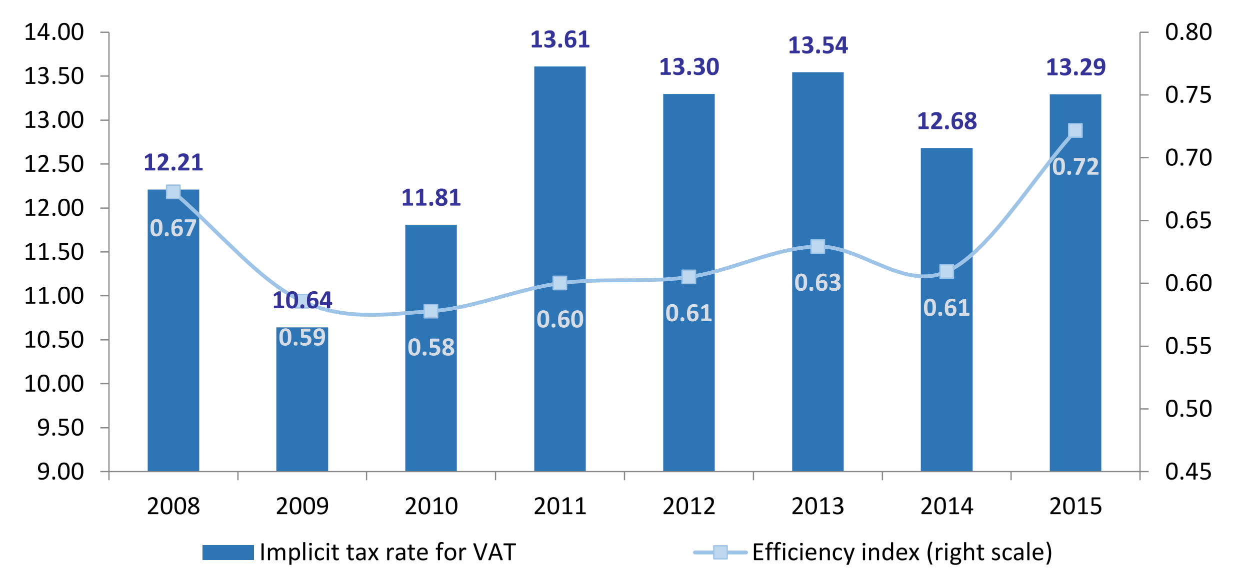
Source: MPF, Fiscal Council`s calculations

Further, the assessing of the efficiency of tax collection will be done through the indicator implicit tax rate (defined as the ratio between the actually collected revenue for a specific type of tax and the corresponding macroeconomic tax base) and weighted average VAT rate. In relation to the latter in the case of VAT, we highlight two aspects. First, the introduction of the weighted average tax represents a change of the methodology compared to previous reports of the Fiscal Council, which makes the results not comparable to those in previous editions of this publication. Secondly, the weights used are those of the harmonized index of consumer prices (HICP), which is the only available source, and is only a proxy for the weighted average VAT rate in the economy. For example, the weighted average rate of VAT for Romania determined based on the HICP in 2014 was 20.8% while the estimated actual weighted average rate in the Convergence Program 2016-2019 was 22.8%, this proxy over-assessing to some extent the collection efficiency.

Using the methodology described above, it can be observed the recording of a substantial increase in the efficiency level of taxation for VAT in Romania in 2015 compared to the post-crisis period. This trend is noticeable also given that the VAT receipts by the standards of ESA 2010, the underlying of these calculations, recorded a dynamic similar to that in cash standards, +12.5% respectively. Thus, after a relative stability of the index in 2010-2013, then a fall in 2009, there is a significant deterioration in it in 2014, probably due to higher tax evasion.

Instead, having a weighted average rate of VAT roughly equal in 2008 and 2015 at about 18.3%, the year 2015 marks a substantial improvement in the efficiency of taxation for VAT even compared to the year before the economic crisis, marking not only the recovery of efficiency lost in 2014, but even a progress in terms of the collection compared to the debut year of the financial and economic crisis. Romania collected in 2015 from taxing VAT consumption only 13.3%, compared to standard statutory rate of 24% at that time, or to weighted average rate of VAT of 18.4%.

Figure 7: The evolution of the implicit tax rate and efficiency tax index for VAT in Romania



Source: Fiscal Council's calculation

Comparing the effectiveness of taxation for VAT in 2015 for the group of new EU member states from Central and Eastern Europe (CEE NSM) the value of 0.72 recorded by Romania is significantly lower than that one recorded by Slovenia (0 98), Estonia (0.93), Hungary (0.91), Bulgaria (0.86) and Czech Republic (0.83). Romania collected in 2015 VAT revenue worth 8.17% of GDP (execution ESA 2010), compared to 8.35% of GDP in Slovenia, Bulgaria 8.93%, 9.15% in Estonia and 9.81% in Hungary, given that the weighted average VAT rate in these countries was: 16.5% in Slovenia, 17.1% in Bulgaria, 18.8% in Estonia and 21.7% in Hungary; Romania registered a weighted average rate of 18.4%[25]. By 2015, lower efficiency of taxation as defined above was noticeable in Lithuania, Latvia, Poland and Slovakia. It may be noted, however, a significant leap in the ranking made by Romania in 2015, i.e. an advance of four places to sixth position.

Table 7: Taxation efficiency - VAT

Country	Weighted average VAT rate (%)			Implicit tax rate* (%)			Taxation efficiency index**			Rank		
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
BG	17.2	17.2	17.1	14.9	14.2	14.7	0.87	0.82	0.86	2	4	4
CZ	18.9	18.9	18.8	15.0	15.4	15.6	0.79	0.82	0.83	4	5	5
EE	18.9	18.8	18.8	16.0	16.8	17.6	0.85	0.89	0.93	3	2	2
LV	19.5	19.4	19.4	12.1	12.4	12.5	0.62	0.64	0.65	8	7	9
LT	19.4	19.4	19.3	11.9	12.1	12.1	0.61	0.62	0.63	9	9	10
HU	22.9	21.8	21.7	17.1	18.6	19.8	0.75	0.85	0.91	5	3	3
PL	16.9	16.8	17.1	11.6	11.9	12.0	0.68	0.71	0.70	6	6	7
RO	21.5	20.8	18.4	13.5	12.7	13.3	0.63	0.61	0.72	7	10	6
SI	15.4	16.4	16.5	15.4	15.9	16.1	1.00	0.97	0.98	1	1	1
SK	18.7	18.9	18.7	11.2	11.7	12.4	0.60	0.62	0.66	10	8	8

Source: EC, Eurostat, MPF, Fiscal Council's calculations

* Calculated as a ratio between "VAT revenues" (ESA cod D211R) and "Households and NPISH Final Consumption Expenditure" (ESA cod P31_S14_S15). In Romania, the revenues for 2013, 2014 and 2015 include additional receipts due to implementation of compensation scheme for clearing arrears (+972 million lei in 2013, +473 million lei in 2014, and +157 million lei in 2015).

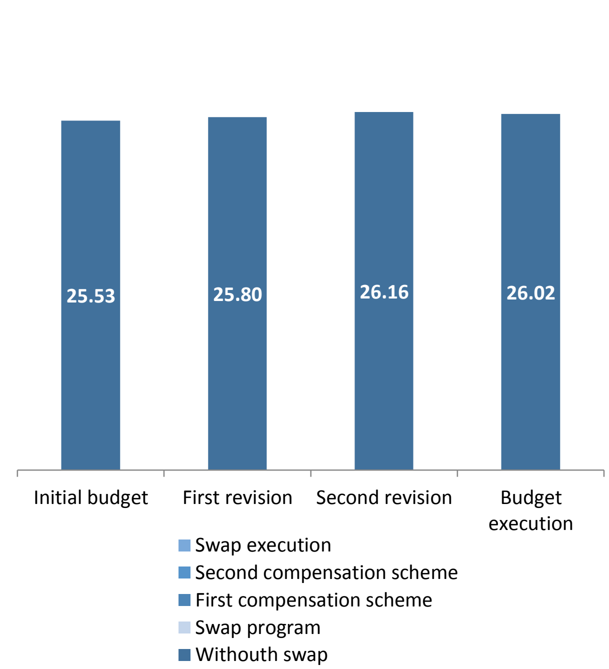
** Computed as a ratio between the implicit and weighted average VAT rate.

Although, it must be noted that the differences in the efficiency index of taxation also reflect the structural differences between economies, since the higher percentage of rural population in Romania is revealed in a higher share of the self-consumption component and farmhouse

[25] The difference from the standard rate of 24% and weighted average rate derives largely from extending the reduced VAT rate on food, which has a high weight in the consumer basket, i.e. 37.3%.

market (non-taxable). Moreover, Aizenmann J. and Y. Jinjarak (2005)[26], examining a panel of 44 countries in the period 1970-1999, concludes that the VAT collection efficiency is negatively related to the share of agriculture in GDP, and directly proportional to the degree of urbanization and the trade openness of the economy – the corresponding indicators for the three variables for Romania being unfavorable. In addition, it should be noted that this method of computing the VAT efficiency indicator does not take into account the impact of the reduced VAT rates and other components of GDP that are subject to VAT (i.e., a part of the intermediate consumption and a part of the fixed gross capital formation - see the *tax evasion chapter*).

Figure 8: Excises, 2015 (billion lei)



Source: MPF

The revenue collected from the **excise** duties in 2015 amounted to 26 billion lei (3.65% of GDP), a level superior to the one from the initial projections envisaged in the draft budget, the first supplementary budget revision altering the collected revenues to 25.8 billion lei (+0.3 billion lei compared to initial estimates), and the second one to 26.2 billion lei (+0.7 billion lei compared to the initial projections); the revaluation was due to the evolution over expectation of the private consumption, whose dynamics in real terms was higher than the forecast level at the moment of making the draft budget (+2.72%). During 2015 the real growth of private consumption was 6.73%, 4 pp higher than initial estimates which, in conjunction with higher excise revenue by only 2% compared to the initial program, could indicate a loss of efficiency in the collection of this revenue category.

Compare to the previous year, the amount of revenue collected from the excise duties was by 8% or by 1.9 billion lei higher, this dynamic being caused by a more favorable development of public consumption and also by the increased excise duty on fuel which involved the introduction of a 7 eurocents/liter of fuel tax which was applied with a delay of 3 months on April 1st,2014 (an annually impact evaluated by the Government at 1.84 billion. lei), while in 2015 it was applied during the whole year, being materialized in a positive impact in three months estimated at about 342 million lei, to which is added the effect of increasing the excise

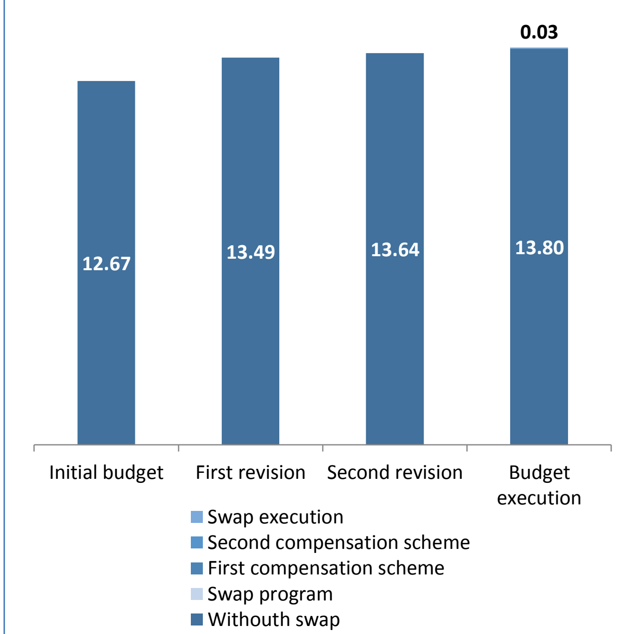
[26] Aizenmann J., Jinjarak Y, "The Collection Efficiency of the Value Added Tax: Theory and International Evidence", National Bureau of Economic Research Working Paper no. 11539, August 2005.

duty on cigarettes, according to the default calendar.

III.3.2. Direct taxes

The revenues from the **corporate income tax** according to cash standards, in amount of 13.8 billion lei, without the compensation schemes (in the amount of 28.4 million lei), registered a significant increase of 13.3% in 2015 (+1.26 billion lei) compared to 2014, higher than the estimates of the initial budget (by about 1.12 billion lei), based on a better than expected evolution for the revenues collected from the non-financial economic agents (+11.1%, respectively 1.33 billion lei) facilitated by the reduction of the number of insolvencies[27], and an increase in corporate tax collected from commercial banks (+ 88.8%, or 246 million lei). This development can be explained by the high elasticity of this aggregate budgetary depending on relevant macroeconomic base namely gross operating surplus, elasticity assessed by EC at a level of 1.81. Thus, if the gross operating surplus recorded in 2015 over the previous year a +6.1% dynamic, the dynamic registered in tax revenue confirms the validity of the estimate of this elasticity of the budgetary aggregate.

Figure 9: Corporate income tax, 2015 (billion lei)



Source: MPF

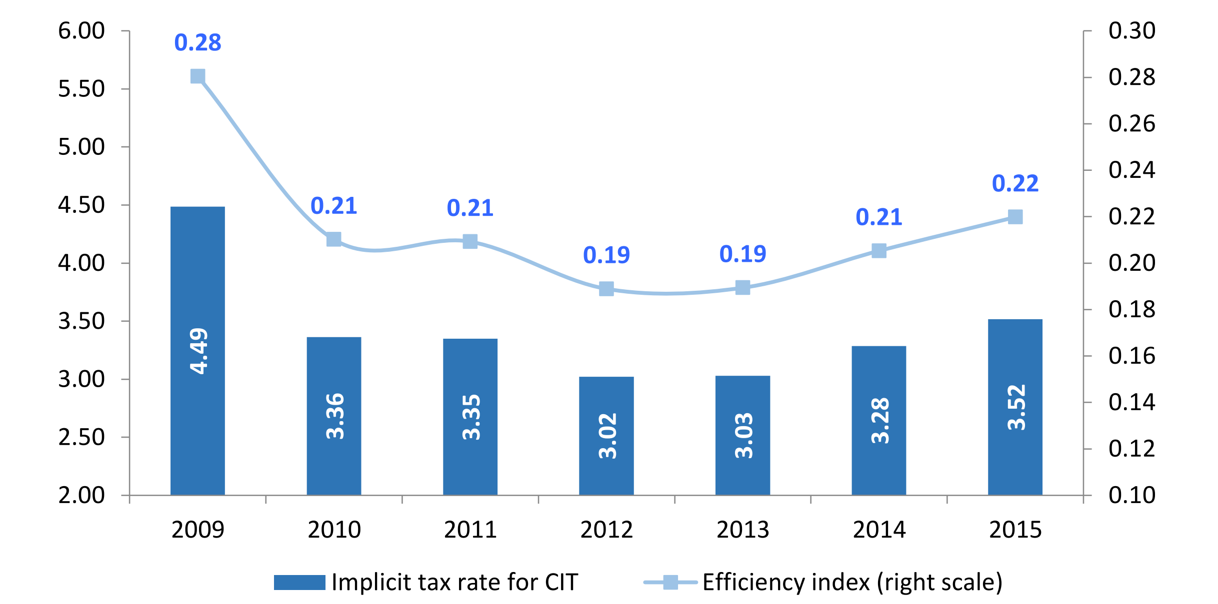
During the first semester of 2014 it was introduced a discretionary measure which provided tax exemption on corporate income tax for reinvested profits in certain categories of assets equivalent, from a fiscal standpoint, to the recovery of eligible investments made in the first year of putting them into operation (in the limit of cumulative accounting profit of that year). This measure was announced to be applied temporarily in the period July 2014 - December

[27] According to the National Trade Register Office (NTRO), the number of companies which became insolvent in 2015 was by 50.38% lower than in 2014 (10,269 companies in 2014). At the same time, the number of companies registered in 2015 (113,167) increased by 11.36% compared to 2014. The insolvency rate calculated as the ratio between the newly opened insolvency cases reported to the number of active companies decreased from 2.76 % in 2014 to 1.33% in 2015.

2016 and the estimated annual budgetary impact by MFP at the time was about 600 million lei. However, the revenues collected suggest a budgetary impact less significant of this measure, most likely as a result of the reduced use of this feature by economic operators, given the temporary nature of the measure which has the potential to make it less attractive.

The nominal revenues from the **corporate income tax**, registered in 2015 a historical maximum, higher in nominal value compared to 2008, but lower as percentage of GDP by 0.55 pp. This trend can be observed also by considering the efficiency index, expressed according to ESA 2010 standards, which showed a significant reduction in the period 2009-2012, a gap that has not been recovered so far; *Figure 10* suggests a direct link between the effectiveness of collection and the cyclical position of economy. After the resumption of economic growth in 2011, the efficiency index seems to be stabilized, followed by an upward trend. While in cash terms the dynamic of the corporate income tax receipts was +13.3% in 2015 compared to 2014, according to ESA 2010 standards, the increase was 13.6%, indicating an improvement in the efficiency index in 2015, as the corporate income tax revenues have advanced at a superior rate compared to the relevant macroeconomic base (the gross operating surplus, +6.1%).

Figure 10: Implicit tax rate and efficiency tax index for corporate income tax in Romania



Source: Fiscal Council's calculations

Compared to other countries from Central and Eastern Europe[28], in 2015 Romania was ranked on

[28] Poland was not included in the ranking for the year 2015 due to unavailability of data on the gross operating surplus.

the seventh position, descending with a spot, although the taxation efficiency index is higher in 2015 compared to 2014. It may be noted that Romania has registered a slight increase in the collection efficiency compared to the previous year, but the same trend can be observed also among other CEE countries.

Table 8: Taxation efficiency – corporate income tax

Country	Legal corporate income tax			Implicit tax rate *			Taxation efficiency index **			Rank		
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
BG	10.0	10.0	10.0	4.3	4.2	4.7	0.43	0.42	0.47	1	1	1
CZ	19.0	19.0	19.0	6.6	6.6	NA	0.35	0.35	0.36	2	2	2
EE	21.0	21.0	20.0	4.0	4.2	5.3	0.19	0.20	0.27	6	7	4
LV	15.0	15.0	15.0	3.3	3.3	3.4	0.22	0.22	0.23	4	5	6
LT	15.0	15.0	15.0	2.7	2.7	3.2	0.18	0.18	0.21	9	9	7
HU	20.6	20.6	20.6	3.3	3.8	3.9	0.16	0.19	0.19	10	8	9
PL	19.0	19.0	19.0	3.4	3.4	NA	0.18	0.18	NA	8	10	NA
RO	16.0	16.0	16.0	3.0	3.3	3.5	0.19	0.21	0.22	7	6	7
SI	17.0	17.0	17.0	3.3	3.8	3.9	0.20	0.22	0.23	5	4	5
SK	23.0	22.0	22.0	5.7	6.4	6.6	0.25	0.29	0.30	3	3	3

Source: EC, Eurostat, MPF, Fiscal Council's calculations

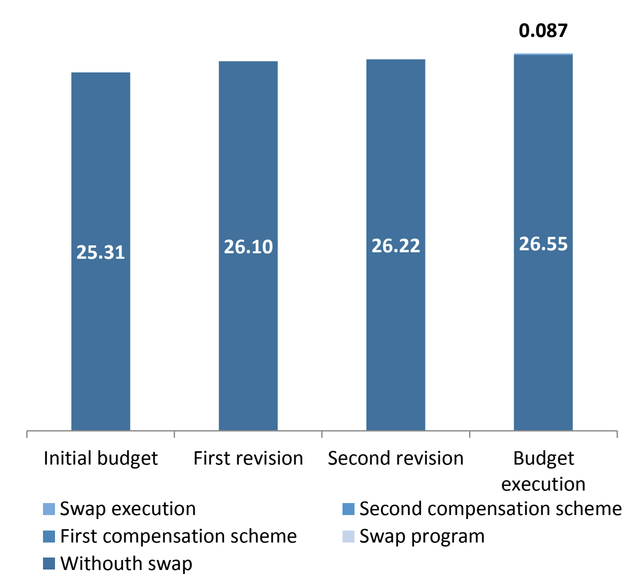
* Calculated as the ratio between "direct taxes paid by enterprises" (ESA code D.5R (S11+S12)) and "gross operating surplus and gross mixed income" (ESA code B2G_B3G).

** Computed as a ratio between the implicit and legal tax rate.

The receipts from the personal income tax expressed in cash standards, in amount of 26.6 billion lei, performed above expectations, being over the initial budget estimates by about 1.24 billion lei (4.89%), exceeding also the revenues collected in 2014 by about 3 billion lei (+12.5%).

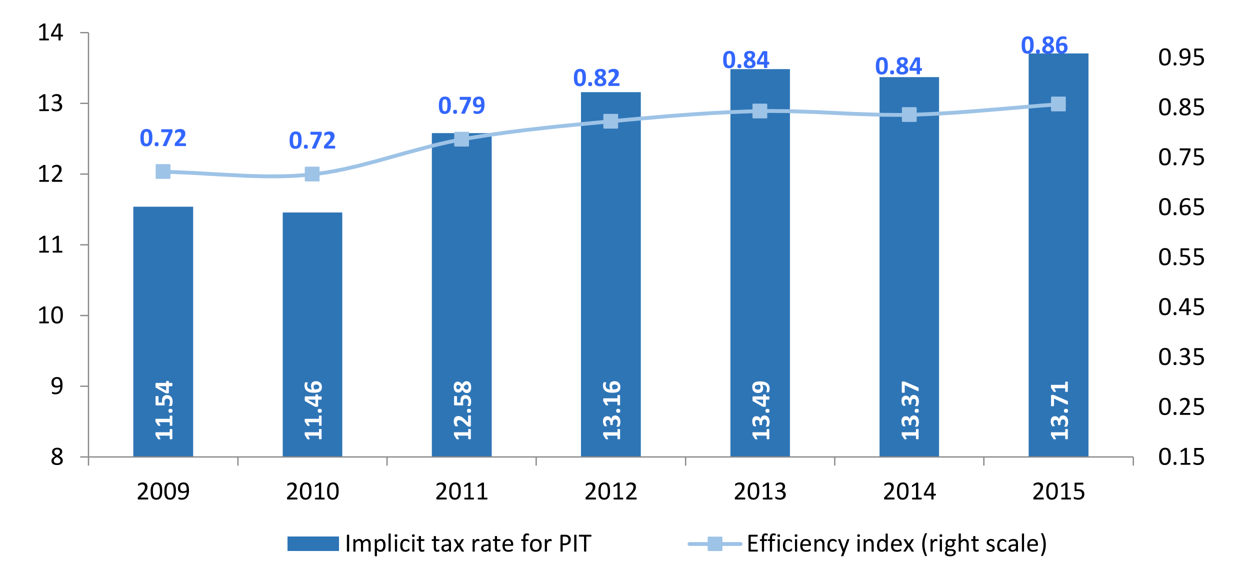
The dynamics of this budgetary aggregate reflects an increase of 8.5% of the average gross wage in the economy (compared to the initial projection of +4.5%), but also the 2.8% increase of the average number of employees (compared to the initial projection of +1.4%), mainly due to an increase in the number of jobs created by the private sector (3.3%) and in a smaller proportion due to increase in the number of public employees (1%).

Figure 11: Personal income tax, 2015 (billion lei)



Source: MPF

Figure 12: The evolution of the implicit tax rate and taxation efficiency index for personal income tax in Romania



Source: Fiscal Council's calculations

Comparing the evolution in 2015 with that from 2014, the dynamics of the personal income tax revenues expressed in ESA 2010 standards (+10.7%) is lower than that in cash terms (+12.5%), being superior to that of the macroeconomic base (gross wages in national accounts, from which were excluded the social contributions paid by employees, which increased by 8%), equivalent to an improvement in the collection efficiency. Thus, the level of this indicator remains quite high (0.86), the period 2009-2015 being characterized by a consistent improvement of the collection efficiency, the personal income tax receipts and the wages have constantly advanced at a rate higher than that recorded by appropriate macroeconomic basis.

Compared with other countries in the region, Romania maintained its second position in the sample [29], with an efficiency index of 0.86 and an implicit tax rate of 13.71% (calculated as the ratio of direct taxes paid by households and gross wages from national accounts - including shadow economy, for which social security contributions paid by employees were deducted from salaries).

Table 9: Taxation efficiency – personal income tax

Country	Legal corporate income tax* (%)			Implicit tax rate** (%)			Taxation efficiency index ***			Rank		
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
BG	10.0	10.0	10.0	8.5	9.2	9.1	0.85	0.92	0.91	1	1	1
CZ	15.0	15.0	15.0	9.0	9.4	NA	0.60	0.63	0.61	7	7	7
EE	21.0	21.0	20.0	16.0	16.5	16.1	0.76	0.79	0.81	5	4	4
LV	24.0	24.0	23.0	17.1	16.7	16.1	0.71	0.70	0.70	6	6	6
LT	15.0	15.0	15.0	11.7	11.8	12.2	0.78	0.79	0.81	3	5	3
HU	16.0	16.0	16.0	12.4	12.8	12.8	0.78	0.80	0.80	4	3	5
PL	25.0	25.0	25.0	14.3	14.5	NA	0.57	0.58	NA	8	8	NA
RO	16.0	16.0	16.0	13.5	13.4	13.7	0.84	0.84	0.86	2	2	2
SI	27.0	27.0	27.0	11.9	12.0	12.3	0.44	0.45	0.46	10	10	9
SK	22.0	22.0	22.0	11.6	11.7	12.7	0.53	0.53	0.58	9	9	8

Source: EC, Eurostat, MPF, Fiscal Council's calculations

* For countries with progressive taxation system (Poland, Slovenia), the figure reported is the average tax rate (Poland - with two tax rates system) or central rate (in Slovenia - with three tax rates system).

** Computed as the ratio between "revenues from direct tax paid by the population" and personal income tax base defined as gross wages from the national accounts from which social insurance contributions paid by employees were deducted. For the Czech Republic and Hungary, the personal income tax base is "compensation of employees", which includes social security contributions paid by employers, given the use of the "super grossing" in computing the personal income tax due.

*** Computed as a ratio between implicit tax rate and legal tax rate.

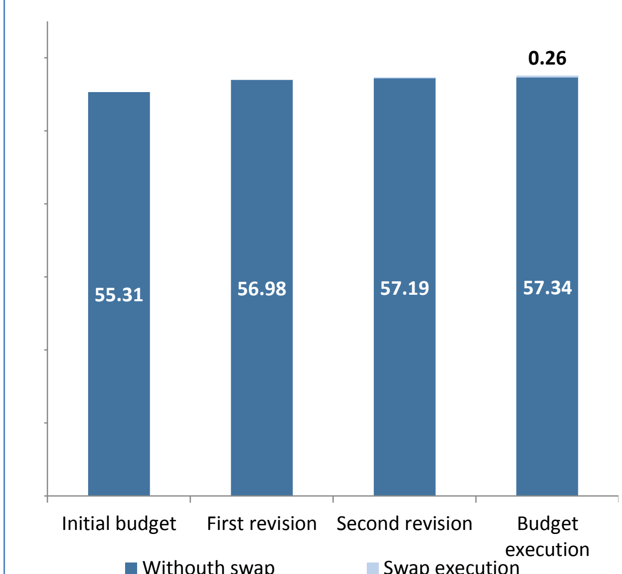
[29] There is no data available regarding the gross wages in the national accounts for Poland in 2015.

III.3.3. Social contributions

The revenues from **social security contributions**, without the impact of compensation schemes, amounted to 57.34 billion lei at the end of 2015 in cash standards, by 3.67% or 2,028 million lei higher than the initial estimates (55.31 billion lei), given that dynamic of the average gross wage in the economy (+8.5%) was higher than the initial projection (+4.5%), while the average number of employees increased by 2.8% compared to the initial projection of +1.4%. Another factor that contributed to higher revenue from those envisaged in the initial budget for 2015 was the supplementation of payments on behalf of the court decisions to grant salary rights by about 1.5 billion lei, which generated additional income of about 479 million lei. In the sense of lower income than that considered in the draft budget, acted the higher amounts transferred to Pillar II pension which exceeded the initial forecasts by 401.9 million lei. Analyzing the projection of revenues from social insurance contributions during 2015 it can be observed that the evolution above expectations of the relevant macroeconomic base was built largely during the first budget revision, when there has been an upward revision of this category of revenues by about 1.7 billion lei, while the second budget revision increased the estimated revenue by another 200 million lei, actual achievements confirming this last projection.

Compared to 2014, the receipts from social contributions, without the impact of the compensation schemes, increased by 0.19%, respectively, being by 7.97% lower than the dynamic recorded by the relevant macroeconomic base (gross wages in national accounts). This dynamic is explained mainly by the reduction of 5 percentage points in social security contribution paid by employer from 1 October 2014 which leads to lower revenue in 2015 compared to 2014 by about 6.5 billion lei, but also by the increasing amounts transferred[30] towards the Pillar II pension (1.12 billion lei) and the lower payments compared to the previous year (4.1 billion lei compared to 4.6 billion lei) on account of court decisions that had a negative impact of about 202 million lei.

Figure 13: Social security contributions, 2015 (billion lei)



Source: MPF

[30] The contribution rate to the private pension fund increased by 0.5 pp per year, starting on 1 January of each year so that in 2015 the share was 5%, compared with 4.5% in 2014, 4.0% in 2013, 3.5% in 2012 and 3.0% in 2011.

In the table below, are presented the revenues from social contributions, adjusted with the impact of several factors that have influenced the evolution of this budgetary aggregate in 2012-2015[31], in order to reflect more accurately the dynamics of the receipts from social security contributions.

Thus, if the unadjusted series are considered, it appears that in 2015, revenues from social contributions, amounting to 62.43 billion lei, surpassing the revenues collected in 2014 with about 2.2% (+1.33 billion lei), the dynamic surpassed the one observed in the budgetary execution, given that latter includes also the transfers to Pillar II which appear as negative revenue. If we analyze the evolution of this aggregate budgetary eliminating both influence of the amounts paid to Pillar II and the temporary impact of additional revenue from court decisions regarding granting of salary rights, the increased revenue from CAS in cash standards would have been about 2.56%.

