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

The Fiscal Council issued a preliminary opinion on the draft budget revision on July 30th 2013, but, considering the insufficient time available to assess the relevant documents, the Fiscal Council reserved the right to issue a more detailed opinion afterwards. This opinion incorporates the assessment of the Half-Year Report regarding the economic situation in the first 6 months of 2013, uncovered by the previously opinion, as well as the additions to the latter regarding the draft of the revised consolidated budget for 2013.

1. Fiscal Council's Opinion on the Half-Year Report Regarding the Economic and Budgetary Situation

Under article 40, paragraph (2) of the Fiscal Responsibility Law no. 69/2010, the Fiscal Council has the legal requirement to "assess the budgetary performance of the Government against the fiscal targets and policies specified in the fiscal strategy and the compliance of such policies with the principles and rules specified in this law, through analyzing and issuing opinions and recommendations on the half-yearly report regarding the economic and budgetary situation".

According to article 29 of Law no. 69/2010, each year by the end of July, the Ministry of Finance should publish on its website a half-year report on the economic and budgetary situation.

In addition, under article 30 of Law no. 69/2010, the Half-Year report on the economic and budgetary situation must include, without being limited to, the following:

a) A review of the macroeconomic framework and the latest data on macroeconomic indicators identifying significant trends and changes since the annual budget law was finalized.
b) An assessment of the impact on the fiscal targets of any changes in the macroeconomic framework and the presentation of necessary measures to be taken to correct such impacts.
c) Data on the consolidated general budget revenues, detailed on each category of revenue, indicating the initial forecast, the revenues collected in the first six months and an updated forecast for the entire year.
d) Data on the consolidated general budget expenditures, detailed by economic and functional classification for each constituent budget of the consolidated general budget, indicating the approved expenditure, the expenditures incurred in the first six months and an updated forecast for the entire year.
e) Data on the state budget expenditure, detailed in economic classification for each central government institution, indicating the approved expenditure, the expenditures incurred in the first six months and an updated forecast for the entire year.

f) Data on the budgetary balance for both the consolidated general budget (total and primary) and for each budget of the consolidated general budget, indicating the approved program, the result achieved in the first six months and an updated forecast for the entire year.
g) Data on the absorption of EU funds, indicating the approved program, the results achieved in the first six months and an updated forecast for the entire year.
h) Data on outstanding expenditure payments for the end of Q1 and forecast for half-year, including arrears and floating debt, for each constituent budget in the consolidated general budget.
i) Data on the government debt and the financing of the budget deficit.
j) Explanations for any failure to collect the forecasted revenues, indicating the measures already taken and those planned to improve the collection.

Thus, given its mandate in accordance with Law no. 69/2010, **the Fiscal Council states and issues the following opinions and recommendations:**

The Half-Year Report on the economic and budgetary situation performs an analysis of the latest data regarding macroeconomic indicators, but it does not identify the trends and significant changes compared to the projections included in the state budget and social security budget laws as required by Law no. 69/2010. In addition, the impact of macroeconomic forecasts revision for the current year and the medium term over the budgetary targets is not quantified and no details regarding the measures to be adopted are mentioned, as required by Law no. 69/2010, under article 30 letter b). In the Fiscal Council's opinion, an assessment of the macroeconomic framework revision's impact over the budget would have been more than necessary as the economic growth forecast for 2013 has been revised upwards from 1.6% to 2%, mainly based on an evolution above expectations of the agricultural sector, on the supply side, respectively of the net exports, on the demand side, and the budget revenues are not very sensitive to these components of GDP. At the same time, the domestic demand (consumption and investment) had a weak evolution in the first half of 2013, the updated forecasts pointing that the domestic demand's dynamic could be far below the initial expectations for 2013, with a negative impact on budget revenues.

The budget execution on the revenue side in the first six months shows a significant underperformance, with a gap of over -6.5 billion lei between the program for the first semester and the actual revenues (leading to a level of only 93.7% achievement of the program), excluding the impact of swap schemes which led to the clearing of state companies' overdue payments. The biggest revenues gaps compared to the program have been recorded in the case of amounts received from the EU (-3,347 million lei), corporate income tax (-827 million lei), excises (-713 million lei), VAT (-485 million lei) and non-tax revenues (-467 million lei).

On the expenditure side compared to the targets set for the first semester, total expenditures have been fulfilled at a rate of 93.5%, an achievement of over 100% being recorded in the personnel expenses and other expenses. A significantly lower than expected achievement ratio can be observed in capital expenditures (-1,471 million lei gap) and other investment expenses (including EU funds, -1,881 million lei gap), reflecting a tool to reach the budget deficit target for the first semester, but also an inability to absorb EU funds for planned investments.

On the tax revenue side, the worst performance was recorded by the corporate income tax, revenues in this area decreasing by 5.5% compared to the first semester of 2012, leading to an 827 million lei lower result than the half-year program. The negative evolution was determined by repayments to commercial banks[1] as a result of lower than expected profits, but also by the very weak evolution of revenues from non-financial businesses (registering an increase of only 0.2% over the same period of 2012, compared to a forecasted increase in the initial budget for 2013 of 8.3%), the latter being negatively influenced by the poor financial performance of companies[2]. The second worst performance on the tax revenue side was recorded in the case of *excises,* the revenues being 713 million lower than the target set in the half-year program (only a 93.3% ratio of achievement), and increasing by only 4.2% compared to the first semester of the previous year, well below the 10.4% projected growth in the initial budget for 2013, given that in 2013 the excise taxes on beer, cigarettes and diesel fuel were increased and the exchange rate used for calculating the excise increased by 5.2% in comparison with the one registered in 2012, suggesting a decrease in consumption of excisable goods and/or an increase in tax evasion.

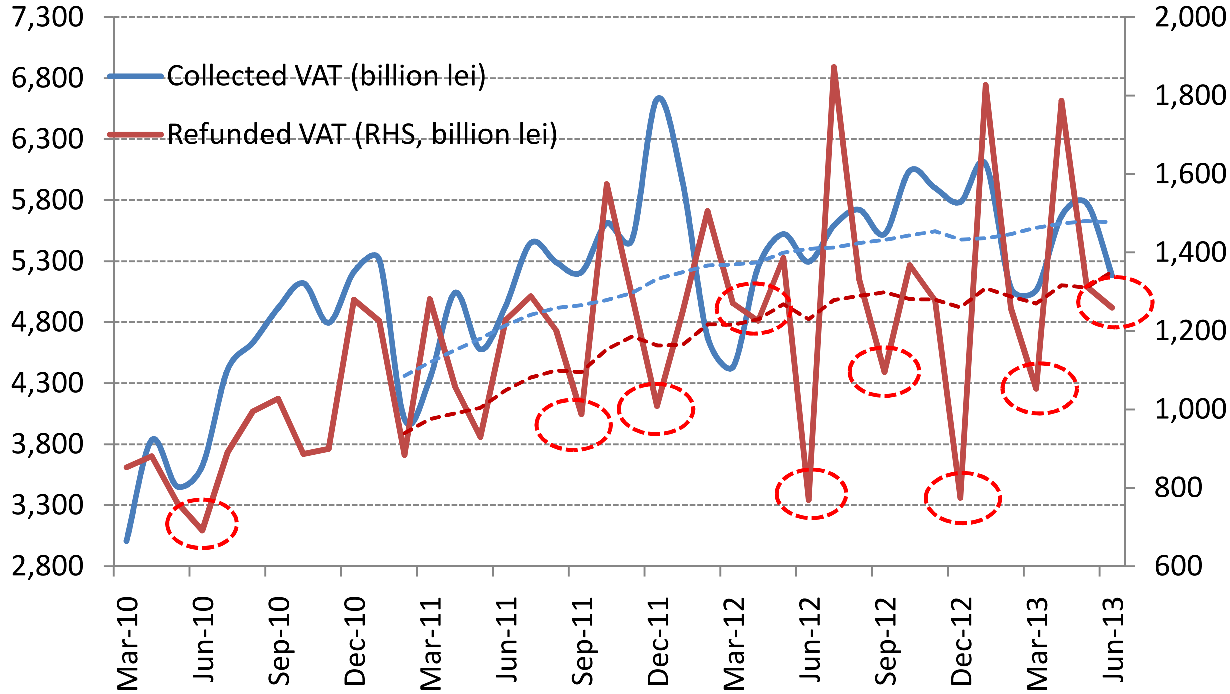
In the case of *VAT* revenue, the execution at 6 months shows a result lower by 485 million lei compared to the program, the net VAT revenues increasing by only 3.3% over the first semester of 2012 (excluding the impact of swap schemes). The evolution of VAT revenues was negatively affected by the lower household final consumption in the first part of the year (-0.3% in real terms in the first quarter of 2013 compared to the same period of last year) and by the decrease of extra-EU imports (-6.0% in January – June 2013 over the same period of 2012). In addition, it is worth noting that although the trend of VAT collected and VAT refunded is

