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

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

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

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

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

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

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

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

Brief description of the legislative proposal. General considerations

Currently, the social contributions for normal working conditions[1] paid by the employer and employee represent 44.35% of the gross wages being distributed as follows: 16.5% paid by the employee - 10.5% pension contributions, 5.5% health contributions, 0.5% unemployment contributions and 27.85% paid by the employer - 20.8% pension contributions, 5.2% health contributions, 0.5% unemployment contributions, 1.35% other contributions[2]. The legislative proposal intends to reduce the pension contribution of the employer by 5 pp., so the new rate envisaged for normal working conditions is 15.8%; the change will be operable starting from October 2014.

The promotion of the normative act is justified by "*the existence of a large labor tax burden associated with a high level of social security contributions that powers the pension system [...] that acts as a disincentive to employment, business stimulation and investments*." In this context, in the Fiscal Council's view, it would be of interest a regional perspective regarding the labor costs incurred by an employer through a brief comparative analysis in the New Member States from Central and Eastern Europe (NMS-CEE[3]). From the strict perspective of the level of contributions to the pension system, Romania indeed ranks first (from nine countries) with a rate of 31.3% (a 20.8% share incurred by the employer and a share of 10.5% paid by the employee), at a distance of about 3 pp. from the following country (the Czech Republic); considering only the contributions to the pension system that fall on the employer, Romania continues to be within the top of the hierarchy, but behind countries such as Lithuania (a share of 23.3%) or the Czech Republic (a share of 21 5%). However, **in terms of the costs incurred by an employer with the labor force, the overall level of social contributions is relevant**, irrespective of their destination (for

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

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

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

public pensions, health insurance, unemployment insurance or other purposes). From this perspective, considering the total contributions payable by the employee and the employer, Romania ranks fourth, their level being by around 4 pp lower than in the case of Slovakia, the country with the highest contributions and around 4 pp above the average; the relatively higher contributions' level for the pension system is partially offset by the relatively lower in terms of rates of contributions to health insurance, where Romania ranks 5 of 9 (with a level of contributions close to the average), but especially that of other social contributions (including unemployment insurance), where Romania ranks 8 out of 9, having a level of contributions significantly below the regional average. Moving the analysis towards the social contributions paid by the employer, Romania slightly exceeds the regional average being placed in the bottom of the hierarchy (6 out of 10). The upward deviation from the average is significantly higher in the contribution rates for employees; its position in these terms is the fourth, the same as in the case of aggregate social contributions.

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

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

Table 1		
Total SSC		
1	SK	48,60%
2	HU	47,00%
3	CZ	45,28%
4	RO	44,35%
5	PL	42,09%
6	LT	39,98%
7	SI	38,20%
8	EE	36,00%
9	LV	34,09%
10	BG	31,00%
Average contribution rates		40,66%

Table 2		
Pensions contributions		
1	RO	31,30%
2	CZ	28,00%
3	LT	26,30%
4	PL	26,02%
5	LV	25,16%
6	SI	24,35%
7	EE	20,00%
8	SK	18,00%
9	BG	17,80%
10	HU	NA
Average contribution rates		24,10%

Table 3		
Health contributions		
1	SK	14,00%
2	CZ	13,50%
3	SI	13,45%
4	EE	13,00%
5	RO	10,70%
6	LT	9,00%
7	PL	9,00%
8	BG	8,00%
9	LV	0,00%
10	HU	NA
Average contribution rates		10,07%

Table 4		
Others		
1	SK	16,60%
2	LV	8,93%
3	PL	7,07%
4	BG	5,20%
5	LT	4,68%
6	CZ	3,78%
7	EE	3,00%
8	RO	2,35%
9	SI	4,00%
10	HU	NA
Average contribution rates		6,18%

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

Table 5		
Total SSC - employer		
1	SK	35.20%
2	CZ	34.28%
3	EE	34.00%
4	LT	30.98%
5	HU	28.50%
6	RO	27.85%
7	LV	23.59%
8	PL	19.38%
9	BG	18.10%
10	SI	16.10%
Average contribution rates		26.8%

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

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

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

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

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

The Fiscal Council's calculations indicate a level of the net budgetary impact (considering only the first-round effects) not significantly different from the one indicated by the MPF. Thus, starting from the projected revenues for the 2014 Social Security Budget, adjusted with the amounts transferred this year to

