Fiscal Council's opinion on the amendments introduced by the Report adopted by the Parliament on the Law approving the Government Emergency Ordinance no. 20/2016 for amending and supplementing GEO no. 57/2015 regarding the remuneration of staff paid from public funds in 2016

On the 9th of November 2016, the Ministry of Public Finance (MPF) remitted to the Fiscal Council (FC) the letter no. 11899/8.11.2016, requesting the Fiscal Council's opinion on the amendments introduced in the Parliament following the adoption by the Chamber of Deputies of the Report on the Law approving Government Emergency Ordinance no. 20/2016 regarding the remuneration of personnel paid from public funds.

The introduced amendments aim at granting increased wages for the personnel in health and education sectors, as follows:

a) The increase of base salaries starting with 1st January, 2017 for teaching personnel, on average by 15%;
b) Increase of the base salary with effect from 1st December, 2016 for healthcare personnel (including administrative staff), on average by 15%;
c) The calculation of bonuses as a percentage of the increased salaries for the health and social assistance personnel;
d) Increase of the base salary with effect from 1st December, 2016 for social assistance personnel;
e) The increase of base salaries starting with 1st December, 2016, for the personnel within the National Health Insurance House;
f) Establishing the wages for the staff of the Counties' Health Insurance Houses and the Counties' Departments of Public Health at 85% of the increased wages for the National Health Insurance House's personnel;
g) Setting salaries for the staff of the Romanian Agency for Rescuing Human Life at Sea similar to the salary rights for the General Inspectorate for Emergency Situations' personnel.

The fiscal statement associated to the adopted amendments (see Annex 2) estimates, *ceteris paribus*, an increase of 4.85 billion lei for the personnel spending in 2017, respectively a first-round net impact on the budget deficit amounting to 2.9 billion lei, after considering the additional budgetary revenues generated by the wage increases on social contributions and personal income tax.

Introduction – a brief overview of the fiscal rules stipulated by Law no. 69/2010

The central element of the Fiscal Responsibility Law no. 69/2010, republished (hereinafter FRL) is the homonym principle which states that "*the Government has an obligation to conduct the fiscal policy prudently and manage the resources and budgetary obligations and fiscal risks in a manner that ensure the sustainability of the fiscal position in the medium and long term*", while stating that the "*sustainability of public finances means that, in the medium and long term, the Government should be able to manage financial risks or unforeseen events without having to introduce significant adjustments to expenditure, revenue or deficit with economic or social destabilizing effects*."

The actual implementation of this principle into the national legislation is achieved through a series of fiscal rules targeted to:

- stipulate the objective of "maintaining the budgetary position in balance or in surplus", this being considered achieved as long as the annual structural deficit of the general government converges to the medium term objective, defined as the structural budget balance as a percentage of GDP that is no lower than the level of -1%, temporary deviations from this level being allowed only in exceptional circumstances (art. 6 - art. 8 of FRL);
- establish nominal ceilings for the budget balance of the general consolidated budget (GCB), for the primary balance of the GCB, for the GCB's total expenses (net of financial assistance from the EU and other donors) and for personnel spending, mandatory for the first year covered by the Fiscal Strategy (FS) approved by the Parliament (art. 12 letter b) and letter c) of FRL);
- setting ceilings defined as a percentage of GDP for the budget balance and for personnel spending, mandatory for the first two years covered by the FS approved by Parliament (art. 12, letter a) of FRL).

Additional relevant fiscal rules target the personnel costs: art. 17 paragraph 1 of FRL explicitly prohibits the promotion of legislative proposals which may lead to an increase of personnel expenditure 180 days before the Government mandate cease and paragraph 2 of the same article prohibits the increase of the personnel expenditure during the budget year, when the budget revisions appear. Moreover, art. 15 states that the introduction of measures/policies/legislative initiatives whose adoption attracts increased government spending requires the elaboration of the financial statement in accordance with art. 15 of Law no. 500/2002 (of the Public Finance) and the submission of a declaration stating that the increase in expenditure involved is consistent with the strategic priorities set out in the FS, the annual budget law and the expenditure ceilings set in the FS. In this regard, Public Finance Law stipulates that financial statement must contain the measures that cover the increase of the expenditure, in order to not influence the budget deficit.