[1] Banking companies contributors – Romanian legal entities and branches of banks in Romania – foreign legal entities that are required under the Tax Code to declare and pay corporate income tax annually (with submission of the declaration by March 25th the following year), with prepayments that are performed quarterly and indexed to inflation. Given that 2012 recorded an aggregate loss of 2.347 billion lei of the banking system compared to 0.786 billion lei in 2011, the regularization made in early 2013 for the advance payments made in 2012 meant corporate income tax refunds for the amounts overpaid in 2012.

[2] According to the National Trade Register Office data, the number of companies that became insolvent in the first 5 months of 2013 was 9.5% higher compared to the first 5 months of 2012, reaching a new record high. Moreover, according to a Coface study, the insolvencies rate – the number of insolvencies opened to the number of active companies – in Romania is very high, reaching in 2012 a level of 5.67% compared to 0.35% in Bulgaria, 0.04% in Poland, 0.47% in Czech Republic, 0.1% in Slovakia and 3.84% in Hungary, reflecting big deficiencies of the insolvency law in Romania. In addition, during the first 5 months of 2013, the average turnover of a company that entered in the insolvency procedure was over 60% higher than the same period of 2012.

similar, the net VAT revenues had a volatile evolution, induced by the very high monthly volatility of VAT refunds. Thus, as reflected in the chart below, starting with September 2011, in the ending month of each quarter there is a pronounced decrease of VAT refunds compared to the previous months, the discretionary cut of refunds being probably intended to help achieving the quarterly deficit targets in cash terms. The Fiscal Council strongly recommends reducing the volatility of VAT refunds, which is likely to adversely affect the liquidity and the overall financial situation of the companies receiving VAT refunds.

The monthly evolution of collected and refunded VAT

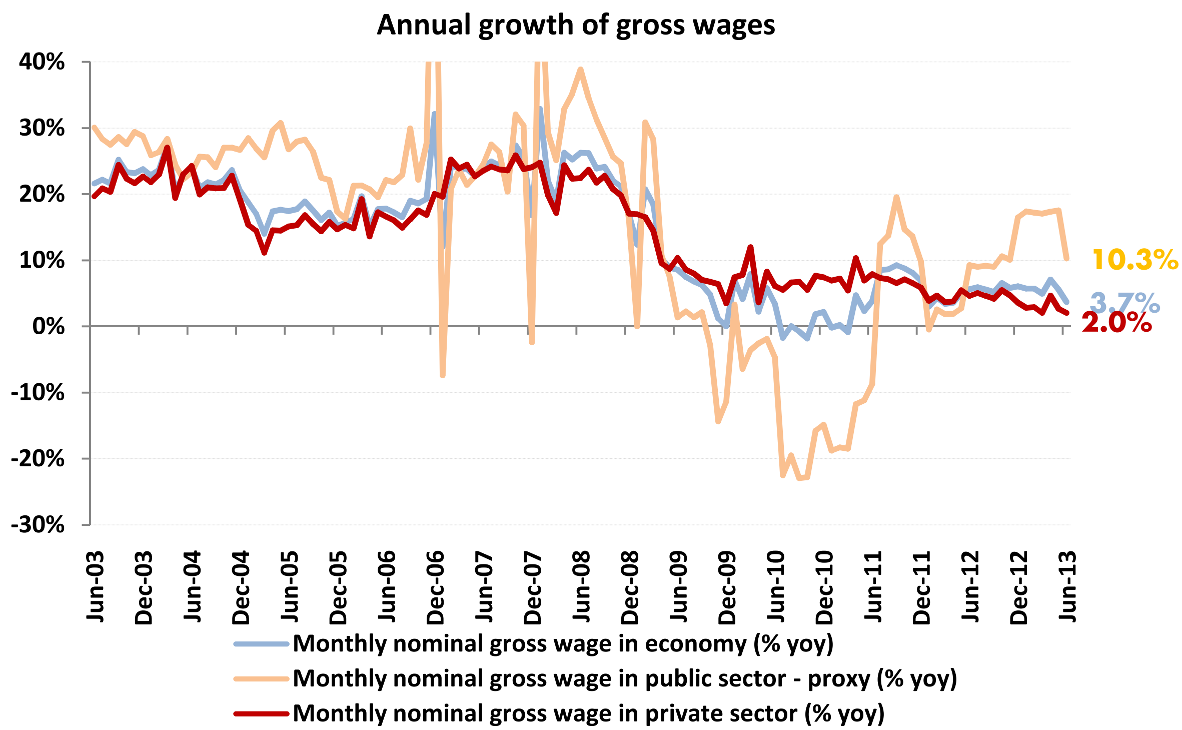


Source: Ministry of Public Finance

Note: The dotted lines are the 12-month moving averages

Receipts from *personal income tax* had an evolution in line with expectations, achieving 99.9% of the half-year program target and registering an increase of 9.3% over the first half of 2012, being mainly influenced by the restoration of the salaries in the public sector, the increase of the average gross wage (with 5.4% in the first half of 2013 compared to the first half of 2012), the increase in the number of employees (with 2.4% in the first 5 months of 2013 compared to the same period of 2012) and by the increase of the minimum wage[3]. However, the developments in recent months show that the increase of the gross average wage in the economy is registering a slowdown, especially in the private sector, where gross wages expressed in real terms have decreased in the last 3 quarters, rendering the expectations embedded in the original budget for 2013, of a gross average wage growth in the economy by more than 7% in 2013, barely plausible.

[3] From 700 lei to 750 lei, from the 1st of February 2013 according to G.D. No. 23/2013.



Source: NIS, Ministry of Public Finance

Receipts from *property tax* increased by 9.5% in the first half of 2013 compared to the first half of 2012, due to the update of the taxable value for property tax, the degree of achievement of the revenue program being 105.7%. The collections from the *taxes on using goods, authorizing the use of goods* or *on carrying activities* grew considerably with 163.9% in the first half of 2013 compared to the first half of 2012, due to the collection, in June 2013, of the license fees for rights of use of radio frequencies, according to G.D. No. 605/2012, and the revenue program in this area registered an achievement rate of 109.5%.

Social security contributions collected by the consolidated general budget increased by 4.3% compared to the same period of the last year and the degree of achievement of the revenue program in this department was 99.8%. The growth was primarily driven by the same factors that influenced the development of revenues from personal income tax.

