

The Fiscal Council's Opinion on the Third Supplementary Budget Draft for 2014

On the 28th of November 2014, at 19:00, the Ministry of Public Finance (MPF) sent via e-mail to the Fiscal Council, by letter no. 20348 from the 27th of November 2014, a third supplementary budget draft for 2014, the explanatory note and the Government Ordinance project regarding the budget revision draft for 2014, as well as the explanatory note and the Government Ordinance project regarding the draft of the revised social security budget for 2014, requesting the Fiscal Council's opinion under the article 40, paragraph (2) of the Law no. 69/2010. The Government's intention is to adopt the above mentioned documents during the meeting from the 3rd of December 2014, so the Fiscal Council is put again in the position of having available only one working day to analyse, elaborate and approve the requested opinion. *Although the Fiscal Council repeatedly asked the Government to provide a reasonable time to fulfil its obligations according to the law, the persistence of this behaviour shows a lack of consideration for the fiscal responsibility law in general and for the institution of the Fiscal Council in particular.*

To the aforementioned documents is added a draft Emergency Ordinance approving distinctively temporary exemptions (effective for the current year) from the Public Finance Law no. 500/2002 and from the Fiscal Responsibility Law no. 69/2010 regarding prohibitions to promote, in the first case, a budget revision after the 30th of November and to approve more than two budget amendments during a year, in the second case. The justification for the temporary suspension of these two laws' provisions, according to the preamble of the enactment, consists mainly of "the surplus recorded at 10 months, as a result of an increased budgetary revenue collection compared to the estimates and given the favourable situation in terms of framing in the general government budget ceiling approved for 2014". The argument is obviously false, **as the situation of surplus after 10 months of budget execution is not due to budgetary revenues that substantially exceed estimates¹, but simply because of the investment expenditure underachievement:** at the end of October 2014, the investment expenses were by 2.3 billion lei lower than the ones from the previous year while for the entire year the programmed level of investment expenses is by 5.8 billion lei higher than in 2013. **From the Fiscal Council's point of view, the situation is far from reflecting a good public finance management and a good budget execution; on the contrary, it is testimony of an obvious inability at the level of the public investment projects portfolio management, likely to induce an unnecessary negative fiscal impulse in the economy².** This statement is confirmed

¹ According to the reports on the MFP's website, the total budgetary revenues from the third quarter represented about 95.7% of the program, respectively 2476 million lei below the estimates, almost entirely because of lower than expected post-accession EU funds by 2446 million lei.

² According to the latest data available on Eurostat, the gross fixed capital formation (investment) in the public sector from the national accounts (by accrual standards) decreased in nominal terms during January-June 2014 by 35.6% compared to the same period of 2013, this being the main factor that led to lower real GDP in the second

by the changes proposed by the third budget revision, given that the public investment program recorded a further reduction of 1.3 billion lei, compared to the level of the second budget revision, the more that the latter one is very recent, taking place at the end of September. In essence, the third budget revision for 2014 uses the fiscal space created by the substantial underachievement of investment spending to pay in advance, compared to the timing established by law, some salary related rights earned by court decisions and also other arrears, with favourable impact on the cash deficit in 2015. However, given that a significant proportion of these outstanding remuneration and other arrears, that the Government intends to pay, has already been included in the execution on an accrual basis (ESA95 / ESA2010) in 2011 - for the first category, or in that from the current year in the case of the second category, it is very unlikely that this inter-annual reallocation would generate a reduction in the existing pressures on the general consolidated budget (GCB) deficit in 2014, determined in accordance to the European standards, relevant from the perspective of Romania's commitments as a member of the European Union and from the perspective of compliance with the preventive arm of the Stability and Growth Pact and the Treaty on Stability, Coordination and governance in the Economic and Monetary Union. In other words, the payment of those sums could have been done just as well, for example in January 2015, under the approved budget for 2015, without this adversely affecting the size of the budget deficit according to European standards and without the need to appeal to many violations of the fiscal rules stipulated by laws and consequently undermining their credibility. In addition, the reduction of investment expenditures in 2014 to a minimum in the last few years and/or their postponement would rather put pressure on the budget deficit in the coming years both in cash and accrual standards (ESA95 / ESA 2010).

