THE FISCAL COUNCIL ANALYSIS ON THE BUDGET FISCAL STRATEGY IN ROMANIA DURING 2013-2016

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ABSTRACT: *This paper presents an analysis done by the Fiscal Council, upon the request of the Ministry of Finance, on the State Budget Law for 2013, the report regarding macroeconomic situation in 2013, the draft law of state social insurance budget for 2013 and its afferent explanatory memorandum as well as on the budget fiscal strategy for the period 2014-2016.*

KEY WORDS: *Fiscal Council, strategy, deficit, GDP, budget aggregates, external financing.*

JEL CLASSIFICATION: *E62, F65, H32, H25.*

1. INTRODUCTION

Documents required by the Fiscal Council for elaboration of the analysis refers to the Report on macroeconomic situation in 2013 and its projection for the period 2013-2016, respectively the updated version of BFS 2013-2015 and the package of amendments to the Tax Code which came into effect since the 1st of February 2013.

The legislative procedure must comply with the principle of transparency enshrined in Law n. 69/2010, under which "the government and local authorities are required to make public and maintain in debate for a reasonable time all the necessary information enabling the evaluation of fiscal and budgetary policy's implementation, their results and the state of public central and local finances".

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2. ROLE OF FISCAL COUNCIL

Under the Fiscal Responsibility Law no. 69/2010, article 40, paragraph (2), letter d), the Fiscal Council has also as task "the analysis and drafting of opinions and recommendations, both prior Government approval and before submission to Parliament on the annual budget laws." Thus, given its mandate in accordance with Law no. 69/2010, the Fiscal Council issued the following opinions and recommendations on the draft budget for 2013:

1. Consolidated General Budget for 2013 (and therefore medium-term budgetary projection) is based on a macroeconomic evolution scenario significantly more unfavourable compared to the one taken into account in developing the fiscal strategy 2013-2015 in the form adopted by the Government (June 2012) .
2. According to the latest macroeconomic projections, economic growth in 2013 is estimated to be only 1, 6% in real terms, compared with a growth forecast of 3, 1 % that was used in developing the strategy. Moreover, the nominal GDP for 2013 relevant for determining the share of budgetary aggregates in GDP is substantially revised down due to both statistical review for nominal GDP in 2011 (-21, 9 billion lei, or -3, 8 %) and economic advance lower than expected during 2012 (updated projection has shown an increase of only 0, 2 %, compared with a forecast of 1, 7% envisaged in developing the Budget Fiscal Strategy 2013-2015 adopted by the Government).

Moreover, the projection of economic growth in 2013 is lower compared even with the most recent assessment of the European Commission in November 2012, which was of 2, 2%. Updated projections for economic growth are below potential GDP growth rates for both 2012 and 2013 (measured by the latest European Commission forecast at 2, 1% and 2, 4%), which implies an expansion of output deficit in the economy and hence a worsening of the cyclical component of the budget balance.

This means that reducing the deficit to 2, 3% of GDP at the end of 2012 involved a structural adjustment effort higher than the one initially considered and maintaining the structural adjustment proposed in 2013, in line with the commitment of achieving the medium-term objective of a structural deficit of 1% of GDP in 2014, resulted, at the same time, in an actual higher deficit.

Fiscal Council described as realistic the macroeconomic scenario considered in the elaboration of budget, assessing the balance of risks to be relatively equilibrated.

On the one hand, amid persistent sovereign debt crisis, major uncertainties still remain regarding economic dynamics in the Euro zone, which implies the existence of adverse risks to the materialization of the targeted economic growth, being possible certain evolutions worse than those anticipated in the case of external demand or any escalation of risk aversion, which would adversely affect the availability and cost of external financing.

On the other hand, the so far good performance of Romania in terms of adjusting budgetary imbalance and the relatively low level of debt compared to the countries from Euro zone and Central and Eastern Europe is expected to have a favourable effect on investors' perception, which might be enforced by further structural reforms and an expected output from the excessive deficit procedure during the current year.

3. FISCAL POLICY REVISION

The significant revision of the macroeconomic framework implies that the Fiscal Budget Strategy for the period 2013-2015 adopted by the Government in June 2012 is no longer important. Moreover, that form of the fiscal budget strategy and the law related to the approval of fiscal indicators specified in the budget framework did not follow throughout the legislative process (the latter only passed in the Senate) and, from the strictly legal point of view, the installation of a new government means it is not constrained by the Strategy. Although the Government has developed an updated version of the budget fiscal strategy, it should pass through the full legislative process of approval prior budgeting for the following year, thus being able to anchor fiscal policy parameters on medium term and to allow assessment of the compliance with the tax rules stipulated by Law n. 69/2010.