The *amounts received from the European Union* had an evolution considerably below expectations, the achievement degree of the half-year program being only 47.6%, reflecting a *significant failure in the absorption of EU funds*. According to European Commission data, in the case of structural funds, Romania had by far the lowest rate of absorption of EU funds in Europe in the period 2007-2013, the difference compared to other countries being very high. The Half–Year Report regarding the economic and budgetary situation presents data on the absorption of EU funds received, stating the approved program and the result achieved in the first 6 months, but it does not present an updated forecast for the full year, as required by Law no. 69/2010. In addition, according to the Fiscal Council, an assessment of the potential impact that any future financial corrections on EU funds might have on the budget in the coming years is absolutely necessary.

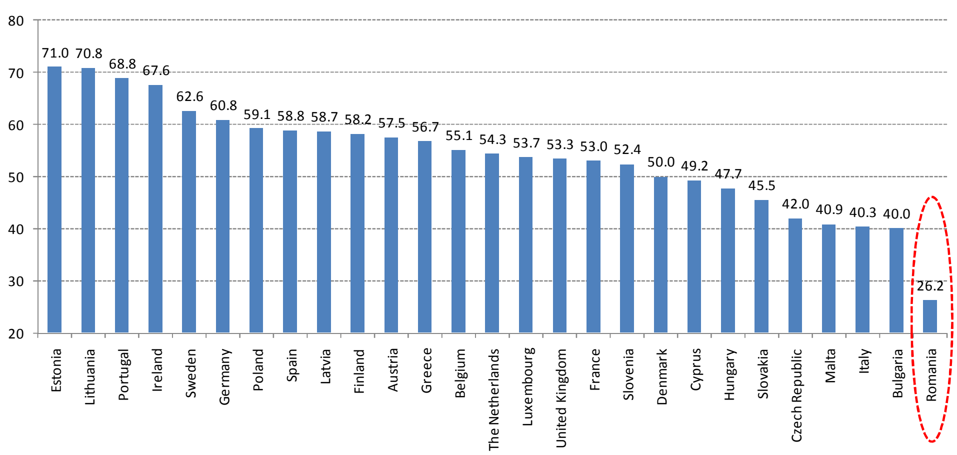
The evolution of financial flows between Romania and the European Union at 30.06.2013

billion euros

No.	Name	Initial program 2013	Actual 30.06.2013 billion euros	Actual 30.06.2013 %	Cumulative 2007-2013
0	A	1	2	3	4
1	***I. AMOUNTS RECEIVED FROM THE EU BUDGET (A+B)***	***8.707,6***	***2.524,0***	***29,0***	***18.045,0***
2	*A. Pre-accession funds*	*81,1*	*27,7*	*34,1*	*2.656,0*
3	*B. Post-accession funds, of which:*	*8.626,5*	*2.496,3*	*28,9*	*15.389,0*
4	*i) Advances*	*106,7*	*46,6*	*43,7*	*3.802,3*
5	*ii) Reimbursements (including FEGA)*	*8.519, 8*	*2.449,7*	*28,7*	*11.586,7*
6	*B1. Structural and cohesion funds, of which:*	*5.754,7*	*755,5*	*13,1*	*5.128,0*
7	*a) Advances*	*0,0*	*0,0*	*0,0*	*2.125,8*
8	*b) Reimbursements*	*5.754,7*	*755,5*	*13,1*	*3.002,2*
9	*B2. Funds for rural development and fishing, of which:*	*1.416,8*	*608,4*	*42,9*	*4.501,8*
10	*a) Advances/Pre-financing*	*0,0*	*0,0*	*0,0*	*601,0*
11	*b) Reimbursements*	*1.416,8*	*608,4*	*42,9*	*3.900,8*
12	*B3. The European Agricultural Guarantee Fund (EAGF)*	*1.323,6*	*1.082,2*	*81,8*	*4.550,9*
13	*B4.Other (post-accession), of which:*	*131,4*	*50,2*	*38,2*	*1.208,3*
14	*a) Advances*	*106,7*	*46,6*	*43,7*	*1.075,5*
15	*b) Reimbursements*	*24,7*	*3,6*	*14,6*	*132,8*
16	***II. AMOUNTS PAID TO EU (C+D)***	***1.542,8***	***1.012,4***	***65,6***	***8.679,6***
17	*C. Romania's contribution to the EU budget*	*1.477,8*	*952,5*	*64,5*	*8.393,0*
18	*D. Other contributions*	*65,0*	*59,9*	*92,0*	*286,6*
19	***III. The balance flows = I - II***	***7.164,8***	***1.511,6***	***21,1***	***9.365,4***

Source: Ministry of Public Finance

The absorption rate of structural and cohesion funds in EU countries (%, 13th of June, 2013)



Source: Current data published by the European Commission - DG Regio4. Data include the advances received.

[4] http://ec.europa.eu/regional_policy/thefunds/funding/index_en.cfm

In the Fiscal Council's opinion, the Half–Year Report regarding the economic and budgetary situation is not sufficiently detailed in terms of justifying the significant failure in achieving the forecasted revenues for the first 6 months and it does not detail the measures taken and those planned specifically for improving the collection in the second semester.

On the *expenditure side*, the amounts reached a level of 93.5% of the planned expenditure in the first semester, increasing by 4.8% in nominal terms over the same period of the previous year (excluding the impact of swap schemes). Expenditure increases were recorded over the first semester of 2012 in personnel expenses (+18%), goods and services expenses (+6.8%), subsidies (+9.3%), other transfers (+19%) and interest payments (+0.7%). Expenditure decreases were recorded only in projects funded by external post-accession grants (-19.2%), capital expenditure (-9.8%) and expenditure funded from reimbursable funds (-33.3%).

Personnel expenses increased by 18% over the previous year, primarily due to the restoration of budgetary wages, recording a surplus of 0.6% (136 million lei) over the half-year program target. The difference was generated by the fact that the original budget for 2013 considered funding a maximum of 1,187,000 jobs in the public sector, but the monthly average number of occupied jobs in the public sector in the first 6 months was higher by 2,197 jobs (1,189,197 total occupied jobs).

Compared to December 2008, the number of occupied jobs in the public sector declined to a minimum of 1,187,070 in September 2012, recording a decrease of over 15% (-211,152 occupied jobs), mainly due to the introduction of a rule stating that only 1 new employee shall be hired for every 7 departures from the system. The largest decreases were registered in this period in the case of local executive authorities (-87,119), pre-university education (-38,305), health care (-23,604[5]), the Ministry of Internal Affairs (-12,401), the Ministry of Public Finance (-5,504), the Ministry of Agriculture and Rural Development (-3,518) and the Ministry of National Defense (-3,036). The highest increases were registered in this period in the case of the General Secretariat of the Government (+4,653), the Ministry of Labor (+1,840), the Ministry of Justice (+1,649) and the Ministry of Economy (+1,502). Since October 2012, after the implementation of the rule 1 to 7 became more lax, the number of occupied jobs in the public sector began to increase (+2,325 during September 2012 – June 2013), the highest increases up to June 2013 being registered by the Ministry of Internal Affairs (+2,062), by the pre-university education (+1,493), by the Ministry of Regional Development and Public Administration (+908) and by the Ministry of Justice (+419), while the largest decreases were recorded in the case of General Secretariat of the Government (-1,539), local executive authorities (-865) and the Ministry of Finance (-413).

In light of these developments, the Fiscal Council recommends a cautious approach in the transition from rule 7 – 1 to 1 – 1 and a very careful monitoring of monthly personnel

[5] Some hospitals have been moved under the authority of local governments.

expenditure in order to avoid overruns related to personnel expenses for 2013, which would lead to a renewed violation of the Fiscal Responsibility Law No. 69/2010.