According to the Fiscal Council, the systematic recourse to exemptions from laws (especially the Law no. 69/2010) and the ease with which they occur, highlight major weaknesses in the implementation of a rule-based framework in the conduct of the fiscal policy, the legal provisions failing to induce significant constraints in the behaviour of the relevant authorities, as intended. It is obvious that stipulating the fiscal rules in the law is not enough and the establishment of functional rules require them to be legislated at the constitutional level.

The compliance with the fiscal rules

Compared to the budget approved on the occasion of the second budget amendment, the GCB revenues increase by 1,796.6 million lei, the expenditure by 1,797.5 million lei, so that the budget deficit is projected to increase marginally by 1 million lei. The GCB primary deficit increases by 211 million lei, due to the downward revision of the interest spending (-210.3 million lei). Taking into account the above mentioned figures and the affected expenditures categories, the budget revision proposal implicates multiple infringements of the fiscal rules stated by Law no 69/2010 (FRL) with further amendments:

quarter from 2014 compared to the previous quarter. At the same time, in the budget execution according to cash standards during January-October 2014, this particular item decreased by 10% over the same period of 2013.

1. It violates the provisions of article 15 paragraph (2) of the FRL according to which in one year, maximum two budget amendments can be approved;
2. It violates the provisions of article 6 letter b) according to which the GCB balance and the GCB primary balance may not exceed the ceilings established by the Fiscal Strategy accompanying law (namely, the Law no 355/2013). Thus, even if the breach of the ceiling for the GCB balance is marginally (3 million lei, corresponding to a deficit ceiling of 14,710 million lei and a programmed level for the GCB balance of 14,713 million lei), the existent gap to the ceiling for the GCB primary balance is increased by 901.1 million lei (the programmed level for primary balance is now 4,387.6 million lei compared to a ceiling of 3,486.5 million lei);
3. It violates the provisions of article 6 letter a) according to which the personnel spending as a share in GDP cannot exceed the ceiling established by the Fiscal Strategy accompanying law (namely, the Law no. 355/2013). Thus, the proposed amendment indicates personnel spending of 7.5% of GDP, compared to a ceiling of 7.3% of GDP (a significantly higher level compared to the lowest level reached during 2011-2012, namely 6.8% of GDP³), as the personnel expenses were increased by 2.406 million lei compared to the second budget revision due to an early payment of the installment for 2015 of some salary rights earned by court decisions, which payment was staggered over five years;
4. It violates the provisions of article 6 letter c) according to which the total spending excluding the financial assistance from the EU and other donors and also the personnel spending cannot exceed the ceiling established by the accompanying law of the Fiscal Strategy (the Law no 355/2013). The personnel spending proposed growth involves the increase of the existent marginal gap (62 million lei) compared to the stated ceiling of 48,006 million lei up to a gap of 2,468.2 million lei. Moreover, the budget amendment involves the increase of the gap to the ceiling for the total spending from 523 million lei up to 2,068 million lei as the growth in the personnel spending is partially offset by the capital spending reduction (-1,797 million lei).
5. It violates the provisions of article 9 paragraph (2) according to which the total personnel spending cannot be increased during the fiscal year on the occasion of budget revisions;
6. It violates the provisions of article 6, letter g) according to which during the budgetary year, the commitment appropriations and the approved budget that are not used for capital expenditure cannot be transferred and used for current expenses, given that the current expenses proposed increase is offset by the reduction of the capital spending in order to meet the deficit target.

Consequently, the proposed amendment induces either new violations of the fiscal rules or an increase in the size of the existing violations, so that the Government evades the responsibility of their observance by recourse to derogations from almost all the legal provisions which establish fiscal rules.

³ The highest level of the personnel spending in the last 10 years was reached in 2009 – 9.4% of GDP

The coordinates of the Third Supplementary Budget Draft– budgetary revenue and spending

Essentially, the main change introduced by this third budget revision is the use of the fiscal space created by the reduction of about 1.8 billion lei for capital spending to pay in advance, compared to the initial programmed rescheduling for certain salary rights earned by court decisions, increasing the personnel spending by 2.4 billion lei compared to the level targeted by the second budget revision at the end of September.