Table 10: Social security contributions (million lei)

		Budget execution 2012	Budget execution 2013	Budget execution 2014	Budget execution 2015
Adjusted series	**1**	**51,658.30**	**54,378.90**	**57,585.40**	**57,603.96**
Swap	2	407.60	31.10	357.1	264.92
Second Pension Pillar	3	2,501.30	3,125.20	3,877.18	5,093.53
Amounts illegally withheld / refunded to retirees	4	262.80	788.50	-	-
Gross series*	**5=1-2+3+4**	**54,014.80**	**58,261.50**	**61,105.50**	**62,432.57**
* of which executory titles		191.89	287.83	1,508.60	1,306.39

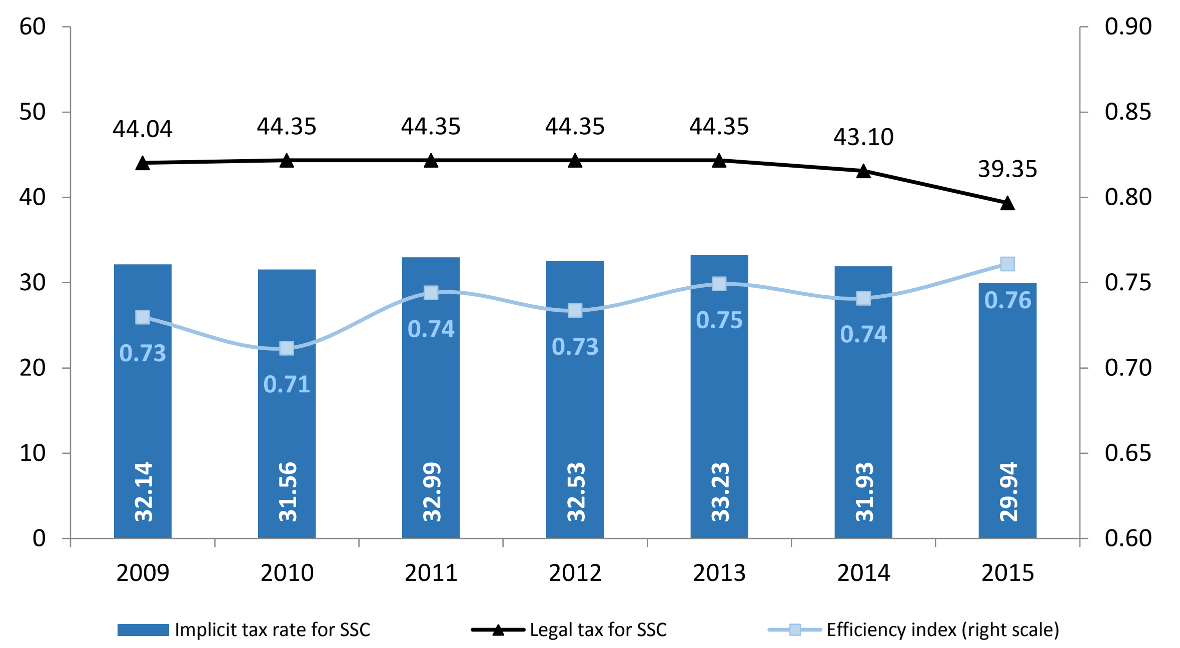
Source: Fiscal Council's calculations

The dynamics of the revenues from social contributions according to ESA 2010 (+1.21%) was lower by about 6.76 pp than that recorded by the relevant macroeconomic base (+7.97%) - respectively the gross wages in the national accounts, while the social contribution rates have been reduced. This implies a reduction of the implicit tax rate from 31.93% in 2014 to 29.94% in

[31] In the years 2012-2013 the social contributions revenues from GCB were adversely affected by the repayment of amounts illegally collected from pensioners representing social health insurance contributions. The Constitutional Court decided in April 2012 that the health insurance contribution applies only to pension income exceeding 740 lei, deducting this amount from the tax base and the Government decided to refund these amounts, withheld illegally, in equal monthly installments during the period June 2012 - September 2013.

2015, while the statutory rate decreased from 43.10% to 39.35%. The implicit tax rate reduction was lower than the reduction of statutory rate, thus the taxation efficiency rose to 0.76 in 2015 from 0.74 in the previous year, following a similar trend in 2014.

Figure 14: The development of the implicit tax rate and taxation efficiency index for social security contributions in Romania



Source: Fiscal Council's calculations

* Legal tax rate was calculated as a weighted average of rates applicable in 2014: 44.35% in the first 9 months of the year and 39.35% respectively from 1 October.

In comparison to other countries in the region[32], Romania was ranked on the sixth position regarding the efficiency of the social contributions collection, improving its position from 2014 with a place, but given that Poland was not taken into account for 2015, since data is not yet available, and previously this country was placed above Romania. However, the implicit tax rate was below the level registered in several countries that impose a lower level of social security contributions, while the position of the statutory rate of social security contributions is fifth in the region, on a par with Poland (after Slovakia, Hungary, Lithuania and the Czech Republic).

[32] There is no available data for gross wages in national accounts in 2015 for Poland.

Table 11: Taxation efficiency – social security contributions												
Country	Legal tax rate for SSC* (%)			Implicit tax rate** (%)			Taxation efficiency index***			Rank		
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
BG	31.0	31.0	31.0	22.0	22.5	23.2	0.71	0.72	0.75	10	8	7
CZ	45.3	45.3	45.3	47.7	48.4	49.1	1.05	1.07	1.08	2	1	1
EE	37.2	36.0	35.4	32.9	32.4	31.9	0.88	0.90	0.90	6	5	4
LV	35.1	35.1	34.1	25.7	24.6	23.3	0.73	0.70	0.68	9	9	8
LT	40.1	40.1	40.0	35.9	36.6	37.2	0.90	0.91	0.93	5	4	3
HU	47.0	47.0	47.0	38.0	38.9	39.0	0.81	0.83	0.83	7	6	5
PL	39.6	39.6	39.4	42.5	42.2	NA	1.07	1.06	NA	1	2	NA
RO	44.4	43.1	39.4	33.2	31.9	29.9	0.75	0.74	0.76	8	7	6
SI	38.2	38.2	38.2	34.7	34.6	35.4	0.91	0.91	0.93	4	4	3
SK	48.6	48.6	48.6	47.0	46.9	47.5	0.97	0.97	0.98	3	3	2

Source: EC, Eurostat, MPF, Fiscal Council's calculation

* Aggregate data for employer and employee. Where rates were changed during the year, weighted average was used.

** Computed as the ratio between "actual social contributions" (cod ESA D.611) and "gross wages and salaries" (cod ESA D11). For Romania, the budget revenues include additional receipts due to implementation of compensation scheme for clearing arrears (31.1 million lei in 2013, 357.1 million lei in 2014, and 264.9 million lei in 2015).

*** Computed as the ratio between implicit and legal tax rate.

III.4. Budgetary expenditures

The budgetary expenditures, without the compensation schemes (in amount of 1,095.3 million lei), have registered a higher rate of growth (+8% compared to the previous year) than that recorded by GDP growth (+6.8%), reaching at the end of the year, 242.82 billion lei, thus increasing its share in GDP by 0.4 pp, from 33.7% to 34.1%. The main budgetary expenditure category that registered a higher dynamic than average was *projects funded by external grants* (+62.41%), while lower dynamics than the average were registered by *goods and services* (+4.5%), *personnel expenses* (+3.26%), *capital expenses* (+2.75%) and *interest spending* (-6.18%). Compared to the initial budget for 2015, the budgetary expenditures were higher by 4.31 billion lei, respectively by 0.61% of GDP, mainly due to the increase of the *personnel* *expenses* (+0.51 pp of GDP), *social assistance* (+0.24 pp of GDP), *goods and services expenditure* (+0,15 pp of GDP), negative contributions coming from and *interest spending* (-0.16 pp of GDP) and *other transfers* (-0.16 pp of GDP).

Figure 15: Quarterly revenues of the GCB in 2015 (million lei)

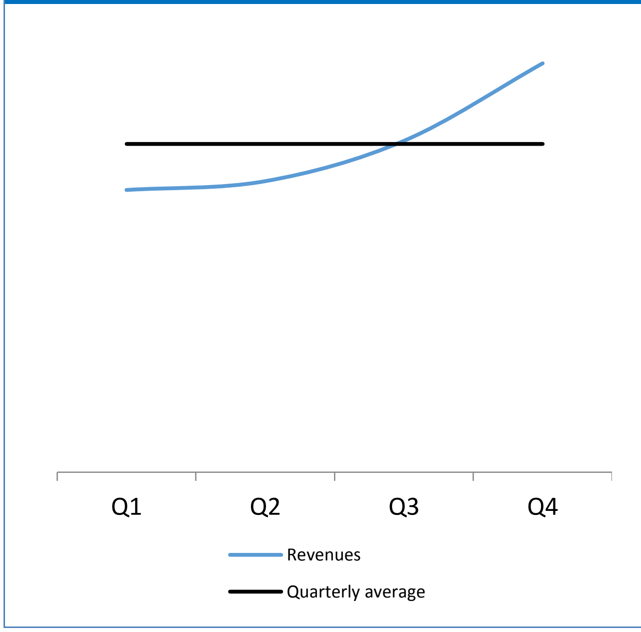
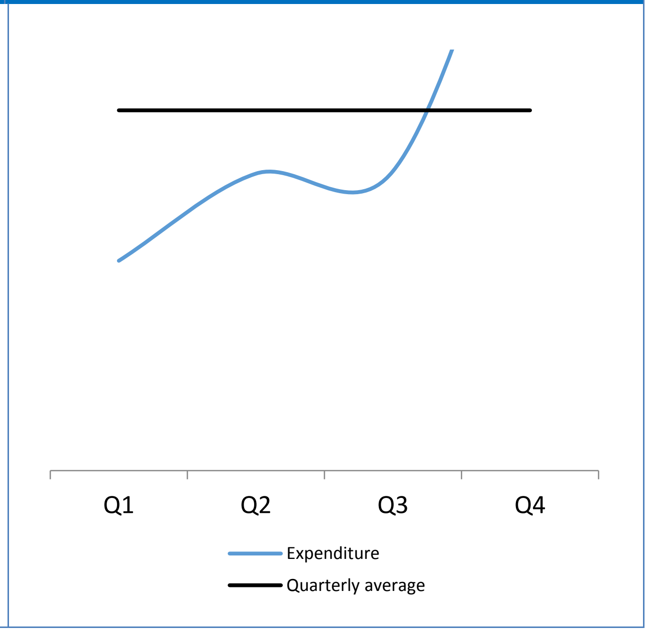


Figure 16: Quarterly expenditure of the GCB in 2015 (million lei)



Source: MPF

Note: The amounts are without the compensation schemes.

Also in 2015, the quarterly evolution of the general consolidated budget expenditures still indicates a spending acceleration in the last quarter of the year, even with a superior pace compared to the previous year. Specifically, the total spending in Q4 2015 reached 80.3 billion lei, (compared with 70.83 billion lei in Q4 2014), being higher by 13.4% than the level recorded in previous quarter (while in the previous year the advance was 39.24%), and by 13.4% compared to Q4 2014. About 61% of the spending increase in Q4 2015 compared to the previous quarter was caused by the acceleration of capital spending that increased sharply (+168% compared to Q3), the expenses regarding the projects financed through non-reimbursable external funds (+162%), and for about 22% due to the increases in goods and services expenses (+39%) and personnel expenses (+11%).

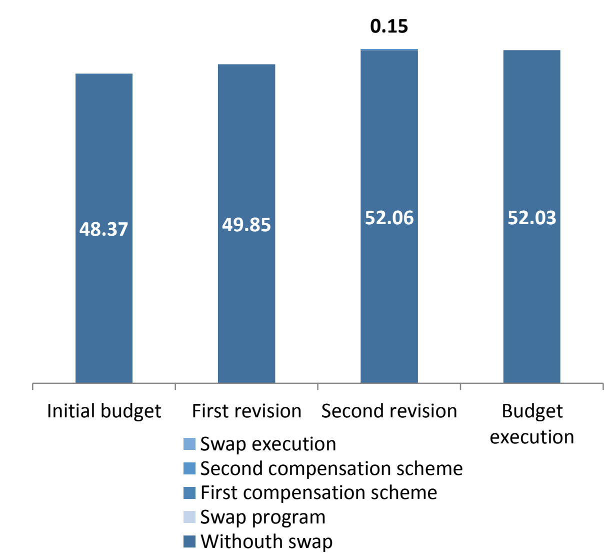
The expenditure concentration in the last quarter highlights serious weaknesses in the budgetary programming process although the principle of prudence might partial justify the postponement of some expenditure until the projection regarding the budgetary revenue has a lower degree of uncertainty. Fiscal Council recommends a lower quarterly volatility of the budgetary expenditures, which is otherwise the declared intention of the Government for the 2016 budgetary programming

III.4.1. Personnel and social assistance expenditure

The execution for the **personnel expenses** increased by 3.65 billion lei compared to the amount considered in the draft budget for 2015. Initially, estimated at a level of 48.37 billion lei, the execution for the personnel expenses accounted for 52.03 billion lei, respectively 7.30% of GDP, exceeding the ceiling considered for this category of expenditure (48.37 billion lei, respectively 6.8% of GDP) by 3.66 billion lei, respectively 0.50 pp of GDP.

This evolution is mainly explained by the decision to pay in advance the installment for 2016 for certain salary rights earned by court decisions, while payments were staggered in the period 2012-2016, and the wage increases for certain categories of personnel in the public sector, operated in the second half of the year. Thus, although initially the amounts on the account of the court decisions for 2014 totaled 2,600 million lei, these were supplemented by 1,503.4 million lei on the occasion of the second budget revision, the source of financing being the plus of revenues collected in the first half of the year, although it was forbidden by FRL, being a discretionary measure.

Figure 17: Personnel expenditure in 2015 (billion lei)



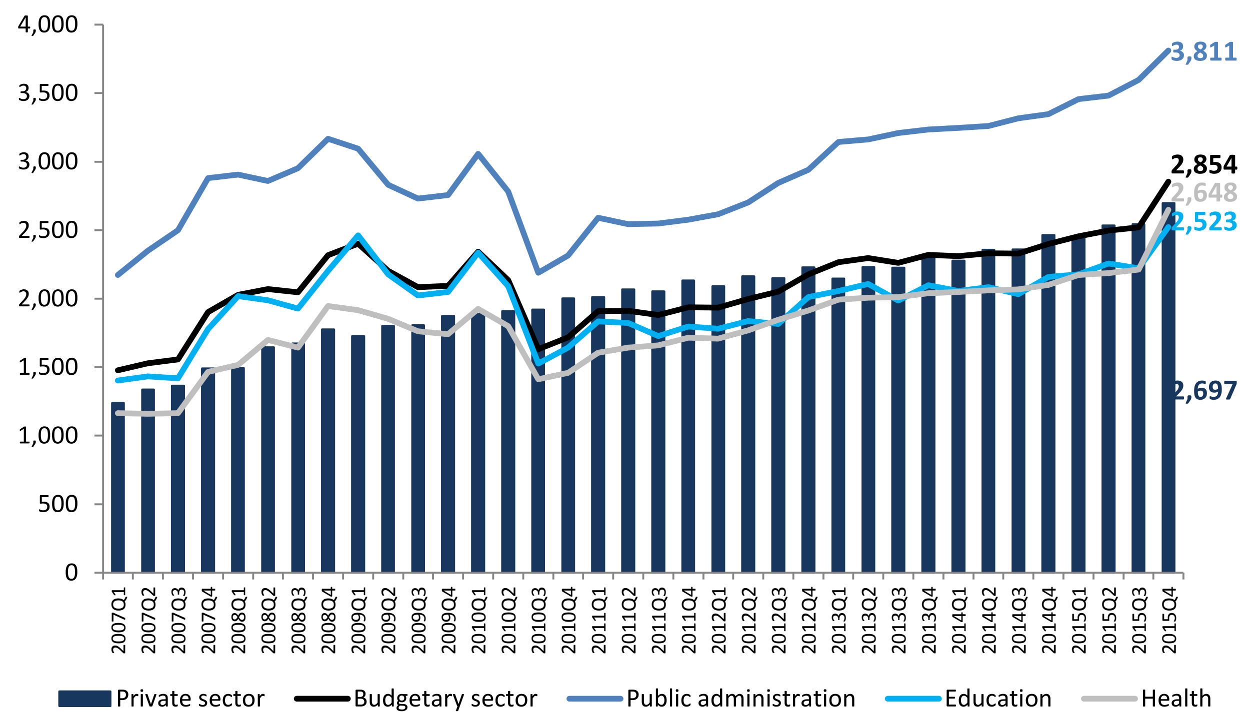
Source: MPF

Also, the increase in the wage bill (in total of 1,032.8 million lei) compared to the initial budget has been determined by the wage increases in the health sector by 25% from October 1st (311.2 million lei), the growth of salaries for the executive staff of the local authorities by 12% starting August, 1st (433 million lei), an increase of 12% for non-teaching staff from August, 1st (38.6 million lei) and the increase of the food norm in the defense and public order sector (250 million lei). Other differences were not explained by MPF on the occasions of the budget revisions.

Compared to 2014, the personnel expenses increased by 1.64 billion lei, respectively by 3.26%. In fact, this increase was much higher, being concealed by the reducing of SSC by 5 pp for the employer contribution from October 1st, 2014 that generated savings in the wage bill and by the lower amounts paid in 2015 compared to the previous year for certain salary rights earned by court decisions. Thus, although in 2015 the amounts paid for certain salary rights earned by court decisions for some categories of the personnel in the public sector were supplemented from 2.6 billion lei to 4.1 billion lei, the final amount is lower than that paid in 2014, of 4.6 billion lei (a difference of -496.6 million lei). The increase in the personnel expenses, net of the impact of the swap compensation schemes, of the payments corresponding to the court decisions and of the reduction in SSC paid by the employer by 5 pp, was by 8.17% compared to 2014.

Beyond the increases decided during the year, the draft budget included a series of increases in personnel expenditures of the state. Thus, in the health sector was foreseen a salary increase of 100 lei from January 1st, 2015, corresponding to an increase in expenses by 269.7 million lei, and in education sector (teachers and auxiliary staff) were specified increases by 5% from March 1st and 5% from September 1st, representing an increase of the expenditure summing 470.6 million lei. A positive influence is attributable to the minimum wage increase from 900 lei/month to 975 lei/month from January 1st, 2015 and to 1,050 lei/month starting July 1st, 2015, this measure having a budgetary impact of 654.3 million lei.

Figure 18: Average gross earnings in the private and public sector in the period (lei/month)

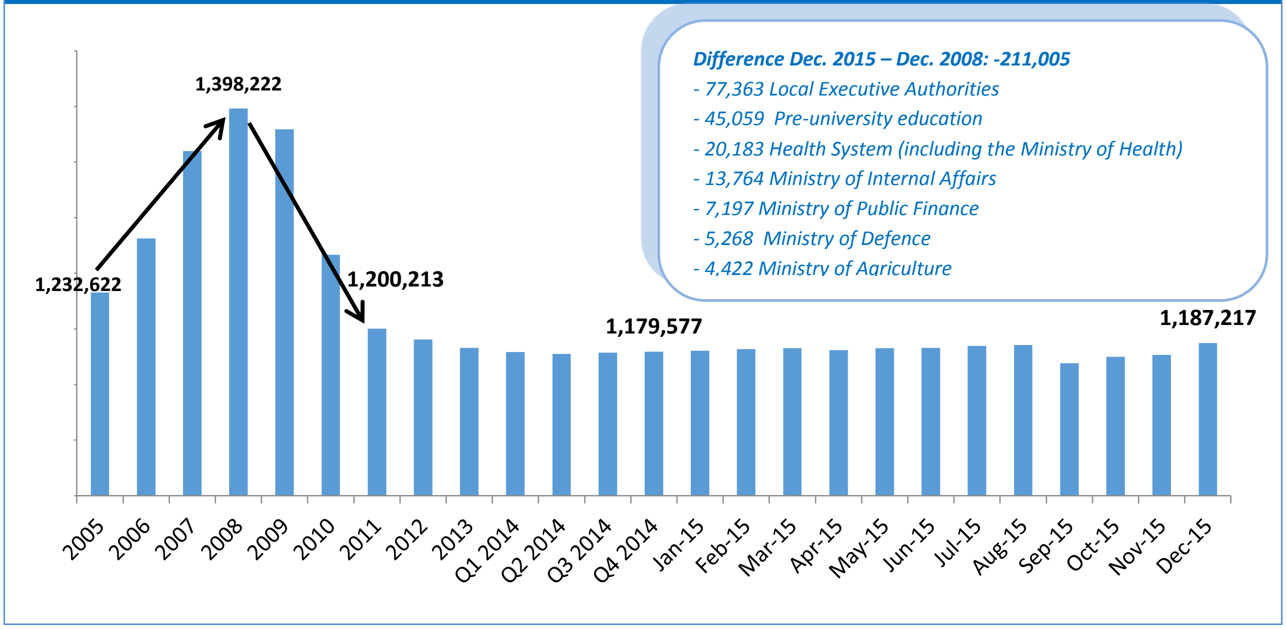


Source: NIS, Fiscal Council's calculations

Following these increases, the average annual salary in the public sector reached 2,582 lei, by 10.25% more than in 2014, surpassing the wage in the private sector amounting to 2,554 lei, by 8.01% over the previous year's level. Considering the quarterly average of the wage, in the fourth quarter of 2015 the wage in the public sector, registered a level of 2,854 lei, by 19.03% more than the same period in 2014, and in the private sector reached 2,697 lei, representing an increase of only 9.45%. In the public sector, although the highest growth occurred in the health and public assistance sector (an increase of 26% compared to the average wage in the fourth quarter of 2014), the highest average wage was registered in the public administration and defense sector (3,811 lei in the fourth quarter of 2015).

Subsequently of the increase by 165,600 persons registered in 2005-2008, the total number of employees in the government sector decreased by 211 005 people between December 2008 - December 2015, to a level of 1.19 million. (*Figure 19).* However, it should be noted that in 2015 there was a reversal of the trend of constant decline in the number of personnel registered in the previous years, as the number of occupied posts increased by 6,434 (+0.5%) compared to 2014, especially at the level of the local executive authorities (5,875 positions filled), the health system, including Ministry of Health (4,630 positions filled) and higher education units (795 positions filled), but also it decreased in pre-university education (-4,501 positions filled), Ministry of National Defense (-1,008 positions filled) and Ministry of Regional Development and Public Administration (-520 positions filled). Practically, most of the personnel reductions took place in the period 2009-2011, when the number of employees in the public sector declined by about 180,000, owing mainly to the introduction of the rule of "one new employee to 7 departures from the system" (applied until 2012, inclusively), whereas in the period 2012-2014 the reduction was approximately of 9,540 persons. The adjustment recorded in the period 2009-2015 took place principally at the level of local executive authorities (-77,363 positions filled), pre-university education (-45,059 positions filled), health system, including Ministry of Health (-20,183 positions filled), Ministry of Internal Affairs (-13,764 positions filled), Ministry of Public Finance (-7,172 positions filled) and Ministry of Agriculture (-4,422 positions filled). On the other hand, during the same period, increases were recorded at the Ministry of Justice (+2,716 positions filled), Ministry of Labour, Family and Social Protection and Elderly Persons (+1,544 positions filled), Ministry of Economy (+1,198 positions filled), public university education entities (+1,017 positions filled) and the Ministry of European Funds (+898 positions filled).

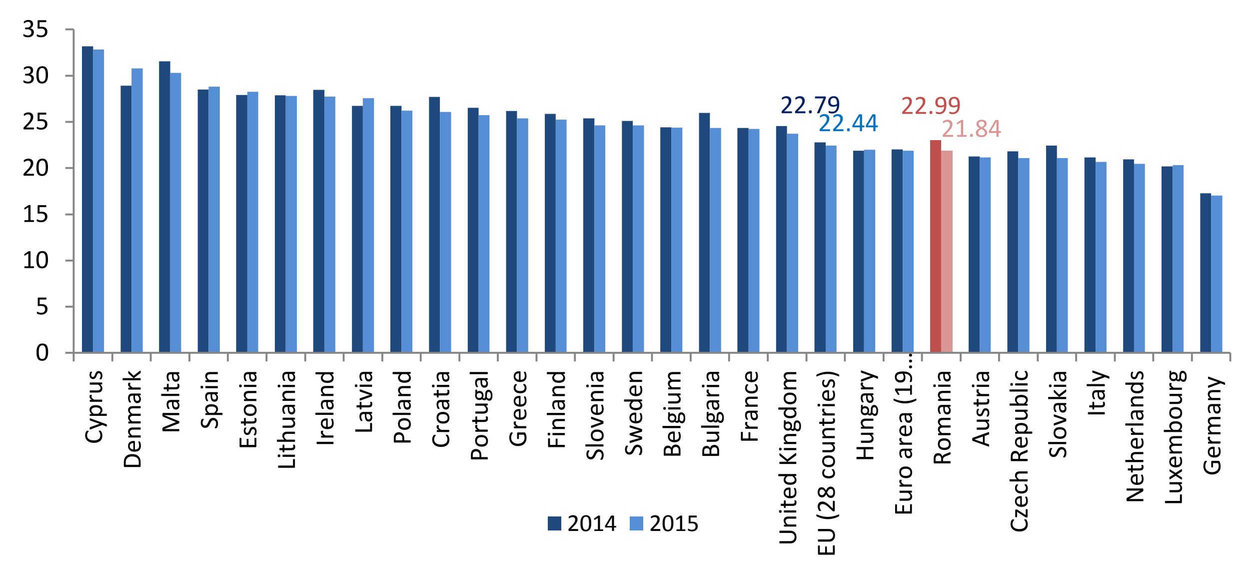
Figure 19: The evolution of the public sector employment in the period 2005-2015



Source: MPF

The adjustment made in the period 2009-2012 is mainly the result of applying the rule of "one new employee to 7 departures from the system" given that most of the exit from the system was achieved through voluntary dismissal or retirement. The abandonment of this rule starting from 2013 was intended to reduce the adverse selection and allowed some changes in the structure of the personnel. Thus, the reductions in the period 2009-2012 was achieved only to a small extent based on qualitative criteria, such as reducing personnel where it was identified a surplus of employees whereas hiring personnel in the sectors with personnel deficit on the basis of cost standards rigorously defined and thus establishing an optimum level of operation. The Fiscal Council considers this approach to be appropriate and recommends that the new appointments to be made in the identified sectors with personnel deficit, even by transfer of posts from the sectors with personnel surplus to the sectors with personnel deficit, also having in view the strict framing in the wage bill previously approved.

Figure 20: Wage bill as a share of total budget revenues in EU28 countries

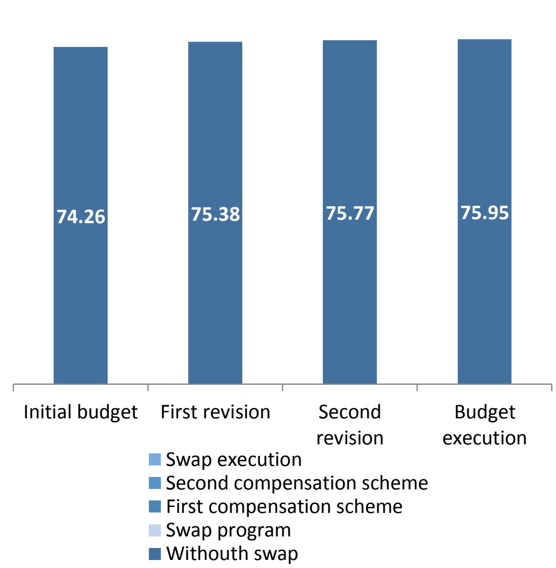


Source: Eurostat

Compared to other European Union's countries, Romania's position in terms of the wage bill in the public sector as a percentage of the total collected revenues, has improved due to the fiscal consolidation measures undertaken since mid-2010. If in 2010, the wage bill as a share of total budgetary revenues placed Romania in the first half of the ranking (on the 6th position out of 27 countries in 2008 and on the 10th position in 2010), in 2011 accordingly to ESA 2010 data, revealed a better ranking for our country, respectively 19th position out of 27 countries, following the 17th position in 2013, on the background of the recovery of wages and wage increases for some categories of state employees. In 2015, Romania is on the best position in the last decade, namely the 17th position out of 28 countries, due to a slight increase of the revenues to the budget and to preserving the share of the wage bill in GDP. Moreover, Romania registered a higher percentage of the wage bill in the public sector in the total revenues compared to similar economies such as the Czech Republic, or Slovakia.

The **social assistance** expenditures registered in 2015 a superior level compared to the projections of the initial budget, being revised upward during the two budgetary revisions. Estimated in the initial budget at a value of 74.26 billion lei, the level of social assistance expenditure, net of the compensation schemes, recorded a final value of 75.95 billion lei, by 2.21% (equivalent of about 1.7 billion lei) higher than the initial budget. Out of this amount, 900 million lei represents the budgetary impact of doubling child allowances from July 1st 2015, which was not taken into account in the initial program.

Figure 21: Social assistance expenditure in 2015 (billion lei)



Source: MPF

Compared to 2014, the social assistance expenditure increased by 6.66% (also due to the increase of the pension point indexation by 5% compared to 3.76% in the previous year), their share in GDP falling marginally (by 0.01 pp) respectively to a level of 10.65%, while nominal GDP advanced by 6.8%. The share of the social assistance expenditure in Romania is significant, however, and the problem of the structural deficit of the public pension system is not yet solved. In consequence, pension expenses are unsustainable in relation to the contributions collected, even if some measures were undertaken in order to improve this shortcoming in the medium and long run[33].

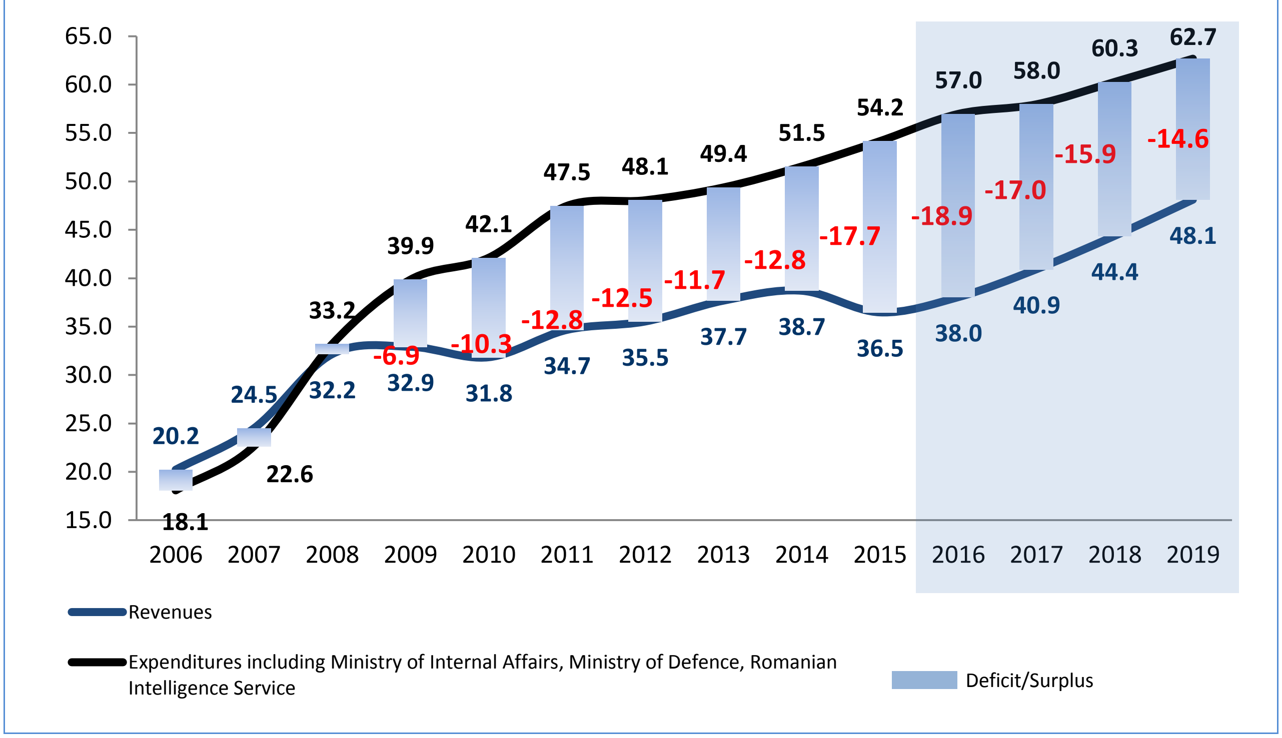
Since 2009, the deficit of the social security budget has widened significantly up to a value of 17.7 billion lei in 2015, and the estimated trend for the following years (2016-2019) shows an increase in 2016 up to -18.9 billion lei, followed by a deepening trend. It is worth mentioning that in 2015 has been a major widening of the SSC deficit, respectively of 4.9 billion lei, due to the measure regarding the reduction of the social security contributions paid by the employer by 5 pp from October 1st, 2014, despite the fast growth of wages and of the number of employees. Starting with 2016, it enters into force the abolishing of the compulsory SSC payment for the employer in the case of employees in police, army and special services in the context of the return to special pension system existing before 2010, that will determine diminished revenue from SSC by 936 million lei. Although the budgetary impact on GCB is

[33] The Law No. 263/2010 regarding the unitary system of public pensions modified the indexation system, increased the standard retirement age and introduced more stringent criteria for early retirement.

neutral, while the public sector will record savings of the same amount at the level of the personnel spending, regarding the state social insurance budget balance, the measure creates an additional deficit equal to the reduction of the SSC revenues.