FRL provisions indicate that the legislator paid special attention to personnel expenditure, instituting rules that individualize it among other categories of expenditure. An argument in favor of this approach relates to the fact that this category of expenditure is substantially more vulnerable than others to the prevalence of short-term considerations, to the detriment of medium and long term strategic objectives. Moreover, these expenses have, by their nature, a permanent feature – an increase of the salary generates *ceteris paribus* an increase in perpetuity of the wage bill, in contrast, for example, with an increase in investment spending, which expires once the investment objective concerned is completed.

The permanent feature naturally involves risks on the medium and long-term sustainability - such increase in expenditure cannot be justified by the existence of a temporary fiscal space, due either to a failure in the programmed expenditure, or to the appearance of exceptional/temporary revenues.

The individualization of personnel expenses by law is not at all intended to prevent salary increases - any level of increase is possible within the constraints exercised by the deficit target and therefore of those concerning total expenditure of the general government, but to discipline wage negotiations and the budgetary process, favoring the adoption of a medium-term perspective regarding the dynamics of personnel expenses within total expenditures of the general government rather than determining their level on an *ad hoc* basis. However, as the Fiscal Council showed in successive opinions, the fiscal rules which do not directly target the budget deficit (those concerning the mandatory ceilings for all other elements relevant from the law perspective - primary balance, personnel expenses, total expenses net of financial assistance from the EU and other donors, strengthened by the prohibition of increasing total expenditure and personnel expenditure during budgetary revisions) were proved in practice to be "weak" rules, whose breach (at least in the context of the proposed parameters of the budget revisions) was the rule rather than the exception, derogations from these intervening in almost all budget revisions that took place after the entry into force of the FRL in April 2010 (the execution under the program of the expenditures made that sometimes some of these "auxiliary" fiscal rules to be respected *ex post*). Three recent examples of *de facto* non-binding nature, despite the formal prohibition, of the rules relating to personnel expenditure, are:

- Personnel expenditures at the end of 2015 were 52 billion lei, compared to the ceiling established by Law no. 182/2014 of 48.4 billion lei. Even adjusting for the additional costs deriving from the executory titles whose payments was decided during subsequent budget revisions (1.5 billion lei), these expenses stood at about 2 billion lei above the ceiling.
- The initial budget construction for the current year provided personnel expenditures amounting to about 7.6% of GDP, despite the fact that the ceiling expressed as a percentage of GDP stated by Law no. 182/2014 indicated a maximum level of 6.8% (it is true that the Government change entails a reset of the ceilings that the new authorities are free to place at any level since it is in line with the deficit targets which are consistent with medium-term objective or the adjustment path towards it).
- The first budget revision of this year involved, as showed in the opinion of the Fiscal Council issued on that occasion, a deviation from the ceiling of personnel expenditure stated by Law no. 338/2015 of 1.37 billion lei (out of which the related impact of the Law no. 85/2016 in the current year represents about 1.02 billion lei, while the rest was caused by changes in wages implied by GEO no. 20/2016, partially accommodated however by some savings in this aggregate, highlighted by the budget execution).

Remarks on the amendments introduced through the Report adopted by the Parliament regarding the Law of approving the Government Emergency Ordinance no. 20/2016 for amending and supplementing the Government Emergency Ordinance no. 57/2015 regarding the remuneration of personnel paid from public funds in 2016

Considering the above mentioned, the Fiscal Council notes that:

- The notification of the Fiscal Council in order to issue an opinion on the financial impact of the amendments introduced and the compliance with fiscal rules has intervened after the adoption of these amendments by the Parliament.
- The introduction of some amendments which specify wage increases above those already provided by GEO no. 20/2016 it is not in accordance with art. 17 para. 1 of the FRL which prohibits the promotion of some normative acts with less than 180 days before the expiry of the Government's mandate, leading to increased personnel expenditure or pensions in the public sector. It has to be noted that the salary increases introduced by GEO no. 20/2016 were initiated before the deadline of 180 days, although involving a lack of conformity with the ceiling of personnel expenditure stated by Law no. 338/2015 and art. 17 para. 2 of FRL which prohibits increases of personnel expenditure during the budget revisions. In both cases, the Government has resorted to derogations from FRL, without affecting the deficit target, the changes being made in the context of an update of the budget construction that identified additional revenue.
- The Fiscal Council validates the computed fiscal impact received from MPF (and shown in Annex 3) according to which the approved amendments would entail an increase in personnel expenses in 2017 to 4.85 billion lei and*, ceteris paribus*, a first round effect budget deficit of 2.9 billion lei, after considering the additional income which the salary increases would automatically lead to in the social security contributions payable by employers and employees, as well as in the revenues from the personal income tax.
- The second-round effects on budget revenues would only arise in the absence of compensatory measures and thus only to the extent that the deficit in 2017 would be allowed to increase the amount of the first-round effect identified (2.9 billion lei or 0.35% of GDP). Even accepting the existence of a high fiscal multiplier of about

0.8 for personal expenses, the income generated by an additional growth of 0.2-0.3 pp would be less than one billion lei, which implies an increase in budget deficit of at least 2 billion lei (0.25% of GDP).