The payment of these rights generates additional revenue for the personal income tax (307.3 million lei) and social contributions (1.091,4 million lei), these income categories thus explaining almost all the increase for the total budget revenue. There are minor increases for nontax revenue (145.3 million lei), anticipated EU funds (234.7 million lei) and donations (18.8 million lei), while other revenue categories remain unchanged compared to the previous estimates.

For total budget spending, excluding the two above mentioned categories, in addition there are 1.1 billion lei of supplementary spending for current expenses. The increases are located at the chapters: goods and services spending, other expenses, transfers between government units and projects funded by external non reimbursable funds and are partial offset by the reduction of the estimates for the interest spending and the use of the budget reserve fund allocations⁴.

The Fiscal Council maintains his reservations already formulated in the context of the second budget amendment regarding the extremely optimistic levels for the projection of VAT receipts and for the estimated inflows from the post-accession EU funds, the two additional months of budget execution available at this time being likely to strengthen his opinions. However, the Fiscal Council assess as unlikely that the underachievement in these income categories would generate an increase in the budget deficit, given that they are likely to be offset by the underachievement of investment expenditure and possible by slightly increased revenue for personal income tax and social contributions. With regard to the investment expenditure it is difficult to understand how, from a level of 20.3 billion lei at the end of October, the investment expenditure will reach 37.5 billion lei at the end of this year, since it would involve levels of spending in November and December comparable in size with the accumulated spending during the first ten months of the year.

In conclusion, the Fiscal Council considers that the Government's decision to operate a third budget revision, obviously violating the provisions of the relevant laws (temporarily suspended by an emergency ordinance), is the evidence of a noticeable administrative incapacity of budgetary programming and budget execution, particularly for investment spending. In addition, it is difficult to understand the opportunity of advance payments for the outstanding wages compared to the originally scheduled by appealing a multitude of violations of fiscal rules stipulated by laws, given that it appears to be unlikely to facilitate the construction of the budget for 2015 in terms of ESA 2010, relevant for the commitments

⁴ It is worth to mention that until 14 November 2014, the reserve fund allocations sum up 956.7 million lei, increasing by 567% compared to the same period of 2013.

stemming out from the perspective of membership of the European Union and the provisions of the Growth and Stability Pact and of the Fiscal Compact.

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 2nd of December, 2014.