Evolution of public sector employment

	Differences (September 2012 - December 2008)		Differences (June 2013-September 2012)
	jobs number	%	jobs number
Total employment, of which:	-211,152	-15.1%	2,325
I. CENTRAL ADMINISTRATION, of which:	-179,507	-25.8%	1,469
1.Institutions financed from the state budget	-20,560	-6.1%	13,759
Presidential Administration	-35	-15.6%	13
Senate of Romania	-32	-3.9%	40
Chamber of Deputies	-124	-6.9%	107
High Court of Cassation and Justice	-36	-7.7%	25
Constitutional Court of Romania	-2	-2.1%	-1
Legislative Council	-21	-21.0%	-3
Romanian Court of Accounts	134	10.0%	28
Competition Council	-13	-4.2%	15
Romanian Ombudsman	-18	-18.2%	5
The National Council for the Study of the Securitate Archives	-22	-8.6%	1
National Audiovisual Council of Romania	-32	-19.3%	-2
General Secretariat of the Government	4,653	169.6%	-1,539
Ministry of Foreign Affairs	-487	-19.1%	145
Ministry of Regional Development and Public Administration	113	17.9%	908
Ministry of Public Finance	-5,504	-16.3%	-413
Ministry of Justice	1,649	12.2%	419
Ministry of National Defense	-3,036	-3.8%	171
Ministry of Internal Affairs	-12,401	-8.4%	2,062
Ministry of Labor, Family, Social Protection and Elderly	1,840	62.2%	26
Ministry for Youth and Sports	-535	-100.0%	171
Ministry of Agriculture and Rural Development	-3,518	-32.7%	-120
Ministry of Environment and Climate Changes	33	0.8%	82
Ministry of Transportation	-245	-30.5%	27
Ministry of National Education	-2,972	-27.4%	-67
Ministry of Health	-1,132	-15.3%	11,206
Ministry of Culture	-377	-43.4%	-95
Ministry of Communication and Information Society	62	44.6%	-3
Public Ministry	185	3.6%	99
The National Integrity Agency	-34	-29.1%	2
The Protection and Guard Service	-129	-8.0%	20
The Special Telecommunications Service	-201	-6.9%	14
Ministry of Economy	1,502		174
The Romanian Academy	-325	-8.7%	4
State Secretariat for the Revolutionary Problems	-6	-16.2%	0
The National Office for Prevention and Control of Money Laundering	-11	-10.8%	1
National Registry Office tor Classified Information	-21	-17.9%	3
National Council for Combating Discrimination	2	3.1%	-2
Superior Council of Magistracy	-9	-2.5%	30
Permanent Electoral Authority	-24	-15.9%	12

	Differences (September 2012 - December 2008)		Differences (June 2013-September 2012)
The National Supervisory Authority For Personal Data Processing	-3	-6.3%	-3
	jobs number	%	jobs number
The Economic and Social Committee	-4	-12.5%	-1
National Council for Solving Complaints	89		2
State Assets Management Authority	260		-15
Ministry of European funds	227		58
National Authority for Properties' Restitution	0		153
2. Institutions financed from the social security's budget	-2,506	-22.6%	-79
3. Institutions subsidized from the state budget and unemployment insurance fund	-4,939	-12.0%	-162
4. Self-financed institutions, of which:	-151,502	-49.8%	-12,049
- hospitals	-140,305	-67.0%	-11,929
- universities	214	0.3%	9
- other institutions	-11,411	-42.6%	-129
II. LOCAL AUTHORITIES, of which:	-31,645	-4.5%	856
1. Institutions financed from the local budgets, of which:	-125,424	-19.5%	628
- pre-university education	-38,305	-11.5%	1,493
- local executive authorities	-87,119	-28.0%	-865
2. Institutions fully or partly funded from own revenues, of which:	93,779	156.6%	228
- hospitals from the health network of local authorities	116,701		1,259

Source: Ministry of Public Finance

E*xpenditure on goods and services* increased by 6.8% in the first semester of 2013 compared to the first semester of 2012, recording a half-year program underperformance of 1,057 million lei also as a result of the delay of implementation of the EU Directive 7/2011 on combating late payments in commercial contracts[6] until August 2013.

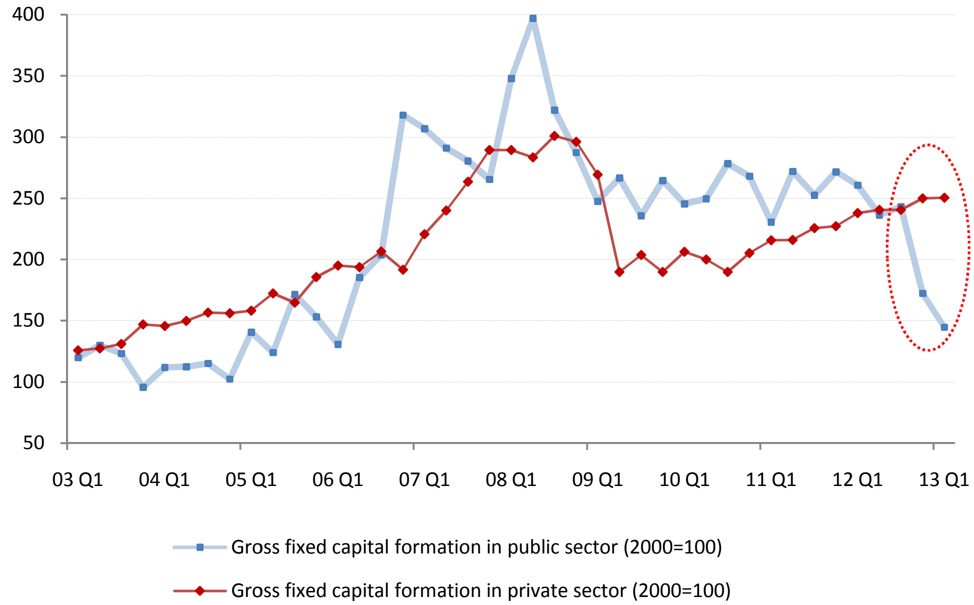
Investment expenditure including projects funded from post-accession external grants, expenditure from reimbursable funds, capital expenditure and other transfers for investments are revised downward by 11.1% compared to the first semester of 2012, representing only 74.5% of the half-year program (with -4,149 million lei less than half-year program). This significant underperformance of the half-year program was generated by the far below expectations EU funds absorption (68.2% achievement of the half-year program) and by the reduction in capital expenditure from own sources (-1,471 million lei compared to the first half of 2012, 83.3% achievement of the half-year program).

The public investment spending decrease of 11.1% in the first half of 2013 compared to the first half of 2012 in cash standards was significantly higher in ESA95 terms (accrual based accounting). Thus, according to the available data from national accounts, in real terms, public

[6] This directive states that "agreements between enterprises should provide limited payment terms, as a rule, at 60 calendar days". In addition, "it should provide specific norms regarding commercial transactions for the supply of goods and services by enterprises to public authorities, rules to determine, 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 features of the contract, but not exceed, in any case, 60 calendar days."

investment expenditure in ESA95 standards decreased by 29.9% in the fourth quarter of 2012, respectively by 32.8% in the first quarter of 2013 compared to the same period of the previous years, thus having a strongly negative contribution to economic growth.