- The Fiscal Council considers that the ceiling on personnel expenses for the year 2017, established by the Law no. 338/2015 at a level of 7.4% of GDP, would be impossible to meet given the current parameters regarding the number of public sector employees and the proposed wage increases, after considering the additional GDP growth caused by the latter in the event of a lack of compensation - we estimate that the personnel expenses following the implementation of the amendments would be equivalent to at least 7.8% of GDP in 2017. Art. 15 para. 1 letter b) of the FRL indicates that this ceiling, as that on total expenses and deficit, are relevant for the legislative initiatives adopted by the current legislature. It should be noted, however, that an equivalent measure adopted by the future legislature would not fall within the scope of this ceiling of expenditure, given that changing the Government implies its freedom to undertake new parameters for the medium term fiscal strategy, within the constraints exerted by the rules laid down by art. 6-8 of the FRL described above with respect to the budget deficit.
- The Fiscal Council believes that the adopted amendments would increase the budget deficit in the absence of compensatory measures in terms of revenues or expenditures with at least 0.25% of GDP in 2017. The budgetary execution for the current year indicates that, *ceteris paribus*, a lower deficit under national methodology is likely, especially due to an under-execution at the level of investment expenditure for projects financed from European funds for the financial year 2014-2020 which appears as inevitable. However, the fiscal space related to the deficit target which has this source is only temporary and its existence can not be extrapolated to 2017, the implementation of investment projects with European funding under the new financial year being likely to accelerate significantly in the years to come. A temporary fiscal space in 2016 can not be a source of coverage in 2017 for the permanent impact caused by the wage increases.
- The Convergence Programme 2016-2019 and the last Fiscal Strategy estimated a deficit of 2.9% of GDP for 2017, therefore being placed in close proximity of the ceiling that might trigger the excessive deficit procedure, given that for the next

year the Fiscal Code adopted in 2015 foresees additional cuts in indirect taxes. The latest forecast of the European Commission indicates an increase in the ESA 2010 deficit from 2.8% in 2016 to 3.2% in 2017, without including the impact of the amendments generating wage increases or other tax cuts recently passed by Parliament (and being in the process of endorsement by the President). Therefore, there is already a substantial risk that the reference value of 3% of GDP for the budget deficit to be exceeded. The proposed amendments, in the absence of compensatory measures, greatly increase this risk, entailing an additional vulnerability for a fiscal position already inconsistent with the principle of fiscal responsibility mentioned above, in an international context more complicated and more volatile than last year[1].

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to article 56, paragraph (2), letter d) of Law no. 69/2010 republished, after being approved by the Council members through vote, on the 10th of November, 2016.

10th of November, 2016

Chairman of the Fiscal Council
IONUȚ DUMITRU

[1] For a review of the vulnerabilities caused by the placement of the budget deficit in the close proximity of the ceiling level of 3% see the preamble to the Fiscal Council's Opinion on the 2016 budget of December, 2015 (http://www.fiscalcouncil.ro/FCopinion2016budget.pdf).

ANNEX 1 - Amendments admitted according to GEO no. 20/2016

	Budgetary impact (mil. lei)
Increase in basic salaries with effect from 1 December 2016 for healthcare professionals (including administrative staff) on average with 15%	1,116.20
Increase in basic salaries with effect from 1 December 2016 for staff in the social welfare system on average with 15%	292.40
Calculation of bonuses as a percentage of the increased salaries for staff in the health system and the social assistance	1,414.02
Increase in basic salaries as of 1 January 2017 for education personnel on average with 15%	1,788.24
Increase in basic salaries from 1 December 2016 with 25% for staff in the apparatus of the National Health Insurance House	5.88
Establishing salaries for the staff of the County Health Insurance Houses and the County Departments of Public Health to 85% of the increased wages for the National Health Insurance House	231.27
Establishing salaries for the staff of the Romanian Agency for Saving Human Life at Sea similar to the remuneration of staff of the General Inspectorate for Emergency Situations	2.20
Total	**4,850.22**