2nd of December, 2014

Chairman of the Fiscal Council

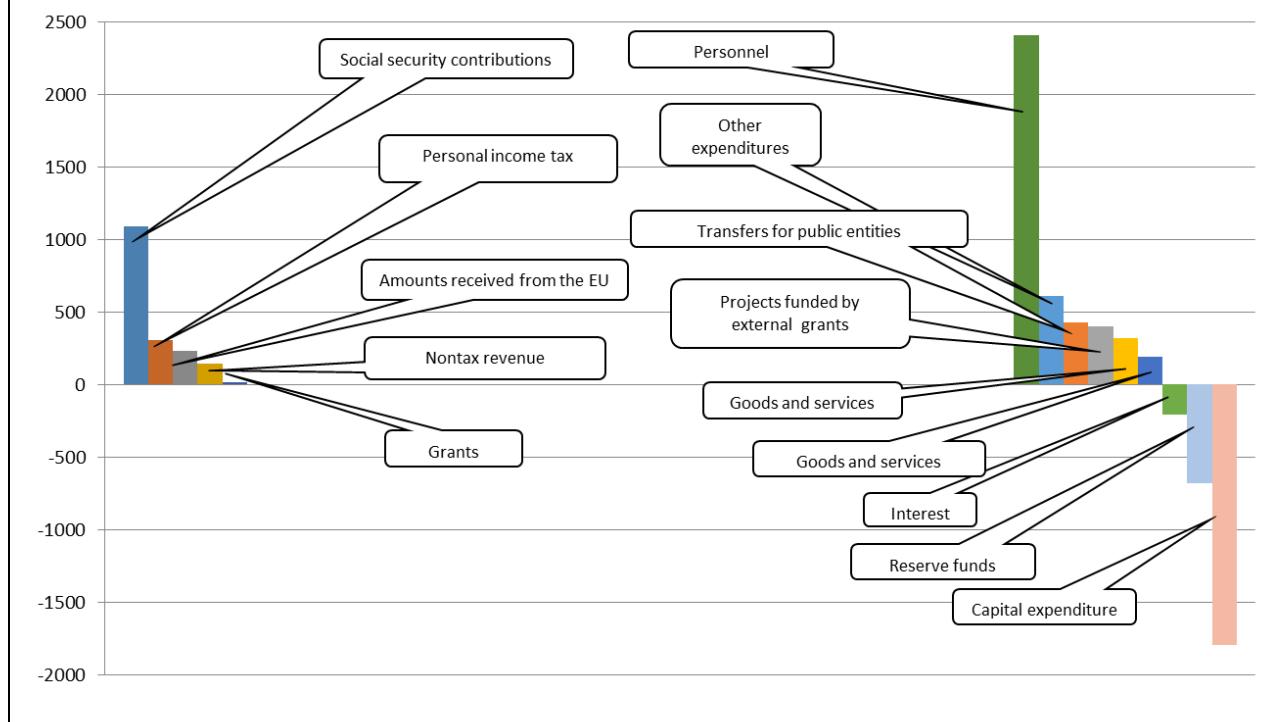
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ANNEX I	Initial budget 2014	Swap program 2014	Initial budget 2014 without swap	Second budget revision (R2) 2014	Updated Swap	R2 without swap	R3	Updated Swap	R3 without swap	R2 - Initial budget	R3 - Initial budget	R3 – R2
	1	2	3=1-2	4	5	6=4-5	7	8	9=7-8	10=6-3	11=9-3	12=9-6
TOTAL REVENUE	216,808.3	850	215,958.3	217,029.5	1407.0	215,622.5	218,827.0	1407.9	217,419.1	-335.84	1,460.72	1,796.56
Current revenue	201,331.2	850	200,481.2	200,772.2	1407.0	199,365.3	202,316.2	1407.9	200,908.3	-1,115.98	427.07	1,543.05
Tax revenue	126,162.2	850	125,312.2	126,804.4	1407.0	125,397.4	127,111.7	1407.9	125,703.8	85.22	391.56	306.34
Taxes on profit, wages, income and capital	36,724.9		36,724.9	36,063.9	0.0	36,063.9	36,371.3		36,371.3	-661.00	-353.69	307.31
Profit	11,378.0		11,378.0	11,991.0	0.0	11,991.0	11,991.0		11,991.0	613.00	613.00	0.00
Personal income	24,000.9		24,000.9	22,726.9	0.0	22,726.9	23,034.2		23,034.2	-1,274.00	-966.69	307.31
Other taxes on income, profit and capital	1,346.0		1,346.0	1,346.0	0.0	1,346.0	1,346.0		1,346.0	0.00	0.00	0.00
Property tax	5,040.7		5,040.7	6,251.0	0.0	6,251.0	6,251.0		6,251.0	1,210.30	1,210.30	0.00
Taxes on goods and services	83,362.6	850	82,512.6	83,480.5	1351.2	82,129.3	83,480.5	1352.2	82,128.3	-383.32	-384.30	-0.98
VAT	54,621.6	850	53,771.6	53,917.0	1351.2	52,565.8	53,917.0	1352.2	52,564.8	-1,205.82	-1,206.80	-0.99
Excises	24,102.0		24,102.0	24,114.0	0.0	24,114.0	24,114.0		24,114.0	12.01	12.01	0.00
Other taxes on goods and services	1,807.1		1,807.1	2,665.0	0.0	2,665.0	2,665.0		2,665.0	857.96	857.96	0.00
Taxes on using goods, authorizing the use of goods or on carrying activities	2,831.9		2,831.9	2,784.5	0.0	2,784.5	2,784.5		2,784.5	-47.48	-47.48	0.00
Tax on foreign trade and international	623.0		623.0	626.0	0.0	626.0	626.0		626.0	3.00	3.00	0.00
Other tax revenue	411.0		411.0	383.0	0.0	383.0	383.0		383.0	-28.01	-28.05	-0.04
Social security contributions	57,779.0		57,779.0	56,321.6	55.8	56,265.9	57,413.0	55.8	57,357.3	-1,513.17	-421.77	1,091.40
Nontax revenue	17,390.0		17,390.0	17,646.2	0.0	17,646.2	17,791.5		17,791.5	256.21	401.52	145.31
Capital revenues	621.0		621.0	1,701.2	0.0	1,701.2	1,701.2		1,701.2	1,080.20	1,080.20	0.00
Grants	14.6		14.6	24.6	0.0	24.6	43.4		43.4	10.00	28.80	18.80
Amounts received from the EU in the account of payments made and	14,841.5		14,841.5	14,531.5	0.0	14,531.5	14,766.2		14,766.2	-310.04	-75.34	234.71
Financial operations	0.0		0.0	0.0	0.0	0.0	0.0		0.0	0.00	0.00	0.00

