Fiscal Council of Romania

Fiscal Council's Opinion on the State Budget Law for 2024, the Social Security Budget Law for 2024 and the 2024-2026 Fiscal Strategy

Summary

- The international environment is marked by economic, political, and geopolitical tensions, as well as military conflicts. Inflation is decreasing from peak levels in most economies.
- Romania's most acute problem (beyond external deficits and institutional weaknesses) is the budget deficit which, in 2023, remained around 6% of GDP. Romania is subject to the excessive deficit procedure and probably has the highest structural deficit in the EU.
- The correction of the deficit must be primarily addressed on the revenue side. In an EU member state with extremely low tax revenues, approximately 27% of GDP, while the EU average exceeds 40% of GDP, with massive and chronic underfunding of education and public health, with tax evasion and tax avoidance almost institutionalized, and with a VAT gap exceeding 36%, compared to the EU average of approximately 5%, this is the sensible and logical alternative.
- Romania needs to spend more efficiently and that is why spending reviews, similar to those conducted in the OECD, are necessary. Such analyses have been developed for health and education in 2023.
- The fiscal measures adopted by the Government in 2023 would have an impact of approximately 1% of GDP in 2024. Additional measures are necessary to reduce the budget deficit to 3% of GDP in the coming years.
- The new pension law is necessary to eliminate blatant inequalities and to account for the aging population. However, the immediate and medium-term impact is severe, significantly increasing the deficit through the introduction of permanent expenditures.
- There is a need to continue the tax reform. Tax evasion and tax optimizations must be fought without compromise. The tax reform also involves labour market reforms, as it is heavily distorted.
- European funds can mitigate the inevitable contractionary effect of correcting the budget deficit.

- The analysis of the macroeconomic framework, underlying both the budget projection for 2024 and the Fiscal Strategy for 2024-2026, specifically the projections regarding real and nominal GDP, GDP structure, inflation, labour market coordinates, leads to the conclusion of their overall plausibility.
- Failure to achieve a credible adjustment, supported by transparent measures that address the existing shortcomings of the current fiscal framework (regressivity/high tax evasion, influenced by both flawed legislation and inefficient institutional architecture), could lead to disorderly developments in the economy.
- There are factors that can prevent unexpected adverse reactions from financial markets, such as the still low level of debt as a percentage of GDP, substantial foreign exchange reserves, and considerable EU funds.
- The most recent data on the 2023 budget execution indicates that the cash budget deficit would exceed the target set in the initial budget (4.4% of GDP) by 39-40 billion lei, approaching the level of 6.8% of GDP. However, given the significant underexecution of capital expenditures, there are indications that the 2023 cash budget deficit could be around 6% of GDP.
- The budget construction for 2024 aims at a cash budget deficit target of 5.0% of GDP, representing a decrease of 0.94 pp from the level estimated by the Ministry of Finance for 2023 (5.94% of GDP). The corresponding deficit target in ESA 2010 terms is 4.9% of GDP.
- The projected reduction of the cash deficit in 2024 is achieved through an increase in budget revenues by 0.92 pp of GDP, while budget expenditures marginally decrease by 0.02 pp of GDP.
- The factors influencing the planned dynamics of nominal budget revenues in 2024 are primarily represented by the projected macroeconomic framework for the next year, the adopted fiscal policy measures, the hypothetical amount of revenues expected from improving collection efficiency/digitalization of the tax administration, and the anticipated evolution of European funds absorption.
- Regarding the inclusion of hypothetical revenues of 19 billion lei in the budget projection, stemming from the desired improvement in collection efficiency/the digitalization of the tax administration, the Fiscal Council (FC) cannot consider them due to the prudence principle. Consequently, the FC considers it possible that lower revenues will be collected by approximately 19 billion lei, representing around 1.1% of GDP, compared to the targets assumed in the budget draft.
- The planned dynamics of budget expenditures, expressed as a percentage of GDP, is primarily the result of an increase in spending on projects financed by European funds, personnel expenditures, social assistance, and other expenditures. This is counterbalanced by a decrease in subsidies, other transfers, and expenditures on goods and services.

- The FC estimates as probable that an additional budget allocation of approximately 4.5 billion lei is needed for expenditures on goods and services and social assistance, representing around 0.26% of GDP.
- **Based on a prudent approach to revenues and expenditures, the FC considers the budget construction for 2024 to be compatible with a cash deficit of around 6.4% of GDP. The assessment of the cash deficit takes into account the information available to the FC, uncertainties regarding the final form of the measures adopted by authorities, and the assumption that there will be no forced reduction in expenditures.**
- Under these conditions, the FC signals the existence of major risks regarding the consolidation process, according to the current budget construction.
- According to the medium-term fiscal-budgetary framework, budget consolidation during the period 2025-2027 will be achieved exclusively on the expenditure side, the proportion of budget revenues in GDP exhibiting a downward trend during the analysed period.
- The FC has emphasized in its opinions and analyses that macroeconomic adjustment and fiscal consolidation require a significant increase in tax revenues.
- By 2027-2028, Romania, through fiscal and labour market reforms, improved tax revenue collection, and other measures, could achieve tax revenues significantly exceeding 30% of GDP. The FC considers such a level of tax revenues necessary given current and future challenges.
- The FC has consistently emphasized in its reports and opinions that European funds represent a key financial resource for Romania's economic development.
- A credible fiscal consolidation can reassure markets and maintain the economy's attractiveness to investors. Alongside reforms and significant investments, it could increase potential GDP and support economic growth significantly above the EU average. It would also contribute to an important reduction of the current account deficit.
- The FC considers that, in the absence of sufficiently concrete and credible policies supporting medium-term fiscal-budgetary consolidation on the revenue side, as well as an increase in collection efficiency, the risk balance is clearly tilted towards recording deficits higher than those anticipated by the 2025-2027 fiscal-budgetary framework.

Fiscal Council's Opinion on the State Budget Law for 2024, the Social Security Budget Law for 2024 and the 2024-2026 Fiscal Strategy

On the evening of December 9, the Ministry of Finance (MF) submitted to the Fiscal Council (FC), through address no. 468.605/9.12.2023, *the draft of the General Consolidated Budget for 2024-2027*, *the Report on the macroeconomic situation for 2024 and its projection for the 2025-2027 period*, the *draft Law on the state budget for 2024, the Explanatory Memorandum* and the *draft Law on the state social insurance budget for 2024*, *the Explanatory Memorandum* and *the draft Law for the approval of ceilings for certain indicators specified in the fiscal framework for 2024*, along with *the Explanatory Memorandum*, *the Fiscal Strategy (FS) for the 2024-2026 period*, requesting, based on art. 53, para. (2) of the Fiscal Responsibility Law (FRL) no. 69/2010 republished, the opinion of the FC regarding these documents.

In the afternoon of December 13th, through address no. 468.791/13.12.2023, the Ministry of Finance transmitted a new set of documents regarding the draft budget for 2024 and the medium-term fiscal strategy that significantly modifies the trajectories of budgetary variables throughout the forecast horizon, both due to changes in the assumptions taken into account and as a result of an Government Emergency Ordinance[1] that was approved together with the budget project for 2024 and 2024-2026 FS. Given the Government's intention to approve the aforementioned documents on December 14, the FC issued a preliminary opinion on December 14, 2023, considering the very short interval for reviewing all received documents.