Draft budget for 2013 foresees a deficit target of 13, 394 billion lei, i.e. 2, 15% of GDP, which is larger by 1, 7 billion (or 0, 35 pp of GDP, of which 0, 1pp. are due to revision of nominal GDP) compared to the limit proposed by the government following the adoption in June 2012 of the Budget Fiscal Strategy 2013-2015.

Upward revision of the deficit target reflects, on the one hand, the worsening of economic growth perspectives in 2013, but also the partial accommodation of some additional expenditure due to acceptance by the Government in December 2012 of flat-rate corrections (valued at 3, 11 billion lei), proposed by the European Commission in order to prevent disengagement of some reimbursable funds from the 2007-2013 allocation for those operational programs in which, as consequence of the audits made, major weaknesses in procurement procedures were found.

Fiscal Council considers that the proposed target is consistent with the structural adjustment line (according to the ESA95 level of deficit) which is needed to achieve in 2014 the medium-term target of 1% structural deficit (which would ensure compliance with the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union ratified in June 2012).

The total revenues of general consolidated budget are estimated to be at a level of 209, 285 billion lei (33, 6% of GDP), higher by 15, 586 billion lei (+8, 05%) compared to the preliminary execution level at the end of 2012, a significant portion of the increase in revenues being attributable to the projected increase in inputs of post-accession reimbursable grants (3, 08 billion lei, i.e. 37%).

Projected revenues include an exceptional income component (one-off) valued at 3, 16 billion lei, coming from the rest of the 2, 1 billion lei gained by lending the frequency bands to mobile operators (910 million lei have already been paid in 2012), and implementing a new scheme of chain extinguishing of overdue obligations to the state budget (with a 1 billion lei impact on revenue and expenditure).

In addition, beyond announced fiscal policy measures (oil and tobacco excise indexation according to the calendar published, increase of the CAS share paid by employees transferred to pillar II of pension) the draft budget includes a package of measures on revenues with a future impact estimated at 2, 98 billion lei.

Revenue projection for 2013 appears to be realistic and well founded, being in line with the expected developments of relevant macroeconomic bases and the impact of discretionary measures (which also appears as properly assessed).

Consolidated general state expenditures are valued at 222, 68 billion lei (35, 7% of GDP), up by 15, 3 billion (or 0, 3 pp of GDP) compared to the level recorded at the end of last year according to preliminary execution.

But for the inputs associated to financial assistance from the EU and other donors (funds after accession and pre-accession funds and other donations), the increase of expenditures is lower than nominal GDP and they decrease (compared with 2012 adjusted value) by 0,2 percentage points of GDP (from 34,9% of GDP to 34,7% of GDP). Therefore, dynamics of government expenditures respects the spirit of tax rule stated by article 6, letter. d) of Law n. 69/2010, that "the annual growth rate of total expenditure of the general government budget will be kept under annual growth rate of nominal GDP projected for the budget year, until the preliminary sold of general government budget has recorded CAS in the year preceding the year for which the budget draft is elaborated."

Beyond the correction rate applicable to operational programs, the level of budgetary spending accommodates 0, 9 billion lei corresponding to the tranche of 10% of enforceable titles afferent to wage obligations related to certain categories of public sector employees (at the level of staff expense) and almost 3, 5 billion lei in expenditure on goods and services meant for the implementation of the EU directive on combating late payment in commercial transactions.

Since both those already mentioned expenditures were already charged in the execution in accrual system of the corresponding ESA95, this should contribute to a significant balancing of cash deficits and ESA 95 in 2013, which is likely to lead to an even higher adjustment at the latter' level in comparison with its counterpart cash, sufficient in terms of structural adjustment necessary step.

Due to lower than expected revenues in 2013, flat tax could increase in 2014. The flat tax increase would be necessary if the IMF and European Council do not accept for 2014 a higher budget deficit from EU co-financing funds, so to allow the increase of salaries and pensions, especially after nine months earnings well below the program set in early 2013.

After the first 9 months of 2013, revenues were approximately six billion lei under the estimation made at the beginning of year, due to lower than expected performance in the banking system, resulting from changes in tax legislation and a weaker collection of taxes that could be explained by the reorganization of NAFA and loss of profits estimated by NBR.