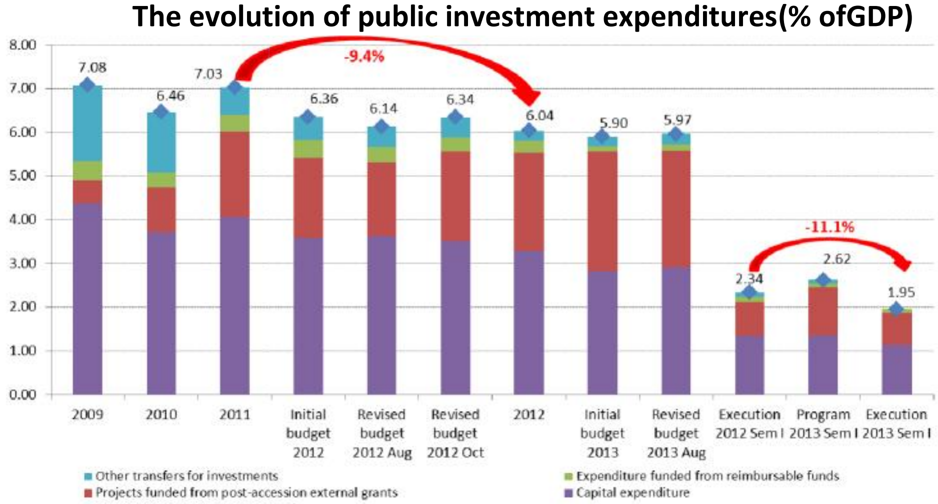
Evolution of investment expenditures in real terms (ESA95)



Source: INS, EUROSTAT

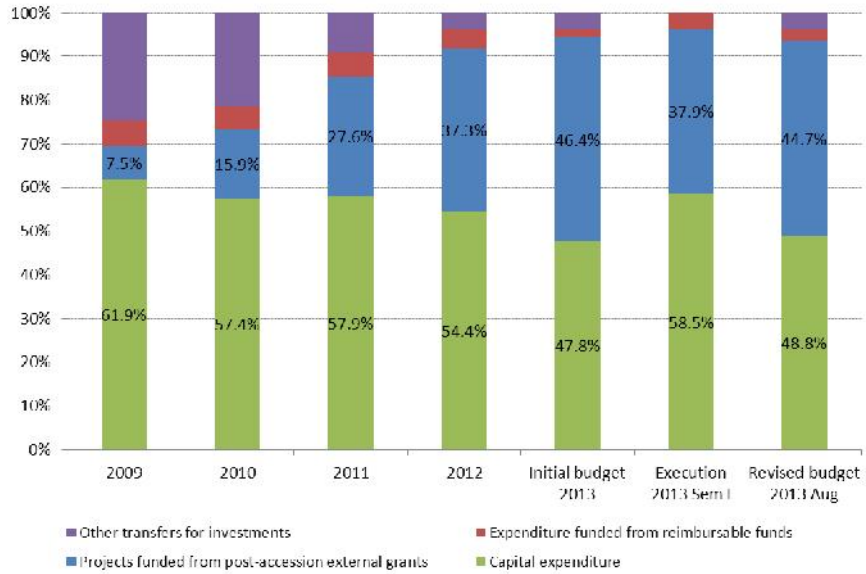
In the initial budget for 2013, it was intended to increase the share of EU funds absorption in total investment expenditure, a right and welcomed approach in the Fiscal Council's opinion, but unfortunately the budget execution in the first 6 months shows a failure in this regard. Within this context, the Fiscal Council recommends the urgent implementation in the legislation of some clear criteria for prioritizing public investments in order to also promote a shift in funding from own resources to European funds, doubled by a budgeting on a multiannual basis.

The evolution of public investment expenditures(% ofGDP)



Source: Ministry of Public Finance

The structure of public investment expenditures



Source: Ministry of Public Finance

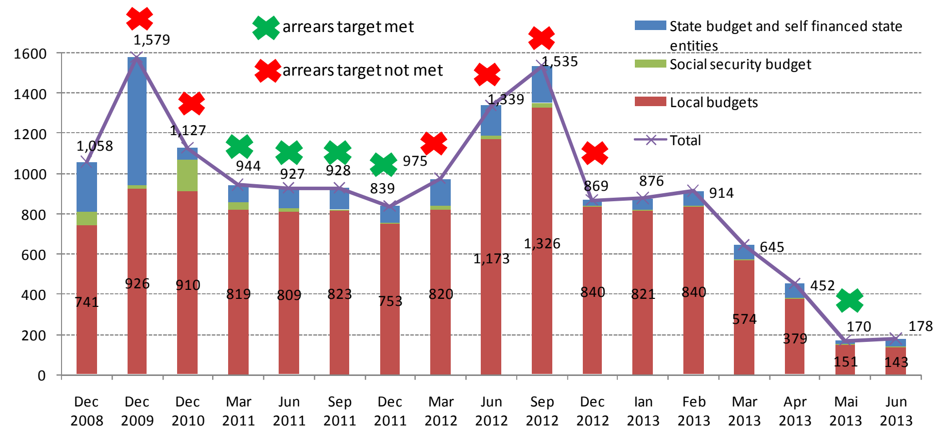
In conclusion, a significant underperformance on the revenue side of the budget was balanced during the first 6 months of 2013 primarily by reducing investment expenditure, by maintaining goods and services expenditure at a level well below the planned one, by interest expenditure under the half-year program and by social assistance expenditure well below expectations.

Regarding ***arrears,*** after 2011 when the targets were met, with arrears recording a downward trend, the targets for 2012 were again missed. The arrears monitored by the IMF (overdue more than 90 days) decreased decisively during March –June 2013. However, if we consider all the ammounts overdue, not only those over 90 days, their current level is still high, at about 0.39% of GDP in June 2013. Most of these arrears are located on the social security budget and on the local budgets. Local budgets arrears' problem appears as a recurring structural problem and it mainly reflects a lack of financial discipline and lack of enforcement of Local Public Finance Law (Law 273/2006, with its subsequent amendments).

Moreover, although arrears over 90 days to the social security budget appear to be eliminated, those between 0-90 days for invoices issued in this sector seem to remain high. In addition, there are unpaid bills[7] for drugs that do not yet appear to be arrears in the system, as the contractual payment terms were extended to 210 days. Effectively, these invoices are paid when appearing as arrears over 90 days, that is at over 300 days of the issue, which makes it more difficult to apply the EU Directive no. 7/2011.

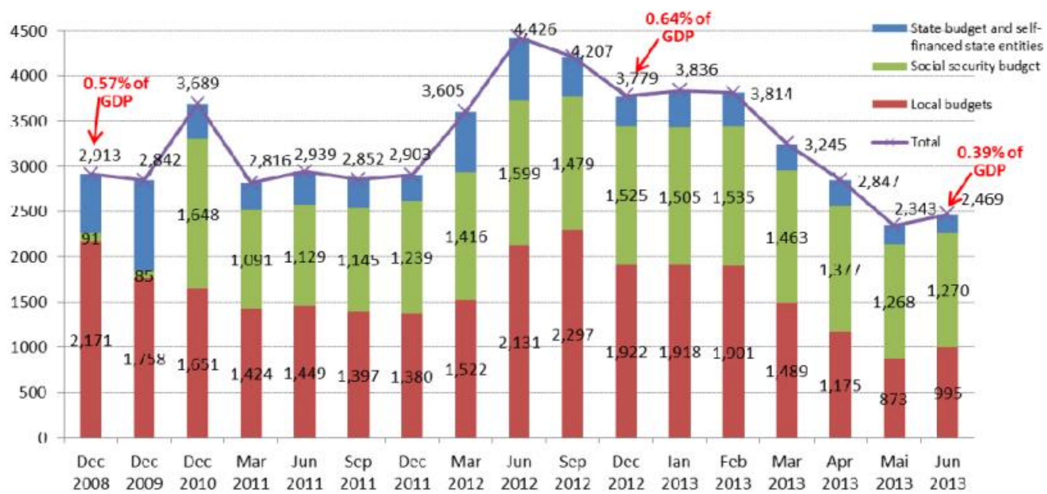
[7] The amount is over 1 billion euro equivalent according to the Association of Pharmaceutical Distributors and Retailers in Romania (ADRFR), http://adrfr.ro/ro/a/60dezile.html.