The current assessment is based on the form approved by the Government of the aforementioned documents. The FC reiterates the requests made to the decision-makers over time in its opinions, emphasizing the need for providing a reasonable time frame for analysis, commensurate with the complexity and scope of the documents for which an opinion is sought.

[1] Titled "Emergency Ordinance on certain fiscal measures in the field of public spending, for fiscal consolidation, combating tax evasion, amending and supplementing certain normative acts, as well as for the extension of certain deadlines".

SUMMARY

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1. The global context and the Romanian economy

The international environment is increasingly complex, marked by economic, political, and geopolitical tensions, as well as military conflicts. While there are positive developments, they are largely outweighed by negative events.

Inflation is descending from peak levels in advanced economies, and the likely trajectory in the coming year is expected to continue downward, even though surges induced by geopolitical shocks and new disruptions in supply chains may still occur. Major central banks have refrained from raising policy rates in their recent sessions, indicating that concrete data will guide their actions in 2024. In the context of the normalization, there are attempts to reduce the balance sheets of major central banks and withdraw liquidity from markets, but this will be done with great caution to avoid causing liquidity disruptions. The latest inflation figure for Germany, at 2.7% in November, compared to the previous year, is meaningful, although it is associated with the pronounced slowdown of the largest economy in the EU. In the US, inflation is generally trending downward, providing a sense of comfort that conditions in international financial markets may not tighten further. In Central and Eastern Europe (EU member states), inflation is also decreasing. However, as officials from the European Central Bank (ECB) note, future disinflationary gains are likely to be more challenging. It is evident that the resurgence of global inflation was primarily driven by supply-side shocks.

Economies have not entered into a recession (yet), although monetary policies have significantly tightened in the past two years. In some countries (e.g., the US, eurozone states), real interest rates are now positive. Numerous companies are facing financial difficulties after many years of cheap energy and minimal interest rates. On the other hand, most economies have demonstrated flexibility and resilience in adverse circumstances. The US economy stands out compared to those in the EU due to fiscal stimuli and superior natural resource endowments. There are notable differences among EU economies, with key indicators being inflation rates, economic dynamics, and imbalances.

A pragmatic approach prevails in the US and the EU regarding economic relations with China – a major economic and geopolitical competitor for both in a multipolar world. The dominant motto is “de-risking”, emphasizing risk reduction rather than decoupling. This approach does not preclude the formation of economic blocs and the imposition of trade restrictions. The rationale behind this approach is the recognition that humanity requires common measures to address the adverse effects of global warming, prevent nuclear accidents, combat pandemics etc. The issue of artificial intelligence may also fall within this framework. The new conflict in the Middle East and the war in Ukraine have created a more complex and dangerous geopolitical context, fuelling uncertainties.

The alarming news is the level reached by global indebtedness, with the public debt of the United States surpassing 130% of GDP, while the eurozone averages around 80% of GDP. However, the US and the EU (as a whole) still possess unmatched economic power, and there

is confidence in the USD and euro as reserve currencies. Failures in the cryptocurrency market and significant frauds are further evidence that this market needs strict regulation, as the entire financial system does.

The very concerning news is the progression of global warming – 2023 has been declared the warmest year in history, according to UN senior officials. The COP-28 meeting in Dubai highlights that there is a long way to go from words to actions when it comes to achieving carbon dioxide emissions neutrality.

The reform of the fiscal governance of the EU has not achieved significant breakthroughs, although the rules framework (discussed in the Council) will introduce more transparency and likely simplify the tracking of debt sustainability by establishing individual trajectories (by country) for net public spending (total spending minus public debt service and other occasional expenses). Germany and other "frugal states" are not in favour of relaxing fiscal rules, although their blind enforcement, without considering the incomplete construction of the eurozone (lack of a common fiscal capacity and weak risk-sharing mechanisms) and spillover effects, has caused significant harm to some member states. A dilemma is how to treat investments in new energies, which are costly and can impact deficits and public debt. Here, a cost-benefit analysis must be conducted over time, considering short-term costs and long-term benefits. "No action" is a policy that would bring disaster for humanity.

Support for Ukraine demands significant, multi-year sums. An increasing number of EU countries will raise defence expenditures, necessitating coordination of defence policies, likely through joint procurement. Military expenditures are placing additional pressure on public budgets.

Aspects regarding our economy in 2023

2023 proved to be a highly complicated economic year for Romania, as well. Inflation followed a downward trend, in line with developments in Europe, albeit at a slower pace. However, the economy slowed down in the second half of the year, and the real GDP growth will be below the initially forecasted figures.

Romania's most pressing issue (alongside external deficits and institutional weaknesses) is the budget deficit, which, in 2023, remained at around 6% of GDP – similar to 2022 (when the ESA deficit, in European methodology, was 6.23%). Romania is subject to the excessive deficit procedure and likely has the highest structural deficit in the EU. The government's target for 2023, 4.4% of GDP, was unrealistic and deemed as such by the Fiscal Council in its opinion on the public budget, which had structural issues (overestimated revenues and underestimated expenses). Therefore, the adoption of fiscal measures is necessary to steer the budget deficit towards 3% of GDP in the coming years.

The public debate regarding the correction of the deficit – whether through revenue growth or expenditure cuts – has highlighted considerable ideological divisions, detachment from reality, and a misunderstanding of inevitable trade-offs in economic policy. Achieving deficit reduction without discomfort and without distributing the correction effort equitably is not feasible. If everyone seeks exemption from participating in this effort, who should bear the burden? It is also not fair for the most vulnerable to bear the brunt of the cost.

For any serious analysis, it is clear that the adjustment must be primarily made on the revenue side. In an EU member state with extremely low tax revenues (including contributions), approximately 27% of GDP, when the EU average is over 40% of GDP, facing massive and chronic underfunding of education and public health, with almost institutionalized tax evasion and tax avoidance, and with a VAT collection gap exceeding 36% compared to the EU average of around 5%, this is the sensible and logical alternative.

Romania needs to spend more efficiently, and, therefore, spending reviews are necessary (similar to those conducted in the OECD, an organization Romania aims to join). Such analyses were conducted for health and education in 2023. Spending reviews do not automatically mean spending cuts. Moreover, you cannot slash public expenditures indiscriminately in a country where they are at the lowest level in the Union, and citizens are deprived of public goods and services in the required quantity. EU funds cannot replace what the public budget should do. Indiscriminate cutting of public expenditures beyond a critical threshold can cause significant damage, leading to a substantial increase in inefficiency.

The fiscal measures adopted by the Government in 2023 are projected to have an impact of approximately 1% of GDP in 2024. The contractionary effect of these measures would be offset, even if only partially, by the absorption of European funds. Additional measures are necessary to bring the budget deficit down to 3% of GDP within the next few years.

The correction horizon for the budget deficit in 2024-2027 is further complicated by the new pension law. This law is necessary to eliminate glaring inequalities in the social assistance system, to account for the aging population, and to support the sustainability of the pension system. **However, its immediate and medium-term impact is severe, significantly increasing the deficit due to permanent expenses.** While necessary, the pension law poses a fiscal risk to budget consolidation. It would have been beneficial for the implementation of this law to be phased in over several years. However, phasing is no longer possible, given the government's decision to implement it in full from September 1, 2024. This clearly entails allocation of resources in the public budget from 2024.

