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

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

Under the article 40, paragraph (4) of the FRL, the Government and Parliament are required to consider the opinions and recommendation of the Fiscal Council **when elaborating and approving the fiscal strategy and the annual budgets, as well as in the preparation of other measures triggered by the implementation of this law**. Given the Government's intention to approve the above documents at the meeting on 12.12.2014, which clearly involves an insufficient time for analysis, development and approval of the requested opinion and the lack of the full set of documents and the required clarifications, the Fiscal Council is unable to develop a complete opinion on the above documents. Moreover, the Fiscal Council repeatedly asked publicly to the Government[1] to offer a reasonable period from the time of submission of the required documents by the MPF and the moment of adopting the relevant legislation in the Government meeting. Beyond the Executive's obligation to consider the opinion of the Fiscal

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

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

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

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

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

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

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

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

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

December 11, 2014

Chairman of the Fiscal Council
IONUŢ DUMITRU