The evolution of budget arrears 90-360 days (mn lei)



Source: Ministry of Public Finance

The evolution of budget arrears 0-360 days (mn lei)



Source: Ministry of Public Finance

Regarding ***the financing of the budget deficit and of the public debt***, the Half-Year Report on the economic and budgetary situation shows how the budget deficit was financed and how the public debt was refinanced in the first semester. The Fiscal Council considers the strategy adopted by the Ministry of Finance in the first semester of 2013 to be adequate, as it managed ***to build a comfortable liquidity buffer and to improve the public debt maturity profile.***

2. Additions to the preliminary opinion on the Draft Budget Revision for 2013

The draft budget revision is based on an economic growth of 2%, the economic advance being revised upward from the initial projection of 1.6%, mainly as a result of the evolution beyond expectations of the economic activity in the first quarter of the current year and as a consequence of a better than expected evolution of the agricultural sector. The increase in real GDP in the first three months of 2013 was entirely due to the external demand, given that consumption and investment had a negative contribution to the growth rate. The short-term economic indicators (the evolution of the industrial production, turnover in retail trade, data on international trade of goods of Romania, etc.) points out to the continuation of this trend also in the second quarter of 2013, which could lead to further changes in the structure of the forecasted economic advance for the entire year. The Fiscal Council considers as realistic the prognosis of economic growth for 2013, the balance of risks being tilted on the positive side, respectively registering a higher economic advance, given that a good agricultural year will contribute substantially to the economic growth rate, taking into account the significant base effect caused by the very poor agricultural production in 2012. However, a further deterioration in international financial markets sentiment, primarily due to concerns about the withdrawal of the monetary stimulus in the U.S., but also as a result of the modest economic activity in the euro area could contribute negatively to the economic growth rate. Moreover, an additional increase of GDP determined by the agricultural production is unlikely to be reflected in a proportional increase of revenues given the experience of the previous years. Also, the explanatory memorandum accompanying the budget revision does not contain a sufficiently detailed macroeconomic framework, respectively the anticipated dynamics of the GDP components, which are absolutely necessary in order to rigorously perform a revenue forecast, are not specified.

Budgetary revenues and expenditures

The draft of the revised consolidated budget estimates an increase in the general government revenues by 0.12 billion lei and also an increase of the overall expenditure by 1.43 billion lei as compared to the initial program, revising upward the deficit target according to the cash methodology from 2.1 to 2.3 percent of GDP andthus violating the provisions of Law no. 4/2013 regarding the approval of ceilings for certain indicators specified in the Fiscal Strategy.

The increase in budget revenues is generated exclusively by a new swap scheme with the purpose of clearing budgetary arrears. According to this scheme, 1.12 billion lei will be transferred from the state budget to local budgets and to certain state owned companies, so that ultimately the outstanding obligations to the budget will be eliminated, while the influence on the budget deficit is neutral.

Excluding the impact of compensation schemes, the revenues are projected to decrease by 1 billion lei as a consequence of the unfavorable impact of the downward revision of VAT revenues (-0.89 billion lei), corporate income tax (-0.85 billion lei), excise revenues (-0.52 billion lei) and non-tax revenues (-0.39 billion lei). Extra revenues are projected to be collected from EU funds (+0.93 billion lei), due to the diminishing national contribution as a consequence of continuing the program with the EU and the IMF, and also from other taxes on goods and services (+0.83 billion lei), as the *claw-back tax* revenues were not included in the initial projection. The downward revision for VAT and excise revenues is due to the adverse evolution of private consumption as the economic growth was supported by the external demand and it is also due to the reduction in VAT rate for bread, flour and wheat. In the case of corporate income tax, the reduction is attributable to the adjustment of commercial banks obligations, as the anticipated payments based on the 2011 profits were higher than the actual amounts due for 2012 (the profits from 2011, indexed with the 2012 inflation rate were used as tax base).

The Fiscal Council expresses serious reserves regarding the projection of certain budgetary revenues considering the outcomes registered in the first semester and the recent development of relevant macroeconomic indicators. For instance, the personal income tax (PIT) dynamics compared to the previous year's similar period of time is projected to speed up to 10.8% until the end of 2013 compared to 9.29% in the first semester, even if the annualized increase of wages in June decelerated at 3.7%, pointing to an unrealistic estimation of PIT revenues for this year. The evolution of wages dynamics can be explained by the unfavorable base effect generated by the dissipated impact of public sector wages' recovery and the very modest increase in private sector wages. Thus, the PIT projections were not revised downward, even if the macroeconomic forecast considered in the initial budget indicating a 7% increase in gross wages seems very optimistic at this moment, while the increase in employment and the proposed discretionary measures seem not to fully compensate the adverse wage dynamics. The same reasoning is valid for the revenues from social contributions that are projected to increase by 6.2% compared to last year, even if in the first semester the annualized rate was only 4.26%, displaying an unrealistic projection for these revenues. Under these circumstances, the Fiscal Council assesses that the revenues from PIT and social contributions are overestimated by around 1 billion lei.

Also, in our opinion there are considerable downside risks regarding the projection of VAT revenues due to the adverse development of private consumption. Meanwhile, the loss in revenues attributable to the reduction of the standard VAT rate for bread, flour and wheat seems to be correctly evaluated, our estimations being close to those produced by the MoF. On the other hand, the Fiscal Council expresses reserves regarding the magnitude of the positive impact generated by the compensatory measures (increase in excise rate for alcohol and luxury products). In addition, achieving the targets regarding the absorption of EU funds seems to be a major challenge, the targets being practically unrealistic as the revised budget foresees an increase by 52.3% compared to 2012, while the budget execution for the first semestershows a reduction of 5% compared to the same period of the previous year. Regarding corporate income tax, despite the first semester's disappointing results, the operative figures for July are more favorable, therefore the revised projection can be appreciated as realistic.

In conclusion, even if the economic growth was revised upward to 2%, its structure is not the *tax rich* type (respectively favorable to an increase in budgetary revenues), which means that the collections could be even lower than the ones stated in the initial budget.

The upward revision of budgetary expenditure by 1.43 billion lei reflects a supplementation of the swap scheme for clearing budgetary arrears (1.12 billion lei, out of which „capital expenditures" 618 million lei, respectively „goods and services" 500 million lei) and of the overall spending by 310 million lei. This increase is mainly due to spending on goods and services (+2 billion lei, partially compensated through revenues from the *claw-back* tax) and it is motivated by an acceleration of the payment of arrears in the healthcare system, reflecting the lack of reforms in this sector. Downward revisions of the expenditure are considered for „social assistance" (–604 million lei), „capital spending" (-439 million lei), „projects financed through post accession grants" (-466 million lei), while the „other transfers" chapter is diminished by -565 million lei, but the reasons behind this revision are not explained.