To believe that the correction of the budget deficit can be achieved through an inflation tax is an illusion; this tax may provide marginal help but not decisively. It could only be effective if there were another significant supply-side shock, creating a new inflationary surge and not followed by compensatory salary and pension adjustments.

In any case, there is a need to continue the tax reform to address a deeply unfair fiscal regime (due to exemptions and loopholes), which is also a result of the capture of fiscal policy by interest groups. There is also a need for significantly improved tax collection; NAFA (National Agency for Fiscal Administration) requires a revolution in this regard, involving not only digitization. Tax evasion and fiscal optimizations must be combated without hesitation. Tax reform also implies labour market reforms, which are heavily distorted. Of the active population, only 5.5 million have formal employment contracts (*Annex III*). Many people work in the informal economy, over 1.5 million are paid the minimum wage, and many citizens do not contribute to the insurance system. Romania has the lowest labour market participation in the EU – 68% compared to over approximately 78% in the EU. There is much to be remedied in the labour market, as indicated by reports from the World Bank (WB), the International Monetary Fund (IMF), and the European Commission (EC). The National Recovery and Resilience Plan (NRRP) also includes provisions in this regard, as it does for tax reform.

The outlined context regarding the Romanian economy emphasizes, even implicitly, the enormous importance of European funds (NRRP and Multiannual Financial Framework – MFF) – for necessary reforms and the financing of significant projects, digitalization, energy transition, infrastructure development, and competitiveness. European funds can mitigate the inevitable contractionary effect of the budget deficit correction. This correction is necessary to reduce the current account deficit, which in 2023 is likely just below 7% of GDP (down from 9.2% in 2022).

It is worth noting that the Romanian banking system has weathered shocks well, and the Investment and Development Bank will finally be put into operation.

The economy in perspective

Consolidation is a challenging process due to our large structural deficit, but there is no alternative. The government resulting from elections will need to adopt measures to adjust the deficit, which may represent a few percentage points of GDP, even if the results will not be immediately visible.

It is expected that measures to offset the impact of the new pension law and budget consolidation, in general, will be adopted in 2025, especially as the rounds of political elections in 2024 are completed. There are measures in the NRRP and recommendations from the EC, WB, and IMF, indicating steps to be taken. 2025 could be a turning point in budget consolidation.

Consolidation is mandatory because, although public debt is not overwhelming (yet), its service can become more burdensome, with the added risk of currency fluctuations. Budget consolidation would significantly reduce the current account deficit.

If the correction measures are credible, even if their effects are visible over time, and the absorption of European funds is intense, there is no risk of worsening sovereign risk.

It is noteworthy that a large part of the current account deficit is covered by non-debt creating flows; this fact supports Romania's sovereign rating. EU membership also helps, including through mechanisms for monitoring imbalances. Romania's foreign exchange reserves have increased significantly, fuelled by European resources.

The business environment has reasons to fear measures that could hamper the economy. However, if the measures correct significant inequalities in the tax regime, reduce tax evasion and tax optimizations, the impact on the economy is unlikely to be negative. The adjustment will be gradual anyway and can be aided, as reiterated, by a massive absorption of European funds; we are talking about tens of billions of euros. Revenue collection is likely to increase significantly in a few years.

At the 2027-2028 horizon, Romania, through tax and labour market reforms, through much better revenue collection, and through other reforms, could reach tax revenues (including contributions) significantly above 30% of GDP (Bulgaria has 31% in 2022), still below the level of approximately 34-35% in the Czech Republic, Hungary, and Poland. It is a very ambitious goal, but not impossible to achieve, in our opinion at the FC.

A clear, even if not rapid, fiscal consolidation can calm the markets, maintain the economy attractive for investors; together with reforms from NRRP and major public and private investments, it would increase potential GDP and support economic growth significantly above the EU average. It would also bring a significant reduction in the current account deficit.

2. Fiscal consolidation, the excessive deficit procedure, and compliance with the fiscal rules outlined in the FRL

Starting from April 2020, Romania has been under the Excessive Deficit Procedure (EDP) as a result of expansionary fiscal policies from 2016-2019 and recording a budget deficit of 4.4% of GDP in 2019, significantly exceeding the 3% threshold set by the Stability and Growth Pact (SGP). Romania is the only EU country subject to EDP, given that the European Commission activated the general escape clause from the SGP, suspending fiscal rules at the EU level in 2020, later extended until 2023, to provide member states with the necessary flexibility to implement measures for managing the challenging situations arising from the evolution of the pandemic, rising energy prices, and the war in Ukraine, with significant budgetary consequences.

On June 18, 2021, taking into account the special circumstances, the EU Council adopted the recommendation within the EDP, stating that Romania should end the situation of excessive deficit by 2024, allowing for a gradual effort and a balance between budget consolidation and economic recovery, thus avoiding major shocks to the economy. According to this recommendation, to meet the deadline, Romania had to go with the following trajectory of gradual reduction of the ESA budget deficit: 8% of GDP in 2021, 6.2% of GDP in 2022, 4.4% of GDP in 2023, and 2.9% of GDP in 2024. While in 2021 and 2022, Romania managed to meet the established levels of budget deficits through the fiscal consolidation calendar, in 2023, a major deviation from the 4.4% target was recorded. The Ministry of Finance estimated an ESA deficit of about 6%, highlighting serious shortcomings in the budget construction for this year, which the Fiscal Council had also warned about in its opinion in December 2022.

It should be noted that, according to the provisions of Article 26, paragraphs (1) and (2) of the FRL, by July 31 of each year, the MF is obliged to submit to the Government the fiscal strategy for the next 3 years, accompanied by the draft law for the approval of the ceilings specified in the fiscal framework. This allows the Fiscal Council to monitor compliance with the fiscal framework defined in the FS, as well as adherence to the limits set for budgetary indicators provided by the Law on Ceilings. This process is crucial for projecting the budget for the following year, outlined subsequent to the two aforementioned documents. However, as observed, the legal schedule for the development and approval of the FS has not been consistently followed. The fiscal strategy has been submitted simultaneously with the budget project, resulting in an identical fiscal framework in both documents.

If we consider total expenditures, they appear to be within the specified ceilings in Annex 1 of the Law on Ceilings for 2024, both for the general consolidated budget and for each of its components. However, in the case of personnel expenses, except those included in the general consolidated budget and the state budget, which are below the ceiling levels, for the other components of the budget system, personnel expenses are precisely at the limit of the ceilings. Given the experience of previous years, with little or no room for manoeuvre between projected expenditures and the level of ceilings, budget adjustments are likely to

lead to a redefinition of the initially set ceilings. Furthermore, by derogation from the provisions of Article 6, 7, and Article 26, paragraph (3) of the FRL, the Law on Ceilings does not provide a pathway for adjustment toward the medium-term budgetary objective of -1% of GDP. However, it is specified that the adjustment of the structural deficit will continue in 2024, estimated at 4.3% of GDP for both 2024 and 2025, with prospects of reduction in 2026 to 4.1%.

Therefore, the establishment of ceilings loses its relevance, and the FS serves more to short-term objectives instead of fulfilling its role of providing strategic guidance for medium-term public finance policies. This is especially important in the context of our country being under EDP, where fiscal strategies should be consistent over time, ensuring their alignment and continuity from one period to another.