In the next three years (2017, 2018, 2019) the deficit of the social insurance budget is estimated to come below the level recorded in 2015, expecting a deficit of -14.6 billion lei in 2019, mentioning that these values appear to be undervalued given the macroeconomic projections underlying the pension point indexation mechanism. From the perspective of the deficit as a percentage of GDP, the execution indicates a decrease from 2.3% in 2011 to 1.92% in 2014, followed by a new increase up to 2.48% in 2015. The estimates for future years indicate a slight increase in 2016 (2.51% of GDP) and a reduction starting with 2017 (2.12% of GDP), up to 1,86% of GDP in 2018 and to 1.59% in 2019. In essence, compared to the previous version of the Fiscal Council's Annual Report, the forecasted deficit for the period 2015-2018 diminished by about 13 billion lei, on average by 3,25 billion lei per year.

Figure 22: The evolution of revenues and expenditures of the social security budget (billion lei)



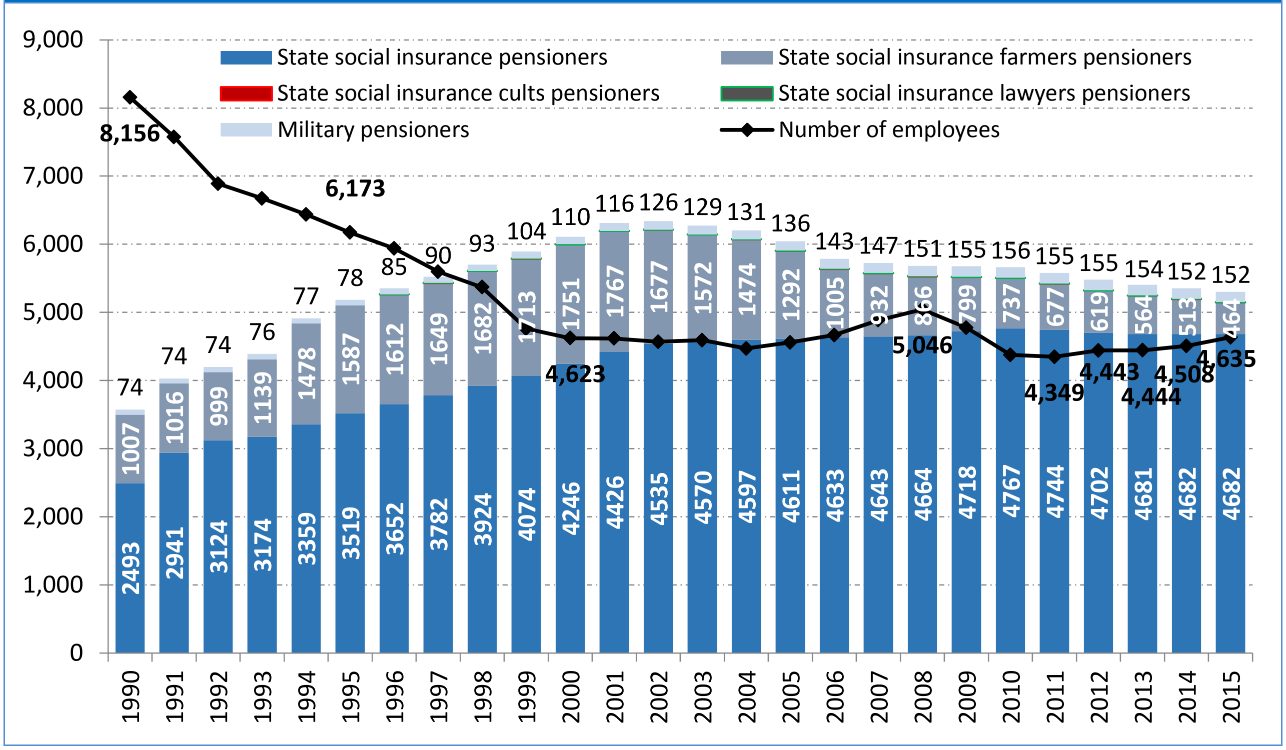
Source: MPF, cash standard data

Note: In addition to the spending of the state social insurance budget for the period 2016-2019 were included spending with military pensions. According to Law no. 223/2015 from 1 January 2016, the funds necessary to pay military pensions and other social insurance rights due to *military pensioners are provided from the state budget, through the budgets of the institutions: Ministry of Defense, Ministry of Internal Affairs, and Romanian Intelligence Service.*

The deficit of the state social insurance budget has occurred on the account of excessive social security budget expenditure in the period 2007-2009 (+75.8%) in the context of a favorable dynamics of the social contribution revenue during the period preceding the financial crisis as a result of the economic boom and also anticipating to maintain this trend in the future. Unfortunately, a significant share of the social contributions revenue augmentation has proven to be of cyclical nature, the further developments invalidating the optimistic forecasts that led to the significant increase of the pension point. Thus, the decision to increase certain permanent expenditures such as those related to pensions should take into account the trend of contributions revenues, as well as the forecasts regarding the employees-pensioner's ratio, especially in the context of amplified demographic aging, as, for instance, from 1st January 2015 the elderly population of 65 years and over outnumbered the young people of 0-14 years (3,419 thousand compare to 3,304 thousand) according to NIS. It also became evident the need to find an indexation rule to ensure long-term sustainability of social insurance budget instead of discretionary approach of the past. On revenue side, the measure regarding the reduction of the social security contributions paid by the employer by 5 pp from October 1st, 2014, contributed significantly to the widening of the pension system deficit, respectively by 7.75 billion lei in 2015.

The ratio between the number of contributors and the number of beneficiaries fell very sharply in the last 26 years, from 2.28 employees per retiring in 1990 to only 0.87 employees per retiring in 2015, the number of the state social insurance pensioners having an increasing trend, while the number of employees had a decreasing trend, especially until 1999-2000. However, in recent years, the ratio has improved from 0.77 employees per retiring in 2010 to 0.84 employees per retiring at the end of 2014, but placing in 2015 slightly below the level registered in 2008 (0.88).

Figure 23: The evolution of the number of pensioners versus the number of employees (thousands persons)



Source: NIS, less the number of employees for 2015 for which the source is NCEF, Winter Forecast 2016

A measure aiming to improve the medium and long term financial situation of the social insurance budget is the new pension law (Law no. 263/2010 on the unified public pension system, updated) through which it has been pursued a number of objectives designed to correct the imbalances recorded in the pension system and can support in long-term achieving this objective under the condition of legislative stability and the rigorous implementation of its provisions:

- decoupling the evolution of the pension point from the evolution of the nominal[34] wage, by indexing the pension point with 100% of the inflation rate, plus 50% (this percentage drops to 45% starting with 2021 and subsequently decreases by 5 pp per year until 2030, when it reaches 0%) of the real increase in gross average wages, achieved during the previous year;

[34] The value of a pension point as previously established by Law 19/2000 was updated by indexing with at least the inflation rate, but the pension point value could not be less than 37.5% of the gross average wage used for drafting the social security budget, starting 1st January 2008, respectively, not less than 45% of the gross average wage used for drafting the social security budget, starting with 1st January 2009.

- integration in the unified public pension system of the persons belonging to special systems (military pensions), as well as of the persons who obtain income from liberal professions;
- introduction of more stringent requirements regarding the access to early pension and to disability pension;
- calculating all pensions based on the contribution principle, respectively in a direct correlation with the level of the income for which social security contributions were paid;
- increase of the retirement age due to increased life expectancy of the population and the gradual equalization – until 2030 – of the complete contribution period for women and men.

Nevertheless, returning to the special pension system eliminated in 2010 and the emergence of new special pensions jeopardize the sustainability of reforms initiated earlier and could generate new pressures on social security budget deficit. The recently adopted laws introduce new rules, ensuring better conditions for early retirement and generous computing formulas based on the salary earned before retirement (instead of formulas based on contributions generally applied in the pension system, taking into account salaries earned during the entire career). It should be noted, however, that the unitary pension system currently applied provides better conditions for some categories of workers, in order to compensate for particularly risky working conditions and shorter occupations.

Thus, on 22 May 2015 it was approved the Law 85/2015 amending the Law no. 223/2007 regarding the status of civil aeronautical professional personnel in the civil aviation in Romania reestablishing the service pensions and stating that pilots and aircrew receive service pension amounting to 80% of average gross wage in the last 12 months of activity, preceding the month in which they demand for retirement. The Law 223/2015 (entering into force starting January, 1st, 2016) establishes military pension scheme[35], the main objective being the reconfirmation of military pensions system, considering the special status of the military, the soldiers, and gradation professionals, the police officers and other employees of the defense system, public order and national security. This change will basically imply the reoccurrence of the provisions of the Law no. 164/2001 regarding the military pensions which was repealed on the 1st January

[35] The pension calculation base is the average of all gross revenues of 6 consecutive months in the last 5 years of activity. On the average obtained it will be possible to add an increase of no more than 15%, and the amount of the pension is 80% of the calculation base. The law provides that pensions for military, police and officials with special status established under other laws being currently under payment for which recalculation are made, will remain the same, if the current one is higher than that resulting from the application of the new law, or it will increase if the new conditions are more favorable.

2011 with the entry into force of Law no. 263/2010 on the unitary public pension system. The necessary funds to pay military pensions and other social insurance rights due to military pensioners are provided from the state budget, through the budgets of the following institutions: Ministry of Defense, Ministry of Internal Affairs, and Romanian Intelligence Service.

Civil servants and employees of Parliament (Law 215/2015), as well as diplomatic and consular staff (Law 216/2015[36]) are also benefiting from the special pension legislation, both entered into force starting August, 21, 2015. The Law 215/2015 reintroduces increased pensions for employees of Parliament and stipulates that at the retirement age, these categories of employees with a contribution of 30 years, of which at least 14 years in the structures of Parliament, will receive service pensions amounting to 80% the average gross income in the last 12 months before retirement. In addition, employees with more than 14 years' seniority will receive 1% of the average income calculated for each additional year. For a period of 4-14 years in Parliament structures, service pension amount will be reduced by 1% for each year that missed from the seniority of 14 years, without exceeding the gross income at the date of retirement.

Another category of special pensions, is that for deputies and senators, introduced by the Law 357/2015 (into force starting January 28, 2016), that amended the Law no 96/2006 regarding the Statute of parliamentarian. The deputies and senators will be entitled, at the standard age for retirement or the reduced retirement age (according to Law no. 263/2010 on the unified public pension system) and after the exercise of their mandate to a monthly allowance[37] for parliamentary work, which will be based on the number of mandates, this indemnity applying also to those which no longer have the quality of parliamentarian.

Thus it can be noted that a reduction of the link between pension contributions and future accrued pension rights which has the potential to generate a negative impact on long-term sustainability of the pension system, especially since other professional groups will be also encouraged to push for the restoration/establishment of privileges.

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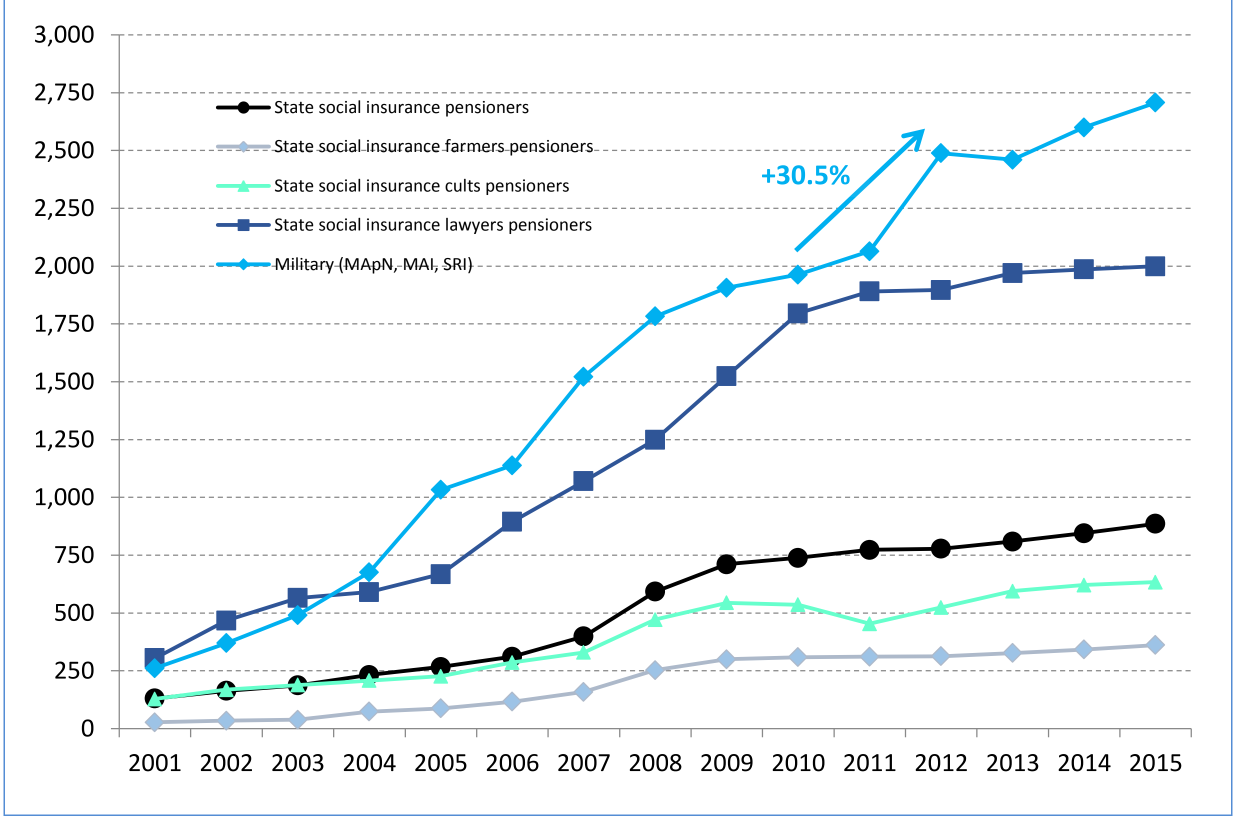
[36] Members of the Diplomatic and Consular Corpus of Romania with a seniority of at least 15 years in the Ministry of Foreign Affairs and the personnel of the specific execution functions can retire on demand and benefit at the age of 60 years of a special pension in amounting to 80% of the base representing gross monthly basic salary for the basic function held in central government, plus allowances and bonuses taken in the last month of activity in the central administration of the Ministry of Foreign Affairs before the date of retirement.

[37] The amount of the allowance is limited for 3 mandates and is the product obtained by multiplying the number of months of mandate allowance with 0.55% of monthly gross allowance realized in the previous month before the retirement request. For incomplete mandates, the allowance is calculated in proportion to the actual exercised mandate, but not less than 6 months of parliamentary activity.

Figure 24: The evolution of the average pension (lei) in the period 2001-2015

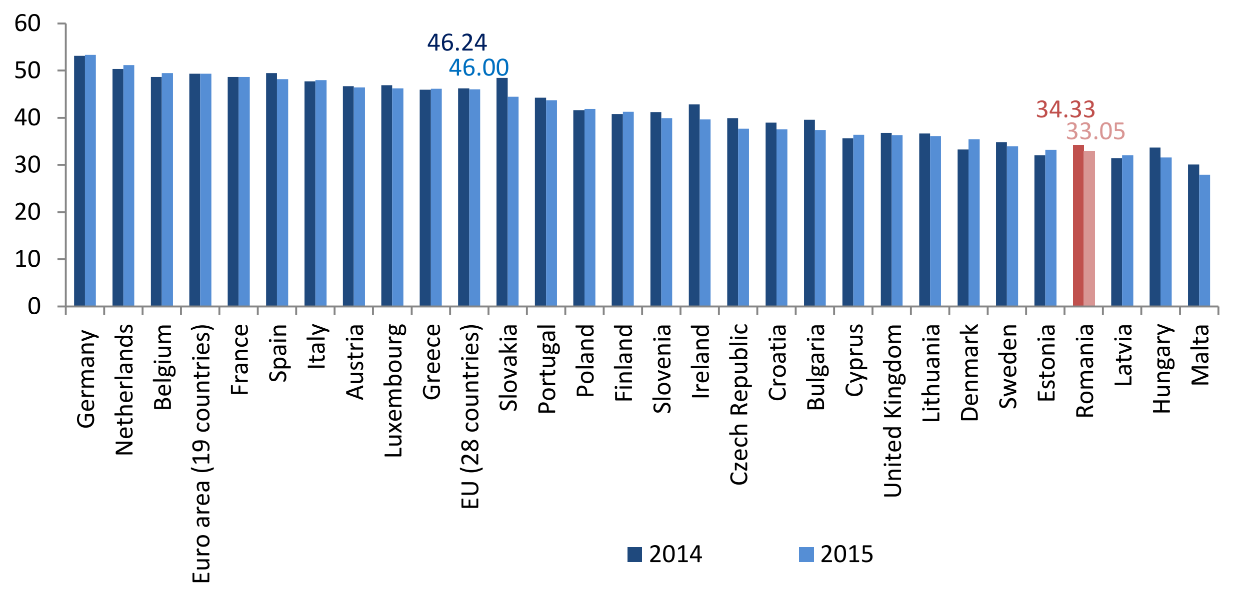


Source: NIS

According to NIS data, in 2015, the average monthly pension was 893 lei, higher by 5.43% over the previous year, as a result of the pension point indexation by 5%[38] respectively by 39.5 lei. Pensions paid from the social insurance budget were situated at an average level of 886 lei, while those for farmer's pensioners were on average 362 lei. However, military pensions reached a monthly average equal to 2,707 lei, by 4.11% more than in 2014. It is worth noting that the average monthly pension corresponding to beneficiaries from defense system, public order and national security increased by approximately 37.88% during 2010-2015, subsequently the recalculation according to Law no. 119/2010 and Government Emergency Ordinance no. 1/2011, even in the circumstances that the initial forecasts indicated a decline in the value of these pensions after applying the contribution principle.

[38] For 2015 the pension point, increase by 5% (respectively, the average inflation rate in 2014 plus 50% of the real growth of the average gross wage from the same year). Thus the pension point value increase in 2015 from 790.7 lei to 830.2 lei.

Figure 25: Social security expenditure as a share of total budgetary revenues in EU28



Source: Eurostat

In the year 2015 Romania dropped two places[39] compared to 2014 regarding the share of social security expenditures in total revenues, placing in the second half of the EU member states ranking. However, even this category of expenditure has a lower share in total budgetary revenues compared to the EU average, the social assistance expenditure registered a significantly higher level compared to the financing sources (especially in the case of the SSC).

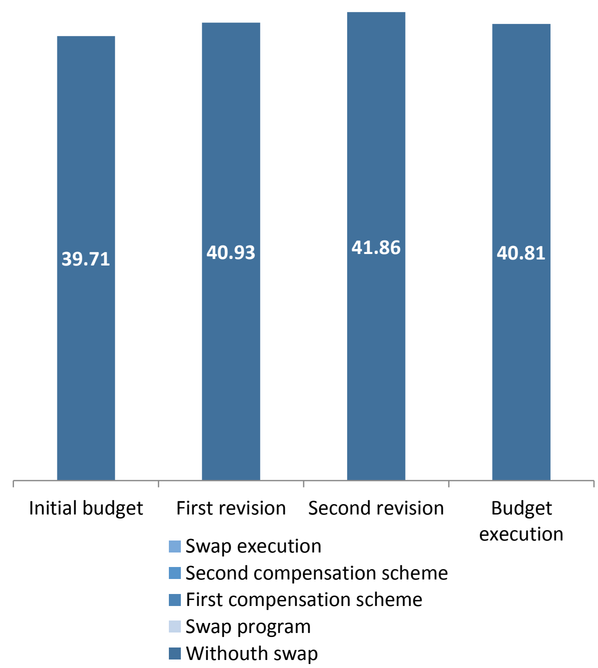
The Fiscal Council notes the manifestation of an obvious trend reversing the pension reforms designed to ensure long-term financial sustainability and pleads strongly in the favor of maintaining the progress made in recent years both in terms of the principles introduced (exclusive use of the principle of contribution in determining the pension value) and in terms of strict compliance with the pension's indexation mechanism as introduced by the new pension law.

[39]Placed on 25th position out of 28 countries.

III.4.2. Goods and services expenditures

The execution of **goods and services** expenditures registered a higher level than the one envisaged in the draft budget (+1.1 billion lei), being however lower than the value projected during the second budget amendment. Initially estimated at 39.7 billion lei, the final amount of this category of expenditure reached a level of 40.8 billion lei, namely 5.72% of GDP, lower by 0.13 pp compared to the year 2014. As can be seen from the figure, expenditures on goods and services were revised upwards during each budget amendment introduced in 2015, despite the fact that the increase in this area of expenditure, after the budget approval and without the operation of a reduction of the same amount in other budget expenditure, is prohibited by the FRL no. 69/2010 republished.

Figure 26: Goods and services expenditures in 2015 (billion lei)



Source: MPF

In the past, the additional spending at the level of this budgetary aggregate was justified by the use of the additional receipts from the clawback tax in the public health system, but since 2014 they have been included in the initial budget, and this argument cannot longer be invoked. Neither in 2015 the motivation for the changes made during the draft budget amendments was not explained by the Government in the substantiation notes accompanying the proposals for the budget revisions, the only reference being in the substantiation note attached to the second budget amendment, stating an additional allocation to the defense sector.

In the previous years, the estimates regarding the goods and services expenditure were increased during the budget amendments, this aggregate proving to be difficult to control: thus, in 2011-2013, the amount spent on goods and services constantly recorded levels higher than originally budgeted or even those already upward revised during budget amendments, beyond what could be explained by the impact of the compensation schemes for the outstanding payments of the budget, or the additional receipts from the clawback tax, while 2014- 2015 was characterized by a different situation, the final execution recording a lower level of spending compared to the last iteration of the budget.

Table 12: Evolution of goods and services expenditures in the period 2011-2015 (billion lei)									
	Fiscal Strategy	**Initial budget**	**First revision (without *swap*)**	**First compensation scheme**	**Second revision (without *swap*)**	**Second compensation scheme**	**Budget execution (without *swap*)**	**Budget execution (without *swap*) %GDP**	**Swap execution**
2011	28.54	28.62	29.32	0.00	29.98	0.13	31.64	5.6	0.13
2012	31.26	31.74	32.78	0.25	33.18	0.50	34.04	5.7	0.41
2013	33.88	37.25	39.27	0.50	38.52	1.00	38.30	6.0	0.28
2014	36.97	39.36	40.19	0.22	41.50*	0.28*	39.10	5.9	0.49
2015	39.71	39.71	40.93	0.00	41.86	0.00	40.81	5.7	0.00

Source: MPF

* *The amounts refer to the third revision.*

Compared to the previous year, in 2015 the goods and services expenditure net of the impact of compensation schemes grew by 4.5%, given the fact that the execution of this budgetary aggregate in 2014 was affected at the level of January by the implementation of the EU Directive 7/2011[40] on combating late payment in commercial transactions, the impact being 0.44 billion lei. Excluding the impact of this temporary factor, the increase in the goods and services expenditure is about 5.8% (+2.15 billion lei), inferior to the nominal GDP growth (+ 6.8%).

The Fiscal Council notes a chronic lack of transparency regarding the projection of this expenditure aggregate, the assumptions underlying this area of expenditure or the motivation for the major revisions made during the year not being explained in the documents accompanying the successive iterations of the budget. These explanations are even more necessary as there are some substantial changes with the potential to influence the achievement of the deficit target or the compliance with the fiscal rules. The Fiscal Council calls for a budgetary programming which should consider including all expenditures envisaged in this budget chapter within the draft budget along with a proper enunciation of the funds' destination, as well as comprehensive explanations during budget revisions regarding the sources of potential increases in this category of expenses. An additional transparency could be a good starting point in streamlining the goods and services expenditure, this being necessary to be accompanied by a comprehensive reform of the public procurement system in general.

[40] This states that *"contracts between firms should provide limited payment terms, as a general rule, at 60 calendar days"*. In addition, *"it should be provided specific rules regarding the commercial transactions for the supply of goods and services by enterprises to public authorities, rules to establish, in particular, payment terms that do not normally exceed 30 calendar days, unless the contract expressly provides otherwise, which must be objectively justified by the nature or by the specific features of the contract, but not exceeding, in any case, 60 calendar days "*.

III.4.3. Public investment expenditures

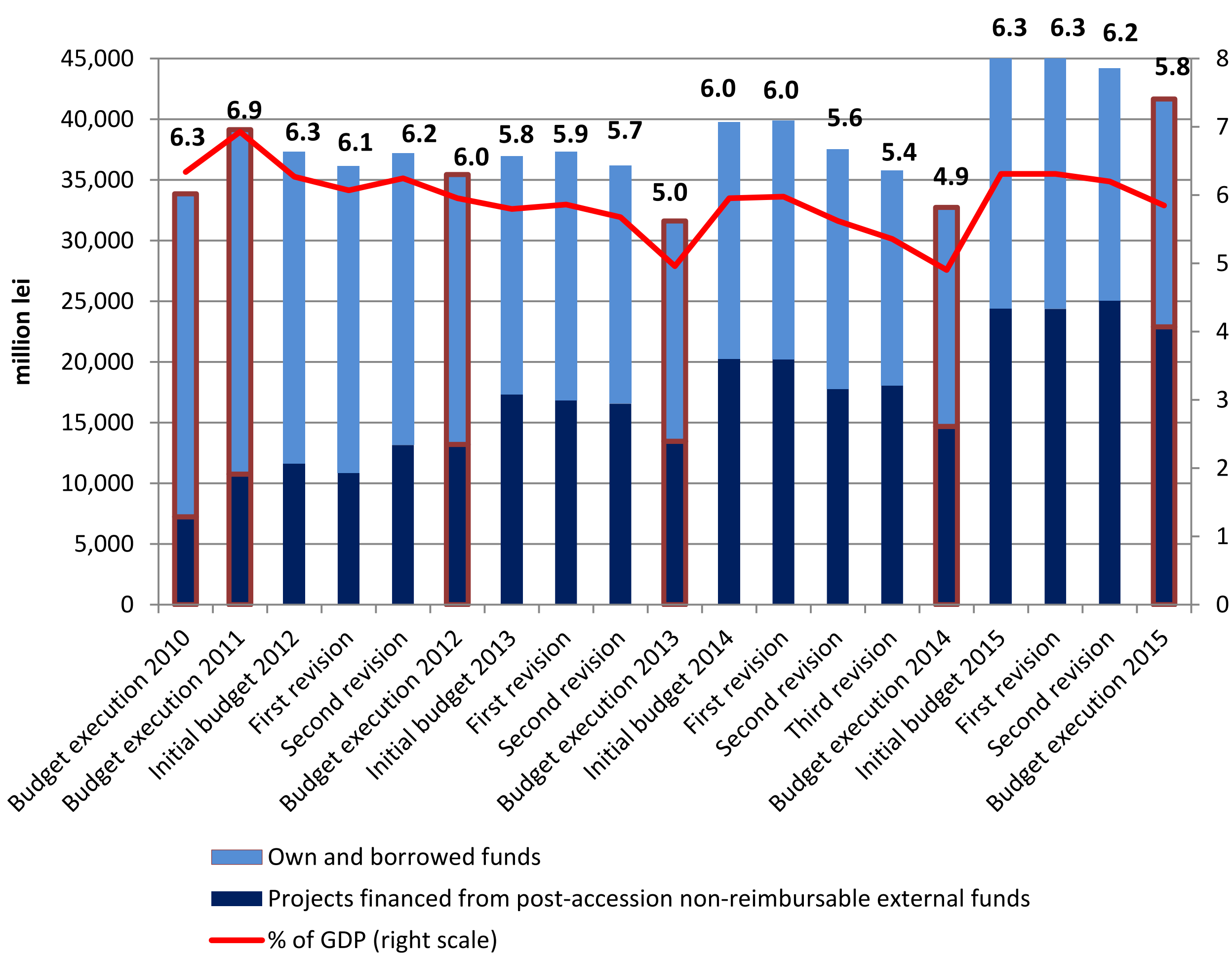
Investment expenses include, according to the budget classification, capital expenditures (non-financial assets), projects funded by external post-accession grants, expenditure for reimbursable programs, capital transfers and other transfers related to investments.

Compared to the previous year, in 2015, the public investment spending, considering all budget items of this category, including *swap* compensation schemes, increased in nominal terms by 27.3%, respectively from 32.7 billion lei to 42.7 billion lei in cash standards, while in real terms the growth rate in real terms being 23.7%[41], the share of public investment spending in GDP increased by 0.94 pp (from 4.90% to 5.85%). Compared to the previous 5 years' development, the execution of investment spending as percentage of GDP recorded in 2015 a level slightly above the average of the period 2010-2014 (5.82% of GDP), but well below the average of the years 2010-2012 (6.5% of GDP), compared to which registered a negative gap of 0,66 pp. It worth to notice that if in the years 2013-2014, the reduction of the investment spending actually represented a way of achieving the short-term fiscal targets, in 2015, the significant acceleration of investment spending was stimulated by the fact that this year was the last dead-line for attracting European funds for the financial framework 2007-2013. Moreover, according to the initial budget for 2016, the level of investment spending was programmed to reach only 37.7 billion lei, which means that 2015 is an investment peak for the period 2013-2016.

The analysis of the actual execution compared to the planned investment expenditures from the initial budget or established through revised budgets during 2012-2015 persistently reveals significant deviations, in the sense that the executions are invariably below the estimates of the initial and the revised budgets, as shown in the following graph.

[41] Using the GDP deflator as price index.