Regarding the expenditure on goods and services, in February 2013, in the opinion on the revised Fiscal Strategy for the period 2013-2015, the Fiscal Council already drew attention on the underestimation of these allocations and warned about the significant risks of exceeding the amounts proposed in the budget. The initial level was quite difficult to achieve considering the impact of the EU Directive no. 7/2011 on combating late payments in commercial contracts, which was initially estimated at around 3.5 billion lei (0.54% of GDP). In this context, the Fiscal Council notices serious deficiencies in the budgeting process, as the initial projected levels were frequently exceeded during the last years, thus affecting the credibility of the trajectory projected for this category of expenditure. Even if the revenues from the claw-*back* tax,which were not included in the initial budget, were to be used for financing goods and services expenditures, the magnitude of the revision (+2 billion lei, respectively around 0.3% of GDP) cannot be explained only by this influence. In this context, the Fiscal Council recommends an appropriate budgeting for goods and services expenditure, in accordance with the assumed commitments, so that this category will no longer represent a factor of uncertainty that threatens the fiscal position on the occasion of a budget amendment. In the medium term, we consider that a more efficient spending strategy on goods and services is not possible without implementing deep structural reforms, mainly in the healthcare system, and without a more efficient public procurement system in general.

Also, the Fiscal Council notes the presence of some buffers on interest expenditures (that seem to be overestimated) in the context of a significant reduction in financing costs recorded in the first 7 months of 2013. Even if the magnitude of the reduction in the interest rate paid by the government was quite large, the positive impact on the effective interest expenditure will be observed gradually, as the debt issued will reach its maturity and it will be refinanced under more favorable market conditions.

in conclusion, the Fiscal Council considers that achieving the new deficit target for this year seems to depend to a great extent on the realization of budgetary revenues projection, which appears to be optimistic, so there is a downside risk, respectively smaller revenues will be collected than the amounts projected in the draft revised budget, situation that should be compensated through a strict control of expenditures and through enhanced tax revenue collection efforts.

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, after being approved by the Council members through vote, on August 12th, 2013.

August 12th, 2013

Chairman of the Fiscal Council

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ANNEX I –Budget execution semester I 2013 vs. the half-year program	The half-year program 2013 without swaps (mn RON)	Budget execution semester I without swaps (mn RON)	Budget execution semester I 2013/ Budget execution semester I 2012 (without swap)	The half-year program 2013 – Budget execution semester I 2013 without swap (mn RON)	The achievement degree of the half-year program (%)
	1	2	3	4=2-1	5=2/1
TOTAL REVENUE	103,812	97,300	5.1%	-6,513	93.7%
Current revenue	96,793	94,254	5.6%	-2,540	97.4%
Tax revenue	60,495	58,464	7.3%	-2,031	96.6%
Taxes on profit, wages, income and capital gains	18,261	17,264	4.2%	-997	94.5%
Profit	6,236	5,409	-5.5%	-827	86.7%
Personal income tax	11,360	11,351	9.3%	-10	99.9%
Other taxes on income, profit and capital gains	665	504	9.5%	-161	75.8%
Property tax	2,590	2,737	9.5%	147	105.7%
Taxes on goods and services	39,652	38,178	8.0%	-1,475	96.3%
VAT	24,456	23,971	3.3%	-485	98.0%
Excises	10,682	9,969	4.2%	-713	93.3%
Other taxes on goods and services	956	698	-20.8%	-258	73.0%
Taxes on using goods, authorizing the use of goods or on carrying activities	3,009	3,295	163.9%	286	109.5%
Tax on foreign trade and international transactions	343	313	-5.2%	-30	91.1%
Other tax revenue	198	217	12.6%	19	109.5%
Social security contributions	26,645	26,603	4.3%	-42	99.8%
Nontax revenue	9,654	9,187	-1.0%	-467	95.2%
Capital revenues	325	286	-2.3%	-39	88.0%
Grants	308	48	-66.5%	-260	15.6%
Pre-accession funds	6,386	3,039	-1.3%	-3,347	47.6%
Amounts collected in the single account(State budget)	-	-327	74.2%	-327	
TOTAL EXPENDITURE	111,449	104,173	4.8%	-7,276	93.5%
Current expenditure	102,825	97,338	6.0%	-5,487	94.7%
Personnel	22,960	23,097	18.0%	136	100.6%
Goods and services	17,663	16,606	6.8%	-1,057	94.0%
Interest	6,959	6,325	0.7%	-634	90.9%
Subsidies	3,380	3,335	9.3%	-46	98.7%
Total Transfers	50,738	47,286	1.3%	-3,452	93.2%
Transfers for public entities	661	212	64.9%	-449	32.1%
Other transfers	6,949	6,346	19.0%	-603	91.3%
Projects funded by external post-accession grants	7,086	5,205	-19.2%	-1,881	73.5%
Social assistance	34,609	34,042	1.6%	-567	98.4%
Other expenditure	1,432	1,481	16.4%	49	103.4%
Expenditure funded from reimbursable funds	575	445	-33.3%	-130	77.4%
Capital expenditure	8,623	7,152	-9.8%	-1,471	82.9%
Payments made in perevious years	-	-317	-8.3%	-317	
Overall Balance	-7,086	-6,629	-2.4%	458	93.5%

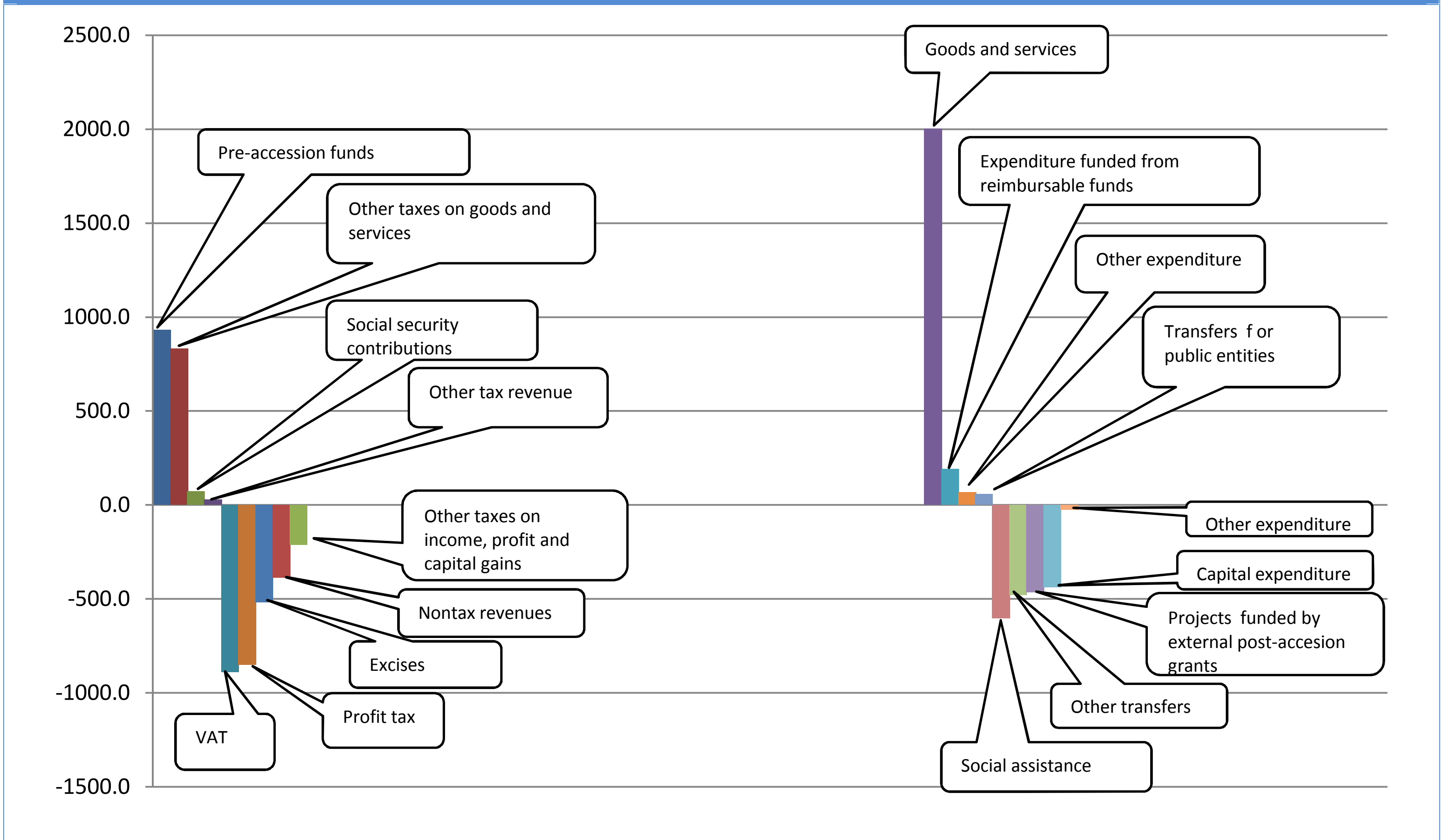
Source: Ministry of Public Finance, Fiscal Council's calculations