3. The macroeconomic framework underpinning the Budget Law for 2024 and the 2024-2026 FS

The analysis conducted by the Fiscal Council on the plausibility of the provisions in the current Budget Law for 2024 and in the Fiscal Strategy for the 2024-2026 period starts from the internal and external macroeconomic framework that underlies these measures. The considerations take into account, among other things, the "Autumn Forecast 2023 – Projection of the Main Macroeconomic Indicators 2023-2027", published by the National Commission for Strategy and Prognosis (NCSP) on November 9, 2023, along with its accompanying note.

The economic coordinates from this forecast are based on recent data, highlighting a slowdown in economic growth, combined with a relative reduction of economic imbalances (both internal, mainly reflected in the inflation rate, and external, reflected in the current account balance of the balance of payments). The latest data on gross domestic product (GDP), published on December 7, 2023, by the National Institute of Statistics (NIS), shows a plateauing of economic growth at a low level, near 2% for the entire year (extrapolating the current trajectory for the fourth quarter of 2023), and cumulatively, in the January-September 2023 interval, the GDP increased by 1.4%. This cumulative growth in the first three quarters of the current year is reflected, from the perspective of the GDP production method, in: (i) contributions of 0.3 percentage points (pp) for each of the agriculture, construction, information, and communication sectors; (ii) contributions of 0.2 pp for the real estate transactions sector, professional, scientific, and technical activities, as well as cultural and recreational activities, along with net taxes on products, with a similar contribution; (iii) a contribution of 0.1 pp to the economic growth rate of the public administration sector. These contributions (leading to a cumulative economic growth rate of approximately 2% in the first three quarters) are offset by a negative contribution of the industrial sector of 0.6 pp. This results in modest overall economic dynamics, of only 1.4% (2 pp positive contributions and 0.6 pp negative contributions to dynamics). However, it demonstrates resilience in adverse economic circumstances and in the context of unfavourable internal and external shocks. From the perspective of the GDP expenditure method, we can notice that the growth rate in the first three quarters (1.4%) is reflected at the level of: (i) gross fixed capital formation (with a contribution of +2.8 pp), (ii) total actual final consumption, representing +2.2 pp (both households with +1.5 pp and public administrations with +0.7 pp), (iii) net exports of goods and services with a contribution of 1.3 pp. All of these are offset by a substantial negative contribution of (iv) changes in inventories of -4.9 pp (which is an indication of the poor quality of GDP data). From the perspective of the intra-annual distribution of economic growth, the small contraction in the first quarter (-0.8%) was followed by advances of 1.6% and 0.9% in the second and third quarters, respectively. This indicates a likely annual growth close to the 2% level and an economic deceleration towards the end of the year. All these developments are visible in indicators with higher frequency (for example, the negative evolution of

industry[2], construction[3], retail sales[4], all affecting the balance of trade in a relatively rapid adjustment[5]) and a faster deceleration (compared to some forecasts and expectations) of the inflation rate, which decreased to only 6.7%[6] in November 2023.

In these conditions, the revision made by NCSP between the summer and autumn 2023 forecasts, reducing the economic growth for 2023 from 2.8% to 2.0%, appears to be in line with the developments and trends in the economy, adding an extra note of realism to the projection. This slower economic evolution in 2023 reflects, according to the latest IMF forecast[7], (i) the completion of the post-pandemic recovery of the services sector, (ii) the impact of tighter monetary and financial conditions in the fight against resurging inflation, (iii) the shock represented by price increases for raw materials, especially energy, due to Russia's aggression against Ukraine, and its effect on consumer goods inflation, the latter being influenced by labour market tensions (in terms of wages but also the increasing qualitative discrepancy between labour demand and supply).

For 2024, economic growth is revised to 3.4% from 4.2% in the NCSP forecast, accelerating compared to 2023, considering: (i) significant public and private investments, including the absorption of multiannual European funds and funds related to the NRRP, (ii) a possible economic revival in the main partner economies due to lower prices for raw materials, especially energy, with a positive effect on the domestic economy, (iii) a faster alleviation of inflationary pressures in most economies, which will erode purchasing power less and therefore encourage real economic activity, especially consumption. Moreover, part of the reduction in inflation may be due to the feedback loop between higher energy prices and those of raw materials in general in the recent past, leading to a lower demand for these in the future, and thus, through this transmission channel, a dampening of price trajectories and expectations, (iv) possible internal and international monetary conditions that no longer

[2] Industrial production contracted by 5% cumulatively in the first 10 months of 2023 compared to the same period in 2022 (NIS press release on December 13). The turnover in the industry for the first 10 months of 2023 compared to the same period in 2022 increased nominally by only 1.3% (real contraction of the activity volume – NIS press release on November 15). New orders in manufacturing increased nominally by only 5.2% in the first 10 months compared to the same period in 2022 (NIS press release on December 14). The press release on economic activity trends (November 28) indicates stagnation in the manufacturing sector in the coming period, both in terms of activity and the number of employees.

[3] The press release on economic activity trends (November 28) indicates a downward trajectory for construction. The one regarding residential construction in Q3 2023 (NIS press release published on December 11) shows a decrease of approximately 11.4% in completed dwellings (2,307 fewer homes in the first three quarters of 2023 compared to the same period last year). Additionally, construction permits (data from November 29) show a decrease of 22.2% in the first 10 months of 2023 compared to the same period in 2022.

[4] The turnover in retail trade is increasing (according to the NIS press release on December 6) by only 2.2% in the first 10 months of 2023 compared to the same period in 2022 (in real terms, the growth is evidently negative). Also, the press release (from November 22) on wholesale trade turnover shows a real-negative growth, in nominal terms, of only 3.6% in the cumulative 9 months of 2023 compared to the same period in 2022.

[5] The press release from December 11, 2023, indicates a contraction of the euro-denominated deficit by 18.4% in the first 10 cumulative months of 2023 compared to the same period in 2022.

[6] NIS Press Release from December 13th.

[7] IMF's World Economic Outlook, October 2023.

strengthen through the lens of interest rate policy rates (given that in most developed economies, but also internally, the cycle of interest rate tightening has probably peaked) associated with the rapidly declining trajectory of inflation, as well as weak/almost non-existent evidence of igniting a wage-inflation spiral globally, despite tense labour markets, (v) despite labour market tensions, wage increases reflect a real compression of wage distributions[8], creating conditions for a robust economic advance, (vi) although the international economic and geopolitical context remains tense, the intensity of induced shocks, relative to previous ones, is forecasted to ease, which should, *caeteris paribus*, be an impetus for economic dynamics.

Maintaining the pace of real wage[9] and pension[10] growth can act as a driver for internal economic growth, particularly through its positive influence on household consumption – one of the main engines of economic growth. However, all the elements mentioned above also represent factors of uncertainty and risk regarding the future economic trajectory. The positive impact on economic activity from these factors in Romania could be diminished by fiscal consolidation (which is relatively moderate in the current forecasts of the Ministry of Finance, including increases in pensions and wages). Achieving fiscal consolidation at a level higher than programmed is likely to quickly constrain aggregate demand, inflation, external deficits, and, consequently, economic growth.