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

the second pension[5] pillar (the result is labeled as gross revenues resulting from social contributions of the Social Security Budget), the annualized impact of reducing the pension contribution by 5 pp for the employer can be determined as: gross receipts from social contributions/ (the weighted average pension contribution rate *100)* 5. According to the information provided by the MPF to the Fiscal Council, the weighted average share for the pension contribution of the employer[6] is about 22%, a result which suggests that the majority of employees operate in normal working conditions, for which the related pension contribution is 20.8%. Under these conditions, the weighted average share of the pension contribution, relevant for the revenues collected to the Social Security Budget equals: 22% (pension contribution for employer) + 10.5% (pension contribution for employee) + 0.25% (employer's contribution to the insurance scheme for work accidents and occupational diseases) = 32.75%. So, the revenue loss from social security contributions is equal to 1.11 billion lei in 2014 (this year, given the intent of applying the measure from October 1st, the revenues are negatively affected in cash basis only for two months). Extrapolating the annualized impact in 2014 using National Prognosis Commission's (NCP) projections for the gross wage dynamics and for the number of employees, the revenue losses from social security contributions in the medium term are 7.02 billion lei in 2015, 7.4 billion lei in 2016 and 7.79 billion lei in 2017. In order to determine the net impact, it should be taken into account the personnel costs savings achieved through a reduction in the amounts owed by the state to itself regarding the related social contributions for which is responsible as an employer. In this respect, it is necessary to extract the gross wages from the personnel costs included in the latest version of the medium term fiscal strategy (dividing them by a factor of 1.288, determined by summing the pension contribution for employer – 22%, the health contribution for the employer – 5.2%, the employer's contribution for unemployment – 0.5%, the contribution for medical leave and other benefits – 0.85% and the contribution for insurance against accidents at work and occupational diseases - 0.25%) and multiplying the result by a rate of 5% corresponding to the pension contribution reduction introduced by the legislative proposal. Calculated in this way the expenditure savings are 0.31 billion lei in 2014 (for the two months affected in the cash execution), 1.94 billion lei in 2015, 2 billion lei in 2016 and 2.02 billion lei in 2017. The net impact determined by considering these two components (reduction of the revenues and cost savings) is about -800 million lei in 2014 (-0.12% of GDP) -5.08 billion lei in 2015 (-0 73% of GDP) -5.4 billion lei in 2016 (-0.73% of GDP), respectively, -5.77 billion lei in 2017 (-0.74% of GDP).

In order to illustrate the impact of the pension contribution reduction on the costs incurred by an employer with the labor force, the Fiscal Council presents in the Annex an example considering a company

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

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

that pays the average wage in the economy, assuming that employees are operating in normal working conditions. Thus, considering the average gross remuneration of 2,279 lei (similar to the projection of the NCP for 2014), the total amounts paid by the employer to the state (insurance contributions and personal income tax) represent in the current situation 1,315 lei and the total cost incurred by the employer is 2,914 lei. Assuming the reduced rate of 5 pp. for the employer, the total amount paid by the employer to the state is reduced by 114 lei, respectively by 8.66%, the new total cost to the employer necessary to pay the same net salary being 2,800 lei, respectively 3.91% lower.

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

Regarding the extra income from the tax on special structures, it must be stated that it is already exhausted by the three months postponement of the additional excise duty on fuel and by the decision to reimburse to the major carriers a part of this additional excise, the two measures having a cumulative negative budgetary impact of 923 million lei (570 million lei + 353 million lei), as the budget for the current year was built on the assumption that the fuel excise duty will be collected throughout the year (not from April as it happened) and not considering the last measure. Therefore, ceteris paribus, the fiscal space created by the difference between the effective revenues and the estimates has already been used and cannot act in the sense of compensating the impact of reducing the social security contribution rate. Nevertheless, this difference, under the assumption that the current tax will be maintained, will lower the net impact of reducing the pension contribution in the medium term, as the refund to the large carriers of a portion of the additional excise duty on fuel was not included in the medium-term fiscal projection and the three-month postponement of the introduction of the additional excise duty will affect only the budgetary revenues of the current year. The Fiscal Council estimates that on the medium-term the fiscal space resulting from the difference between the estimates and actual receipts from the tax on special structures is approximately 600 million lei per year in the period 2015-2017.