However, the authorities have a program for next year which assumes no tax increases, if the European Commission will accept a budget amendment for the last quarter that incorporates an economic growth of 2.2% this year and the investment clause will be applied for 2014.

The European Commission is currently discussing the introduction of rules to allow the exceeding of the budget deficit targets with the sums allocated to coinvestment programs supported by EU funds for states found in difficult conditions without jeopardizing the level of 3% of GDP deficit.

In 2013 the economic growth is based mainly on exports, which reflects negatively on the state budget because signifies VAT refunds.

A solution for higher receivables in 2014 would be the domestic aggregate growth from both public investment, including EU programs, and private sector consumption, following the completion of the budgetary rectification.

For 2014, before determining if fiscal measures are needed, the evaluation starts from the basic variables, namely economic growth, inflation and deficit, so as not to jeopardize framing in the deficit threshold of 3% of GDP.

An increase of the flat tax, currently at 16%, and a reduction of VAT, which is now 24% are foreshadowed for fiscal year 2014. One version was that they should reach the same level (20 or 22%).

Unification of flat tax with VAT at 22% would allow even a reduction of CAS and the scenario with 20% flat tax and 22% VAT would cover only pensions and salaries, which involve a budgetary effort of 3 billion lei.

Compared with the budget rectified in July of 2013, execution in September has brought down revenues (excluding EU funds) by 2.5 billion, after 3.5 milliard lei were cut at the ratification.

Of the minus 2.5 billion lei gathered for the last two months, almost 40% represents incomes unrealized from the NBR profit tax, estimated at around 1 billion lei that was not realized.

However, the Ministry of Finance was significantly below the deficit agreed with the IMF for the end of September 2013, meaning 9, 1 billion lei.

4. FISCAL, FINANCIAL AND LEGAL MEASURES

The main measures taken for fiscal consolidation:

- Increasing the efficiency of the tax system refers to the process of harmonization of national legislation with Community law by transposition into national law of the Directives adopted at European level in the field of VAT and excise duties, developing the strategy for the new tax regime in the oil and natural gas domain for the period 2015-2024, transposition into national law of Directives that have been adopted by the European Commission in the field of excise duties, within the terms laid down in those directives, for improving tax legislation in relation to escapist phenomena in order to counter them, increasing revenues by broadening the tax base.
- Continuation of structural reforms through comprehensive reforms in the health sector: development of a strategic plan, which sets out the main objectives of reform and deadlines; defining the basic service package which will be financed from public funds within the limits of available funds; shifting health care delivery from hospital system to outpatient one and the primary care system; re-evaluation of financing system of hospitals; review of national health programs; the introduction of co-payment took place on the 1st of April 2013 , the minimum co-payment is 5 lei and the maximum is 10 lei. Co-payment will be charged by each

hospital, based on the approval of the Board, once, at discharge. By this mechanism, the unjustified availability of medical services is reduced and there is a more accurate control of the consumption of medical services in the hospital. There are limited as well bogus admissions that could be resolved inpatient or outpatient day.

Comprehensive reform of the transport and energy sectors is a crucial element of the economic program of growth and increase of investments. The corporate governance law provides for the appointment of board and professional managers in state enterprises that are under the process of monitoring and remain in majority in state's property. Selection of board members and managers is made solely on the basis of lists of candidates drawn up by independent firms employed to support this process.

The role of structural reforms is to restore confidence and stabilize the economic and financial situation, and they are the starting point for a sustainable economic recovery, generating jobs, leading to the transformation of the economy in the medium term.

Another objective is to strengthen budget discipline by paying the arrears of the state budget, local authorities and state enterprises and prevent formation of new arrears.

By the preventive stand-by agreement signed with international financial organisms, Romania has committed to gradually reduce and then totally eliminate the arrears recorded in central and local government, commitment to be respected as this agreement is the essential condition for strengthening the improved perception of foreign investors on the national economy and finally repositioning public finances on strong fundamentals.