The remaining risk factors include: (i) a shift in investor sentiment, driven by a potential recession in developed economies, (ii) the outbreak of additional geopolitical conflicts or the escalation of existing ones, (iii) a deterioration in the prospects for economic growth in Asia, especially China, due to sectoral issues and very high levels of debt, (iv) an unexpected decline in confidence in the economy among households and businesses in the main partner economies of the Romanian economy, as a result of more profound and widespread effects of the economic environment characterized by high interest rates and/or a more pronounced impact of the climate crisis.

A higher economic growth rate for 2024 compared to 2023 in the NCSP projection is thus justified – and can be further supported by recent projections from international institutions (e.g., the autumn forecast of the European Commission or the IMF). Regarding the structure of economic growth – which is equally important for fiscal impact as its level –, we can observe the continuation of current trends, placing the focal point of economic growth in the areas of gross fixed capital formation and private consumption.

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[8] Defined in the World Economic Outlook by the IMF as the reduction of the gap between high and low wages in an economy, which, *caeteris paribus*, alleviates pressure on the labour market.

[9] In the NIS press release dated December 13, 2023, the average gross wage gain in October compared to the same month in the previous year increases by 16.2%, and in real terms by 8.4%.

[10] The NIS press release dated December 19, 2023, regarding the average monthly pension in the third quarter indicates a year-on-year nominal increase (compared to the third quarter of 2022) of 14.1%, resulting in a real increase of approximately 4.1%.

For the next two years underpinning the 2024-2026 FS, NCSP anticipates the continued acceleration of economic growth to 4.2% and 4.6%, respectively – values surpassing the potential growth rate for the Romanian economy, which likely falls within the range of 3.5-4%. In the NCSP forecast, the consequence is a gradual reduction of the demand deficit[11], closing it by the horizon of 2026. A demand deficit aids the structural consolidation trajectory, reducing the estimate of the structural deficit compared to the actual one. However, the existence of a demand deficit at the starting point of the projection is improbable, given the external imbalance of 9.1% of GDP in 2022, inflation at 16.4%, and a budget deficit of 5.7% of GDP in cash terms and 6.3% in European methodology.

A plausible trajectory for the excess demand, starting with initially positive values and then being reduced by actual growth that is at or below the economy's potential (and not easily overestimated as in the NCSP forecast), would lead to a downward but positive trajectory for most of the forecast period for excess demand. Placing excess demand in positive territory for a significant period of the forecast can, all else being equal, mitigate the reduction of inflation and the external deficit.

Regarding the structure of economic growth in 2025-2026, the NCSP projection shows a continued emphasis on private consumption, albeit at a slower growth rate than that of gross fixed capital formation. Additionally, in terms of sectors, there is an increasing contribution from "Construction", "Services", and "Industry", with a reduction of "Agriculture, Forestry, Fishing" – elements that have a high level of plausibility. However, regarding the evolution of "Industry", the significant jump in its contribution to projected economic growth, from 0.2 pp in 2024 to 0.7 pp in 2025, appears spectacular and, at the same time, relatively less likely to occur at this magnitude.

Regarding the projected levels for real economic growth throughout the projection horizon, the cumulative effect can be considered to be sensibly close to the upper limit of a probable range of evolution, considering the factors mentioned earlier. For these reasons, the FC believes that the real GDP forecast for the 2024-2026 period is marked by a slight optimism, relying on a high level of absorption of European funds (both multiannual and related to the National Recovery and Resilience Plan) and the non-materialization of a significant recession in the global economy – especially in the economies of the United States and the EU27 – as well as the non-realization of other risks mentioned earlier.

It is worth noting that these slightly higher annual growth rates reinforce each other, accumulating, towards the end of the projection, systematic positive gaps that lead to a higher GDP level. This contributes to higher budgetary revenues and has an impact on the denominator of fiscal indicators in GDP (deficit, debt etc.), both with favourable effects on

[11] This is demonstrated by the fact that in the FS (page 18, table "Projection of budgetary indicators for the period 2021-2026"), the actual deficit (ESA2010) is higher than the structural deficit (indicating the presence of a cyclical deficit corresponding to a negative output gap), and the gap between them progressively narrows over time until it becomes zero (actual deficit equals structural deficit) by the horizon of the year 2026.

budgetary aggregates. Additionally, if the fiscal projection takes into account significant efficiency gains in collection (for example, in 2024, these are 19 billion lei, or 1.1% of GDP[12]), these gains are partially[13] augmented by an update with a generous macroeconomic framework, pulling the entire revenue trajectory upward. This favours a systematic, and increasingly pronounced, underestimation of the budget deficit in the coming years.

The FC appreciates, as it has done in previous opinions, that the projected GDP deflator growth rate of 10.2% in 2023, revised upward from 9.7% in the NCSP's previous macroeconomic projection, is prudent and could, in plausible scenarios, be slightly higher. It is noteworthy that the CPI inflation rate published by NIS for November 2023 was 11.2% (annual average; the GDP deflator being closer to the average values of inflation and not the end-of-period values), and the inflation rate for industrial producer prices for October 2023 was -2.2% (year on year). This characteristic of the GDP deflator projection is also reflected in the level anticipated for 2024, with the expected variation of +5.9%, appearing to be very prudent.

And for the years at the end of the projection horizon (2025 and 2026), the NCSP estimates deflator values of +4.1% and +3.3%, respectively, which are very likely within the lower range of a plausible projection interval (demonstrated by comparison with recent projections from domestic and international institutions). All of these lead to the opposite conclusion, as formulated earlier regarding real GDP, in this case, possible systematic negative errors aggregating to ultimately result, *caeteris paribus*, in a lower level of nominal GDP. However, considering the magnitude of these systematic deviations (positive for real GDP and negative for its deflator), we can consider that both at the level of each year and over the entire interval these possible systematic deviations offset each other, leading to the conclusion of a nominal GDP projection – FC appreciates – with a high level of plausibility, given all the economic information available at the current moment.

Thus, nominal GDP is anticipated to increase by 12.3% in 2023 (following a projected increase of 18.6% in 2022) and by 9.5%, 8.5%, and 8.1% in 2024, 2025, and 2026, respectively. These high values contribute through both channels described earlier (the additional tax revenue channel and the denominator effect) to the reduction of fiscal imbalances expressed as shares of GDP.

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[12] And the "Report on the Macroeconomic Situation for 2024 and its Projection for 2025-2027" mentions on page 107 that amounts related to the improvement of collection are added each year of the projection horizon, in an annual amount of 8.5 billion lei. *"The projection of budget revenues [...] based on Romania's commitment included in the NRRP, to increase collection by 2.5% of GDP by the end of 2025, the additional revenues from the digitization of the NAFA were included in the revenue projection – estimated at 10.5 billion lei, as well as the target of improving revenue collection by NAFA, by 8.5 billion lei annually (3.2 billion lei for VAT, 2.2 billion lei for social contributions, 1.0 billion lei for excise duties, 1.0 billion lei for non-tax revenues – revenues from concessions and rentals, 0.6 billion lei for corporate income tax, 0.5 billion lei for income tax)"*.

[13] Only the 8.5 billion lei from the improved collection, added annually (for three consecutive years) as an income boost, are updated with the dynamics of the associated macroeconomic bases.