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

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

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

The Fiscal Council had already expressed its reservations about the feasibility of achieving the structural adjustment envisaged for 2015 in the context of the opinion on the State Budget Law, Social Insurance Budget Law for 2014 and the updated version of the 2014-2016 Fiscal Strategy, in the abscence of a specific set of measures able to produce such an adjustment. However, it should be noted that those reserves were expressed before the occurrence of the adverse effects on the fiscal position arising from the recently adopted measures, mainly those reffering to the reinvested profit tax exemption (in which case the Fiscal Council's evaluation indicates revenue losses significantly higher than the one developed by the Government) and the reduction of pension contributions. Moreover, the doubts about the likelihood of the adjustment path envisaged, also before considering the impact of the fiscal measures outlined above, have been expressed recently by the European Commission too, whose assessment indicates for 2015 a risk of significant deviations from the required structural adjustment and foresees that in 2015 Romania will deviate from the reference expenditure criterion. Briefly, the European Commission considers that there are not sufficient tax measures envisaged that have the ability to generate a structural adjustment of 0.8 pp. of GDP necessary to ensure the achievement of the medium-term objective of structural deficit in 2015, according to the obligations arising from preventive arm of the Stability and Growth Pact. Thus, the forecasted budget deficit is arround 0.5 pp. of GDP higher that the budget deficit target that would ensure the compliance with these obligations and the EC concludes that the program presents risks of a significant deviation from the requirements of the preventive arm in 2015. In this context, the EC recommends to Romania, among others, to implement the fiscal strategy for the period 2014-2017, ***to significantly improve the fiscal effort in order to ensure the achievement of the medium-term objective in 2015 in accordance with the commitments under the balance of payments programme as reflected in the Convergence Programme for 2014-2017, in particular by specifying the measures to be undertaken for this purpose, and to comply with the medium-term objective in 2015 and in the subsequent period.***

Given the above, the Fiscal Council considers that the balance of risks regarding the conduct of the fiscal policy was already been titled on the downside for 2015 (a budget deficit higher than projected), even in the absence of the present legislative proposal, given both the proposed pace of fiscal consolidation (0.8 pp. of GDP according both to the cash and European methodology) which does not appear to be supported by the measures announced so far, and also the significantly underestimated level[7] of the negative impact on the corporate income tax receipts from the fiscal measures adopted***. If the legislative proposal would be adopted without compensation measures of the negative budgetary effects, not only that the achievement of the medium-term objective in 2015 appears as virtually impossible, but there would be a high risk of a major slippage in fiscal policy, which would dangerously close the budgetary position to the threshold for triggering the excessive deficit procedure (3% of GDP)***. Moreover, the favorable perception of the investors on the Romanian economy, reflected in the historical lows of the state financing costs, is founded on the assumption of continuing the fiscal consolidation in line with the commitments. A major slippage in 2015, as currently projected, would be likely to damage this perception, with adverse consequences on the financing costs.

In addition, the reduction of the pension contribution rate will have a significant impact on the financial position of the public pension system. Currently it is very precarious, characterized by a substantial structural deficit, as the budget expenditure on pensions are unsustainable in relation to the contributions received. In the Annex there is a graph that shows the evolution of the revenues and expenditures of the Social Security Budget for the period 2006-2013 and the projections for 2014-2017 corresponding to the application of the proposed legislative measure. In 2013, the public pension deficit was 11.7 billion lei (1.86% of GDP) and the projections for the period 2015-2017 are considering a deficit ranged between 19 and 21.1 billion lei given the reduction with 5 pp. of the pension contribution, with about 7 billion lei greater than with the current rates. Also, the support ratio in Romania is the second worst in the European Union, even below one, as it can be seen in the chart no. 2 from the Annex. The measures taken in the recent years in order to improve the medium and long term financial position (such as those provided by the new pension law) would likely be entirely canceled under the application of the proposed legislative measure. Moreover, considering the effects of population ageing[8], the concerns on the medium and long term sustainability of the public pension system are likely to worsen.