Figure 27: Investment expenditures in 2015 (million lei)



Source: MPF

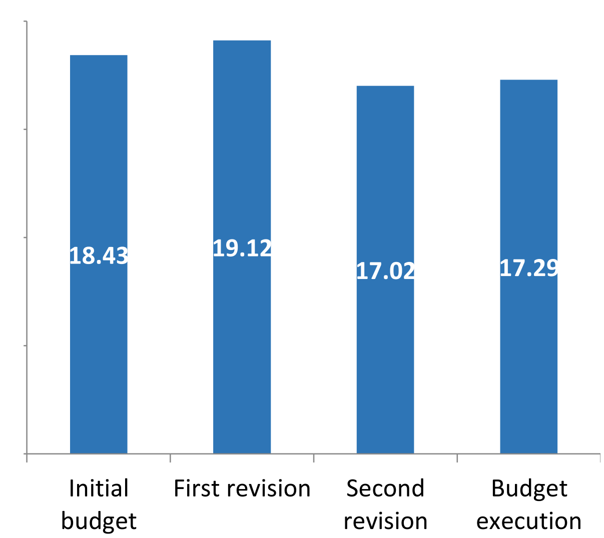
The 2015 budget was elaborated by preserving the same approach of the 2013-2014 period regarding the financing of investment spending with priority from non-reimbursable European funds, and thus limiting the allocations from the state budget. In this respect, for the 2015 budget it was envisaged a bigger share of the external sources (by increasing EU funds absorption) in the total investment expenditures, respectively, reducing the share of internal sources (capital expenditure), a correct and welcomed approach in the opinion of the Fiscal Council, thus freeing financing resources that could be used for fiscal consolidation or other purposes.

Nonetheless, the initial plan to substitute capital expenditures with non-reimbursable European funds functioned only partially also in 2015, even if the magnitude of the underachievement was lesser compared to 2014, investment spending being by 3.7 billion lei lower than the amount estimated in the initial budget for 2015 (respectively a gap expressed as share of GDP of 0.52 % of GDP, much lower than the gap of 1.05% of GDP registered in the previous year).

As well in 2015, the quarterly evolution of the investment spending shows a concentration in the last quarter (54.3% of the total year) and more, even in the last month of the year, which put into question the effectiveness of the budgetary programming both in terms of the management of investment projects and of defining their importance and utility. Specifically, in the last quarter the investment spending was about by 3.6 times more than the average of the three previous quarters, and by 1.5 times superior to the estimated level for this quarter according to the updated program at the end of the year, which highlights serious deficiencies in programming this budgetary aggregate characterized by an extremely high volatility of the quarterly distribution of the programmed spending compared to the actual ones. Thus, analyzing the evolution of the difference between the quarterly programming and execution, it is noted that this was more noticeable in the first half of the year (a ratio of the quarterly execution over the program below 30% in the first quarter and 37% in the second quarter, reaching 79% in the third quarter of 2015), in line with the developments of the ratio of the quarterly execution over the program for the projects funded by external post-accession funds.

In 2015, the capital expenditure[42] were projected in the initial budget at a higher level (by 1.8 billion lei) compared with the actual spending from the previous year, but the final execution registered a decrease of the capital expenditures by 1.1 billion lei compared to the initially programmed level (-6.2%), respectively, by about 676 million lei more than in 2014 (+4.1%).

Figure 28: Capital expenditures in 2015 (billion lei)



Source: MPF

The projects financed by post-accession external funds, although in an accelerated rise compared to 2014 (+8.2 billion lei) had a development below the expectations, being lower than the level projected in the initial budget (-1.5 billion lei, respectively a gap of -0.21% of GDP), and representing together with the underachievement of the capital expenditure the cause of the underperformance of the investment spending related to the initial program. Even if this under-execution had no

[42] Representing the main component of the capital expenditure (that also include capital transfers and stocks).

impact on the deficit, as the decline of investment projects implied savings in terms of co-financing and ineligible expenditure, the failure in reaching the programmed level for the European funds in this year induces negative effects on economic growth both in terms of direct effects (the reduction of public investment) as well as propagated effects, but moreover regarding the final disengagement of these funds for the period 2007-2013. Missing the target for the projects funded by external post-accession grants is correlated with the EU funds absorption rate, for which the underachievement of the revenues in 2015 compared to the initial budget accounted for -1.8 billion lei (-0.25 % of GDP).

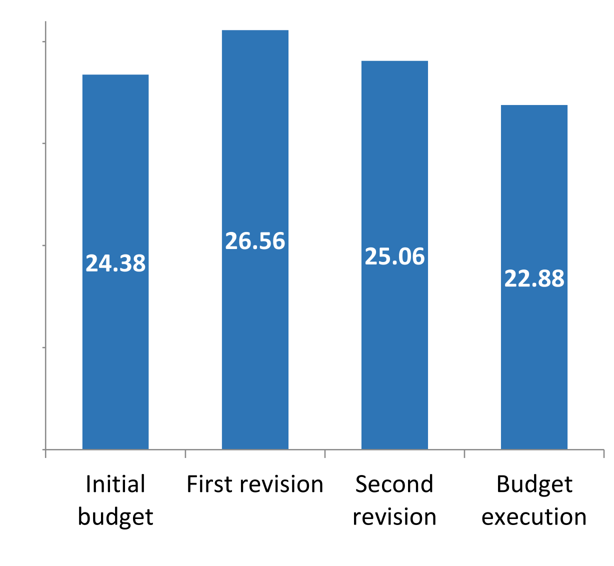
Expenditure regarding the projects funded by reimbursable programs that have a very small share in the total investment spending were below both the level in the previous year (by 136 million lei, respectively by -22.9%), and of the initial budget projection, respectively by 341 million lei (representing only 57.1% of the program).

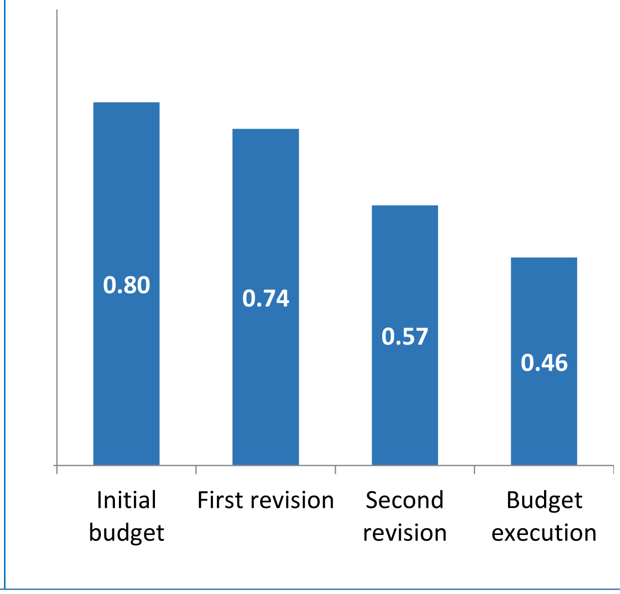
In fact, the EC assessment of the progress achieved in 2015[43] stated, similarly with the previous year's report, that the implementation of the project financed by structural funds still faces serious challenges, so that public investment, especially in energy and infrastructure, is lagging behind, the major projects being delayed or postponed according to the electoral cycle or other political factors, so that continued to hamper foreign investment and Romania's economic sustainable growth[44].

[43] *Country Report Romania 2015 Including an In-Depth Review on the prevention and correction of macroeconomic imbalances*, EC, Brussels, 26.2.2016 SWD (2016) 91 final.

[44] The contribution of investment to potential growth is crucial, ensuring a non-inflationary economic growth and counterbalance the expansionary fiscal policy.

Figure 29: Projects funded by external post-accession grants in 2015 (billion lei)	Figure 30: Expenditure funded from reimbursable funds in 2015 (billion lei)





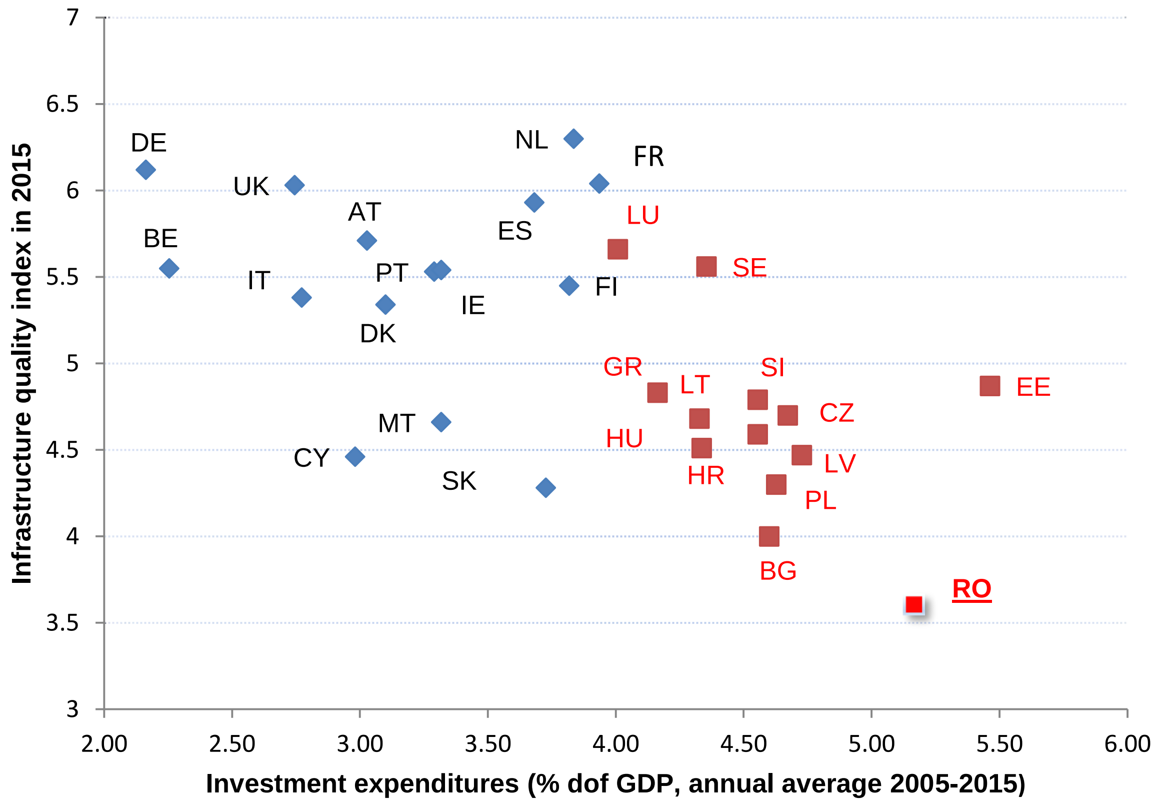
Source: MPF

From another perspective, considering the average spending for public investment as a share of in GDP over the last decade, Romania ranked second among EU member states (after Estonia), while in terms of the share of public investment in total budget revenues Romania ranked first, but the infrastructure quality places our country on the last position within the same group of countries. Thus, according to the Global Competitiveness Report 2015-2016 Romania is ranked on the 91th position[45] (out of 140 countries) in terms of the overall quality of infrastructure, respectively on the 120th position[46] (out of 140 countries) regarding the quality of roads.

[45] A lower position compared with the assessment in Global Competitiveness Report 2014-2015 (place 88/144).

[46] Compared with the position 121/144 from the previous Report.

Figure 31: Public investment expenditures and infrastructure quality



Source: EUROSTAT, World Competitiveness Report 2015-2016

In the case of Romania, there are high efficiency reserves regarding the use of public funds allocated to investments and the Government had initiated during 2013 - March 2014 a reform of the public investment management[47]. In this respect, it was signed a technical assistance contract with the World Bank for the project "*Improvement of Public Investment Management*", aiming at improving the process of preparation, selection and strategic prioritization of the public investments projects, that was ended in December 2015, following that in 2016 the recommendations for improving the selection process of the investment

[47] In accordance with the requirements of the new legal framework, prior to approving the budget, the MPF is obliged to present to the Government the list of prioritized significant public investment projects to be financed through the state budget, which are selected according to opportunity, economic and social justification, financial affordability, period remaining until the completion of Romania's commitments to international financial institutions.

projects and strengthening the role of the Public Investment Unit will be implemented by amending the legislation (GEO 88/2013[48] and GD 225/2014)

For the year 2015 we consider that no improvements were made regarding the communication of the achievements in this area, the list with the prioritized investment projects being made public only at the beginning of 2016 (22 February) on the MPF website, at the chapter " Transparency in public investment projects " related to the 2016 State Budget Law, which included updated information at December 2015 for the list[49] of the 120 projects valued above 100 million lei. The data indicate that most projects are in an advanced stage, having an achievement degree of over 75 %, frequently being located in the transport sector.

The Fiscal Council advocates for the effective application of the legal framework of the public investment management and notes that some progress was made regarding the reform of the public investment management, the transparency of the prioritization process being in an early stage, similar with the efficiency of the allocation and spending of public money for the strategic public investments. Moreover, as highlighted in the Progress Report of the EC, selecting and prioritizing public investment projects is fragmented (at the level of line ministries, local authorities or public institutions (National Company for National Highways and Roads in Romania) and even if centralized at the MPF – the *Unit of evaluation public investment*'s role is only formal, as long as this unit does not act based on the power to assess strategic coherence, cannot reject proposals or to monitor progress in order to propose appropriate policy proposals on changing the funding decision in relation to the performance of the projects. Moreover, considering the developments from 2012-2015, although the sharp descending trend in investment spending was stopped in 2015, on the account of a faster pace in the absorption of European funds for the financial framework 2007-2013 compared to the previous years, it was maintained the under-execution pattern of their execution compared with initial annual planning, which reflects not only an easy way to achieve fiscal consolidation, but seems to reflect an administrative inability to perform the planned investment projects, especially in the case of those funded by external grants.

[48] It was amended in May 2015 in order to align the process of prioritization of the significant projects with the budget calendar.

[49] The priority list includes data related to the present value, the physical stage, the value stage, the completion date and the budget allocations in 2016, according to State Budget Law.

III.4.4. The contingency reserve fund and the intervention fund at Government's disposal

According to the Public Finance Law no. 500/2002, article 30 paragraph (2), the **contingency reserve fund at the Government's disposal** is allocated to line credit officers from state government and local governments, based on Government decisions, for the financing of "urgent or unforeseen expenditures" incurred during the budgetary exercise. The legal framework provided by the Law no. 500/2002 specifies only in general terms the allowed allocations from the contingency reserve fund (respectively for "unexpected or urgent" situations) without explicitly specifying the categories of expenses that can be undertaken from this fund or the allocations amount, thus providing space for discretionary and non-transparent allocations. Moreover, both the Fiscal Council and the Court of Accounts have repeatedly called for the legislative clarification of the allocations' allowed destinations and their manner of use, but these demarches have not changed the legal framework in the desired direction.

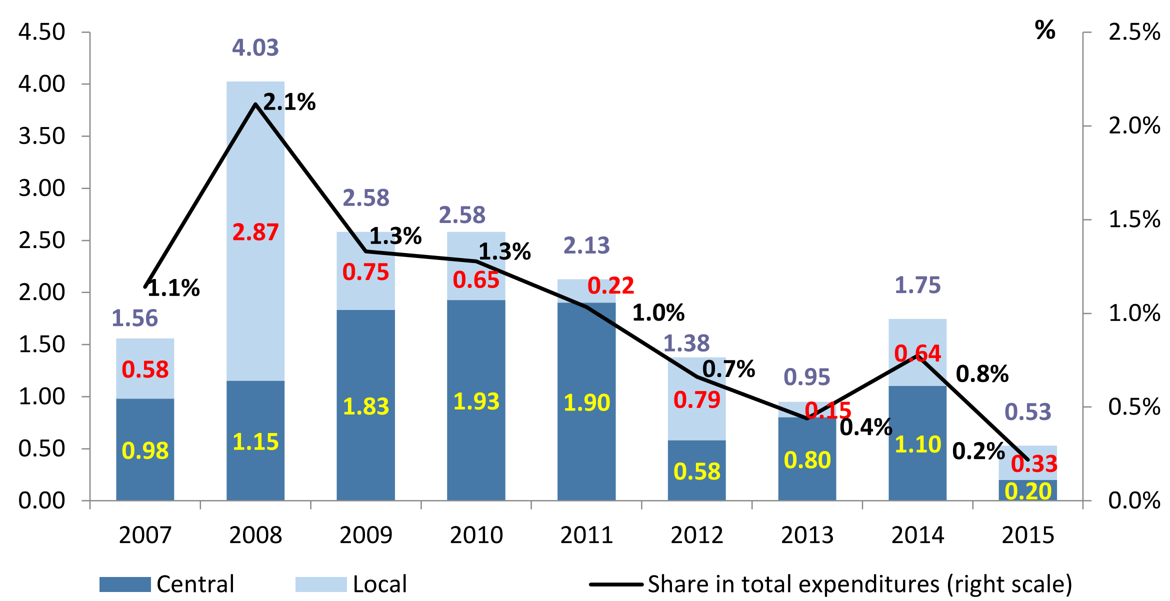
During the recent years, the Government issued a series of emergency ordinances which established the use of money from the contingency reserve fund beyond the framework enforced by the Public Finances Law no. 500/2002, respectively for spending that cannot be classified as urgent or unforeseen expenditures. **For instance, although the reduction of arrears or the payment of enforceable titles represent valid objectives, they should be included in the draft budget or during budget revisions at the corresponding expenditure items, and they should not affect the contingency reserve fund.**

The utility of a contingency reserve fund lies in the flexibility given to the Government regarding the annual budget execution, particularly for covering urgent or unforeseen expenditures. The opportunity of including a contingency reserve fund into the general budget is confirmed by the literature on budget programming, which also highlights the necessity of finding a balance regarding the dimension of such a fund. Thus, a too low level of the contingency reserve fund might be insufficient to cover unforeseen expenditures, while an oversized fund might grant too much power for the authorities to make excessive outlays, without the Parliament's approval.

The Court of Accounts, in its Public Report for the year 2014, identified the following problems regarding the use of the contingency reserve fund: oversizing budgets during the budgetary programming, (especially those for "General actions" of the MPF, the amounts not spent creating the premises for their use in supplementing the contingency reserve fund), the creation of a mechanism by which from the contingency reserve fund at the Government's disposal are allocated sums to line credit officers for uses that cannot be classified as "urgent or unforeseen expenditures incurred during the budgetary exercise", by issuing simple ordinances or emergency ordinances approving derogations from the art.30 para (2) of the Public Finances Law no. 500/2002, thus repeatedly supplementing the line credit officers' spending from the contingency reserve fund. Thereby, the contingency reserve fund was increased by around 15 times in 2014 compared to the initial budget, by allocating significant amounts for uses that cannot be classified as "urgent or unforeseen expenditures". The Court of Accounts recommended a higher degree of responsibility both for the line credit officers and for the MPF's general departments involved in the elaboration of the MPF's budget - General Actions and the amending of the Law 273/2006 on local public finances by including an explicit definition of "urgent or unforeseen expenditures" and to define clearly and unambiguously the "situations of extreme difficulty".

This report studies the use of the contingency reserve fund at the Government's disposal during 2015, based on the Government decisions published in Romania's Official Journal by which are allocated amounts to line credit officers and to specific destinations. The complete list of the Government decisions is presented in *Annex 1*.

Figure 32: Total contingency reserve fund allocations (billion lei)



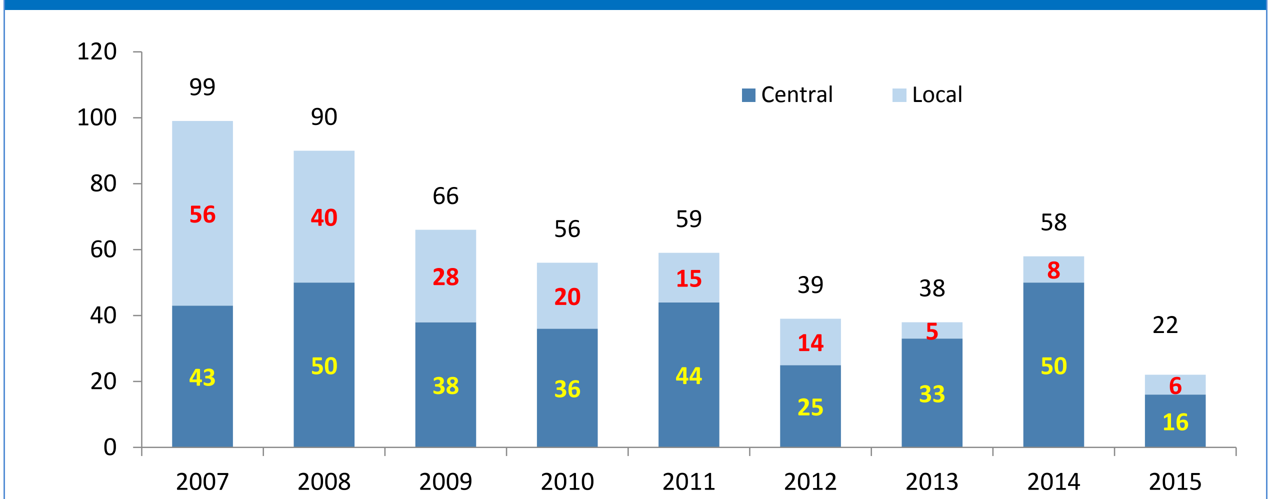
Source: Fiscal Council's calculations based on Government decisions regarding the contingency reserve fund allocations

In 2015 there were allocated from the contingency reserve fund approximately 528.1 million lei (0.2% of the total spending), of which about 201.8 million lei to the central administration and 326.3 million lei to the local authorities. Compared to the initial allocations, the contingency reserve fund was increased by 527.5 million lei. Compared to the previous year, **the allocations**

from the contingency reserve fund have been reduced by 1217.8 million lei, respectively by 69.75%, on the account of decreasing the transfers to the local authorities by 901 million lei, while the amounts directed to the central administration were lesser with 316.7 million lei.

In 2015 it can be noticed an improvement of the contingency reserve fund use compared to the previous year, that indicates the return to the trend registered in the 2009-2013 period, **in terms of reducing both the amounts spent** and the number of Government decisions promoted in order to allocate money from the contingency reserve fund which reached the minimum of the analyzed period. This reversal of significant magnitude compared to the situation in the previous year can be explained by the fact that 2014 was an election year. Instead, the tendency of the preceding years to employ most spending from the contingency reserve fund in the last month of the year was maintained, but unlike in the previous years, when the sums allocated from it were not necessarily those established during successive iterations of the GCB, their source being represented by the unspent funds allocated at the level of the line credit officers, in 2015 significant amounts were allocated for this specific purpose during the budget revisions (up to 992.1 million lei). However, the budgetary execution for 2015 represent only 53% of the level set by the second budget amendment, while the allocations from the contingency reserve fund in December 2015 compared to same month of the previous year decreased by 56.2% and, respectively, by 44% compared to December 2013.

Figure 33: Number of Government decisions regarding contingency reserve fund allocations

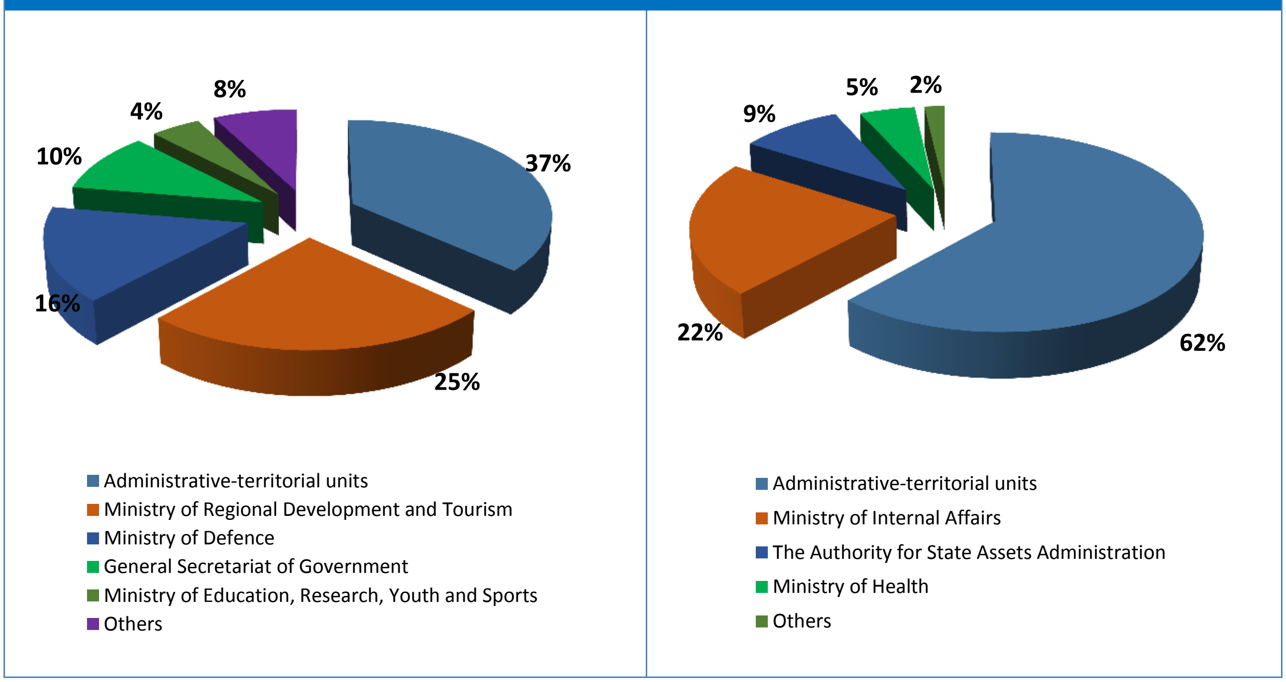


Source: Fiscal Council's calculations based on Government decisions regarding the contingency reserve fund allocations

From the perspective of the destinations for the allocations from the contingency reserve fund at the Government disposal, in 2015, they were mainly directed to the local authorities (62% of total). The central authority received 38% of the total, the main beneficiaries being the Ministry of Internal Affairs that received 22% of the total, the Authority for State Assets Administration with a share of 9% of the total and the Ministry of Health with a share of 5% of total allocations from the contingency reserve fund. Comparing the shares of the amounts allocated from the contingency reserve fund in the last two years (as shown in *Figure 34*) it can be underlined that the main beneficiary in 2015 is represented by the local authorities that received 326 million lei, while, in 2014, this funds were directed mainly towards the central authority (1102.8 million lei or 63% of total), the local authorities benefiting from allocations from the contingency reserve fund in an amount of 640 million lei (37% of total).

Figure 34: The Beneficiaries of allocations from the contingency reserve fund (% of total allocations)

2014 | **2015**



Source: Fiscal Council's calculations based on Government decisions regarding contingency reserve fund allocations

Based on the analyses elaborated in the previous years regarding the manner of using the amounts from the contingency reserve fund, the Fiscal Council revealed the lack of transparency in terms of their utilization, the nonexistence of explicit identification criteria of the expenditure that can be made from the contingency reserve fund, the absence of a Parliamentary or of other institution's control of the money utilization and formulated strong recommendations regarding amending the legislation that regulates the contingency reserve fund use. Nevertheless, in 2015 the same pattern was maintained, in the sense that the initial spending as approved by the Parliament was modified during the fiscal year by using the amounts not spent by some line credit officers for supplementing the contingency reserve fund, and moreover, by a massive increase of this fund on the occasion of the second budgetary amendment, operated with 2 months before the end of the fiscal year. The amount initially approved by the Parliament is permanently modified during the budgetary year, this situation being possible as a result of the expansion of the reserve fund by cancelling budgetary credits from some of the authorizing officers. This practice makes it more difficult to track the amounts spent from the contingency reserve fund and constitutes an additional argument for the discretionary nature of the formation and utilization of this fund.

Considering the international best practices in the field and the Court of Accounts conclusions, the Fiscal Council considers as absolutely necessary the implementation of urgent measures to amend the legislation that regulates the contingency reserve fund use, reiterating the recommendation on the explicit identification of expenditure that can be made from the contingency reserve fund and a higher transparency, including through reporting on a regular basis to the Parliament about the use of this fund. Thus, detailing the contingency reserve fund allocations, presenting the conditions and the criteria of allocations and a breakdown between line credit officers are required. The Fiscal Council also recommends limiting the amounts that can be assigned and used from this fund as a share of total budgetary expenses, a level of 1% being apparently adequate for the *urgent expenses,* given the previous developments. Moreover, the contingency reserve fund application should be accompanied by an increase in transparency – possible by implementing the principles outlined in the IMF Manual on Fiscal Transparency.

According to the article 30, paragraph (4) of the Public Finance Law no. 500/2002, the intervention reserve fund at Government's disposal is allocated, based on government decisions, to line credit officers of the state budget and local budgets, to finance urgent expenditures designed to eliminate the effects of natural disasters and to support the individuals affected. If the possible destinations of the allocations from the contingency reserve fund can be interpreted differently, in the case of the intervention fund, the allocations' destinations are clearly indicated in the law, the existence of such a fund being fully justified. During a year, this fund may be increased by allocations from the contingency reserve fund, depending on the needs regarding the amounts that are necessary for the removal of the effects of natural disasters. In 2015, the amounts allocated from the intervention reserve fund at Government's disposal amounted 2.4 million lei, their destinations being in accordance with the Public Finance Law no. 500/2002.

III.5. The Public Debt

The interest expenses decreased in 2015 by 630 million lei (respectively with 6.2%) compared to 2014, their share in GDP decreasing from 1.53% to 1.34%, in the conditions of a 6.8% nominal GDP advance. This development can be explained by the significant decrease in financing costs recorded in 2014, which continued in 2015, while the full manifestation of this effect on interest expenses will take place in time, as debt issued in the past will reach maturity and will be refinanced at the more favorable current costs. The final value of this expenditure chapter was lower than projected in the original budget by 1,144 million lei (0.16% of GDP) suggesting an overvaluation of this budgetary aggregate at the moment of drafting the budget given that the interest expenses can be predicted with a high degree of accuracy for the next calendar year.

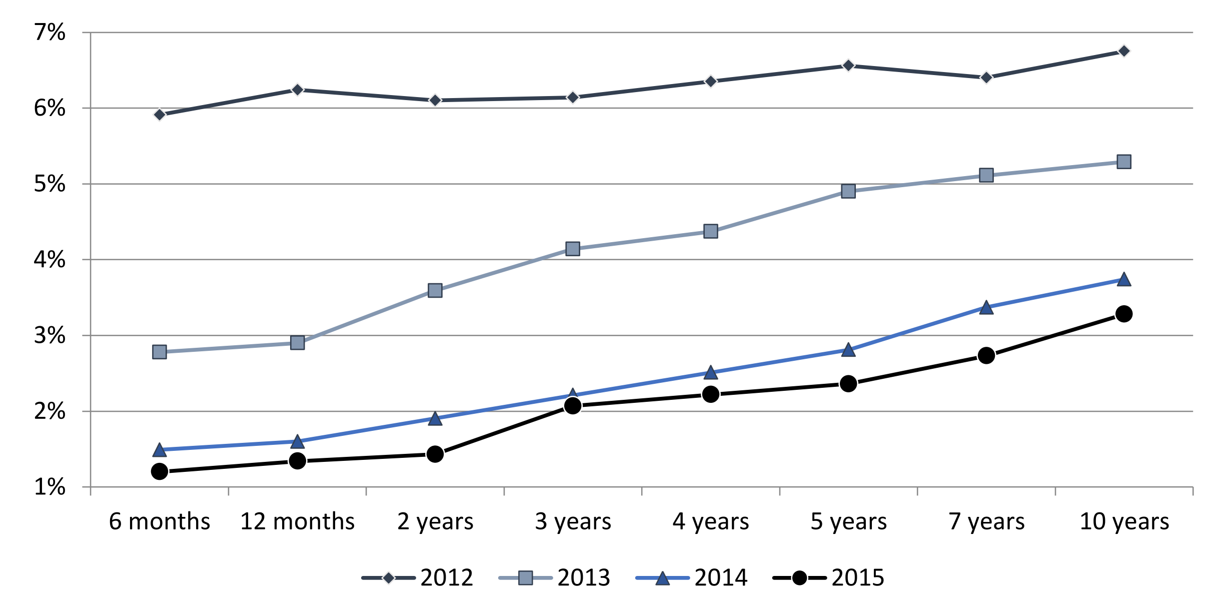
The public debt decreased in 2015, its share in GDP decreasing, according to ESA 2010 methodology, to 38.4%[50] from 39.8% at the end of 2014, as a result of recording a primary surplus, a strong economic growth and a reduction in real terms of the interest paid for contracting loans. In addition, the reduction by 3.79 billion lei of the buffer designed for protection against the manifestation of adverse conditions in the financial markets has also contributed to the decrease of the public debt as a share of GDP. The role of this buffer is to provide in advance the financing needs and according to the Convergence Programme 2016-2019, the Government plans to secure in advance the necessary needs for a period of at least 4 months, the Fiscal Council considering this approach as being prudent and appropriate. According to national standards, the public debt decreased to 42% of GDP at the end of 2015, compared to 42.1% in 2014.