Source: Ministry of Public Finance

ANNEX 2 - Financial statement (financial impact on the consolidated general budget)

Indicators	Current year mil. lei
1. Changes in budget revenues, plus / minus, of which:	**1,940.1**
a) the state budget	465.6
b) the centralized general budget of the administrative-territorial units	
c) the state social insurance budget	1,016.6
d) the unemployment insurance budget	38.6
e) the budget of the Sole National Fund for social health insurances	419.3
f) the budget of institutions / activities funded wholly and / or partially from own revenues	
2. Changes in budgetary expenditures plus / minus, of which:	**4,850.2**
a) the state budget	291.4
b) the centralized general budget of the administrative-territorial units	3,620.3
c) the state social insurance budget	
d) the unemployment insurance budget	
e) the budget of the Sole National Fund for social health insurances	106.6
f) the budget of institutions / activities funded wholly and / or partially from own revenues	831.9
3. Financial impact plus / minus, of which:	**-2,910.1**
a) the state budget	174.2
b) the centralized general budget of the administrative-territorial units	-3,620.3
c) the state social insurance budget	1,016.6
d) the unemployment insurance budget	38.6
e) the budget of the Sole National Fund for social health insurances	312.7
f) the budget of institutions / activities funded wholly and / or partially from own revenues	-831.9

Source: Ministry of Public Finance

ANNEX 3 - Additional impact on personnel expenditure (mil. lei, 2017)

The 15% personnel salaries increase in the healthcare system		
Expenses with the base salaries in the healthcare system (monthly average)	1	505.8
15% wage increase (monthly)	2=1*15%	75.9
Monthly impact	3=2*122.6%	93.0
Impact at 12 months	**4=3*12**	**1,116.2**
The 15% personnel salaries increase in the social assistance system		
Expenses with the base salaries in the social assistance system (monthly average)	5	132.5
15% wage increase (monthly)	6=1*15%	19.9
Monthly impact	7=2*122.6%	24.4
Impact at 12 months	**8=7*12**	**292.4**
The calculation of bonuses as a percentage applied to the increased salaries for health and social care staff		
Expenses with the bonuses in the healthcare and social assistance system (monthly average)	9	124.1
Percentage bonuses (30% in base salaries)	10=1*30%	220.2
Monthly impact on bonuses	11=10-9	96.1
Monthly impact on expenditures	12=11*122.6%	117.8
Impact at 12 months	**13=12*12**	**1,414.0**
The 15% personnel salaries increase in the education system		
Expenses with the base salaries in the education system (monthly average)	14	884.0
15% wage increase (monthly)	15=14*15%	132.6
Monthly impact	16=15*122.6%	162.6
Impact at 12 months	**17=16*11**	**1,788.2**
Increase of the salaries for NHIS staff		
NHIS personnel salaries expense (monthly average)	18	1.6
15% wage increase (monthly)	19=18*25%	0.4
Monthly impact	20=19*122.6%	0.5
Impact at 12 months	**21=20*12**	**5.9**
Increase of the salaries for Departments of Public Health Directorate and County Health Houses staff at 85% of NHIS wages		
No. of Public Health Department jobs	22	3,873
The average salary base at the Public Health Directorate (lei)	23	3,362
No. of Counties' Departments of Public Health	24	2,990

jobs		
The average salary base at Counties' Department of Public Health (lei)	25	3,362
Expenses with the base salaries system (monthly average)	26=(22*23+24*25)/1,000,000	23.07
The average salary base at NHIS (lei)	27	5,320
The average base salary increased by 25% for the NHIS (lei)	28=27*125%	6,650
The base salary increased to 85% of the increased salaries for NHIS (lei)	29=28*85%	5,653
Expenses with the increased base salaries	30=29*(22+24)/1,000,000	38.8
Monthly impact on the base salaries	31=30-26	15.7
Monthly impact on expenditures	32=21*122.6%	19.3
Impact at 12 months	**33=32*12 months**	**231.3**
Payroll for the Romanian Agency for Rescuing Human Life at Sea staff similar to the remuneration of General Inspectorate for Emergency Situations		
Impact	**34**	**2.2**
Total impact on personnel expenditures		**4,850.2**

Source: Ministry of Public Finance