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

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

Conclusions

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

The Fiscal Council considers that the adoption of the legislative proposal regarding the reduction of the pension contribution rate for the employer by 5 pp, although desirable from the business environment point of view, is not possible under the commitment of pursuing the fiscal consolidation envisaged (derived from adopting the European treaties) without identifying equivalent compensatory measures (of significant amplitude) - increases/extensions in the tax base and/or expenditure cuts. In the Fiscal Council`s opinion, such a large decrease in the statutory pension contribution rates, which is beneficial considering the fiscal burden on labor, can be accomplished in a neutral way for the budget, if the significant differences in the fiscal treatment of various categories of taxpayers (wages, revenues from copyright, self-employed, microenterprises) that discriminate the contributors, are reduced/eliminated. Also, the Fiscal Council reiterates its previous recommendation to consider the alternative of a firm commitment regarding the adoption of a multiannual trajectory for a gradually implementation of the reduction in the pension contribution rate that could be easily offset by equivalent discretionary measures or, eventually compensated ex-post via an improvement in the collection rate, reflected in bigger budgetary revenues (and corresponding, lower deficits compared to the targets). Such a multiannual plan has the advantage of anchoring the economic agents` expectations and, under the hypothesis of credibility accumulation, could generate favorable effects in the economy even before the effective implementation of the measures.

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

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

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

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

July 3th, 2014

Chairman of the Fiscal Council

IONUȚ DUMITRU

ANNEX

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

Source: European Commission; United Nations Economic Commission for Europe Statistical Database

Table 2: Tax burden								
Country	Total cost	SSC employer	Gross income	SSC employee	Income before taxes	Personal income tax	Total PIT and SSC	Tax burden
SI	1161	161	1000	221	779	210	592	51,02%
SK	1352	352	1000	134	866	191	677	50,04%
HU	1285	285	1000	185	815	160	630	49,03%
PL	1179	179	1000	227	773	147	553	46,88%
RO	1279	279	1000	165	835	134	577	45,14%
LV	1236	236	1000	105	895	215	556	44,96%
CZ	1343	343	1000	110	890	150	603	44,89%
EE	1340	340	1000	20	980	206	566	42,22%
LT	1310	310	1000	90	910	137	536	40,95%
BG	1181	181	1000	129	871	87	397	33,62%
Average tax burden								**44,88%**

Source: European Commission, Fiscal Council's calculations

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

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

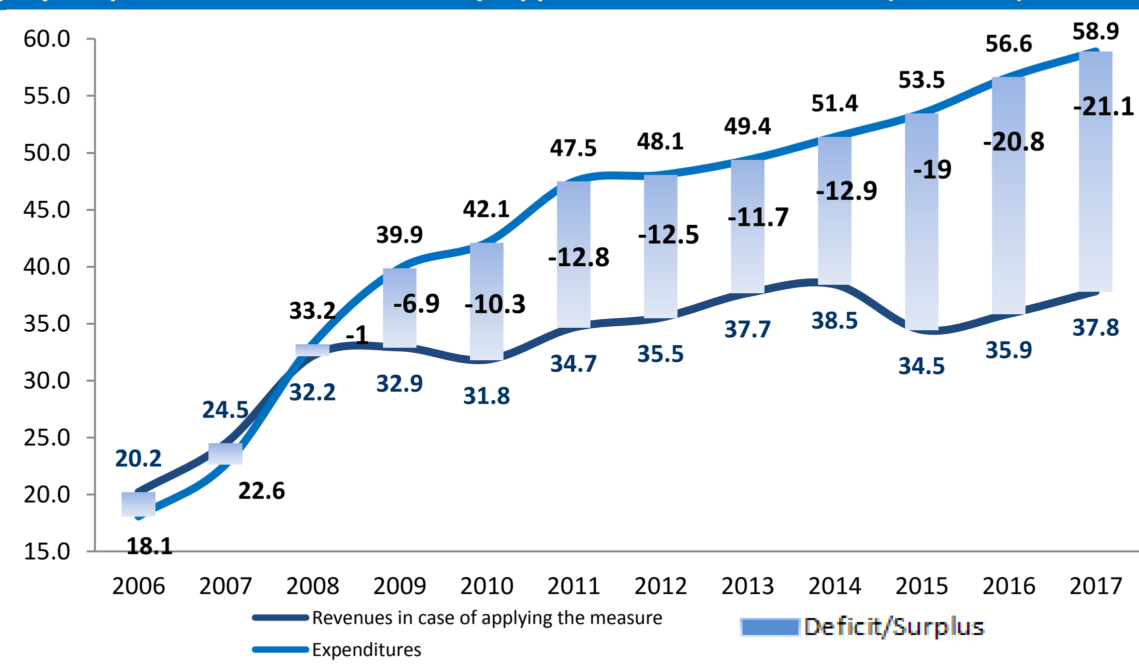
*** For Czech Republic and Hungary, in determining the personal income tax it was taken into account "the super grossing" – the personal income tax base is "compensation of employees", which includes social security contributions paid by employers.