The forecast for the CPI inflation rate (year on year, end of period) in 2023 at 7.4% (remaining constant compared to the previous NCSP projection), as well as an average inflation of 10.5% (in a marginal upward revision from the previous 10.4%), is considered cautious from a fiscal perspective. The latest Inflation Report (November) from the National Bank of Romania (NBR) indicates forecasts of 7.5% for CPI inflation in December 2023. The FC appreciates that, regarding the starting point of the multi-year inflation projection, represented by the year 2023, there is a possibility of the inflation at the end of this year being lower than projected (a phenomenon observed internationally as well, due to the moderation of shocks on the prices of raw materials, especially energy).

This already has effects on budgetary construction – the average inflation in T-2 being relevant for pension indexing in 2025 (alongside ½ of the real salary increase at the same time, in the specifications of the new pension law to be applied from next year). Another effect is on the projected inflation in 2024, a lower level in 2023 acting, through its persistence, negatively for 2023, especially if the lower rate is recorded in products related to the adjusted CORE2 index, with high persistence. The level of end-period inflation and the average for 2024, anticipated by NCSP at values of 4.6% and 6.0%, respectively, appear to be within a plausible range. For the 2025-2026 period, the end-period and average inflation rates, which underlie the fiscal aggregates dynamics in the FS, are projected by NCSP to be at 3.4% and 4.0% in 2025 and at 2.6% and 2.9% in 2026 – values that can also be characterized as prudent and close to those forecasted by other domestic and international institutions.

The dynamics of the national economy and its structure (with a focus on domestic absorption – final consumption and gross fixed capital formation) is also illustrated by the size of external imbalances which, despite adjustments, remain elevated. The trade balance surplus is projected to be 33.6, 36.0, 38.1, and 39.6 billion euros in 2024-2027, while the current account deficit of the balance of payments is estimated by NCSP[14] to be 6.9%, 6.6%, 6.3%, and, respectively, 5.8% of GDP[15] in 2024-2027 – all values above the 4% threshold set by the European Commission's Macroeconomic Imbalance Procedure.

However, it is noteworthy that the widening of external deficits in 2022 is also caused by the re-acceleration of projected economic growth, as well as the deterioration of the terms of trade, as observed in many EU countries. This, in turn, is driven by high prices for fuels and some essential raw materials on major international markets. Although the financing of these deficits is expected to be primarily through non-debt-generating flows (considered to be the capital account surplus and, in the financial account, only "equity participations"), for the first 10 cumulative months of this year, their share is only 60.3% of the total current account deficit (11.1 billion euros out of 18.3 billion euros), compared to 48.4% in the similar period in 2022 (11.1 billion euros out of 23.0 billion euros). However, given the high level at which they are

[14] In the context of a delayed scheduled fiscal adjustment towards a deficit of 3% of GDP only in the year 2027.
[15] Corresponding to current account deficits of 23.9 billion euros, 24.4 billion euros, 24.8 billion euros, and respectively 24.7 billion euros in the 2024-2027 period.

forecasted, these remain a major vulnerability for the Romanian economy, accentuating the risk of a sudden stop in financing.

It can also be noted that, until now, this external deficit is almost entirely determined by the public sector deficit (69% in 2022 and approximately 85% in 2023); in the projection, the public sector deficit contributes to more than 78% of the external deficit over the entire projection horizon (2024-2026). The very limited adjustment of the fiscal deficit highlights a slight increase in the contribution to the deficit from the private sector perspective in terms of the savings-investment gap, raising concerns about its financing (alongside the public deficit) from autonomous sources. This occurs in a macroeconomic and financial environment that is still complicated and marked by significant risks, both domestically and internationally.

In the labour market[16], according to NCSP's forecast, there will be an increase in the average number of employees in 2023 – representing the starting point for the projection related to the 2023 budget and the 2024-2026 FS –, with a growth of 0.9% (compared to the previous 1.3%) and an increase in average gross wage earnings by 13.2% (compared to the previous 12.8%). The unemployment rate remains close to previously forecasted values, standing at 5.5% – the BIM unemployment rate (5.4% in the previous NCSP projection) and 2.9% – the registered unemployment rate at the end of the year[17] (down from 3.0% in the previous forecast). These new coordinates, relatively similar from the perspective of macroeconomic fiscal bases, indicate, similar to previous opinions, a plausible trajectory for labour market aggregates overall. For 2024, the average number of employees is anticipated to increase by 1.6%, and the average gross wage is expected to rise by 9.1%, accompanied by an unemployment rate of 5.4% (BIM) or 2.7% (officially registered unemployment). This places the dynamics of the labour market, especially regarding gross wages, at a slightly more pessimistic level than in other projections, yet still considered highly plausible by the FC.

In 2025 and 2026, the increase in the number of employees accelerates, according to NCSP, to +1.9% and +2.0%, while the dynamics of the average gross wage increase to 7.9% and 7.1%, respectively. In the case of these data, the FC considers that they fall within the (immediately) higher range of a plausibility interval for future developments. This positioning raises concerns that their aggregate forecast at the level of the personnel expenditures in the economy and cumulatively over the two years (accumulating and thus amplifying their effect) may indicate risks of overestimating these macroeconomic bases for fiscal revenues, both in terms of level and proportion. Consequently, these factors add as elements of risk to the fiscal projection for 2025 and 2026.

A separate issue, valid for the years 2025-2027, is represented by the implausible gap between the variation in the personnel expenditures for the entire economy (+10%, +9.2%,

[16] Significant through the macroeconomic bases related to income tax, social contributions, certain expenditure elements such as unemployment benefits and social transfers, all of which have a significant impact on the value of the deficit.

[17] According to ANOFM (National Agency for Employment) data.

and +8.2% total economy personnel expenditures variation) and the variation in the personnel expenditures in the public sector (+3.2%, +3.9%, and +1.9% public personnel expenditures variation). This restrictiveness on the budget's personnel expenses is implausible, especially considering: (i) the high concentration of elections in 2024, which can increase the baseline from which salaries start in the projection, (ii) the new unitary salary law that needs to be adopted – being part of the National Recovery and Resilience Plan – and which will likely lead to a salary increase in key areas, larger than in the FS project, (iii) the inflation rate, which, although decreasing over the projection horizon, remains relatively significant, and in any case, cannot be consistently higher than the increase in the public wage. Moreover, the increase is much lower than that for the entire labour market (and below the nominal GDP variation).

An increase in the public personnel expenditures that is real-negative for the vast majority of the four years in the projection, and situated, in the 2025-2027 interval, at between ¼ and ½ of the increase in the entire labour market, is implausible. The unemployment rate in 2024 and 2025, in the BIM methodology, is 5.1% and 4.7%, while in the national methodology, it is 2.5% and 2.3%.

The correlation of recent economic information and data with the dynamics of relevant macroeconomic variables projected by NCSP (real GDP, GDP deflator, inflation, labour market coordinates) leads to the conclusion of a plausible trajectory for these aggregates in 2024, with a compensation between the projected real GDP growth rate and the GDP deflator.

For 2025-2027, at the nominal GDP level – as a result of the compensation described earlier between the growth rate of real GDP, possibly higher, and that of the deflator, possibly lower – we can consider the projection as plausible. At the overall labour market coordinates level, the forecast is made with caution, according to FC.