The average interest rate paid on public debt declined from 4.5% in 2014 to 4% in 2015, and this decline should continue in the coming years given the much lower current expenses for debt refinancing and the relatively low average maturity of the public debt. The cost of attracting new resources in national currency registered a positive development in 2013-2015, the government bonds yields dropping significantly compared to the level of about 6% at the end of 2012, due to the inclusion, starting with July 2014, of bonds issued by the Romanian State in the calculation of the GBI-EM Global Diversified index series by JP Morgan, as well as due to reducing the financing needs of the Romanian state as a result of a significant reduction of the budget deficit and the extension of the average maturity of public debt, due to loose monetary policy measures adopted by the central bank, to obtaining of a BBB- rating from

[50] GDP for 2015: 712,832.3 million lei.

Standard & Poor's in May 2014[51], but also due to a liquidity surplus in the financial markets. Considering the conditions at the end of 2015, a decline in bond yields can be observed for short-terms maturities (less than 1 year) at about 1.2% from 1.49% a year before, as well as for those with longer-term maturities, financing costs for a tenor of 5 years decreased to 2.36% from 2.81%, while the interest rate for 10-year state loans decreased to 3.28% from 3.74% recorded at end of 2014. Regarding the cost of attracting new resources in foreign currency from the external markets[52], the state was able to finance itself cheaper in 2015 compared to 2014 for the issuances of the government bonds denominated in euro, the yields obtained for a maturity of 10 years were 2.84% compared to the level of 3.7% in April, or 2.97% in October 2014.

Figure 35: The evolution of financing costs in national currency in the period 2012-2015



Source: NBR

The central administration debt[53] represented at the end of 2015 94.7% of the total public debt, compared to 95% in 2014, while local debt represented only 5.26%, slightly increasing from the level of 5% registered in the previous year. Government bonds have the largest share in total debt, cumulating 34.6% of the total (compared to 34.8% in 2014), followed by euro-bonds with

[51] Some investors have restrictions on investing in sovereign debt of countries that are not classified in the category of those recommended for investment.

[52] In October 2015, Romania attracted on foreign markets 2 billion euros over a period of 10 years and 1.25 billion euros with a maturity of 20 years

[53] According to the national methodology.

23.7% (compared to 22.7% in 2014), state loans which represents 22.4% (compared to 25.4% in 2014) and treasury bills that provided 2.9% of total public debt financing (compared to 3.7% in 2014). Thus, two trends can be noted in the management of public debt: on the one hand, a higher proportion of maturing debt is refinanced through financial markets and on the other hand the attracted amounts from external markets experienced a significant increase in the desire to diversify the sources of funding, but also in the condition of the limited capacity to domestically absorb new debt.

Regarding the maturity structure of government securities newly issued in 2015, the trend of attracting longer-terms resources initiated in the last years did not continue. Therefore, the treasury bills with maturities lower than 1 year totals approximately 32% of new loans in 2015, increasing compared to the share of 29% recorded last year. Under these conditions, the average residual maturity of government securities issued on domestic market decreased in 2015, compared to 2014 (to 3.68 years from 4.24 years). However, share of funding over longer periods has advanced compared to the period 2009-2012 (the share of treasury bills with maturities lower than 1 year totaled 65% of new loans in 2009), while the bonds with maturities longer than 1 year accumulating 68% of the new loans. The preference in the last years of the state for funding longer-term yields was favored both by lower yields, excess liquidity in the financial markets as well as an improved risk perception regarding Romania.

The debt structure by currencies revealed an increase in the share of loans in national currency to 49.5% in 2015 from 45% in 2014, while the euro financing registered a decrease to 41% of total in 2015, from about 45% in 2014, the declared intention for the next period of Ministry of Public Finance being to increase the amounts attracted in national currency from domestic market. In 2015, the state didn’t contracted loans from the U.S. market, but the share of debt denominated in U.S. dollars was located at the level recorded in 2014, i.e. about 9% of the total government debt, under the significant appreciation of the US dollar in 2015.

In order to forecast the future evolution of the public debt in the coming years, its dynamic as a share of GDP can be expressed by the following formula, derived from the budget identity.

$$\boldsymbol{\frac{d_t}{y_t} = (1 + \lambda_t) \times \frac{d_{t-1}}{y_{t-1}} + \frac{pb_t}{y_t} + sfa_t}$$

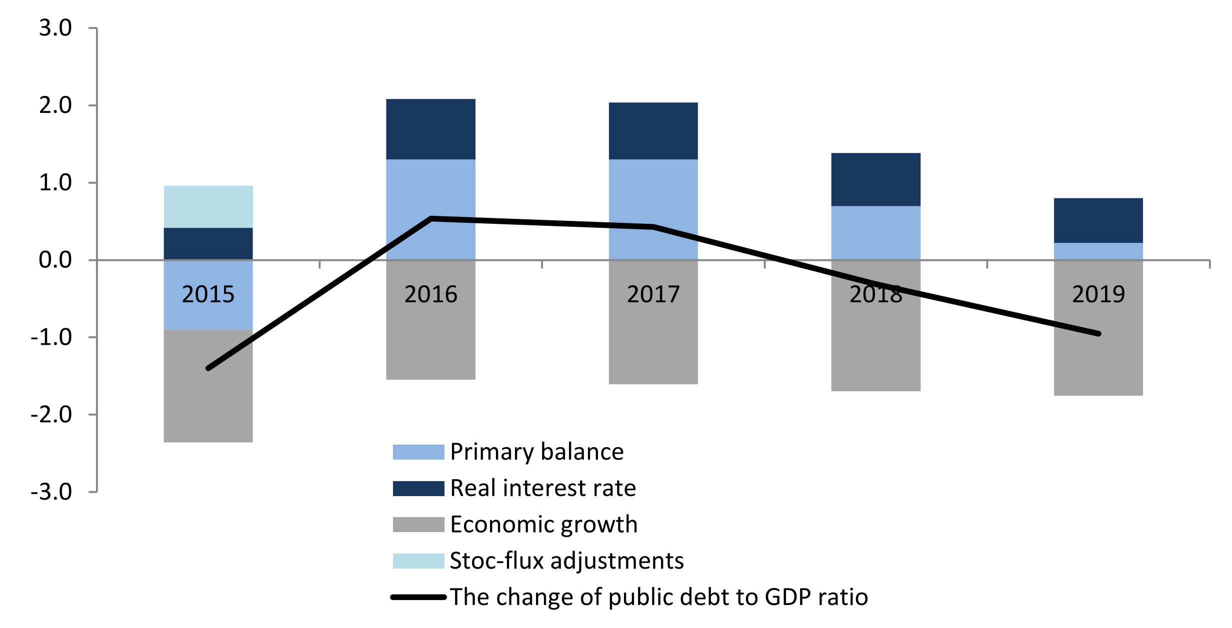
Where d_t is public debt stock at time t, y_t represents nominal GDP at time t, pb_t – is primary deficit at time t, sfa_t - stock-flow adjustments at time t, and

$$1 + \lambda_t = \frac{1 + i_t}{(1 + \pi_t) * (1 + \gamma_t)}$$

Where γ_t - real GDP growth rate during time t, i_t – interest rate at time t and π_t - inflation rate at time t.

The above relationship shows that public debt as share of GDP at time t depends on its weight in the previous period adjusted by the difference between the real interest rate and the economic growth rate, plus the consolidated general budget primary deficit expressed as percentage of GDP. In case of a real economic growth rate higher than the real interest rate for the public debt, the latter, expressed as a percentage of GDP, will have a downward trend even when the primary deficit equals to 0. It is therefore possible to reduce public debt as a percentage of GDP even when the primary balance registers a primary surplus lower than the interest expenditure provided that the real economic growth is higher than the real interest rate of public debt. The coefficient λ_t can be seen as a real interest rate adjusted by the economic growth.

Figure 36: Contributions to changes in public debt as share of GDP in the period 2015-2019



Source: NCEF, MPF, Fiscal Council's calculations

Analyzing contributions to the public debt variation as share of GDP of -1.4 pp in 2015, favorable contributions can be observed, respectively a decrease trend of share of real economic growth (-1.46 pp), inflation (-1.08 pp) and primary surplus (-0.9 pp), while real interest rates contributed to an increase in the debt to GDP by 0.42 pp, in the same direction acting also the stock-flow adjustment, respectively with a contribution of 0.5 pp. Regarding the latter factor, while lowering buffer by 3.79 billion lei would have led to a positive contribution on the dynamics of debt as a share of GDP, this influence has been canceled by the amounts extra borrowed for funding EU projects given that, although significant amounts have already been recorded as being income, they have not been actually received, which required contracting bridge loans until the actual receipt of funds. This influence should be a temporary one, and as the amounts are received, this element would help to reduce public debt. The contribution of this factor was 7.8 billion lei, while amounts absorbed from EU funds experienced a peak in the previous year. Also, an unfavorable influence (1.3 billion lei) on the level of public debt has been exercised by depreciation of the RON against the US dollar by 12.5% considering the parity at the end of 2015 compared to the one from the same period of the previous year, this factor being found also at the level of stock-flow adjustment. It should also be noted that the economic growth of 3.8% registered in 2015 was higher than the real interest rate of 1.09%, which involved a negative value for the coefficient λ_t that being a favorable development in terms of the dynamics of public debt as share of GDP.

Using Government's official forecasts[54] for the determinants of the trajectory of public debt and assuming for the period 2016-2019 a stock-flow adjustment equal to zero, we calculated their contributions to the public debt variation as a share of GDP between 2016 and 2019. In the period 2016-2019, according to the baseline scenario, the share of public debt in GDP is projected to be close to the level recorded in 2015, the value of this indicator being projected to be 38.1% of GDP at the end of period, given that there are recorded high economic growth rates, respectively of about 4.4% in average per year, that will be offset by high budgetary deficits (estimated at 2.9% of GDP in 2016 and 2017, 2.3% of GDP in 2018 and 1.6% of GDP in 2019) due to fiscal loosening measures contained in the new Fiscal Code as well as other expenditure increases contained in the draft budget for 2016. It should also be noted that Government's estimates regarding the budgetary balance in 2017 of -2.9% of GDP differs significantly from those of the EC, that expects a deficit of 3.4% of GDP given a no fiscal policy change scenario, while significant fiscal consolidation envisaged for the period 2018-2019 totaling 1.3 pp of GDP in the government's forecast is not accompanied by concrete measures to support it. In their absence, public debt will be placed on an increasing trajectory, even with a sustained economic growth anticipated for the next years.

The above results depend to a large extent on the forecasts used for the real interest rate and for the real GDP growth rate. A higher-than-expected real interest rate would involve additional costs for public debt financing and may lead to an increased public debt as share of GDP. Furthermore, a lower economic growth rate may cause an increase in the public debt ratio to GDP compared to the initial forecasts. Considering the uncertainty associated to the forecasts, a sensitivity analysis is appropriate in order to assess the impact of changes in the variables used for assessing the development of the public debt.

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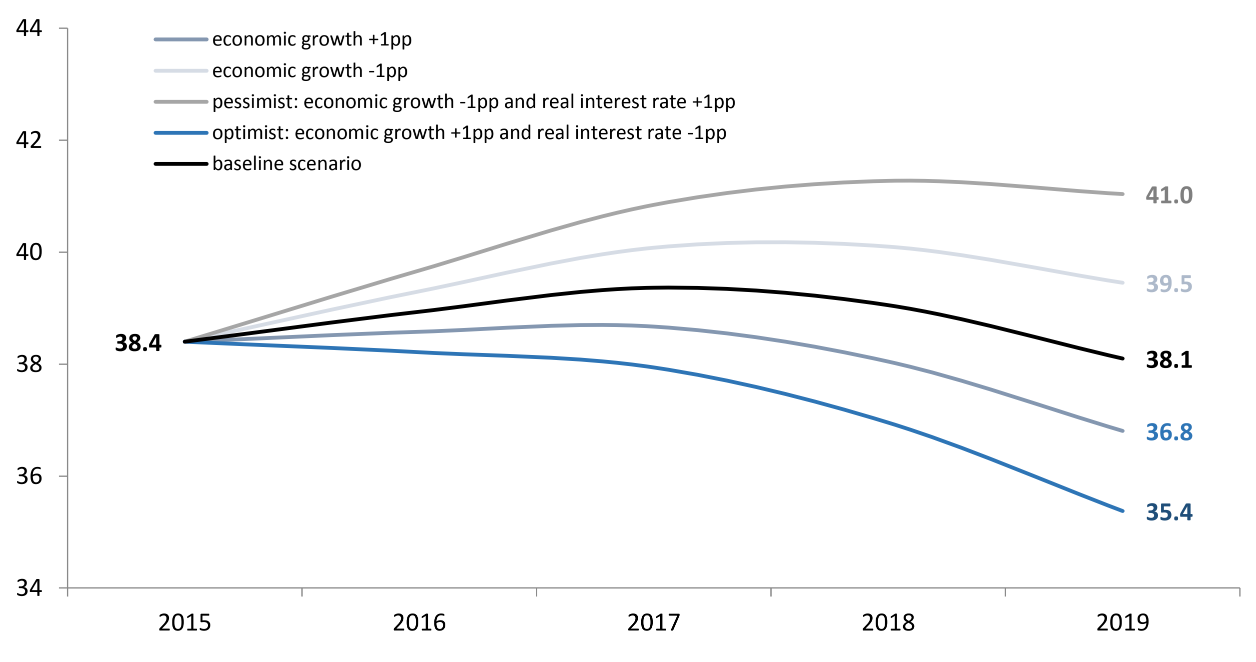
[54]Respectively those from the Convergence Programme 2016-2019.

Figure 37: Scenarios for the evolution of public debt (% of GDP)



According to the baseline scenario, the public debt will stabilize during 2016-2019 at around 39% of GDP, reaching at the end of the period a lower value of 38.1% of GDP, supported by the decline of the budgetary deficit starting with 2018. In an optimistic scenario, characterized by an economic growth higher than projected by 1 pp and a real interest rate lower by the same amount, a reduction in the public debt down to 35.4% of GDP will be observed in 2019. On the other hand, if considering a pessimistic scenario, according to which the real GDP growth rate decreases by 1 pp, in conjunction with an increased real interest rate by 1 pp, the public debt as a share of GDP will reach a level of 41% - a lower level, but relatively close to the threshold of 45%, defined by the Fiscal Responsibility Law no. 69/2010 with subsequent amendments.

The aforementioned Law was amended at the end of 2013, one of the changes being represented by the introduction of the public debt thresholds which trigger actions from the Government. Thus, if the public debt exceeds 45% of GDP, the Ministry of Public Finance presents to the Government a report to justify the debt increase and presents proposals to maintain this indicator at a sustainable level; if the public debt exceeds 50% of GDP, the Government shall freeze the total expenditures for the public sector wages and eventually adopts additional measures to reduce the public debt; if the indicator is above 55% of GDP the total social assistance expenditures of the public sector will be automatically frozen. All these new provisions are aimed at preventing the situation in which the public debt would exceed the 60% of GDP threshold, stipulated in the Maastricht Treaty.

Stabilization of public debt around a sustainable level in the medium and long term is an important objective of national fiscal policy, which joins the European economic governance framework. EC, in the country report published in 2016, warns Romania about debt sustainability in the medium term, forecasting a debt of 60% in 2026 in the baseline scenario, assuming a constant structural deficit of 2.3% of GDP from 2017 to 2026, which can be registered under an unchanged fiscal policy.

The Fiscal Council considers that the next period corresponding with the upturn in the economic cycle should be used to reduce indebtedness, as the current trajectory of the public debt development as share in GDP could lead to an excessive accumulation of vulnerabilities that would become fully visible in a future descending phase of the economic cycle. The rapid growth of GDP obscures in a large extent the increase in public debt as share of GDP, vulnerabilities having the potential to be quickly revealed in the context of adverse cyclical developments. In addition, further increasing public debt above 40% of GDP could become problematic given the current level of economic development and the limited capacity of local financial markets to absorb it.

IV. The absorption of EU funds

In **the period 2007-2013**, as it appears from data provided by the Ministry of European Funds (MEF), Romania has been allocated structural and cohesion EU funds amounting to 19.06 billion euro to which is added 13.8 billion euro in the Common Agricultural Policy. Coordinated through the EU cohesion policy, the cohesion and structural funds are financial instruments (Cohesion Fund – CF, European Regional Development Fund – ERDF, European Social Fund - ESF), designed to eliminate economic and social disparities between regions, supporting the convergence of member countries, increasing competitiveness and employment. Considering these aspects, this report examines the absorption of EU funds in Romania considering only the structural and cohesion funds.

Considering the obligation of Member States to contribute to achieving Europe 2020 strategy objectives, each country draws up a National Reform Programme (NRP) which transposes the EU's overall objectives into national targets and which is transmitted together with the Stability and Convergence Programme, both programs being integrated into the national budgetary plans for the next three years. Each Member State is faced with different economic circumstances and implements the overall objectives of EU in national targets by national reform programs, a document containing policies and measures in support of smart, sustainable and inclusive growth, high levels of employment and achieving the targets set by the Europe 2020 strategy.

In the 2015 NRP submitted by Romania to the European Commission in April 2015, there are defined the reforms and development priorities for a period of 12 months, taking into account the priorities set out in the Annual Growth Survey 2015, the Country Report's recommendations for Romania in 2015 and the measures taken in the context of the Europe 2020 strategy. The Plan of priority measures for strengthening the capacity of absorption of the structural instruments 2007-2013 and the European structural and investment funds 2014-2020, agreed by the EC, was implemented during 2015, aiming at two sections, facilitating the access to the European structural and investment funds in the 2014-2020 programming period and increasing the absorption capacity of structural and cohesion funds for the financial framework 2007-2013.

According to the 2016 NRP, this Plan of priority measures has resulted in ensuring the necessary amounts for the payment of reimbursement claims submitted by beneficiaries and preventing the loss of significant funds by December 31, 2015 as a result of automatic disengagement by the EC (the situation of disengagements is presented in *Table 13*) by temporarily allocating certain amounts from privatization income to the line credit officers with role of Management Authority, amounting 10.55 billion lei, the phasing of 80 infrastructure projects, mostly in the environment and transport sectors aiming to complete them in the 2014-2020 programming period, the identification of retrospective financing projects under the 2007-2013 operational programs and the continued use of international technical expertise by developing technical assistance projects with WB, EBRD and EIB.

Table 13: Automatic decommitments situation at 31st December 2015 (million EUR)	
Regional Development	263
Environment	669
Transport	211
Competitiveness	429
Human Resources	692
Administrative Capacity Development	5
Technical Assistance	27
Total	**2,296**

Source: MEF (press conference of 4 February 2016)

Note: The values represent the target for the n+3 rule at 1st January 2015 (mil. euro), annual disengagement for the major projects considered.

The closing calendar of the operational programs 2007-2013[55] includes three stages: by December 31, 2015 - the deadline for the eligibility of the expenditure incurred by beneficiaries; by June 30, 2016, the MEF must submit to the EC and the Audit Authority the last application for interim payment; by March, 31 2017, Romania must submit to the EC, through the SFC 2007[56], the payment application of the final balance and the final statement of expenditure, this being the final deadline by which the EU funds can be received based on the eligible expenditure related to the programming period 2007-2013.

Although efforts have been made, Romania's capacity to absorb European structural funds remains low. Romania has absorbed slightly above two thirds of the total funds allocated under the 2007-2013 programming period (69.91% in January 2016).

In 2014, the EC revealed several factors that contributed to maintaining the lowest rate of absorption of EU funds in Romania, pointing out that they may have a negative impact on the preparations for the new generation of programs and their execution:

- insufficient administrative capacity to manage programs and projects;

[55] According to Government Decision 678/2015 on the closure of operational programs financed during 2007-2013 through the European Regional Development Fund, the European Social Fund, the CF and the European Fisheries Fund.

[56] System for Fund Management in the European Community for the period 2007-2013.

- poor coordination between ministries, the factors responsible for sectoral policies and funds management institutions;
- precarity of the management and control systems and practices in public procurement.

In addition to these elements, the EU Council Recommendations of July 8, 2014 on the National Reform Programme 2014 of Romania were also identified as having a negative impact:

- the strategic planning and priority setting in the government policies, and the lack of multi-annual budgetary planning in ministries with major investment portfolios;
- institutional framework (multiple actors, overlapping responsibilities, etc.);
- corruption and conflict of interest.

It should be noted, however, that in January 2016 compared to January 2015, Romania registered an increase in the absorption rate of structural and cohesion funds, respectively from 56.30% to 69.91%, according to data from the EC.

Analyzing the data provided by the MEF, with the highest absorption rate (95%) for the Operational Programme Administrative Capacity Development under an initial allocation of only 208 million euro and the lowest rate (62.26%) for the Sectoral Operational Programme Human Resources Development corresponding to an initial allocation of 3,476.14 million euro, Romania still faces major challenges in terms of the capacity to absorb EU funds.

Although the absorption rate remains modest in Romania, in the last two years progress has been visible. Most of the increased absorption rate was for the Operational Programme Technical Assistance (by 53.73 pp), but the amount raised is the smallest (123.8 million euro) considering also the low initial allocations. The Sectoral Operational Programme Economic Competitiveness had an accelerated growth in the last two years, the absorption rate advancing by 31.41 pp and the money spent amounting to 1,498.39 million euro. Although the absorption rate for the Sectoral Operational Programme Transport obviously increased (by 49.34 pp in the last two years, reaching 73.38% in January 2016 compared to only 24.04% in 2014), it remains still one of the least efficient operational programs, with only 2,620.87 million euro spent by January 2016. With payments of 2,555.94 million euro, the Sectoral Operational Programme Environment has an increased in the absorption rate of 37.21 pp in the last two years.

Table 14: Structural funds absorption by operational programs (million EUR)						
	Total allocations 2007-2013 (cumulative)	Payments January 2016			Absorption rate Jan. 2016	Absorption excl. pre-financing Jan. 2016
		Total, out of which:	Pre-financing [57]	Refunds UE		
Regional Development	3,966.02	2,870.18	335.34	2,534.84	72.37%	63.91%
Environment	4,412.47	3,076.71	520.77	2,555.94	69.73%	57.93%
Transport	4,288.13	3,146.48	525.61	2,620.87	73.38%	61.12%
Competitiveness	2,536.64	1,728.26	229.87	1,498.39	68.13%	59.07%
Human Resources	3,476.14	2,164.24	451.89	1,712.35	62.26%	49.26%
Administrative Capacity Development	208.00	197.60	27.04	170.56	95.00%	82.00%
Technical Assistance	170.23	139.12	15.32	123.8	81.72%	72.73%
Total	**19,057.65**	**13,322.59**	**2,105.84**	**11,216.75**	**69.91%**	**58.86%**

Source: MEF, Fiscal Council's calculations

It can be noticed a significant dynamic in the case of the Operational Programme Administrative Capacity Development, the absorption rate increasing by 44.55 pp, but the amounts drawn remains low (170.56 million euro); although the amounts drawn are low, at the beginning of 2016 this program was the most efficient in the absorption of structural funds in Romania, being followed by the Operational Programme Technical Assistance and Sectoral Operational Programme Transport, at a distance of more than 10 pp, respectively 20 pp. The Regional Operational Programme had a consistent growth from the beginning, the absorption rate advancing in the past two years with 26.21 pp, reaching 72.73% in January 2016, this program being in the fourth position in term of the absorption of structural funds in Romania, immediately after the Sectoral Operational Programme Transport, with a drawn amount of 2,534.84 million euro.

[57] According to GEO no. 64/2009, prefinancing is the amount transferred to the beneficiaries of structural instruments through direct payments or through indirect payment in the initial stage to support start carrying out projects and/or the implementation thereof, as provided in the agreement/ decision/order financing between a beneficiary and the managing authority/intermediate body responsible/accountable to ensure the proper conduct of the projects financed under the operational programs.

The Sectoral Operational Programme Human Resources slowed its growth rate, the difference compared to January 2014 being of only 15.59 pp, reaching an absorption rate of 62.26%. Until May, Romania had to pay over 420 million euro which represented financial corrections applied under the Sectoral Operational Programme Human Resources.

According to data provided by MEF, the common mission conducted in early May by the Audit Authority and EC noted progress in terms of preliminary error rate (was about 3%) for the application submitted to EC on 31 December 2015 (amounting to 167.9 mil. euros).

Compared to other new EU Member States, according to the data released by the European Commission, the absorption rate in Romania remains the lowest, being only 69.9% in 2015 (74.8% in May 2016) excluding Croatia which joined the EU in 2013 (with an absorption rate of 58.6%). All the other new EU member states have absorption rates between 84.7% (Czech Republic) and 95% (Estonia, Latvia, Lithuania, Poland and Slovenia).

Table 15: Absorption of structural funds – comparison with other EU member states

	Total allocations 2007-2013 billion EUR	Payments 2015 billion EUR	Absorption rate 2015 %	Total allocations /inhabitant 2007-2013 EUR	Total payments /inhabitant 2015 for 2007-2013 EUR
Bulgaria	6.60	5.62	85.20%	916.08	780.50
Croatia	0.86	0.50	58.60%	203.03	118.98
Estonia	3.40	3.23	95.00%	2,591.59	2,462.01
Latvia	4.53	4.30	95.00%	2,281.08	2,167.03
Lithuania	6.78	6.44	95.00%	2,319.37	2,203.40
Poland	67.16	63.73	94.90%	1,767.11	1,676.99
Czech Republic	25.82	21.86	84.70%	2,449.95	2,075.10
Romania	**19.06**	**13.32**	**69.90%**	**959.18**	**670.47**
Slovakia	11.49	9.80	85.30%	2,118.67	1,807.22
Slovenia	4.10	3.90	95.00%	1,988.03	1,888.63

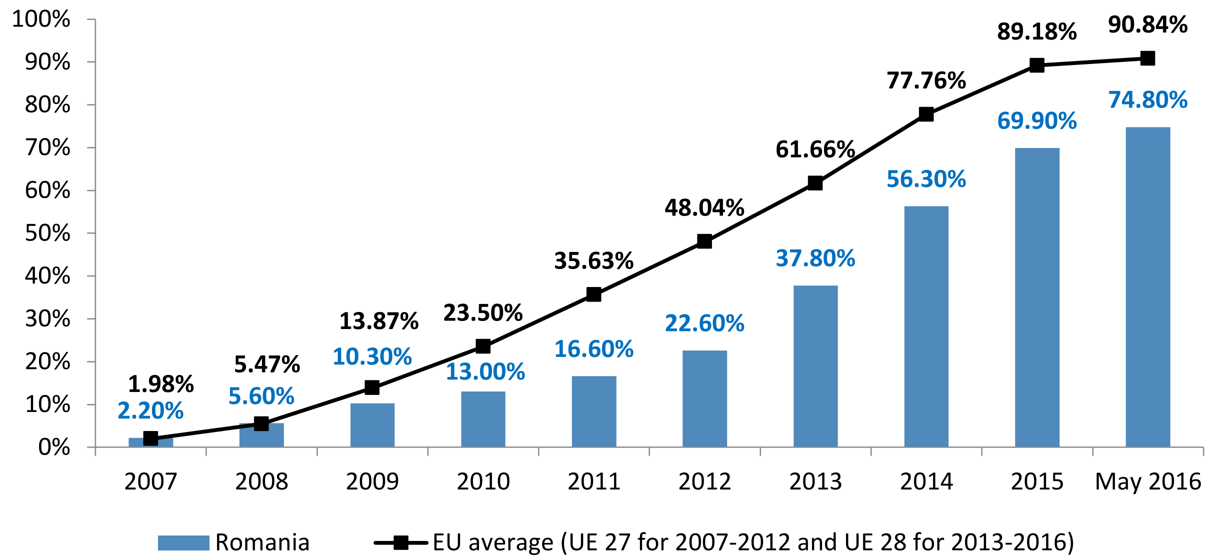
Source: EC (structural funds) and Eurostat (population, 2013)

Note: The absorption rate calculated by the European Commission on interim payments and pre-financing.

The low level of absorption is explained also by the blockages occurred in attracting European funds in 2011-2013. To minimize the risk of losing these funds, Romania and Slovakia have received an additional year for drawing European funds for the financial year 2007-2013, until the end of 2015.

Considering the EU funds allocated divided by the number of inhabitants, Romania is also ranked on the lowest position between the new Member States of EU, reaching in 2015 to 670.47 euro/inhabitant compared to 2,462 euro/inhabitant in Estonia or 780.50 euro/ inhabitant in Bulgaria.

Figure 38: Evolution of EU funds absorption rate: Romania versus EU 28 average, 2007-May 2016 (financial exercise 2007-2013)



Source: EC, Fiscal Council's calculations

Compared to the EU 28 average, EU funds absorption performance in Romania remains low, the level of absorption being by more than 20 pp below the EU 28 average at the end of 2015. Although the absorption rate is slightly higher, the gap persists also in May 2016 (the difference is only 16 pp).

It is true that in the last years there have been made progresses in terms of attracting European funds, evidenced by the increase in the absorption rate with 15.10 pp in 2013 compared to the end of 2012, by 18.5 pp in 2014 compared to the end of 2013 and by 13.6 pp in 2015, compared to the end of 2014, according to data released by the European Commission. However, given the deadline for drawing European funds allocated for the period 2007-2013, respectively December 31, 2015, the growth rate should have been one more accelerated. For the year 2015 there were announced ambitious targets concerning European funds absorption, namely an absorption rate of 80%[58], which would imply an increase with 23.7 pp compared to 2014, but the value achieved was lower by about 10 pp.

In 2015, EC has created an operational working group in order to remedy difficulties encountered in the eight Member States which are facing problems in attracting European funds, to reduce the risk of disengagement of EU funds and enhance absorption capacity of these funds. In this way it was allowed the implementation of major projects which were in distress, generally by project phasing. In agreement with the Romanian authorities an action plan has been established for the Cohesion Fund programs: Operational Programme Environment, Transport, and Regional Competitiveness. Following the work of this group in 2015, around 80 projects (including 50 major projects, each value exceeding 50 million euro) have been identified to be rescheduled for 2014-2020 (the phased projects totaling around 4 billion euro), which means that Romania can continue to partially implement in the current financial year projects from the period 2007-2013. Phasing is a measure that saved significant funds allocated to the country, reducing the number of potentially broken projects and those that will be completed from national sources.