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	1	2	3=1-2	4	5	6=4-5	7	8	9=7-8	10=6-3	11=9-3	12=9-6
Amounts collected in the single account (State)	0.0		0.0	0.0	0.0	0.0	0.0		0.0	0.00	0.00	0.00
TOTAL EXPENDITURE	231,298.4	850	230,448.4	231,741.5	1407.0	230,334.5	233,539.9	1407.9	232,132.0	-113.93	1,683.61	1,797.55
Current expenditure	213,514.3	850	212,664.3	213,416.0	1007.0	212,409.0	217,011.4	1007.9	216,003.5	-255.31	3,339.23	3,594.54
Personnel	47,786.2		47,786.2	48,068.2	14.8	48,053.4	50,474.2	14.8	50,459.4	267.19	2,673.20	2,406.01
Goods and services	39,363.7		39,363.7	41,468.7	282.8	41,185.9	41,786.4	283.8	41,502.6	1,822.23	2,138.89	316.66
Interest	11,223.5		11,223.5	10,535.6	0.0	10,535.6	10,325.3		10,325.3	-687.90	-898.18	-210.27
Subsidies	5,732.7		5,732.7	5,678.4	0.0	5,678.4	5,708.2		5,708.2	-54.30	-24.47	29.82
Total Transfers	108,139.7	850	107,289.7	106,238.2	709.4	105,528.8	107,920.7	709.3	107,211.4	-1,760.90	-78.34	1,682.55
Transfers for public entities	1,399.9	850	549.9	1,642.0	600.0	1,042.0	2,071.9	600.0	1,471.9	492.15	921.98	429.84
Other transfers	11,816.7		11,816.7	12,067.6	68.4	11,999.2	12,261.4	68.4	12,193.0	182.53	376.26	193.73
Projects funded by external grants	20,250.9		20,250.9	17,795.5	0.0	17,795.5	18,193.2		18,193.2	-2,455.48	-2,057.78	397.70
Social assistance	71,512.7		71,512.7	71,494.2	41.0	71,453.2	71,543.7	41.0	71,502.7	-59.51	-9.96	49.55
Projects funded by external post-accession grants 2014-2020							64.5		64.5	0.00	64.45	64.45
Other expenditure	3,159.5		3,159.5	3,238.9	0.0	3,238.9	3,850.6		3,850.6	79.42	691.06	611.64
Reserve funds	168.3		168.3	834.3	0.0	834.3	155.4		155.4	666.04	-12.90	-678.94
Expenditure funded from reimbursable funds	1,100.2		1,100.2	592.5	0.0	592.5	576.8		576.8	-507.68	-523.42	-15.74
Capital expenditure	17,784.1		17,784.1	18,325.5	400.0	17,925.5	16,528.5	400.0	16,128.5	141.38	-1,655.58	-1,796.96
Financial operations	0.0		0.0	0.0	0.0	0.0	0.0		0.0	0.00	0.00	0.00
Payments made in previous years	0.0		0.0	0.0	0.0	0.0	0.0		0.0	0.00	0.00	0.00
EXCEDENT(+) / DEFICIT(-)	-14,490.0		-14,490.0	-14,712.0	0.0	-14,712.0	-14,713.0		-14,713.0	-222.0	-222.9	-1.0