However, at the level of salary and employment forecasts in the public sector – reflected in the dynamics of personnel expenses in the budget over these three years – there is an evident underestimation. This underestimation is likely to lead to an implausible restrictiveness at the level of this category of expenses and, consequently, to an increasing undervaluation from year to year (with successive annual underestimations amplifying as a final effect) of the deficit level in the last years of the budget projection.

The current economic circumstances highlight several issues/risks for the 2024 budget project and the 2024-2026 FS:

- Higher real economic growth, compensated at the nominal GDP level by underestimated deflators, combined with a starting point characterized by an aggregate demand deficit, sets a favourable trajectory for the structural deficit, underestimating its value. A more plausible forecast for GDP, with real growth rates at or below potential growth rates (likely between 3.5-4%), combined with a starting point characterized by an excess of aggregate demand (suggested by statistical data –

significant external deficit and high double-digit inflation) would give a positively sloping path to the excess of demand, but it would place it in a positive range for a significant part of the forecast period. These latter coordinates, which FC consider more realistic for the excess of demand, would lead to a higher value of the structural deficit (compared to the MF estimate), highlighting a more imbalanced fiscal position (in practice, it would bring to the forefront or make more visible the very large structural deficit, one of the largest in the EU27, throughout the analysis period). Moreover, the more realistic trajectory of the excess of demand, positive over a significant time span, could, *ceteris paribus*, mitigate the reduction of inflation and the external deficit.

- The update of the collection increase added in each of the 3 projection years (8.5 billion lei each) with generous macroeconomic bases leads to the amplification of revenue overestimation towards the end of the forecast horizon, thereby increasing the gap between the projected deficit by the Ministry of Finance and that which would correspond to a prudent projection.
- Underestimating the dynamics of budget personnel expenditures, through a projection of their dynamics significantly lower compared to the overall labour market dynamics, as well as in relation to the evolution of the inflation rate and nominal GDP dynamics, tends to underestimate budgetary expenses, thereby also underestimating the deficit value. Additionally, underestimating personnel expenses in one year is amplified by underestimating their dynamics in the following year, making the trajectory towards the end of the projection period much more improbable than in the early years. The artificially induced fiscal adjustment (accentuated towards the end of the projection by the accumulation of successive underestimations) in the personnel expenses category is implausible, considering the need to promote the unitary salary law (a criterion in the National Recovery and Resilience Plan), the electoral rounds, and the impossibility of continuously adjusting real wages in the public sector throughout the projection period.
- Inflation, especially the "surprise" inflation (as seen, for example, in 2022), is equivalent – observationally impossible to distinguish – to a structural adjustment[18]. However, inflation is on a downward trajectory (emphasized according to the latest statistical data), indicating that its contribution to fiscal adjustment will be very limited in the future. Moreover, relatively high previous inflation leads, according to the legal framework, to pension indexation[19] and salary increases, as well as the adjustment of prices for goods and services purchased by the budget and the increase in the prices of investment projects – all of which increase expenditures and, therefore, the deficit, acting in the opposite direction to the initial "adjusting" effect that surprise inflation

[18] Determining budgetary indicators with a lower share in GDP – both as a result of higher revenues due to larger fiscal bases for key taxes, and as a consequence of a denominator effect.

[19] The pension indexation rule, both in the old law and the new one, stipulates that indexing is based on inflation and half of the real wage dynamics recorded by official statistics two years before the current year.

initially has. Furthermore, high inflation has prompted a monetary policy that worsens financing conditions, with the higher cost of money also implying higher interest expenditures. All of these demonstrate that the initial positive effect of higher inflation on budget balance is limited over time, and a medium to long-term fiscal-budget projection must consider significant negative effects of inflation that, although on a decreasing trajectory, is still high. The opposing effects mentioned earlier, accentuating fiscal imbalance, of still high inflation are all arguments for why the adjustment of the internal fiscal imbalance should be achieved through reform measures, especially in terms of tax revenues, as public expenditures in Romania and, implicitly, the level of public goods (quantitatively and qualitatively very low according to internal and international statistics) cannot accommodate repeated adjustments. **At the same time, possible additional expenses arise from current and future challenges (decarbonization/energy transition, military expenditures, population aging, adequate financing of transportation infrastructure, education, health etc. – which have been chronically underfunded for a long period).**

- The non-implementation of the multi-year plan for gradual fiscal consolidation from the FS project poses risks to the future sustainability of public finances. Adjusting the structural deficit, which should prioritize the revenue side, should also address the glaring deficiencies of the existing fiscal regime (pronounced regressivity / flawed categorization of taxpayers, low collection, including due to institutional reasons / legislative gaps etc. – aspects consistently emphasized by the Fiscal Council).
- The need for adjustment is highlighted by the magnitude and dynamics of the external imbalance – whose main determinant is found in the historical and forecasted deficit of the public sector – which could pose challenges in its future financing. Possible deviations from the fiscal projection in the FS – which already has a slow pace of fiscal correction and some questionable assumptions – may lead to less favourable macroeconomic dynamics and even towards a precarious balance in the economy. The projected economic evolution critically depends on ensuring financing, which, in turn, is conditioned by maintaining reform commitments (including fiscal adjustment) agreed with the European Commission. The reforms included in NRRP, including fiscal and collection-related reforms, should improve the sustainability of public finances, while also ensuring a substantial volume of financing under highly favourable conditions. Achieving the targets also conditions access to international capital markets[20], highlighting the issue of public debt sustainability in the broader context of securing the refinancing of Romania's total external debt (public and private).
- However, there are also factors that can prevent hasty reactions from financial markets: (i) the level of debt is still relatively low[21], despite recent rapid growth, (ii) foreign exchange reserves are substantial – meeting the requirements of specialized

[20] Essential for financing and refinancing the deficit and debt.

[21] Even though we are approaching the sustainable public debt limit associated with a country having the characteristics of the Romanian economy.

indicators (Guidotti-Greenspan, months of import coverage, or liquidity indicators), (iii) EU funds are considerable – both within the multi-year program and especially at the level of the National Recovery and Resilience Plan.

- Even though fiscal adjustment is pro-cyclical, driven by the lack of an anti-cyclical policy that accumulates fiscal space during economic upturns, it is still urgently necessary – especially considering that external financing is largely provided by institutional sources (multi-year European funds and NRRP) that, in addition, stimulate investments and economic growth. Indefinitely postponing the adjustment at the level of the structural deficit, relying on external financing, hypothetical favourable future economic developments, and the inflation effect (equivalent to short-term structural adjustment) are not, in the opinion of the FC, a viable macroeconomic option.

4. The fiscal framework

Fiscal-budgetary developments during 2023

The evaluation of the budget projection for 2024 starts with the analysis of the main aggregates of the general consolidated budget throughout 2023. In this regard, it should be mentioned that the budget project for 2023 targeted a deficit of 4.4% of GDP, overestimating budget revenues (especially due to the *ex-ante* consideration of additional amounts expected to be obtained from the desired improvement in collection efficiency), while allocating insufficient resources for certain expenditure categories (especially those related to goods and services, interest, and social assistance). At that time, the FC flagged issues with the budget construction and noted that it was compatible with a likely deficit of around 5.7% of GDP. It was deemed necessary for subsequent budget adjustments to identify measures to approach the budget deficit target.