To have the time necessary to complete the proposed corrective measures, a two months extension of the program has been requested till the end of May 2013. Measures taken in 2013 to reduce the arrears were taken by the mean of:

1. The Law on State Budget for 2013, no.5/2013 provided that the amounts included in the budgets of the ministries, as transfers from the state budget to local budgets, are allocated with priority to territorial-administrative units / subdivisions that have recorded arrears as result of failing to fulfil contracts concluded with them, according to law.
2. Government Emergency Ordinance no.3/2013 regulating measures to reduce arrears in the economy, other financial measures, and modification of legislation envisaged that authorized credit officers of the local budgets of territorial-administrative units / subdivisions, who record arrears on January 31, 2013 from providers of goods, services and works, are obliged to reduce their volume with at least 85 %, by 31 March 2013. To achieve this measure, the possibility was created for the administrative - territorial units / divisions to contract from the Ministry of Finance, until March 29, 2013, loans from privatization payments recorded in the General Account of Treasury within the limit of 500 million, with a maximum repayment term of five years and an interest rate at the level of the monetary policy interest rate applied by the National Bank of Romania of 5, 25% per year. Debt limit for these loans is a maximum of 70 %, calculated in accordance with article

63, paragraph 4 of the Law on Local Public Finances no.273/2006, amended and supplemented.

3. Through Government Emergency Ordinance no.12/2013 regarding certain financial - tax measures and extension of deadlines, the possibility was given to county councils to allocate to territorial-administrative units / subdivisions that recorded arrears sums able to settle those, from the amount afferent to the percentage 20% deducted from the 18.5% income tax and amounts deducted from the tax added value, in order to balance local budgets.
4. The Minister of Public Finance Order no.241/2013 on empowering the managerial staff of county and Bucharest public finance offices to carry out checks on arrears recorded by territorial-administrative units / subdivisions, as amended, has approved the checks on correct highlighting the arrears in the accounts of territorial-administrative units / subdivisions, at the 31st of January 2013.
5. Law no.72/2013 on the measures to combat late payment in the executions of obligations resulting from contracts between professionals and between them and the contracting authorities, published in the Official Gazette of Romania, Part I, no. 182, dated 02.04.2013, was adopted in order to transpose EU Directive nr.7/2011 on combating late payments in commercial activity and it is applied to all contracts concluded after the entry into force (3 days from publication in the Gazette Romanian Official Journal).

Measures that must be taken into consideration by public institutions in applying the law:

- Institutions that have, under the law, regulatory powers must review, where applicable, secondary rules containing provisions contrary to Directive (payment terms greater than those specified above, verification procedures of the compliance of goods that go beyond the 30 days, etc.);
- Contracts (including framework contracts), to be completed by contracting authorities after the entry into force of the transposing legislation cannot contain clauses contrary to the Directive (e.g. payment terms greater than 60 days). If the new contract does not stipulate payment terms, public institutions must ensure payment within the statutory 30 days.

Table 1. Total expenditures and investment expenditures included in CGB during 2012-2016

	2012 Execution	**2013 Proposals**	**2014 Estimates**	**2015 Estimates**	**2016 Estimates**
Total Expenditures in CGB (mil. lei)	207.922,00	222.679,00	235.986,00	247.212,00	260.610,00
% of GDP	35,4	35,7	35,7	35,5	35,5
Investment Expenditures in CGB (mil. lei)	35.085,00	36.954,00	43.161,00	47.811,00	55.961,00
% of Total Expenditures	16,8	16,6	18,3	19,3	21,5

Public institutions must ensure that there is budgetary allocation for execution of the obligations to be incurred; in the event that they exceed budget allocations, fault for payment defaults will exclusive belong to public institution responsible for payment.

Increasing the efficiency of budget allocations through the public investments reform refers to the orientation of substantial funds to co-finance European projects and priority funding, from their own resources, of those investments that have high performance and can be completed in an average time horizon (3-5 years).

5. CONCLUSIONS

The economic model of development, from financial and budgetary perspective, will be focused on public investment, those investments designed to support infrastructure, agriculture and rural development, energy and advanced technology. A new approach to financing investment will be considered, different from the years 2010-2011, as well as a limit for funding from the state budget and an orientation on those projects funded primarily from European programs with reimbursable funds for which an audit and a multiplication perspective of how to invest public money exist. It is necessary to elaborate a new framework for the public-private partnership, appreciating the highly positive economic role that a more dynamic public sector could play by promoting the development of infrastructure programs able to attract significant private funding. The advantage of this solution is relieving pressure on the state budget (especially in the context of a fiscal area which is pre-determined by the applicable grant agreements and the effects of economic crisis), as far as the related complexities and risks are managed in an informed, transparent and substantiated manner.

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