The second category of projects included in this programming period that is about to end, aimed to grow the absorption rate related to the 2007-2013 financing period, is represented by retrospective projects. At the end of March, according to the Ministry of European Funds, the management authorities of the Operational Programme Environment, Transport, Competitiveness Human Resources Development analyzed 1,561 projects, of which they approved 40, totaling approximately 541 million euro (EU contribution of approximately 464 million euro). In evaluation stage there are 33 more projects worth approximately 630 million euro (EU contribution of approximately 520 million euro). Unfortunately, less than one in 10 analyzed projects met the financing demands, in general due to the failure in complying the law of public acquisitions, lack of construction authorizations or environmental agreements. The deadline by which projects can be identified and analyzed is set for June 2016.

For the **financial framework 2014-2020**, there was a shift in the EU policy orientation towards fulfilling the objectives derived from Europe 2020 strategy, Commission services position paper and Country-specific recommendations. The Partnership Agreement between a Member State and the European Commission which set funding priorities, referred to the management of EU funds programming by: CF, European Regional Development Fund, European Social Fund, European Agricultural Fund for Rural Development (EAFRD) and European Maritime and Fisheries Fund (EMFF).

[58] Ministry of European Funds (2014), "Balance 2014. Structural and Cohesion Funds Absorption" („Bilanț 2014. Absorbția fondurilor structurale si de coeziune”), December 30th, 2014.

The total budget for the cohesion policy 2014-2020 was established in December 2013 and amounts to 351.85 billion EUR. More than half of this budget (54.74%, respectively 192.63 billion EUR) is allocated to new EU Member States (Bulgaria, Czech Republic, Croatia, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia and Hungary).

In the period 2014-2020, according to data from the Ministry of European Funds, Romania will receive a total allocation of about 22.88 billion euro in structural and cohesion funds for operational programs, increasing against the 19.06 billion euro budget for 2007-2013. To these allocations are added other 19.43 billion euro [59] for Common Agricultural Policy (financed by both financial instruments, EAFRD and the European Agricultural Guarantee Fund - EAGF) and 168.42 million euro for the Operational Programme for Fisheries and Maritime Affairs - OPFMA (funded by European Maritime and Fisheries Fund - EMFF).

Under the Partnership Agreement proposed by Romania and approved by the European Commission on August 6, 2014 for the programming period 2014-2020, there are 6 Operational Programmes on Cohesion Policy, compare to 7 in the period 2007-2013. Sectoral Operational Programme Transport and Sectoral Operational Programme Environment were united and together with the funding for energy sector constitute the Operational Programme Large Infrastructure with a budget of about 9.41 billion euro. The Operational Programme Human Resources changed its name in the Operational Programme Human Capital, further comprising a new initiative "Jobs for Youth" and having allocated a total sum of 4.32 billion euro[60]. There was also added a new program, namely the Operational Programme Helping Disadvantaged People, the first Romanian program for the period 2014-2020 that received the European Commission's approval on November 28, 2014, a program through which in financial period 2014-2020 Romania will dispose of 441 million EUR. Among the first programs approved by the European Commission are also the Operational Programme for Technical Assistance amounting to 212.76 million euro approved on December 18, 2014 and the Operational Programme Competitiveness that has allocated an amount of 1.32 billion euro, approved on December 19, 2014. The Operational Programmes Regional Development, Large Infrastructure and Administrative Capacity Development received allocations amounting to 6.6 billion euro, 9.4 billion euro, and 553.19 million euro respectively, in July 2015 Romania is having approved all operational programs for the period 2014-2020.

In general, the financial allocations for future programs are bigger than those in the period 2007-2013, except for the Sectoral Operational Programme Increase of Economic Competitiveness, which received only 1.32 billion euro, compared with 2.55 billion euro in the

[59] According to Ministry of Foreign Affairs, a substantial increase over the previous allocation period, 13.8 bln. euro.

[60] The program was approved by the EC on February 25, 2015.

previous period, the allocations for the period 2014-2020 being halved. The operational Programmes with the highest rates of absorption in the previous financial period (2007-2013) received funding higher by more than 65% (the Operational Programme Regional Development - 6.6 billion euro, compared to 3.96 billion euro and the Operational Programme Administrative Capacity Development - 553.19 million euro, compared to 208 million euro).

Table 16: Comparison between the allocations in 2007-2013 and 2014-2020 (million EUR)

Total allocations 2014-2020 according to Operational Programs and Partnership Agreement [61]		Total allocations 2007-2013	
Regional Development	6,600.0	**Regional Development**	3,966.02
Large Infrastructure	9,418.52	**Environment**	4,412.47
		Transport	4,288.13
Competitiveness	1,329.79	**Competitiveness**	2,536.64
Human Capital	4,326.84	**Human Resources**	3,476.14
Administrative Capacity Development	553.19	**Administrative Capacity Development**	208.00
Technical Assistance	212.77	**Technical Assistance**	170.23
Helping Disadvantaged People	441.00		
Total	**22,882.11**	**Total**	**19,057.65**

Source: MEF

Note: 3,058.8 million euro allocation for Operational Programme Large Infrastructure Programme *(32.5%) is the allocated budget for 74 phased projects.*

There are added[62] to allocations highlighted in the table, Programme for Fisheries and Maritime Affairs (OPFMA - 168.42 million euro), the National Programme for Rural Development (NPRD - 8.12 billion euro), the Cross Border Cooperation Programme (about 452.70 million euro) and other programs (managed directly by the EC, with a budget of 33.24 billion euro allocated to all member states) totaling about 33 billion euros for the 2014-2020 financial framework.

Romania, like other new Member States, has received for the period 2014-2020 a higher

[61] There are presented available data at the beginning of March 2016.

[62] Situation for February 2016.

allocation for the structural and cohesion funds, compared with the previous financial period (22.99 billion euro compared 19.21 billion euro), exception to this rule, being the Czech Republic (21.98 billion euro compared to 26.53 billion euro), Slovenia (3.07 billion euro compared to 4.10 billion euro), and Latvia, which received almost the same amount for the next period (namely 4.51 billion euro, compared to 4,53 billion euro).

With regard to allocations for 2014-2020 relative to the number of inhabitants, Romania is still on the second lowest position with 1,150.85 euro/inhabitant, exceeding only Bulgaria (1,048.26 euro/inhabitant). It can be seen that the Baltic countries have among the highest allocations per inhabitant for the next period, respectively 2,725.78 euro in Estonia, 2,271.7 euro in Latvia, and 2,319.13 euro in Lithuania. Allocations relative to population increased significantly in the case of Slovakia (from 2,125.06 euro compare to 2,579.74 euro) and Poland (from 1,743.57 euro to 2,037.36 euro) and decreased in the case of Czech Republic (from 2,522.45 to 2,086 euro), Slovenia (from 1,991.94 EUR to 1,490.53 euro) and Hungary (from 2,515.05 EUR to 2,217.06 euro).

Table 17: Situation of the allocations of the European funds: 2014 - 2020 compared to 2007 - 2013 - comparison with other EU countries

	Total allocations for EU Cohesion Policy 2014-2020 billion EUR	Total allocations/ inhabitant 2014-2020 EUR
Bulgaria	7.55	1,048.26
Croatia	8.56	2,026.73
Estonia	3.58	2,725.78
Latvia	4.51	2,271.70
Lithuania	6.77	2,319.13
Poland	77.43	2,037.36
Poland	21.98	2,086.00
Romania	**22.88**	**1,150.85**
Slovakia	13.99	2,579.74
Slovenia	3.07	1,490.53
Hungary	21.85	2,217.06

Source: EC (European funds) and Eurostat (population, 2015)

Note: The amounts allocated to each Member State include, in addition to structural and cohesion funds, represent the performance reserve and cross-border and transnational cooperation funding, as well as funds allocated to the initiative "Jobs for Youth" according to the data available on the EC[63] website.

[63] Available data in March 2016.

The new multiannual financial framework 2014-2020 has begun with difficulties not only in Romania but also in other EU countries. The legal framework for this period was finalized with a delay by the EC, the European Parliament and EU Member States, predominantly affecting countries who have a lack of experience and administrative capacity to recover delays.

Romania will continue to receive the expertise of the European Investment Bank (EIB), EBRD and WB in order to modernize public administration, support structural reforms and prepare and implement projects financed from European funds by extending their partnership signed in 2012 with them, but these were valid until 31 December 2015.

According to MEF data, in April 2016 were released guidelines that represent 40% of total allocations for programmes announced for 2014-2020 worth about 20 million euro (Operational Programme Human Capital, Operational Programme Large Infrastructure, Operational Programme Competitiveness, Operational Programme for Technical Assistance, Operational Programme Helping Disadvantaged People).

In the country report for Romania published by the EC in February 2016 were identified several factors that help maintaining a reduced EU funds absorption rate. One aspect is the lack of strategic planning for medium and long-term infrastructure development, those being often affected by political factors. Romania is not preparing new projects that are mature enough to boost the absorption of the funds allocated for the programming period 2014-2020, their preparation being influenced by various external factors. At the same time, it was determined that the mechanisms for selecting projects and setting priorities are fragmented and are not standardized. The increase in transparency and efficiency for the public acquisitions system, followed by the ongoing reorganization, is essential for the development of public investments. Such deficiencies are considered to be the cause for the low absorption rate of EU funds, but also for the substantial financial corrections.

Romania is facing delays accumulated in the course of the new financial year. Thus, the Romanian authorities responsible for managing EU funds have not experienced the procedure of appointing and without it the expenditures incurred in new European projects cannot be reimbursed. In addition, in March 2016 only 13 of the 36 ex-ante conditionalities imposed by the EC were met. In case of non-compliance, until the end of 2016, there is a risk that operational programs that are targeted to be suspended before they start, the EC can stop the associated costs. Areas where ex-ante conditionalities recorded the biggest problems are public acquisition, health, management of waste and transport. Given these delays, there is a risk that in 2016 to be carried only works related to projects begun in 2007-2013 (phased projects) without being started new projects related to the new programming period 2014-2020 of which there are only four years.

Given that during 2015-2016 two financial frameworks are overlapping (2007-2013 and respectively 2014-2020), Romania has an additional opportunity to implement more EU funded projects, this imposing decisive actions for the start of fundraising procedures under the new financial period along with measures to reduce the risk of allocations' loss for 2007-2013 period. The absorption of EU funds remains a national interest objective and a solution to stimulate the economy, especially in the context of the constraints imposed by the new fiscal pact. For the 2007-2013 programming period, even if special measures have been taken and have made progress in recent years it is unlikely to reach a maximum performance. For a better implementation of programs for the period 2014-2020, it is imperative that the issues identified in the previous financial period to be settled and Romania must overcome the difficulties which caused a low absorption rate in the past.

Given the potential possessed by European funds for the economic growth, the acceleration of the absorption rate is essential for its sustaining, Romania currently has one of the highest economic growth in the EU. Early preparation of projects and increase the administrative capacity for planning and management of European funds constitutes key factors for the implementation of EU funded projects. Considering the stage of European funds absorption for 2007-2013, but also the slow start of the implementation of the 2014-2020 programming period, the difficulties found regarding delays in designation of the management and control authorities and the fulfillment of ex ante conditionalities, the Fiscal Council considers that there is a substantial risk that the absorption estimates for 2016 to not be met by a significant margin.

V. The Sustainability of Public Finance

V.1. Arrears of the general consolidated budget

The evolution of the GCB's[64] stock of arrears to the private sector in 2015 indicates that it currently does not represent a major problem, in the recent years taking place an improvement in terms of financial discipline, both at central and local level.

Table 18: Quarterly evolution of GCB arrears in 2014 (million lei)

	QIV 2014	QI 2015	QII 2015	QIII 2015	QIV 2015
State budget	**119.5**	**224.4**	**106.3**	**102.4**	**103.3**
Under 90 days	113.8	157.1	92.6	91.0	90.3
Over 90 days	2.8	10.1	3.2	2.3	1.6
Over 120 days	1.5	53.3	7.8	6.9	9.1
Over 360 days	1.2	3.9	2.8	2.3	2.2
Local authorities	**775.6**	**766.7**	**809.4**	**824.9**	**583.1**
Under 90 days	654.9	511.4	561.4	569.4	510.2
Over 90 days	80.9	150.4	80.2	88.3	41.3
Over 120 days	24.6	94.6	155.0	143.9	20.8
Over 360 days	15.2	10.2	12.9	23.3	10.8
Social security budget	**72.6**	**108.9**	**121.0**	**35.3**	**8.9**
Under 90 days	72.6	108.9	120.9	35.2	8.8
Between 90 and 360 days	0.0	0.0	0.1	0.1	0.1
Total	**967.7**	**1,100.0**	**1,036.7**	**962.6**	**695.3**
Under 90 days	841.3	777.4	774.8	695.6	609.3
Over 90 days	83.8	160.5	83.4	90.6	42.9
Over 120 days	26.1	148.0	162.8	150.8	30.1
Over 360 days	16.5	14.1	15.7	25.5	13.1
Total arrears (90-360 days)	**126.3**	**322.6**	**261.9**	**267.0**	**86.0**

Source: MPF

Thus, the level of arrears at the end of last year amounted 86 million lei, decreasing by approximately 40 million lei compared to the same period of the previous year. Also, it may be

[64] According to the Public Finance Law no. 500/2002 with subsequent amendments and supplements are considered arrears overdue payments older than 90 days, calculated from the due date.

observed the stock of arrears' volatility during 2015. After an increase of about 196 million lei in the first quarter of the previous year, the GCB's arrears declined slowly over the next two quarters, while in the last month of 2015 they decreased significantly, i.e. by 70%, due to paying certain arrears of the local budgets from the contingency reserve fund at Government's disposal.

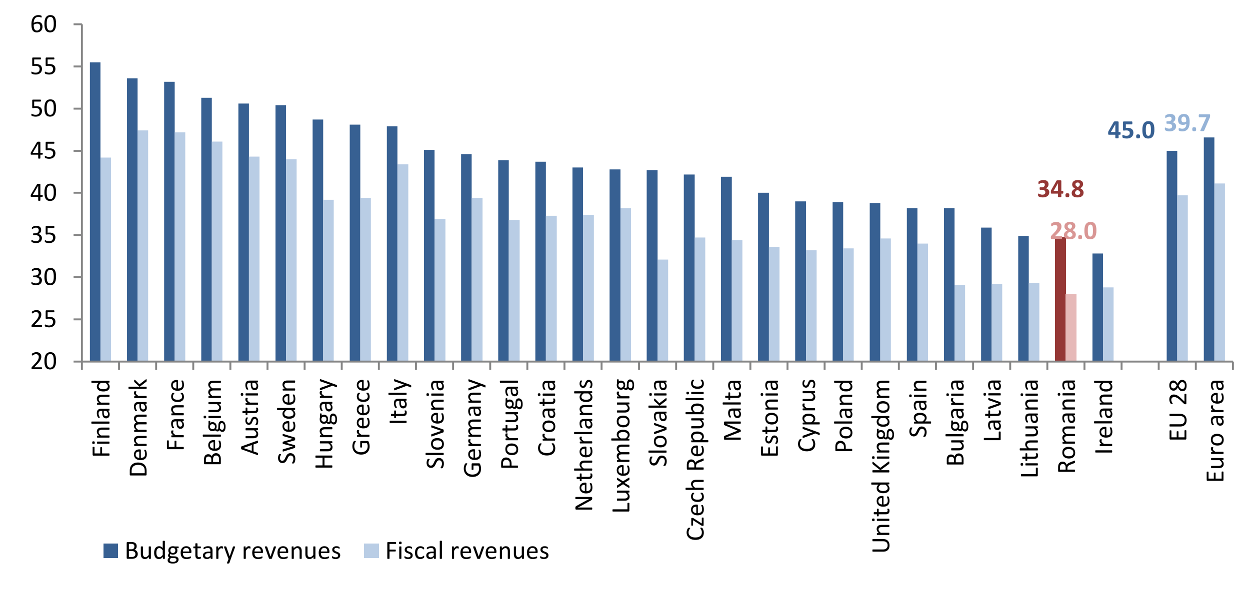
As regards the outstanding payments with a delay of less than 90 days that do not fall in the category of arrears according to the Public Finance Law no. 500/2002, although they have reached a level of 609.3 million lei at the end of 2015, are by 27.6% lower than the previous year level (841.3 mil. lei), significantly decreasing compared to 2013 (1.7 billion lei). Compared to 2014, the decrease was mainly located at the level of the local budgets' outstanding payments (-145 mil. lei, i.e. a decrease of 22%) and at the level of the social insurance budget (-64 million lei, i.e. a decrease of 88%).

The considerable reduction of the GCB's outstanding payments in the last 3 years (from 3.8 billion lei in 2012 to 0.7 billion lei in 2015) is explained mainly by the implementation of the EU Directive no. 7/2011 on combating late payment in commercial transactions (Law no. 72/2013) and other legislative measures taken in the recent years which aimed to reduce the stock of arrears (GEO no. 29/2011 governing the granting of payment rescheduling, GEO no. 3/2013 which restrict the local authorities' possibility of contracting new loans strictly to extinguish the arrears, GEO no. 12/2013 which introduced a mechanism of mutual extinction of payment obligations).

V.2. Tax collection in Romania – international comparisons

Romania recorded in 2015 a share of government revenues (tax and non-tax revenue) to GDP of 34.8% of GDP, 10.2 pp lower than the EU average (45.0% of GDP), among the lowest in relation to the EU Member States, being succeeded only by Ireland (32.8%). The level of tax revenues to GDP (taxes and social contributions) in Romania reached 28.0% of GDP in 2015, being placed on the last position, with a difference of 11.7 pp compared to the EU average, which is 39.7% of GDP. Analyzing the data according to the ESA 2010 methodology, compared to 2014, the gap between Romania and the EU average decreased by 1.6 pp of GDP in the case of the total budget revenues, while in the case of the tax revenues it decreased marginally by 0.3 pp of GDP. The share of tax revenue to GDP is significantly lower than in similar economies like Hungary (39.2%), Slovenia (36.9%), Czech Republic (34.7%) and Poland (33.4%).

Figure 39: Budgetary revenues and fiscal revenues in 2015 (% of GDP, ESA 2010)



Source: Eurostat; Tax revenues include social contributions.

The structure of tax revenue in Romania, relatively unchanged from 2014, reveals a high share of revenues from indirect taxes, respectively 47.1% of total tax revenue compared to the EU28 average of 34.0%, while the share of revenue from social security contributions was 28.9% (4.6 pp below the average EU28) and from direct taxes - only 23.9% (8.6 pp below the average EU28). The indirect taxes are the main component of tax revenues, their weight being significantly above the EU average (by 13.1 pp), given that the fiscal consolidation initiated in 2010 included on the revenue side of the budget an increase in indirect taxes that led to a widening gap between Romania and EU average in this respect.

In 2013 has launched a wide-ranging reform process of the Romanian tax administration, on May 8, 2013 being signed the Loan Agreement between Romania and the International Bank for Reconstruction and Development, the loan value, of 70 million euro[65], following to be used for the Revenue Administration Modernization Project (RAMP), implemented during a period of 5 years (since the fourth quarter of 2013). The development objectives underlying the project mentioned above are stated as follows: *"(a) increasing effectiveness and efficiency in tax collection, taxes and social contributions; (b) increasing tax compliance; and (c) reducing the burden on taxpayers to ensure compliance"[66]*, in order to achieve them, being decided the project structure based on four components: (a) institutional development; (b) increasing

[65] Plus 7 million euro, which constitute the NAFA's contribution.

[66] According to Law no. 212/2013 on the ratification of the Loan Agreement between Romania and the International Bank for Reconstruction and Development.

efficiency and operational effectiveness; (c) services for taxpayers and corporate communications; and (d) the coordination and project management. After the restructuring and modernization of the NAFA are expected results such as increasing voluntary compliance at declaration and payment (targets for 2018: VAT - 83.5%; tax on income and wages - 86.0%; social contributions – 82.5%), lowering the cost of collection (from 1.1% to 0.9%) and increasing the satisfaction of taxpayers on the integrity and quality of the services (with 15% by December 2018), obtained through a series of measures desired to be fully implemented by the end of 2016: reorganization of the territorial apparatus on a regional structure, requalification and redistribution of the personnel to deficient areas, modernization of the information and communication technology system and redesigning the activities' process of the NAFA.

In 2014 the reorganization program of NAFA developed in collaboration with the World Bank (August 9, 2013) was broadly completed, this targeting in particular the medium term improvement of the budget revenues' collection, in the context of the results available at that time, by optimizing the tax administration. In this regard, it was considered a priority the consolidation of the 263 financial administrations, existent in 2011, in 8 central financial administrations, by 2014, and 215 local financial administrations[67]. Thus, as a consequence of the objectives undertaken by NAFA in the context of the Loan Agreement between Romania and the World Bank, the total number of financial administrations fell by 40 in 2014, compared to 2011. Also, the increase of efficiency in activities was pursued by rising the number of staff assigned for purposes of prevention and inspection, in this regard being reallocated approximately 1,700 employees, who previously occupied support functions. The increase in the number of employees in the NAFA's structure by 1,496 compared to 2011 is also justified by increasing the staff in the Bucharest area, in order to combat fraud, but also by taking over the responsibilities of the Financial Guard (November 1, 2013), thus 1,100 employees joining the NAFA's apparatus, with tasks of prevention and fight tax evasion and customs fraud.

[67] From 2015, the number of local financial administrations was scheduled to be reduced to 47 as part of NAFA's commitment of modernization and restructuring.

Table 19: The efficiency of tax system

Country	Number of financial administration				Number of financial administration for 1 mil. population	Revenue collected (% GDP)/ Number of administrations	Number of employees in structures that collect taxes	Number of employees in structures that collect taxes	Total tax revenue (% of GDP)	Tax revenues as a share of GDP to a thousand employees of tax collection structures*	Number of payments per year for fulfillment of tax obligations **	Ease of paying taxes (rank)	Number of employees structures to collect taxes / 1 mil. pop.	Pop. (thous.)
	Total, out of which:	Central	Local	Total, diff. from 2011				Differences from 2011						
	2014				2014		2014		2014		2014			2014
Bulgaria	29	6	23	0	4.0	1.0	7,680	-28	27.6	3.59	14	88	1,067	7.2
Czech R.	216	15	201	9	20.6	0.2	15,031	391	34	2.26	8	122	1,432	10.5
Estonia	15	0	15	11	11.5	2.2	983	200	32.9	33.47	8	30	756	1.3
Latvia	32	0	32	-2	16.0	0.9	4,312	12	28.8	6.68	7	27	2,156	2.0
Lithuania	10	10	0	0	3.4	2.8	3,476	-40	27.6	7.94	11	49	1,199	2.9
Poland	432	32	400	0	11.4	0.1	48,558	-715	32.9	0.68	7	58	1,278	38.0
Romania	223	8	215	-40	11.2	0.1	24,481	1,496	27.6	1.13	14	55	1,230.2	19.9
Slovakia	170	17	153	60	31.5	0.2	9,296	3,953	31	3.33	10	73	1,721	5.4
Slovenia	16	16	0	-60	7.6	2.3	2,362	-55	36.8	15.58	10	35	1,125	2.1
Hungary	75	25	50	-2	7.6	0.5	22,482	-577	38.3	1.70	11	95	2,271	9.9

Source: OECD, Tax Administration 2015

According to the sixth edition of the report Tax Administration 2015 elaborated by the OECD, an overview of the system of tax administration in 56 countries, the Romanian administrative apparatus of tax collection has undergone a transformation process after which it became simpler and more efficient. The number of financial administrations has been significantly reduced at the central level, thus decreasing the complexity of the Romania's administrative apparatus. In the future, it is also proposed the reducing of the local structures because Romania is still well above the average of the new EU Member States regarding the number of financial administrations.

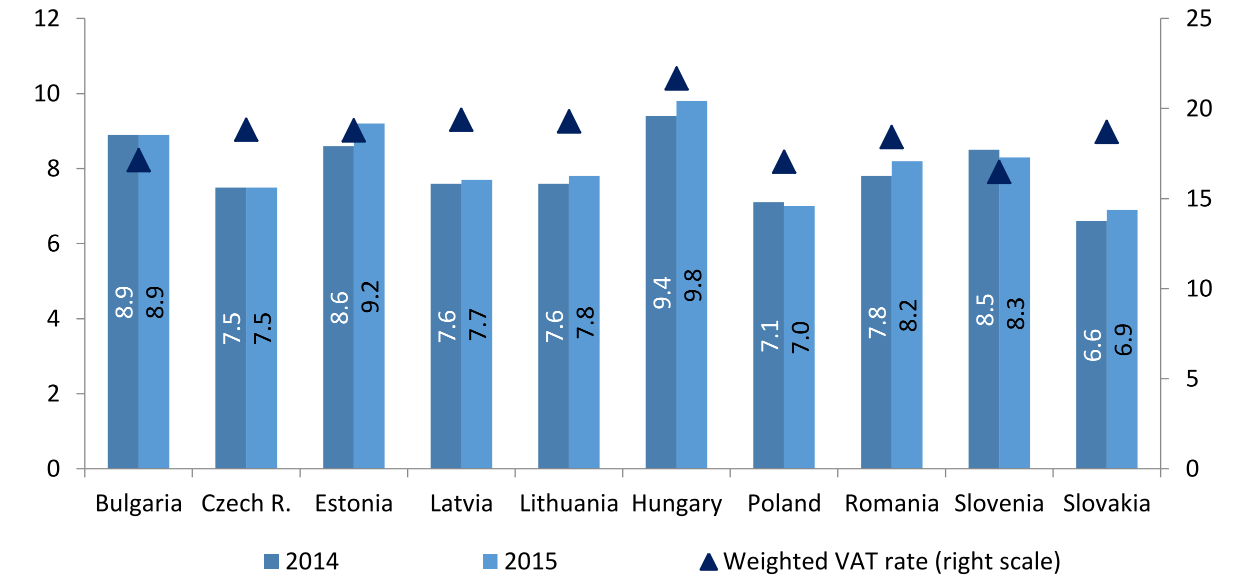
From the perspective of tax revenue collection, it can be appreciated that the tax system in Romania is characterized by low efficiency, the weak tax collection being largely due to a not yet fully effective administrative apparatus. However, in the recent years were initiated a number of measures to improve this situation, the tax administration reform initiated in 2013 aiming to simplify the tax system, reduce tax evasion and increase tax collection. At the level of 2014 were collected tax revenues amounting 27.6% of GDP. One thousand employees collect 1.13 pp of this total. The number of employees from the tax collection structures grew by approximately 5%, so that the ratio of employees to 1 million inhabitants has increased, this increase taking place in the context of the population decrease.

According to the report Paying Taxes 2016 elaborated by the World Bank in collaboration with PricewaterhouseCoopers (PWC), Romania ranks 55 on the ease of paying taxes, a major leap compared to 2012 given that, currently, are required only 14 payments for the fulfillment of the tax obligations, but also due to other indicators such as the number of hours per year for spent for the fulfillment of the tax obligations. This remarkable improvement was driven largely by the measures taken by the fiscal authorities during 2010-2013 period in order to facilitate the electronic payments and filing the tax statements online.

Compared with similar economies, Romania is facing with an average tax collection from VAT receipts. For example, although in 2015 the weighted VAT rate (determined based on the HICP weights and characterized by the limitations described in section III.3.1) was ranked 7 among the new EU Member States (18.4%), Romania collected VAT revenue of 8.2%[68] of GDP, which is above countries with higher weighted VAT rate, such as Latvia (weighted VAT rate of 19.4%), Lithuania (weighted VAT rate of 19.3%), Czech Republic (weighted VAT rate of 18.8%) and Slovakia (weighted VAT rate of 18.7%). However, Bulgaria, having a structure of the economy similar to that of Romania and a weighted VAT rate of only 17.1%, collected revenue from VAT of 8.9% of GDP in 2015, higher, therefore, than the Romania's level.

[68] The level of this indicator increase by 0.4 pp compared to 2014, when Romania collected VAT revenue of 7.8% of GDP.

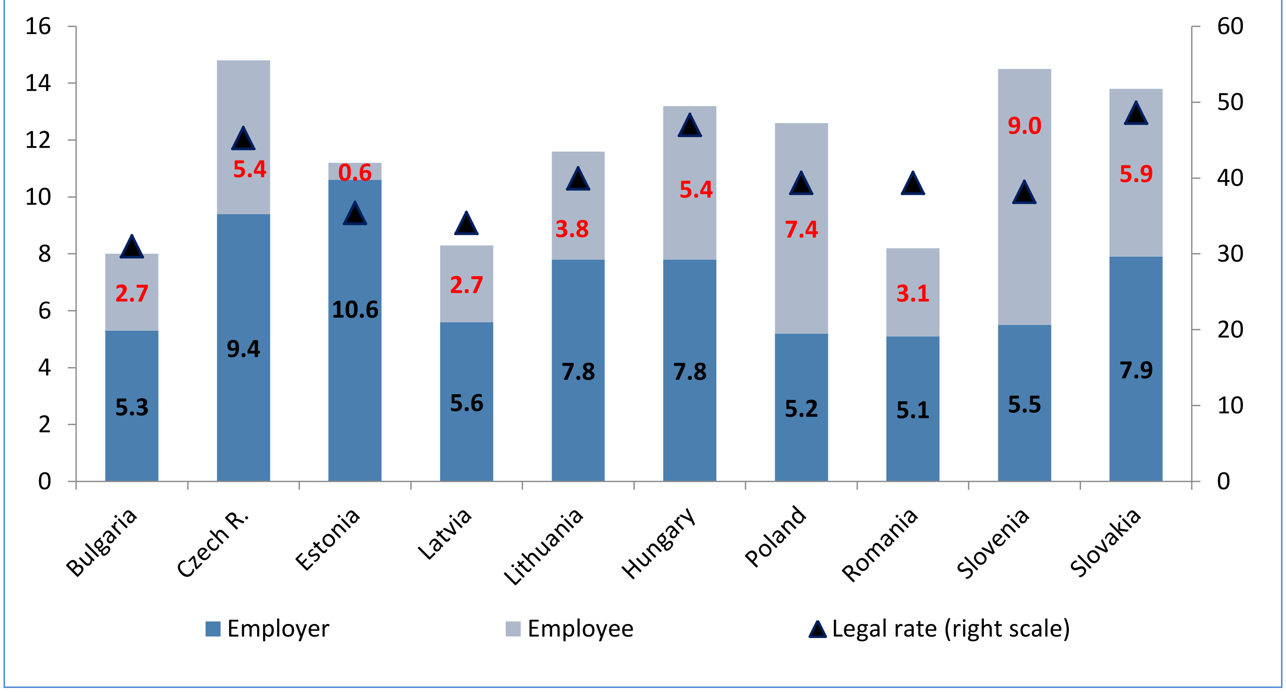
Figure 40: VAT revenues in 2015 (% of GDP)



Source: EC, Eurostat

Comparing with the other selected countries regarding the share in GDP of the revenues from social security contributions paid by employees and employers relative to the legal quota of social contributions, for Romania it is highlighted the low level of the collection (see *Figure 41*). Thus, the revenues from the contributions collected by Romania in 2015 were 8.2% of GDP (on a legal rate of social security contributions of 39.35%), being one of the smallest shares, surpassing only Bulgaria (which has legal rates of social security contributions much lower, of 31%). Slovenia (14.5% of GDP), Estonia (11.2% of GDP) and Latvia (8.3% of GDP) recorded budget revenues related to this category higher than in Romania, given that the legal rates are significantly lower for social contributions. Compared to Poland, that collected from social contributions 12.6% of GDP, the legal quota in Romania is by only 0,02 pp lower, while compared to Lithuania (social contributions of 11.6% of GDP), the legal quota in Romania is lower by 0,63 pp.