	Budget execution 2012	Initial budget 2013	Revised budget 2013								
GDP, mn lei	587499	623300	626200								
ANNEX II	**Initial budget 2013**	**Swap program 2013**	**Initial budget 2013 without swap**	**Revised budget 2013**	**Additional swap**	**Revised budget 2013 without swap**	**Revised budget - Initial budget 2013 with swap**	**Revised budget - Initial budget 2013 without swap**	**Budget execution semester I 2013/Budget execution semester I 2012 (without swap)**	**Revised semester II 2013/Budget execution semester II 2012 (without swap)**	**Revised budget 2013/ Budget execution 2012 (without swap)**
	1	**2**	**3=1-2**	**4**	**5**	**6=4-5**	**7=4-1**	**8=6-3**	**9**	**10**	**11**
TOTAL REVENUE	209285.0	1000.0	208285.0	209406.6	1118.0	207288.6	121.6	-996.4	5.1%	11.8%	8.56%
Current revenue	196747.6	1000.0	195747.6	195935.0	1118.0	193817.0	-812.6	-1930.6	5.6%	7.6%	6.60%
Tax revenue	122965.3	1000.0	121965.3	122468.1	1118.0	120350.1	-497.2	-1615.2	7.3%	7.8%	7.55%
Taxes on profit, wages, income and capital gains	36359.9		36359.9	35293.9		35293.9	-1066.0	-1066.0	4.2%	12.3%	8.19%
Profit	11721.8		11721.8	10869.8		10869.8	-852.0	-852.0	-5.50%	8.4%	1.03%
Personal income tax	23146.2		23146.2	23146.2		23146.2	0.0	0.0	9.3%	12.3%	10.80%
Other taxes on income, profit and capital gains	1491.9		1491.9	1277.9		1277.9	-214.0	-214.0	9.5%	51.3%	31.52%
Property tax	4493.8		4493.8	4493.8		4493.8	0.0	0.0	9.5%	12.5%	10.67%
Taxes on goods and services	80980.7	1000.0	79980.7	81519.5	1118.0	79401.5	538.8	-579.2	8.0%	5.2%	6.50%
VAT	52948.8	1000.0	51948.8	53175.0	1118.0	51057.0	226.2	-891.8	3.3%	5.2%	4.31%
Excises	22363.2		22363.2	21843.2		21843.2	-520.0	-520.0	4.2%	11.0%	7.83%
Other taxes on goods and services	956.2		956.2	1788.8		1788.8	832.6	832.6	-20.8%	-9.1%	-14.07%
Taxes on using goods, authorizing the use of goods or on carrying activities	4712.5		4712.5	4712.5		4712.5	0.0	0.0	163.9%	-29.9%	44.14%
Tax on foreign trade and international transactions	741.8		741.8	741.8		741.8	0.0	0.0	-5.2%	13.6%	4.88%
Other tax revenue	389.1		389.1	419.1		419.1	30.0	30.0	12.6%	16.1%	14.29%
Social security contributions	54355.3		54355.3	54428.2		54428.2	72.9	72.9	4.3%	8.0%	6.20%

ANNEX II	Initial budget 2013	Swap program 2013	Initial budget 2013 without swap	Revised budget 2013	Additional swap	Revised budget 2013 without swap	Revised budget - Initial budget 2013 with swap	Revised budget - Initial budget 2013 without swap	Budget execution semester I 2013/Budget execution semester I 2012 (without swap)	Revised semester II 2013/Budget execution semester II 2012 (without swap)	Revised budget 2013/ Budget execution 2012 (without swap)
	1	2	3=1-2	4	5	6=4-5	7=4-1	8=6-3	9	10	11
Nontax revenue	19427.0		19427.0	19038.7		19038.7	-388.3	-388.3	-1.0%	9.7%	4.27%
Capital revenues	687.1		687.1	687.1		687.1	0.0	0.0	-2.3%	11.4%	5.27%
Grants	629.9		629.9	630.7		630.7	0.8	0.8	-66.5%	94.8%	42.43%
Pre-accession funds	11220.2		11220.2	12153.8		12153.8	933.6	933.6	-1.3%	86.1%	52.32%
TOTAL EXPENDITURE	222679.2	1000.0	221679.2	224106.7	1118.0	221988.7	1427.5	309.5	4.8%	10.8%	7.91%
Current expenditure	205009.7	1000.0	204009.7	206258.2	500.0	204758.2	1248.5	748.5	6.0%	10.2%	9.11%
Personnel	46154.0		46154.0	46152.7		46152.7	-1.3	-1.3	18.0%	8.6%	13.12%
Goods and services	37262.9		37262.9	39766.8	500.0	39266.8	2503.9	2003.9	6.8%	22.5%	15.36%
Interest	11383.0		11383.0	11362.9		11362.9	-20.1	-20.1	0.7%	13.7%	6.09%
Subsidies	5229.8		5229.8	5242.9		5242.9	13.1	13.1	9.3%	-37.8%	-14.36%
Total Transfers	103990.2	1000.0	102990.2	102568.5		101568.5	-1421.7	-1421.7	1.3%	13.8%	7.61%
Transfers for public entities	1632.8	850.0	782.8	1692.4		842.4	59.6	59.6	64.9%	-8.0%	3.50%
Other transfers	12265.7	150.0	12115.7	11785.4		11635.4	-480.3	-480.3	19%	5.7%	12.54%
Projects funded by external post-accession grants	17311.2		17311.2	16845.7		16845.7	-465.5	-465.5	-19.2%	71.9%	27.45%
Social assistance	69979.4		69979.4	69375.7		69375.7	-603.7	-603.7	1.6%	5.3%	3.47%
Other expenditure	2801.1		2801.1	2869.3		2869.3	68.3	68.3	16.4%	-18.1%	-3.31%
Expenditure funded from reimbursable funds	782.9		782.9	976.8		976.8	193.9	193.9	-33.3%	-43.9%	-39.50%
Capital expenditure	17669.5		17669.5	17848.5	618.0	17230.5	179.0	-439.0	-9.8%	-6.4%	-7.85%
Overall Balance	-13394.2		-13394.2	-14700.0		-14700.0	-1305.9	-1305.9	-2.4%	1.1%	-0.50%

Source: Ministry of Public Finance, Fiscal Council's calculations

The main changes in expenditures and revenues after the budget revision (without the impact of swap schemes), mn lei



Source: Ministry of Public Finance