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

Table 3: Illustrative example regarding the impact of the 5 pp employer's pension contribution rate reduction on the total cost of an employer with an employee		
	Actual situation	**Reduction of employer pension contribution rate by 5 pp**
Average gross income (lei)	2.279	2.279
SSC employer (lei)	635	521
SSC employee (lei)	376	376
Income before tax	1.903	1.903
Personal income tax (lei)	304	304
Total PIT and SSC (lei)	1.315	1.201
Total cost of an employer with an employee (lei)	2.914	2.800
Tax burden (%)	45.14%	42.91%
Budgetary revenues loss from social security contributions per employee (lei)	114,0	
Budgetary revenues loss from labor taxation (contributions + personal income tax) per employee (%)	8.66%	
Reduction in total cost of an employer with an employee (%)	3.91%	

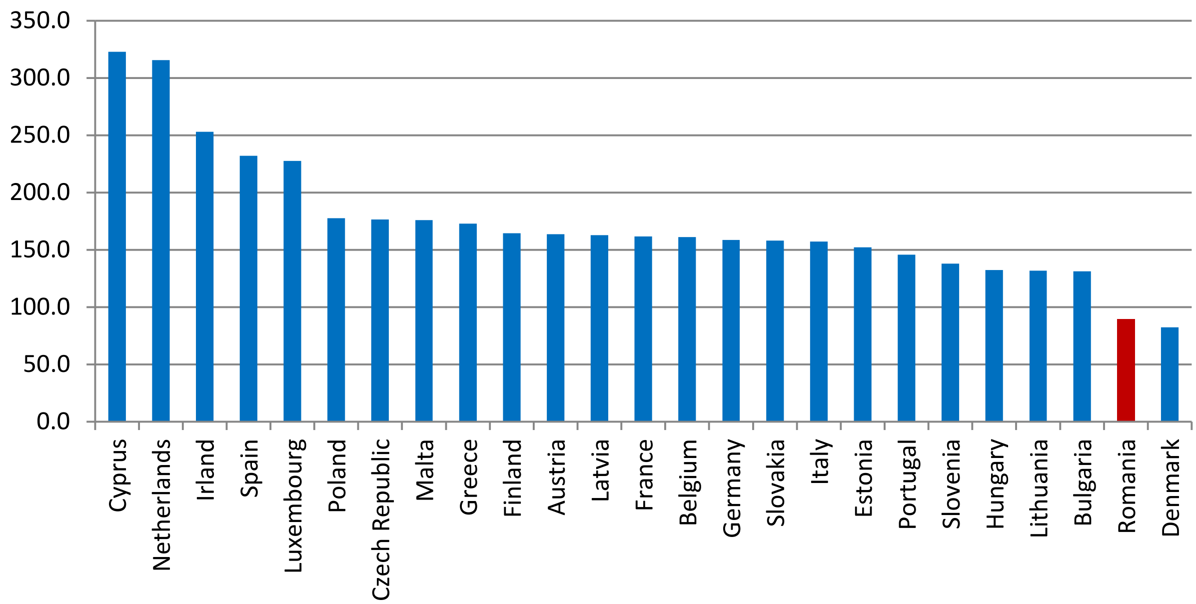
Source: Fiscal Council's calculations

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



Source: Ministry of Public Finances, cash standard data

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



Source: Ministry of Public Finances, cash standard data

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

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

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

Source: Fiscal Council's calculations