Figure 41: Social contributions revenues in 2015 (% of GDP)



Source: EC, Eurostat

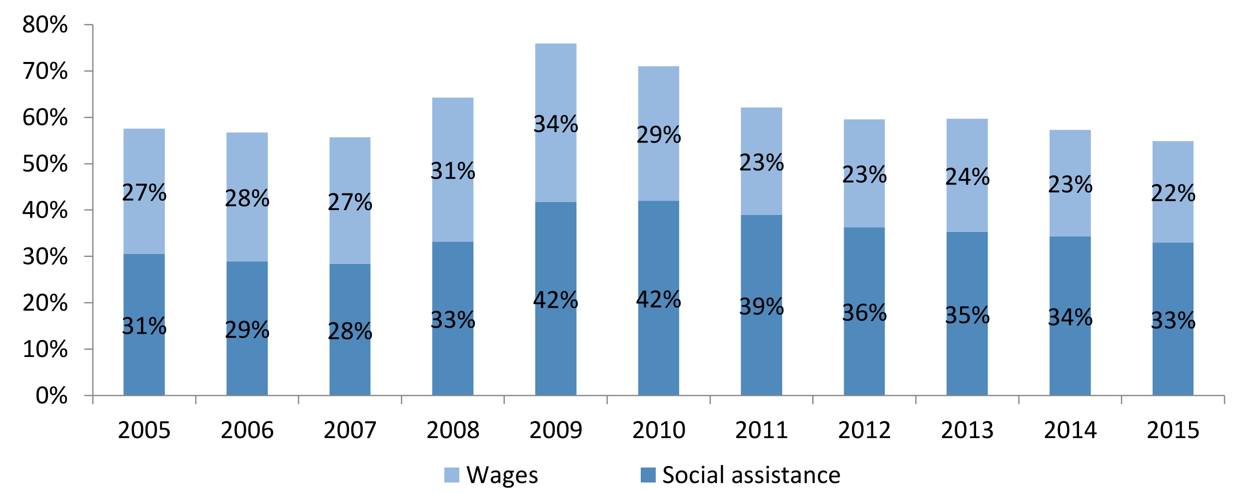
Concluding, it can be noticed an improvement in terms of efficiency and simplifying the administrative apparatus of tax collection, highlighted by the decrease in the number of financial administrations, increasing the number of employees in these structures, but also in terms of ease of paying taxes. The reform initiated in Romania in this field seems, however, to have led to positive results under the initial expectations. It should be noted that the World Bank has assessed the project in August 2015, considering the overall progress of its implementation as moderately unsatisfactory and the risk of failure to complete its objectives as high. Thus, it is considered that the first steps towards the goal of the project have made, but at a pace too slow and with delays, since the date of completion was established in March 2019 and the targets should be achieved by the end of 2018. Therefore, the reform has the potential to lead to significant long-term positive effects, but we consider that further efforts are required.

V.3. Public expenditure – structure and sustainability

In Romania, the structure of the budgetary expenditures is characterized by the dominance of personnel and social assistance expenditure (pensions, social aids), but their relative importance has declined significantly in 2011 – 2015 as a result of the fiscal consolidation

(*Figure 42*), i.e. up to 54.9% of 2015 budget revenues, which is in fact the minimum of the last 11 years, compared with an average of 70.4% in 2008-2010. After a relatively stable evolution in items of the expenditure share in the budgetary revenues, before 2007, the personnel and pension expenditure strongly increased during 2008 and 2009, to a level much higher than the EU28 average, then diminishing below the level recorded in the CEE countries, with the exception of Hungary in the period 2013 2015 (*Figure 43*). If the share of personnel expenditure in total budgetary revenues in 2015 is lower than during 2005-2007, social assistance expenditure represents a significant share of government revenue, much higher than in 2005-2007, even in the context of the adjustments made in recent years. Compared to the previous year, the share of social expenditure in the total budgetary revenues decreased by 1.3 pp, while the wage bill decreased its share in total revenues with 1.37 pp.

Figure 42: Social assistance and personnel expenditure as share of total budget revenues (%)



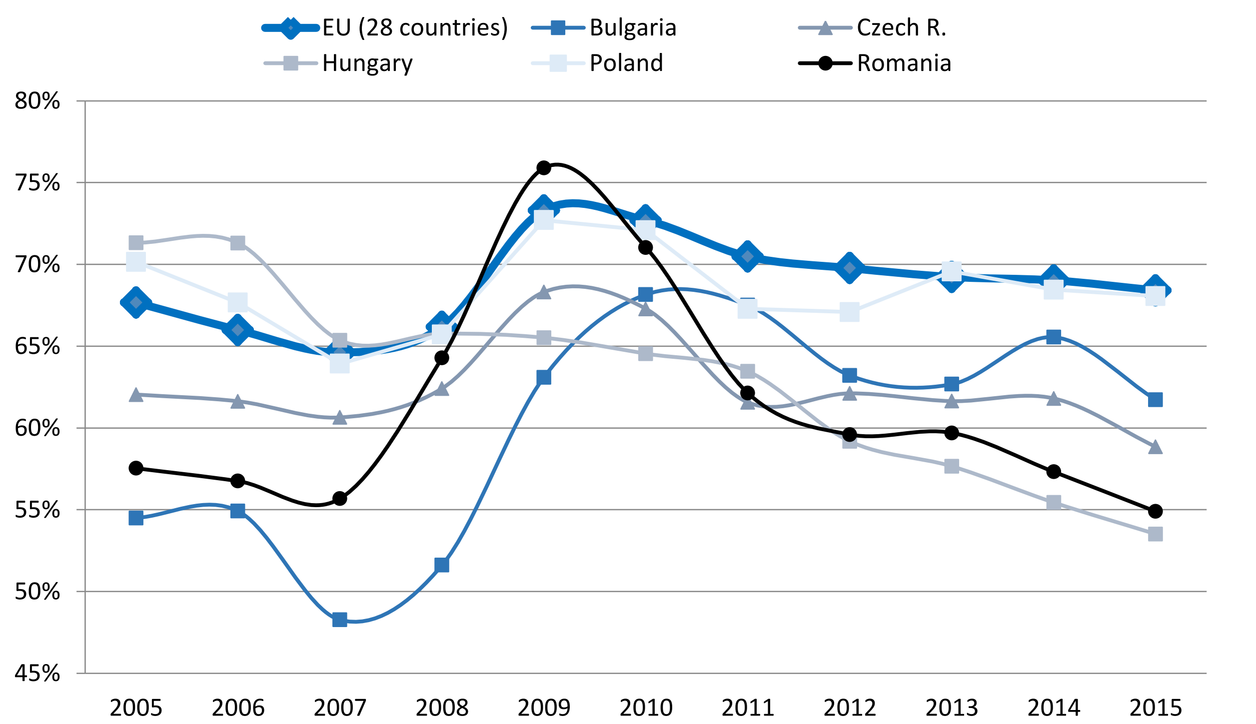
Source: Eurostat

Note: Data according to ESA 2010 - differences from the previous reports are due to the transition from ESA 95 methodology ESA 2010.

The precarious state of the public pension system is an important vulnerability of the public finances position and the share of this expenditure category in total revenues is still too high, but applying the new pension law should support the objective of reducing the share of this expenditure category in total budgetary revenues in the medium-term. This objective, however, is currently jeopardized by the manifestation of some reversing pressures of the pension system reform initiated in 2010, with initiatives to restore some of the special pension disbanded by it. In terms of medium and long-term sustainability, it is important that any increases of wages in the public sector in the following years to be done only in line with the evolution of economic activity and, especially, with productivity gains, given that during 2015-2016 there was a trend of increase in personnel expenses of the state with significantly higher rates than nominal GDP growth.

As can be seen in the figure below, in 2009, Romania recorded the highest share on wages and social assistance in total budget revenues of the countries of CEE and the level is even higher than the average UE28. Instead, in 2015, as a result of the undertaken measures supported by the nominal GDP growth, Romania is 14 percentage points below the average UE28, a minimum level for the given period, i.e. 2005-2015.

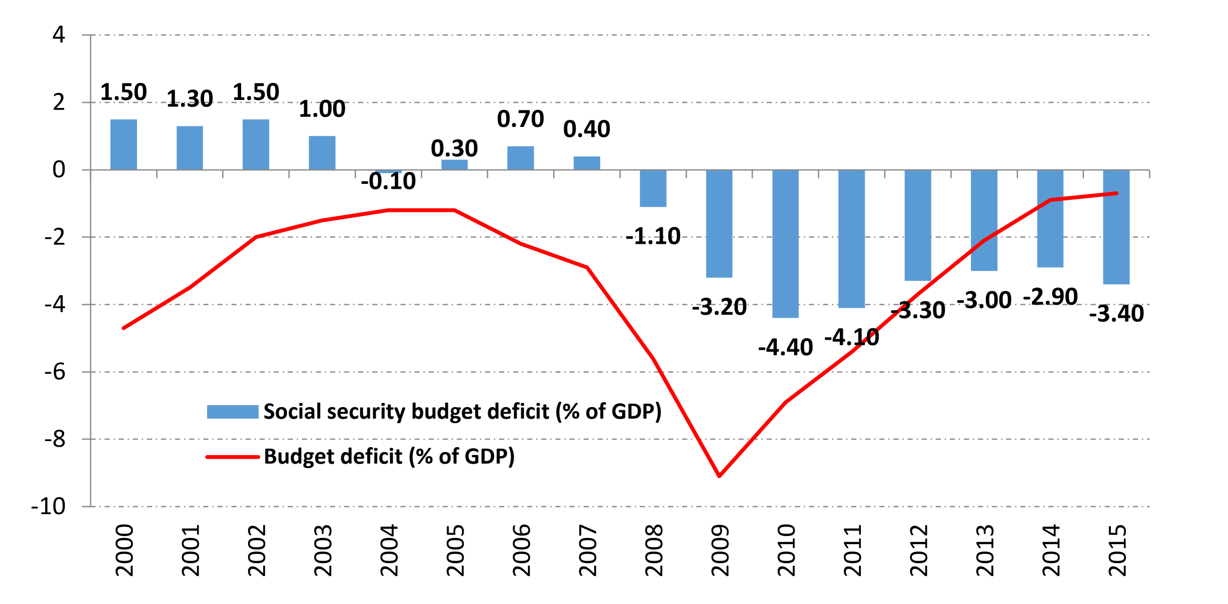
Figure 43: Social assistance and personnel expenditure (including pensions) in total budgetary revenues in EU 28 and CEE during 2005-2015



Source: Eurostat

If in the period 2000–2007, social security budget (pensions, unemployment and health) were characterized by a relatively equilibrated or even positive balance, after 2008 the deficits have represented an important component of the general consolidated budget deficit, respectively between 64% and 486% in the period 2010 – 2015. Basically, in the period 2013-2015, Romania would have had a significant budgetary surplus if the social security budget had been in equilibrium. In particular, the deficit recorded in the public pension system (-2.48% of GDP)), the most important part of this budget, significantly affects the public finance position, representing a relevant risk to the sustainability of fiscal policy in the medium and long-term.

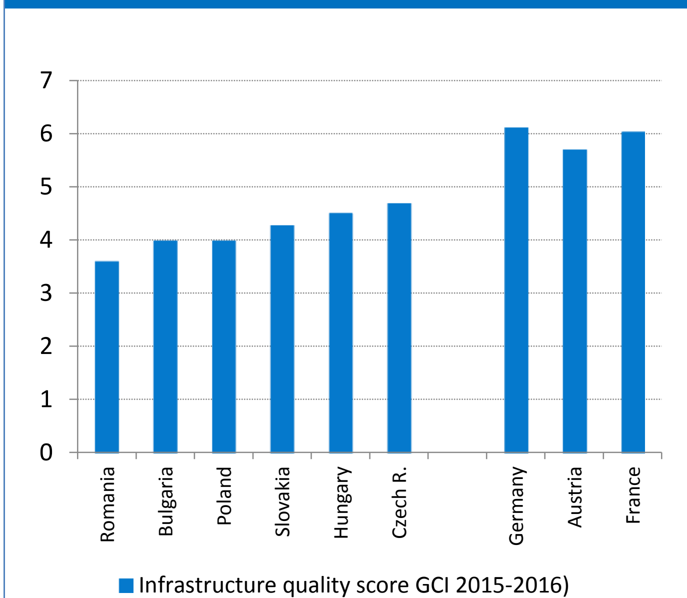
Figure 44: Social security budget deficit (pensions, unemployment and health) and total budget deficit – ESA 2010 (% of GDP)



Source: Eurostat

Note: Data according to ESA 2010 - differences from the previous reports are due to the transition from ESA 95 methodology ESA 2010.

Figure 45: Infrastructure quality



Source: World Economic Forum, The Global Competitiveness Report 2015-2016

The efficiency reserves on the side of budgetary expenditure are very high.

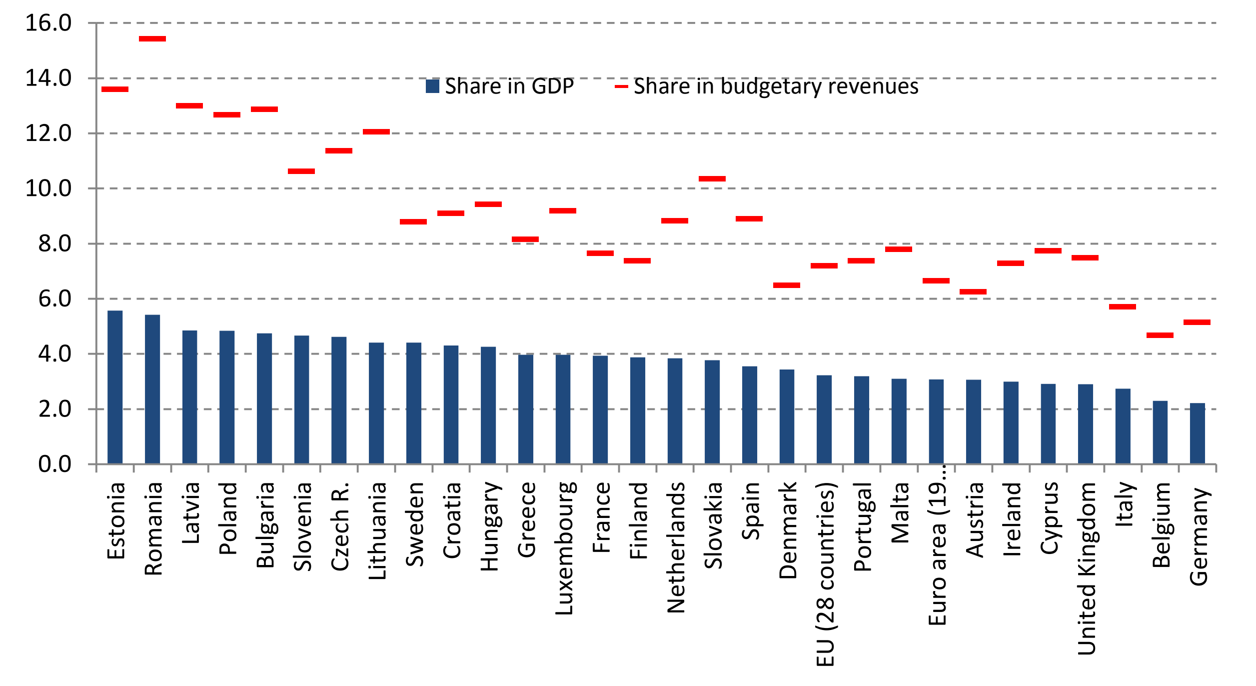
For instance, Romania had the second largest allocation for investment expenditure as a share of all European countries during 2007–2015; however, the results were modest, as Romania is still characterized by the poorest infrastructure in the EU.

In 2015, Romania is at 1.6 pp of GDP distance from the maximum allocation for capital expenditure in the EU. With a score of 3.6, Romania ranks 91 of 140 countries on infrastructure, road quality being its weakest component (ranked 120).

The score concerning infrastructure is part of the global competitiveness index for which Romania has a score of 4.32, being ranked in 53 of 140 where Switzerland has the highest position, a better position than the previous year (59th).

It should be noted that 2015 is the first year after 2008 in which spending on public investments are increasing from the previous year (both relative to GDP: 0.8 pp more than in 2014 and to budget revenues: 1.8 pp more than in 2014), but it still remains below pre-crisis level. The reason for this increase was the fact that 2015 was the last year for the absorption of EU funds for the financial framework 2007-2013, the share of EU payments to beneficiaries in relation to the allocation for this period registered a sudden increase at the end of December 2015 (74.3%) compared to the end of November 2015 (64.26%).

Figure 46: The share of investment expenditure in GDP and in total budgetary revenues (average 2007-2015)



Source: Eurostat

In the Convergence Program 2016-2019, the Ministry of Public Finance examines also the risks posed by an aging population and the rising cost of health services. It notes that in Romania there is a pronounced reverse age structure which will change the ratio of working to retired population. Aging, migration and low birth rate are factors with negative implications on the labor market. Long-term forecast pension expenditure shows that Pillar 1 will represent 8.4% of GDP in 2040 from a level of 8.2% in 2013, while Pillar 2 will have an increasingly share in total pension expenditure, reaching 0.8% at the end of the forecasting period, in 2060. The long term projection of age-related expenditures shows an increase of 2.2 pp of GDP for the period 2013-2060 while the EU average is projected to increase by 1.8 pp.

The Fiscal Council considers that there has been some progress in both the structure and sustainability of public spending given the fact that the share in total budget revenue of the "mandatory" expenditure (i.e. those with salaries and pensions) decreased significantly, thus correcting the previously accumulated imbalances, also partly in terms of increasing their transparency, given the ongoing reform of the management of public investment which was analyzed in more detail in the section dedicated to public investment. However, the reserves on the efficiency of the use of public money are still high, being absolutely necessary to conduct a wide-ranging reform in this regard. An important step in this direction may be represented by the new law on public procurement which can contribute to increasing transparency and reducing inefficiency of the public spending.

V.4. Indicators for assessing the sustainability of public finances

The European Commission is studying the sustainability of public finances through three indicators depending on the time horizon considered: S0 for short term, S1 for medium term and S2 for the long term.

S0 captures the period up to 1 year and it is a composite indicator made of a set of 28 fiscal and financial-competitiveness variables, divided into two sub-groups. S0 is methodologically very different from S1 and S2, the methodology lying behind the S0 indicator being the "signals approach" which makes it an "early detection indicator". Thresholds are separately derived for the composite indicator, the two fiscal and financial competitiveness sub-indexes and each of the variables incorporated in the composite indicator. Such optimal threshold is determined by maximizing the "signaling power"[69] of the model, i.e. its ability to correctly predict past fiscal stress. The thresholds are: 0.43 for the aggregate index S0, 0.35 for the sub-fiscal index and respectively, 0.45 for financial-competitiveness sub-index. Based upon S0, the EC concluded that no European country is exposed to medium or major short-term risks.

The medium-term sustainability is analyzed based on the indicator S1 and the debt sustainability analysis (DSA) over ten years. The fiscal gap indicators S1 and S2 are derived from the government inter-temporal budget constraint, which is the condition of solvency for the public sector, and they are compute with reference to the baseline no-fiscal policy change scenario. The medium-term sustainability indicator S1 shows the additional adjustment

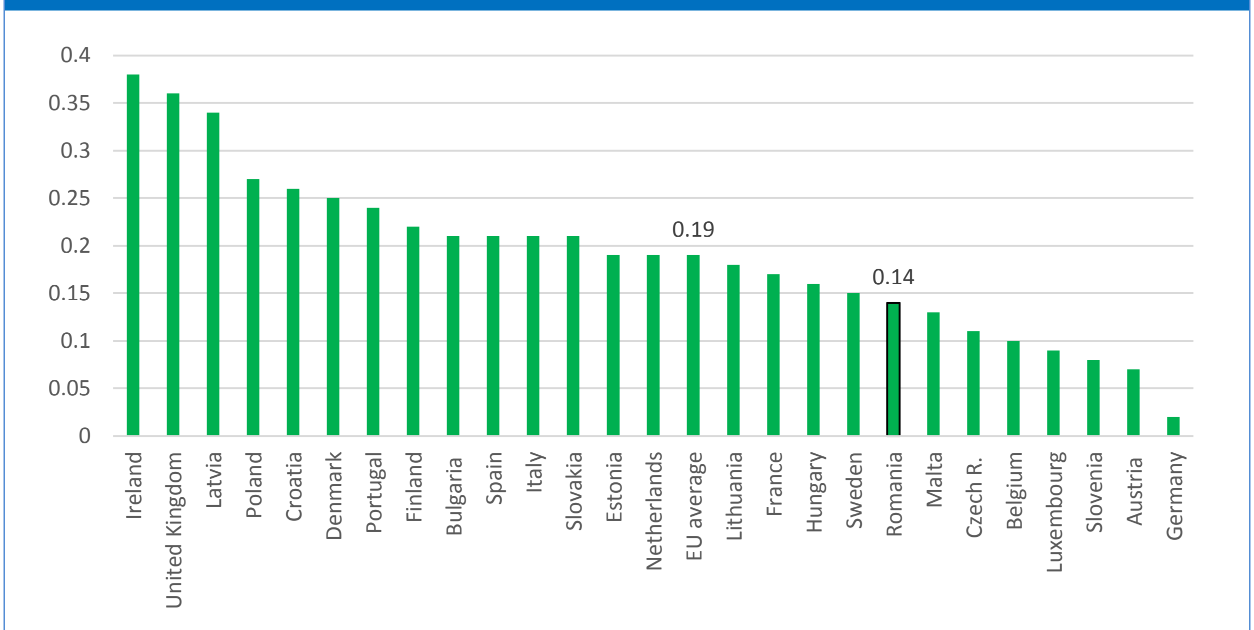
[69] 1 - (type 1 error + type 2 error).

required, in terms of a cumulated gradual improvement in the structural primary balance for an interval of 5 years over the forecasted period (2018-2022), to reach a 60% public debt-to-GDP ratio by 2030.

The long-term sustainability indicator S2 shows the adjustment to the current structural balance of the GCB needed to fulfil the government inter-temporal budget constraint over the infinite horizon. The indicator aims to cover entirely the current debt, and the present value of the future expenditure, including those related to ageing population costs. The indicator is measured as a percentage of GDP and higher values indicate that the need for fiscal adjustment and the risk to fiscal sustainability are higher.

The EC report on fiscal sustainability, edition 2015, published on January 1, 2016, indicates that, on a short time horizon, Romania does not pose a significant risk indicator, S0 scoring a low level, below the EU average and in the second part of the ranking. The net international investment position and the share of non–performing loans could represent a source of short-term contingent liability risks while the analysis of the structure of public debt financing highlights some short-term risks in terms of foreign currency denomination and nonresident creditor base.

Figure 47: Short-term sustainability indicator S0

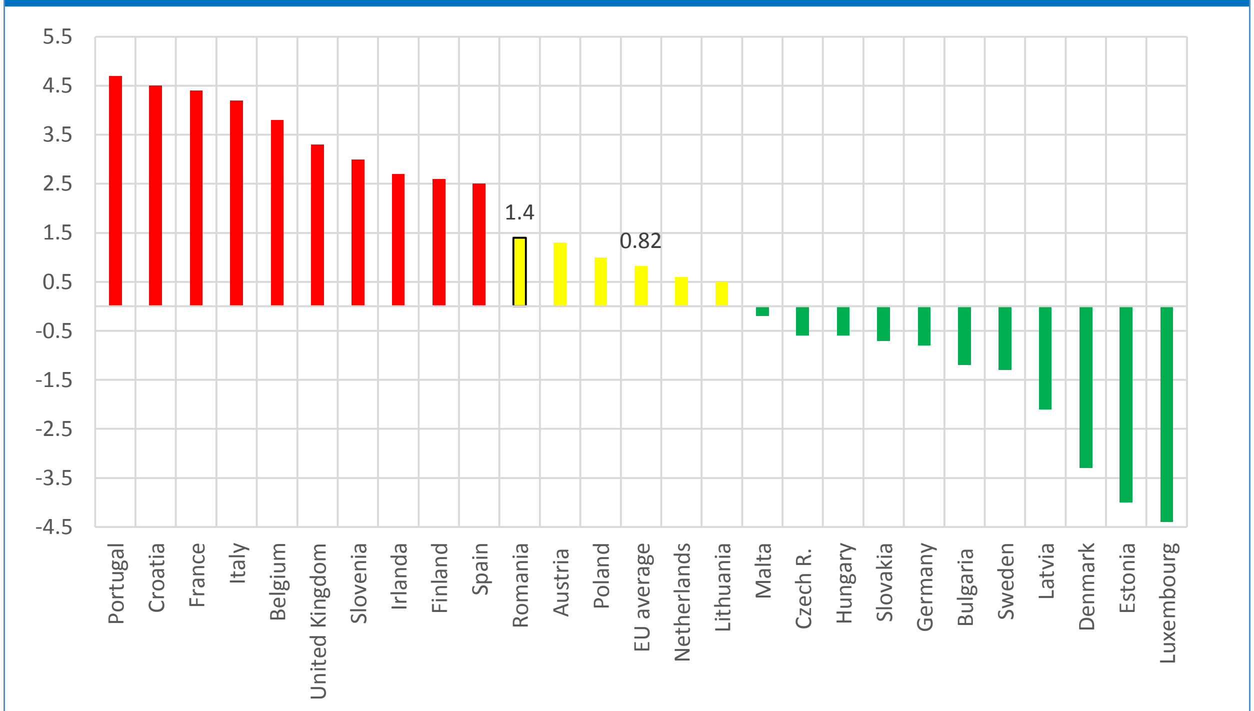


Source: EC, "Fiscal Sustainability Report 2015"

Note: In the graphs illustrating the sustainability indicators SO, S1 and S2, the green color signifies a low risk, yellow designates a medium risk and red represents a high risk.

On the medium-term, from the perspective of the sustainability of the public debt, Romania faces major risks as the public debt would increase above 60% of GDP in 2026 (last projection year) while maintaining constant the current deficit, sensitivity tests, in particular the negative shocks affecting the primary balance. In the case of a simulation of simultaneous shocks on economic growth, interest rate and primary balance, the EC estimated a probability greater than 70% as Romania's public debt in 2020 will be higher than that of 2015 (39% of GDP). The sustainability gap indicator S1 has a value of 1.4 pp of GDP and indicates medium risk, but in conjunction with the debt sustainability analysis, led that Romania was ranked in high-risk category, being the sole country in that category with a medium S1.

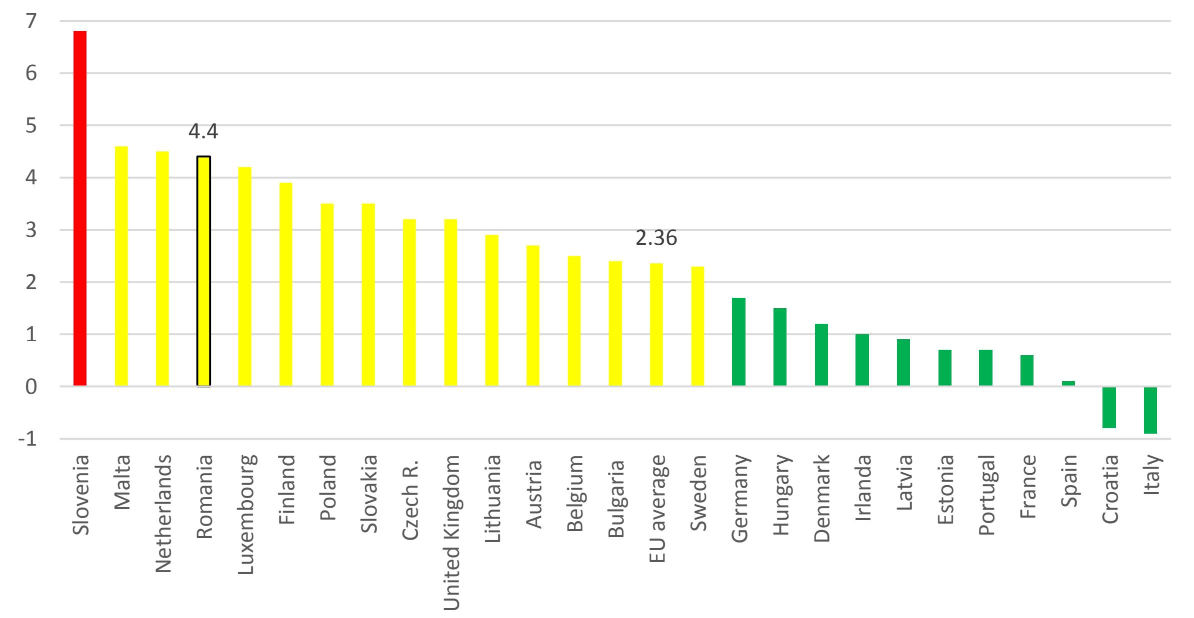
Figure 48: Medium-term sustainability indicator S1



Source: EC, "Fiscal Sustainability Report 2015"

The fiscal sustainability gap indicator S2 shows a medium risk on long term for Romania. It stresses the need for a fiscal adjustment of 4.4% of GDP, relative to a baseline scenario with no fiscal changes, in order to ensure long-term sustainability of public finances. Romania is placed on the fourth position among the European countries' ranking on this indicator, far above the EU average of 2.36%. The indicator S2 has two main components: the initial budgetary position (2.9 pp contribution to the adjustment required) and long-term costs of aging: pensions (0.1 pp), health (1.1 pp) and other (0 3 pp). Although, compared to 2009, Romania has progressed regarding the S2 indicator (9.1% of GDP in 2009) compared with 2012, it increased by 0.7 pp (from 3.7% in GDP in 2012), indicating an upsurge of the risk for long-term sustainability.