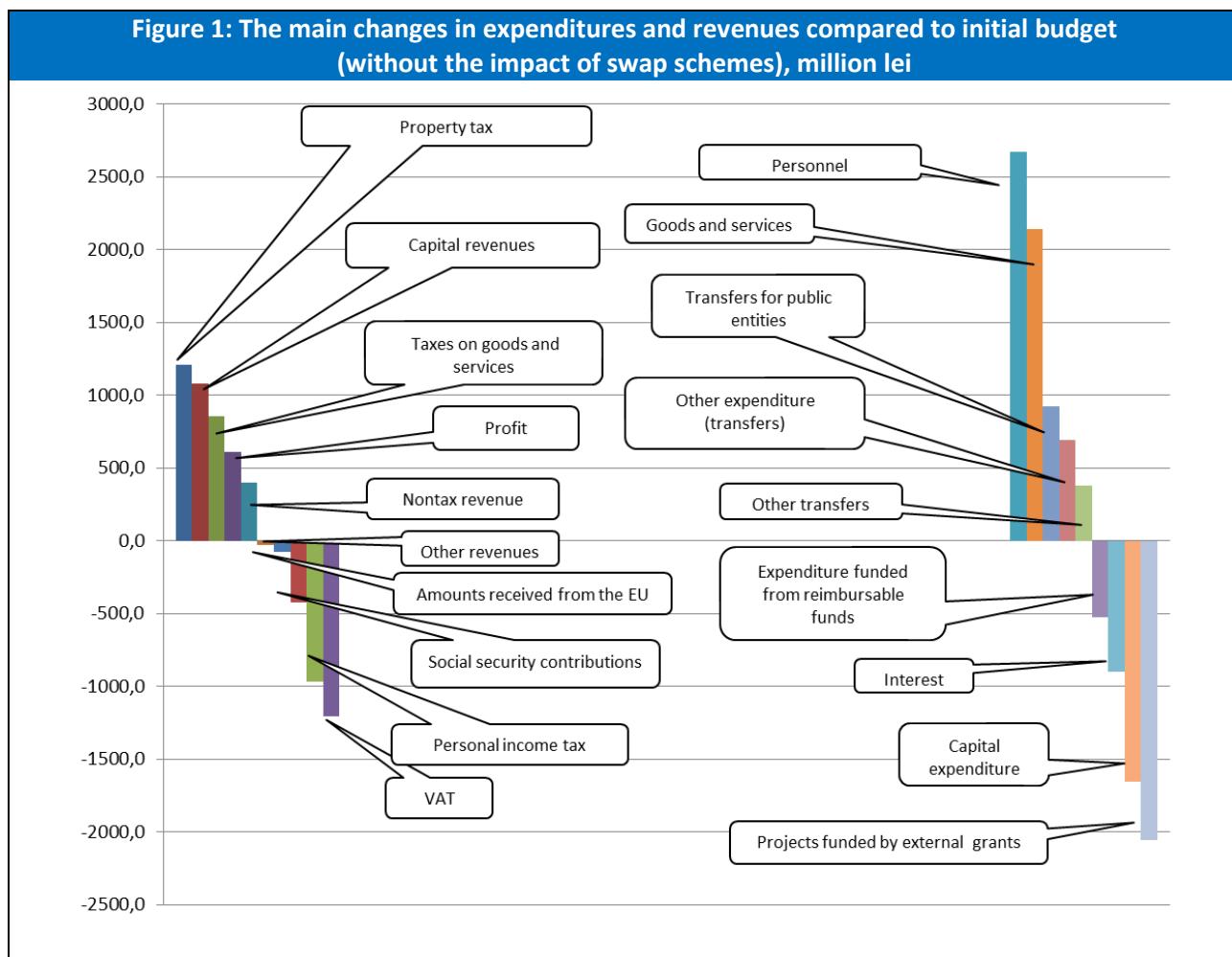
Source: Ministry of Public Finance, Fiscal Council's calculations

**Figure 1: The main changes in expenditures and revenues compared to second budget revision
(without the impact of swap schemes), million lei**



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

**Figure 1: The main changes in expenditures and revenues compared to initial budget
(without the impact of swap schemes), million lei**



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