Figure 49: Long-term sustainability indicator S2



Source: EC, "Fiscal Sustainability Report 2015"

VI. 2016 – Macroeconomic and fiscal perspectives

VI.1. Macroeconomic framework

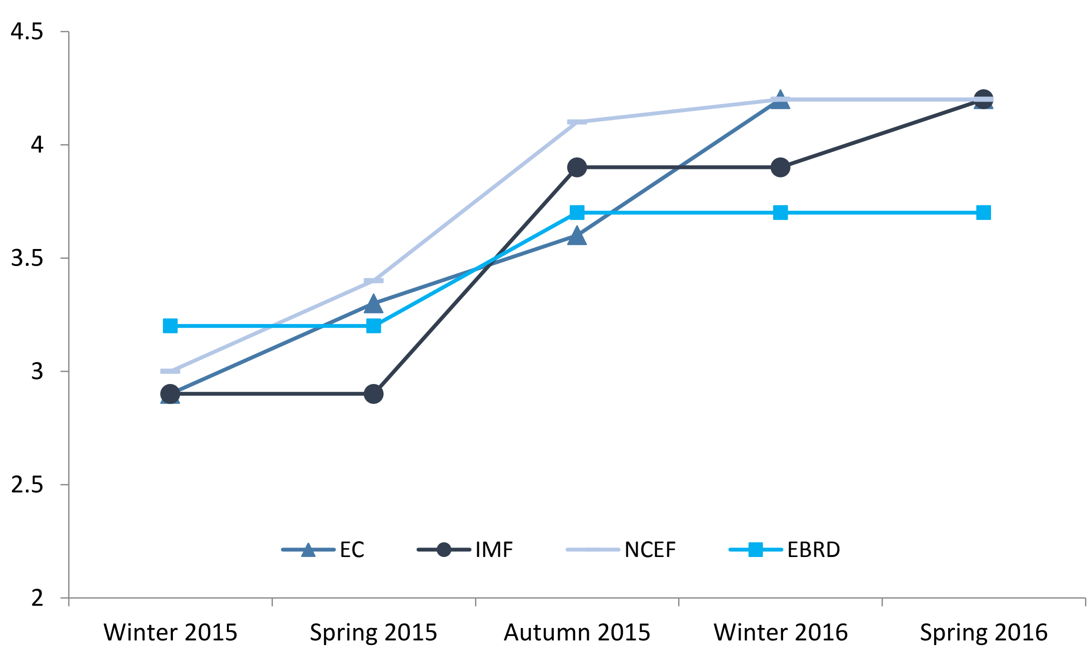
2016 represents the fourth year of recovery and moderate growth of the European economy, supported by the euro depreciation and higher private consumption favored by low interest rates and lower oil prices. In the Spring Economic Forecast published in May 2016, the EC estimate for 2016 a real GDP growth of 1.8% in the EU and 1.6% in the euro area, and for 2017 an economic growth of 1.9 % for the EU and, respectively, of 1.8% for the euro area. The positive factors that underpinned growth in 2015 are expected to persist in the coming period, but new challenges such as geopolitical tensions, uncertainty in global markets, the slow pace of development of emerging markets and weak global trade could threaten the economic growth. Also, political uncertainty and the immigrant's crisis pose major risks on the economic development in Europe, in particular affecting investment.

The European Commission estimates positive growth rates in almost all EU countries, except, as in the previous year, Greece (-0.3%). The best performing countries in terms of projected real GDP growth are Ireland (4.9%), Romania (4.2%), Malta (4.1%), Poland (3.7%) and Sweden (3.4%). In contrast, Finland will be expected to record the lowest rate of positive growth in the EU (0.7%). Average economic growth in Europe is expected to be lower than in the United States (2.3%) and below the level of global economic growth (3.1%). Is worth mentioning that in real terms, at least one third of EU countries has still to recover to reach the level before the crisis, GDP in Greece being in 2015 at a level of only 74.1% of real GDP registered in 2008, while another ten European countries stand at over 90% of the GDP level in 2008. In contrast, significantly higher levels of real GDP compared to 2008 were recorded in Poland (+23.1%), Malta (+21.5%), Slovakia (+11.7%), Sweden (+10.9%). Thus, it can be noticed a heterogeneous development of the economic activity and partly divergent among the EU member states in the period 2008-2015, the crisis affecting in different ways the economies of these countries, in conjunction with preexistent domestic imbalances.

For 2016, it is estimated a low inflation rate, below the initial expectations, 0.3% and 0.2% for the EU and, respectively, for the euro area (the 2015 Autumn Forecast predicted a double level of inflation: 1.1% for the EU and 1% in the euro area), but higher compared to the previous year (0%). Inflation rate is expected to rise gradually as a result of wage growth, stronger domestic demand and a moderate recovery in oil prices. Thus, the expected level of the inflation rate in the EU is 1.5% for 2017, while for the euro area is projected to 1.4%. The inflation rate in Romania recorded in the first months of 2016 the minimum values for the harmonized index of consumer prices: -1.5% (January 2016 compared to January 2015), -2.1% (February 2016 compared to February 2015), respectively - 2.4% (March 2016 compared to March 2015), and the average forecasted by EC for 2016 is -0.6%. Romania will be among the nine EU countries that will register negative values for inflation rate, together with Greece, Spain, Cyprus, Luxembourg, Slovenia, Slovakia, Bulgaria and Croatia.

For Romania, the EC spring forecast predicts a GDP growth rate of 4.2% in 2016, a higher value than in 2015 (3.8%), when it was recorded the highest value of this indicator since the beginning of the crisis in 2008. Moreover, the advance of the Romanian economy is superior to both the European average (1.8%) and the global average (3.1%). Relying on a growing trend of private consumption stimulated by the fiscal loosening and higher income for some social categories, Romania will register the second highest rate of the projected economic growth in Europe after Ireland (4.9%). Regarding the composition of the economic growth, domestic demand will contribute with 6.4 pp, while net exports have a negative contribution of -2.2 pp. It is expected that Romania will record a current account deficit (-2.1% of GDP) due to a faster growth rate of imports compared to exports. For 2017, the EC estimates for Romania a slowdown of the economic growth to 3.7%, which is still higher than the forecast for the EU average growth rate.

Figure 50: The evolution of the Romania's economic growth forecasts for 2016



Source: EC, IMF, NCEF, EBRD

When analyzing the dynamics, the economic growth forecasts for Romania in 2016 have been revised upwards for this year by all three international financial institutions, the estimate for the economic advance increasing from a value of about 3% in early 2015 to nearly over 4%, at the beginning of 2016. Thus, on the background of increasing optimism regarding the economic recovery in a sustainable way, the international institutions have modified upwards by more than 1 pp the estimate of real GDP growth in 2016. The factor that contributed to the need for these adjustments was the decisions regarding the fiscal loosening in 2016, subsequently included in the new Fiscal Code.

According to the Inflation Report published by NBR in May 2016, the consumer price index development will be affected by the fiscal relaxation measures regarding the indirect taxes. According to the baseline scenario, annual CPI inflation will remain in the negative territory until mid-2016 and will record a value of 0.6% at the end of 2016 and 2.7% at the end of 2017. The fiscal loosening measures have transitory effects on inflation, explaining its volatility on the reference period and having the potential to negatively alter the accuracy of forecasts. In the alternative scenario, when calculating eliminating the first-round transitory effects of the gradual reductions in VAT, inflation is situated on an upward trajectory, and within the associated range of the target (multi annual stationary target of 2.5 +/- 1 pp) starting the third quarter of 2016 until the end of the reference period. In the first quarter of 2018 when the transitional effects of the tax measures will be exhausted, the two scenarios are identical.

In the Fiscal Council's opinion, the risks to real GDP growth in 2016 are relatively balanced, as the advance above expectations in the first quarter of this year by 1.6% compared to the previous quarter and, respectively, by 4.2% compared to the same period in 2015, has the potential to be offset by the negative effects on the economic activity associated to the law regarding the discharge of mortgage-backed debts through transfer of the property to the creditor, by the uncertainties regarding the external environment or by the delays to the start of the projects financed from European funds for the financial framework 2014-2020.

VI.2. The fiscal framework

The initial budget for 2016 envisaged a general consolidated budget deficit target of 2.8% according to cash methodology, respectively of 2.95% of GDP according to European standards, given that at the moment of preparing the budget for the current year (4 December 2015), the impact of changes in the Fiscal Code and public sector wage increases legislated in the second half of 2015 were incorporated and the Government's estimates indicated a level of the budget balance for 2015 of -1.2% of GDP, according to both cash and ESA 2010 standards. Data on the budget execution for 2015, published in April 2016, shows a deficit of only 0.74% according to the European methodology, mainly due to outperforming revenues, which is likely to support the achievement of the fiscal targets this year.

According to its opinion on the state budget law, drawn up in December 2015, the Fiscal Council noticed that the draft budget for 2016 and its associated medium term are characterized by a deliberate and large deviation from all fiscal rules imposed by both national legislation and the European treaties signed by Romania and induce a significant vulnerability for the position of the public finances, thus substantially complicating their management in the event of adverse shocks manifestation. Thus, subsequent to accelerated fiscal consolidation in the period 2010-2015, the budget construction for 2016 records the deterioration of the structural budget balance to the amount of -2.8% of GDP from -0.7% of GDP in 2015, but without indicating the convergence path towards the medium-term budgetary objective. **In this context, the country's risk of re-entering in excessive deficit procedure appears as significant, given that for 2017, the latest projections of the EC indicate a level of 3.4% of GDP for headline deficit in ESA 2010 standards as well as in structural terms.** In addition, automatic correction mechanism established by the Fiscal Compact and provided by FRL is not functional at this time. In the same document, the Fiscal Council identified a possible overestimation of budget revenues projected for current year, but considering the starting point more favorable than the estimated one at that time in terms of aggregate revenues at the end of 2015, it lifts its reservations expressed then on this aspect.

Fiscal Council has repeatedly drawn attention to the fact that a major fiscal loosening passed under a production gap close to zero in 2016 and subsequent positive during the period 2017-2019 is totally counterproductive because the adopted measures accentuate the procyclical stance of fiscal policy with permanent negative impact on the budget deficit. This slippage, whose subsequent correction through a fiscal consolidation in the downward phase of the economic cycle is likely to generate economic and social costs that will exceed the positive short-term effects of fiscal loosening, as it is shown by economic theory, empirical estimates at international level and also by the Romania's experience in the last 10 years. Moreover, the Fiscal Council expresses serious reservations about the authorities' opinion relative to the potential positive implications on economic growth in the long term, that the new Fiscal Code could bring, aimed to reduce taxation on consumption, the most likely scenario is that of a plus temporary aggregate demand, unaccompanied by a significant similar impact on the long-term growth potential.[70]

At the end of March 2016, both revenues and, especially, expenditures were, significantly below the quarterly program corresponding to the initial form of GCB. Thus, the total revenues of the GCB were below the amount programmed by about 1.86 billion lei (96.8% achievement

[70] Scientific literature indicates that reducing taxation on consumption does not improve domestic and external competitiveness of the national economy products. In addition, the effect of reducing taxation on consumption on long-term economic growth is relatively modest.

rate compared to the budgetary revenue program), and the budgetary expenditure by about 12.9 billion lei (only 80.3% achievement rate compared to the program), so the impact of the budget balance is favorable, moreover it is an achievement of a budget surplus of around 3 billion lei compared to the quarterly target, which foresaw a deficit of about 8 billion lei.

Regarding the budgetary revenues, the underachievement it was exclusively the effect of the massive underperformance of the revenues from European funds (-2.6 billion lei compared to the program) and also those for the financial framework 2007-2013 (-0.7 billion lei, respectively an achievement rate of 13.7%), while the current revenues, respectively those related to the economy's development, recorded a superior growth rate compared to the programmed level (+1.1%), respectively an excess of about 0.6 compared to the program. To this revenue aggregates, underperformance compared to the programmed level of receipts for the first quarter of this year were recorded at the level of contributions (-731 million lei), property taxes[71] (-683 million lei), other taxes on goods and services (-480 million lei), non-tax revenues (-156 million lei), while overruns of the quarterly targets were observed for the VAT receipts (+1.1 billion lei), income from: corporate income tax (+627 million lei), other taxes on income, profits and capital gains (+207 million lei), excise (+190 million lei), wages and income tax (+170 million lei) and non-tax revenues (+156.3 million lei).

It is noteworthy that the VAT revenues for the first quarter of this year, includes for January 2016 the receipts for December 2015 related to the standard VAT rate of 24%, the impact of reducing VAT rate from 1 January 2016 will be highlighted from February of the current year. Thus, after a significant increase compared to the same period of the last year of 17% of VAT receipts in January, in the next 2 months, significant growth rates entered in a negative territory, respectively -15% in February and -14.3% in March. Under these conditions, the achievements over the programmed level in the first quarter are significantly influenced by performance in January, projected VAT receipts for this year having a higher degree of uncertainty given the significant rate cuts from last year.

On the expenditure side, all the expenditure categories, without exceptions, registered at the end of the first quarter, lower levels than the programmed levels. The largest share of the 12.9 billion lei deviation of total expenditure compared to the programmed level corresponds to the projects funded by external post-accession grants (-3.9 billion lei, of which 1.35 billion lei for financial framework 2014-2020) and capital expenditures, whose achievement rate is only 36.9% of the quarterly program (-2.7 billion lei). An underperformance of lower magnitude compared to the program can be observed in the case of expenditures related to: goods and

[71] The decrease of 25.9% compared to the program was due to a delay of the payment or postponement of the deadline for payment of tax on property by 30 June, date until can be applied a 10% discount to full payment of tax on housing, land and cars.

services (-1.9 billion lei), subsidies (-1.0 billion lei), interest (-989 million lei), other transfers (-984 million lei) and personnel expenditures (-796 million lei).

Essentially, the budget execution for the first quarter of 2016 recorded massive underachievevments for the revenues from European funds, combined with current income slightly exceeding the programmed level, while on the expenditure side, their underperformance against the initial planning is widespread and at extremely high levels for projects financed by external EU funds or for the capital expenditures. In those circumstances, also this year, the intention of reducing the volatility of inter-quarterly budget execution, especially at the level of investment spending, it has not materialized up to now.

In the context of maintaining the actual parameters of the fiscal policy, the balance of risks for 2016 appears to be balanced and the Fiscal Council considers that the target of deficit for this year is achievable. On the negative side, the risks come from the possible new expansionary legislative initiatives that could emerge in the context of local and parliamentary elections taking place this year, including the increase of the wages in the public sector, while in the purpose of registering a smaller deficit than projected could imply, without being a desirable evolution, an underachievement of the investment spending as a result of a low absorption of EU funds for financial framework 2014-2020, given the late start of the investments financed from this source.

The Fiscal Council notes that the construction of the budgetary framework for the period 2016-2018 is in flagrant contradiction with the principles and rules established by the FRL and with the fiscal governance treaties at the European level at which Romania adhered, observing a de facto failure of the fiscal framework based on rules, which have not been able to exert strong constraints on fiscal policy makers, the following years revealing a major budgetary slippage generated by a mix of aggressive tax cuts, particularly on consumption, combined with significant budgetary expenditures, in particular related to wages. Moreover, Romania will have, since 2016, the lowest budgetary revenues at the European level, which will greatly complicate the budgetary construction on the medium-term. **The persistence in the next period of high budgetary deficits, would imply in the upswing phase of the economic cycle maintaining public debt expressed as a share of GDP on an upward trajectory, instead of using this period in a prudential manner to reduce indebtedness, which would make possible to accommodate future vulnerabilities from an inevitable downward phase of the economic cycle[72].**

[72] According to a study by the NBR, at a level of 40-45% of GDP for public debt, there is an adverse effect on economic growth.

Again, we emphasize the idea that it would be sufficient the maintaining of a budget deficit below 3% of GDP is incorrect; this level is not a "target", but rather a ceiling that is allowed to be attained only under adverse cyclical effects of deep recession, which obviously is not at all the case of Romania. Moreover, there is a major qualitative difference between having structural/headline deficits still high as a result of a fiscal adjustment trajectory less abrupt than necessary and achieving a relatively similar structural/headline deficit following a deliberate slippage in flagrant contradiction to the principles and rules established both by national law and European treaties. According to EC projections, Romania is among the few EU countries that reversed fiscal consolidation trend, and the magnitude of the structural deficit increases in the period 2016-2018 is the largest in the EU.

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Appendix – Glossary of terms

Adjustment program - a detailed economic program, usually supported by use of IMF resources, that is based on an analysis of the economic problems of the member country and specifies the policies implemented or that will be implemented by the country in the monetary, fiscal, external, and structural areas, as necessary to achieve economic stabilization and set the basis for self-sustained economic growth.

Aggregate demand - total expenditures of internal and external users for acquiring final goods and services produced in an economy. It is computed as the sum between internal demand and exports of goods and services.

Aggregate supply - represents all goods and services offered on the domestic market by all domestic and foreign operators. In other words, the aggregate supply is total domestic production of economic goods plus foreign countries offer (imports).

Annual spending ceiling – the maximum amount, set by law, that can be allocated to a certain category of government spending in one year.

Arrears of the general government – money loans or debt that have become overdue for more than 90 days following the breach of a contract between economic entities and the state as result of contractual terms' violations.

Automatic disengagement – part of the budget commitment that is automatically disengaged by the European Commission if it remains unused or if no request for payment is received by the end of the third year after the budgetary commitment. The difference between the two values (the one allocated and the one forwarded to the Commission for reimbursement) is lost through the automatic disengagement procedure.

Automatic stabilizers - features of the tax and transfer systems that tend to offset fluctuations in economic activity without direct intervention by policymakers. Examples are unemployment compensation and progressive taxation rates.

Balance of payments - accounting record describing the transactions concluded between a country and its external partners in a specified period of time.

Base point –unit of measure for the interest rate, equivalent to 0.01%.

Budget balance - indicator computed as the difference between overall budget revenues and budget expenditures.

Budgetary policy - financial policy of the state regarding the public expenditures; public resource allocation policy.

Budget revision – operation through which the budget is amended during a budgetary year.

Buffer – a reserve established by the Ministry of Public Finance in the Treasury in order to cover in advance the financing needs and which serves to protect against the event of adverse conditions in financial markets.

Capital account - account which reflects the evolution of capital transfers and acquisitions/ sale of non-financial assets.

Cash methodology - involves recording revenues when they are actually received and recording expenses at the time of payment.

Clawback tax – charge imposed on the pharmaceutical industry that requires that all manufacturers of medicinal products to help the finance public health system with part of the profits made from sales of subsidized drugs in excess of their allocated from the Unique National Fund for Health Insurance.

Cohesion Fund (CF) – financial instrument supporting investments in transport infrastructure and environment.

Conditionality - economic policies that members intend to follow as a condition for the use of IMF resources. These are often expressed as performance criteria (for example, monetary and budgetary targets) or benchmarks, and are intended to ensure that the use of IMF credit is temporary and consistent with the adjustment program designed to correct a member's external payments imbalance.

Contagion - the transmission of shocks to several economic sectors, internally and abroad.

Contribution - compulsory imputation of a share from the revenues of employees or firms, with or without the possibility of obtaining a public service in exchange.

Countercyclical fiscal policy - is a fiscal policy behavior which has the role of stabilizing the economic cycle and helps to reduce cyclical fluctuations and inflationary pressures from excess demand.

Country risk premium – additional return required by an investor to compensate for the increased risk posed by a certain investment in a country. This is reflected in CDS quotations which measure the cost of insuring against default risk.

Current account deficit - occurs when total imports of goods, services and transfers of a country are greater than exports of goods, services and transfers of that country; in this case, that country becomes a net debtor to the rest of the world.

Cyclical adjustment of budgetary revenues - elimination of the budgetary revenues component dependent to the demand excess/deficit (economic expansion/contraction), eliminating trend deviations; the level of budgetary revenues cyclically adjusted is the level that would have been collected if the GDP reached its potential growth.

Cyclical component of budget balance - modification of the budget balance due to cyclical developments in the economy.

Cyclically adjusted budget balance (CABB) – the general government balance net of the cyclical component. CABB is a measure of the fundamental trend in the budget balance.

Direct Public Debt - total public debt, except guaranteed public debt.

Disinflation - process of reducing inflation.

Economic classification - expenditure structuring based on their economic nature and effect.

Economic growth - annual growth rate of the real GDP

ESA 2010 methodology (*European System of National and Regional Accounts*) - The European System of National and Regional Accounts is an accounting reporting framework used internationally for an systematic and detailed description of an economy (of a region, a country or group of countries), or its components and its relations with other economies; The main differences between ESA 2010 methodology and cash methodology are revenues and expenditures recording in "accrual" system (based on commitments, not actual payments like in cash system). ESA 2010 methodology replaces ESA 95 methodology being adopted in 2013.

Euro Plus Pact - it is also known as the Competitiveness Pact and its objective is the stability of euro area, member states committed themselves to take measures to encourage competitiveness, employment and consolidation of public finances.

European Agricultural Guarantee Fund (EAGF) - European funds for implementation of support measures for farmers.

European Regional Development Fund (ERDF) - Structural Fund which supports the less developed regions by financing investment in the productive sector, infrastructure, education, health, local development and small and medium enterprises.

European semester - additional tool for preventive surveillance of economic and fiscal policies of the Member States; the European Semester is a six-months period every year during which the Governments of the member states have the opportunity to collaborate and discover the experiences and opinion of their EU homologues in order to detect any inconsistencies and emerging imbalances of economic and fiscal policies that could violate the rules of the Stability and Growth Pact.

European Social Fund (ESF) - Structural Fund for Social Policy of the European Union, which supports employment measures for labor and human resource development.

Eurosystem - the central banking system of the euro area. It comprises the ECB and the national central banks of those EU Member States whose currency is the euro.

Excessive Deficit Procedure (EDP) – the corrective arm of the Stability and Growth Pact (SGP) that impose penalties in cases of no prompt correction of excessively high deficits (having breached or being in risk of breaching the deficit threshold of 3% of GDP at market prices) or excessively high debt (having violated the debt rule by having a government debt level above 60% of GDP, which is not diminishing at a satisfactory pace. This means that the gap between a country's debt level and the 60% reference needs to be reduced by 1/20th annually on average over three years).

Exchange Rate Mechanism II (ERM II) - the exchange rate arrangement established on 1 January 1999 that provides a framework for exchange rate policy cooperation between the Euro system and EU Member States whose currency is not the euro. Although membership in ERM II is voluntary, Member States with derogation are expected to join. This involves establishing both a central rate for their respective currency's exchange rate against the euro and a band for its fluctuation around that central rate. The standard fluctuation band is ±15%, but a narrower band may be agreed on request.

Excise – special consumption tax applied to domestic and imported products, borne by consumers and included in the sale price of some specific commodities.

Expansionary fiscal policy - is a fiscal policy behavior that has an accelerating effect in aggregate demand growth and possible amplification of inflationary pressures.

Expansionary monetary policy - the monetary policy behavior has effect in stimulating aggregate demand and a possible amplification of inflationary pressures.

Fee - the price one pays as remuneration for services provided by an economic agent or a public institution.

Final consumption - component of the aggregate demand which includes private consumption and government expenditures for public good and services.

Financial account - account which presents the transactions associated with ownership change on assets or liabilities of a country and includes foreign direct investments, portfolio investments, financial derivatives, other capital investments and reserve assets.

Fiscal Compact – part of the Treaty on Stability, Coordination and Governance signed on March 2, 2012 by all EU member states, excepting the United Kingdom and Czech Republic. The treaty is aimed at strengthening fiscal discipline by introducing an automatic correction mechanism and stricter surveillance. The fiscal compact establishes a requirement for national budgets to be in balance or in surplus. This criterion would be met if the annual structural government deficit does not exceed 0.5% of GDP at market prices. If public debt is significantly below 60% of GDP and risks addressing long-term public finance sustainability are low, the structural deficit may reach a maximum level of 1% of GDP.

Fiscal consolidation - the policy aimed to reduce budgetary deficits and the accumulation of public debt.

Fiscal impulse - the impact of discretionary fiscal policy on aggregate demand. It is computed as change of structural balance from the previous period; a positive value corresponds to an expansionary fiscal policy and a negative value - to a restrictive fiscal policy.

Fiscal policy - a policy that wants to influence the economy using the system of taxes as instrument.

Fiscal revenues - budget revenues collected through taxation. Fiscal revenues include: personal income taxes, corporate income taxes, capital gain taxes, property taxes and fees, good and services taxes and fees, taxes on foreign trade and international transactions, other taxes and fiscal fees, social contributions.

Fiscal rule - a long-term constraint on fiscal policy through numerical limits on budgetary aggregates. Fiscal rules are intended to avoid pressure from incentives and excessive spending, especially in the upward phase of the economic cycle so as to ensure accountability in the management of public finances and public debt sustainability.

Fiscal space – 1. The difference between current public debt and a threshold of public debt, a threshold level that does not involve increasing costs for financing the deficit and which takes into account historical evolution of fiscal adjustment; 2. Financial resources available for additional expenditure required to implement development projects.

Fiscal strategy - public policy document designed to set out fiscal objectives and priorities, revenue and expenditure targets of the General Consolidated Budget and its components and the evolution of the budget balance for a three-year period.

Fiscal sustainability - a set of policies is said to be sustainable if the state is able to meet its debt payments without any major additional correction in the budget balance.

Functional classification - expenditure structuring based on their destination in order to assess public funds allocations.

GDP deflator - an indicator that reflects the change in prices of the goods and services composing GDP; it is computed as a ratio of GDP in current prices and GDP in prices of the base year.

Guaranteed public debt - loans guaranteed by the Ministry of Finance and local government authorities.

Harmonized Index of Consumer Prices - Consumer price index whose methodology has been harmonized between European Union countries; the inflation objective of the European Central Bank and the euro area inflation rate are expressed based on this index.

Implicit tax rate - the ratio between revenue collected for a particular type of tax and its associated tax basis.

Inflation - reflects the widespread and persistent increase in prices and it is typically measured by the consumer price index. Inflation erodes the purchasing power of money: the same amount is used to buy fewer goods.

Inflation target - inflation target set by central banks that have adopted inflation targeting strategy. The target can be set as a fix-level of inflation and/or as a range. The National Bank of Romania sets the target as a midpoint within a target band of +/- 1 percentage point.

Informal Economy - legal economic activity, but hidden from public authorities in order to avoid paying taxes, social contributions or to avoid compliance with legal standards on labor and with other administrative procedures.

Medium Term Objective (MTO) - is the medium-term objective for the budgetary position and differs for each EU member state. For states that have adopted the euro or are in the Exchange Rate Mechanism II, it is -1% of GDP or a budget surplus. Reassessment of medium-term objectives is done every four years or when major structural reform is adopted.

Monetary policy interest rate – the monetary policy interest rate represents the interest rate used for the main open market operations of the NBR. At present, these are one-week repo operations, developed by auction at fixed interest rate.

Nominal convergence criteria (Maastricht) - the four criteria set out in Article 140 (1) TFEU that must be fulfilled by each EU Member State before it can adopt the euro, namely: 1) the inflation rate must not exceed by more than 1.5 percentage points the average of the three best performing EU countries in this respect; 2) the long-term nominal interest rate must not exceed by more than 2 percentage points the average interest rate in the first three member states with the best performance in terms of price stability; 3) the public budget deficit must be less than 3% of GDP, public debt to GDP ratio must be less than 60%; 4) exchange rate fluctuations must not exceed + / - 15 percent in the last two years preceding the examination.

Nominal variables – variables expressed in current prices.

Non-fiscal revenues - other budget revenues that do not include taxation, such as royalties, payments from SOE' profit, fines, charges.

One-off component of the budget balance – a component of income or expenses that has a temporary nature.

Output gap - an indicator that measures the difference between actual GDP of an economy and potential GDP; the term "excess demand" is also used.

Pillar 1 of the pension system – the name given to the state pension system; has a compulsory character and is based on the redistribution of money collected during a financial year, the "pay as you go" system (the present employees pay now for the currently retired population).

Pillar 2 of the pension system – name given to the private pension system; has a compulsory character for employees below the age 35 at the time of its introduction (2007) and aims to provide a private pension that supplements the public pension. Contributions to private pension funds are nominal and immediately after they are paid into the employee's account, they become his property.

Potential GDP - real GDP that can be produced by the economy without generating inflationary pressures; Potential GDP is determined by long-term fundamental factors as organization of the economy and the productive capacity of economy determined by technology and demographic factors that affect the labor, etc.

Primary balance of the General Consolidated Budget - the difference between budget revenues and budget expenditure, excluding the interest payments with regard to public debt.

Pro-cyclical fiscal policy - the fiscal policy behavior does not fulfill its stabilizing role of economic cycle but rather contribute to amplify cyclical fluctuations and inflationary pressures from excess demand.

Proxy – A variable which estimates /approximates and replaces another variable, an unobservable one.

Quasi-fiscal deficit - takes into account public sector expenditure not recorded into the budget; particularly, it refers to the losses of state owned enterprises which translate in the defaults of their financial obligations to the public budgets and public utilities.

Real convergence - in the process of adhesion to a single currency area, it is necessary to achieve also a real convergence, respectively a high degree of similarity and cohesion of economic structures of the candidate countries; although the Maastricht treaty does not mention real convergence criteria, these can be summarized by a series of economic indicators like GDP per capita, the degree of openness, the share of the commerce with member states, economic structure.

Real GDP - represent the value of final goods and services produced in an economy in a given period, adjusted with price increases. Real GDP dynamics is used to measure the economic growth of a country.

Real variables – variables expressed in constant prices (the prices of a base year).

Reference interest rate – Starting with September 1st, 2011, the NBR's reference interest rate is the monetary policy interest rate, established by decision by the NBR's Board of Directors.

Restrictive monetary policy - the monetary policy behavior constrains the aggregate demand in order to reduce inflation.

Royalty - payment to the holder of a patent or copyright or resource for the right to use their property.

S0 – an "early detection indicator" which was designed to highlight shorter term risks of fiscal stress (within a 1-year horizon) through the "signals approach".

S1 - indicator of the sustainability gap that shows increasing taxes or reducing expenditure (as a percentage of GDP) required subject to a debt level of 60% of GDP at the end of the period.

S2 - indicator of the sustainability gap that indicates the fiscal effort (as a percentage of GDP) required subject to the inter-temporal budget constraint on an infinite time horizon.

Seasonality - periodic pattern in the evolution of an economic variable that systematically appear at certain times of the year.

Stability and Growth Pact - The Stability and Growth Pact consists of two EU Council Regulations, on "the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies" and on "speeding up and clarifying the implementation of the excessive deficit procedure", and of a European Council Resolution on the Stability and Growth Pact adopted at the Amsterdam summit on 17 June 1997. More specifically, budgetary positions close to balance or in surplus are required as the medium-term objective for Member States since this would allow them to deal with normal cyclical fluctuations while keeping their government deficit below the reference value of 3% of GDP. In accordance with the Stability and Growth Pact, countries participating in EMU will submit annual stability programs, while non-participating countries will provide annual convergence programs.

Stand-by Arrangement - A decision of the IMF by which a member is assured that it will be able to make purchases (drawings) from the General Resources Account (GRA) up to a specified amount and during a specified period of time, usually one to two years, provided that the member observes the terms set out in the supporting arrangement.

Stock-flow adjustment of public debt – process that ensures consistency between changes in debt stock and net lending flows. It takes into account accumulation of financial assets, changes of foreign currency debt and statistical adjustments.

Structural budget deficit - the budget deficit that would be recorded if GDP was at its potential level; it’s the size of the deficit recorded in the absence of business cycle influences.

Structural budget balance – is determined by deducting from the cyclically adjusted budget balance the temporary elements (one-offs).

Swap – chain compensation scheme for outstanding obligations to BGC; operation through which the extinction of outstanding budgetary obligations, with equivalent impact on revenues and expenses.

Taxation efficiency index – index through which it is measured the effectiveness of tax collection. It is computed as the ratio of the implicit tax rate and the statutory tax rate.

Taxes - compulsory and non-refundable levy charged by a government with the purpose of financing public goods and services.

The contingency reserve fund – amount of money available to the Government, which is allocated to line credit officers from state government and local governments, based on Government's decisions to finance urgent or unforeseen expenditures incurred during the year.

The implicit tax rate – the ratio between the actually collected revenue for a specific type of tax and the corresponding macroeconomic tax base

Trade balance - section of the balance of trade which presents the difference between exports and imports of goods and services recorded in a specified period of time.

Voluntary compliance – principle under which taxpayers will comply with the tax laws and, more importantly, will accurately report income and the deductions they benefit from, without direct compulsion by the authorities empowered to do so.