The weaknesses of the budget project were highlighted as early as the first quarter of 2023, which ended with a deficit of 1.4% of GDP. Budget executions indicated a revenue dynamic that was lower than justified by relevant macroeconomic foundations and the adopted fiscal policy measures, while on the budget expenditure side, several aggregates were increasing at a pace higher than programmed. A first attempt to halt the budgetary deviation was represented by the adoption of Emergency Ordinance no. 34/2023, which aimed to control budget expenditures by reducing spending on goods and services and by suspending the filling of vacant or temporarily vacant positions in the public sector through competitions or exams. However, the proposed measures appeared insufficient from the perspective of the budget consolidation process.

In this context, based on the performance in the first semester of 2023, which recorded a deficit of 2.3% of GDP, about 0.6 percentage points higher than the same period the previous year, considering also the salary increases granted in certain sectors (education, defence, internal affairs), the Fiscal Council revised its deficit projection upward. It estimated that the deficit could be above 6% of GDP. The FC also emphasized the importance of quickly adopting measures to prevent a deepening of the budget deficit, given the short time frame in which they could still impact the budget execution for 2023[22].

Discretionary increases in salaries in certain sectors, coupled with the erosion of purchasing power driven by high inflation, have created conditions for wage growth pressures in the public sector to persist into the second semester of 2023. Consequently, following labour disputes, authorities implemented salary increases in the healthcare sector, the Ministry of Finance and its subordinate institutions, institutions under the Ministry of Health, and institutions under the Ministry of Labour and Social Justice.

[22] Annual Report of the Fiscal Council for 2022, Chapter VI.2. Fiscal Framework.

The adoption of consolidation measures was achieved through Law no. 296/2023, which introduced a package of fiscal measures aimed at increasing tax revenues, a package of economic and financial discipline measures to reduce budgetary expenditures, and a package of measures to ensure tax compliance. The FC appreciated that these measures represent a step towards achieving a fair tax system and combating tax evasion. However, considering that the law came into effect on October 30, 2023, and given the constitutional challenge submitted to the Constitutional Court (CCR), as well as the fact that numerous measures are implemented starting from January 1, 2024, the effects of the legislative act on the budget execution for 2023 are not significant.

In this context, the Government also adopted Emergency Ordinance no. 90/2023, which aims to limit expenditures on goods, services, and investments in the last two months of the year to the average level of January-September 2023. At the same time, the legislative act transformed the Government's contingency reserve fund into a discretionary instrument through which authorities can adjust the general consolidated budget by redistributing the unspent resources of the main credit allocators to other areas. Changes regarding the operation of the contingency reserve fund came after the Government issued in September 2023 Emergency Ordinance no. 73/2023, deciding that funds from the contingency reserve fund could be allocated, based on government decisions, to finance the current and capital expenditures of the main authorizing officers. Thus, the contingency reserve fund became the instrument through which the adoption of a budget adjustment was avoided.

From the beginning of the year until September 14, 2023, when the legislative framework regarding the functioning of the contingency reserve fund was modified, 12 Government Decisions were issued, totalling only 0.6 billion lei. Subsequently, under the new legislative framework for the contingency reserve fund, 91 government decisions were adopted, totalling around 29.5 billion lei[23]. For comparison, from 2007 to 2022, allocations from the contingency reserve fund varied between a minimum of 0.53 billion lei in 2015 and 7.96 billion lei in 2020 (see *Annex XV*). Therefore, allocations for the current year, until December 15, are nearly 4 times higher than the previous maximum recorded in the first year of the pandemic and over 8 times higher than last year (3.6 billion lei allocations in 2022). The Fiscal Council emphasized that the use of the contingency reserve fund, effectively replacing a budget adjustment, sets a precedent that involves major risks, from a lack of transparency in budget execution to discretionary use and an increase in resorting to deviations from fiscal rules. Regarding the budgetary impact of the ordinance, a substantial reduction in the cash deficit without accumulating arrears (deferment of payment of some bills etc.) is not possible because payments for projects carried out during the year are usually made at the end of the year. Moreover, reducing the ESA deficit through such a mechanism is significantly more limited, and any such effect is offset by an increase in the deficit in 2024[24].

[23] Situation as of December 15, 2023.
[24] The Fiscal Council's Position Note regarding the restriction of public expenditures.

The most recent data on the budget execution for 2023 confirm a significant overrunning of the deficit target assumed in the budget project. Thus, at the level of the main revenue aggregates, the Fiscal Council estimates the following developments in annual collections compared to the targets assumed in the budget project: for the profit tax, approximately -3.5 billion lei; for the salary and income tax, between +2.5 and +3 billion lei; for other taxes on income, profit, and capital gains, approximately +1.5 billion lei; for property taxes and fees, approximately -2.6 billion lei; for VAT, between -9.5 and -10 billion lei; for excise taxes, approximately -1.5 billion lei; for other taxes and fees on goods and services, approximately +6 billion lei; for customs duties, approximately -0.6 billion lei; for social security contributions, between -4 and -4.5 billion lei; for non-tax revenues, between -3 and -4 billion lei. Regarding budget expenditures, more significant overrunning of budgeted targets is outlined for the following aggregates: personnel expenditures, approximately +4 billion lei; goods and services expenditures, between +3.5 and +4.5 billion lei; interest expenditures, between +2 and +3 billion lei; subsidies, approximately +6 billion lei; social assistance, between +8 and +9 billion lei; other expenditures, approximately +1.5 billion lei, while for other transfers, savings between 2 and 3 billion lei are possible.

Considering the data presented above, the actual deficit for 2023 would exceed the target set in the initial budget by 39-40 billion lei, nearly reaching the level of 6.8% of GDP. On the other hand, the most recent data on budget execution indicates significant underperformance in capital expenditures, over 21 billion lei, and it is expected that a portion of these amounts will remain unspent at the end of the year, considering the restrictions imposed by Emergency Ordinance no. 90/2023. In this context, the FC believes that there are grounds for the cash budget deficit for 2023 to be around 6% of GDP, with the most recent projections from the Ministry of Finance indicating a value of 5.94% of GDP. This level of the cash deficit will serve as the starting point in evaluating the budget construction for 2024.

Objectives and targets of the fiscal policy for the 2024-2027 period

The budget construction for 2024 aims for a budget deficit target of 5.0% of GDP, according to the cash methodology. This represents a decrease of 0.94 percentage points from the estimated level by the MF for 2023 (5.94% of GDP). The corresponding level of the budget deficit target for 2024, according to the ESA 2010 methodology, is 4.9% of GDP. Compared to the estimated level by the MF for the previous year (6.0% of GDP), this represents a reduction of 1.1 percentage points of GDP. According to the MF, this development is compatible with a reduction of the potential structural deficit by 1.1 percentage points of GDP, from 5.4% to 4.3%. This structural deficit is viewed through the lens of a negative output gap, as also considered by the European Commission. However, the Fiscal Council sees a positive output gap, which increases the structural deficit.

The reduction of the cash deficit in 2024 by 0.94 percentage points compared to the previous year is projected to be achieved through an increase in budget revenues by 0.92 percentage points of GDP, while budget expenditures would marginally decrease by 0.02 percentage points of GDP. In the structure of budget revenues, significant increases are estimated in the expected revenues from the digitization of the National Agency for Fiscal Administration (+0.61 percentage points of GDP, this aggregate being newly introduced in the structure of the general consolidated budget), social security contributions (+0.56 percentage points of GDP), and tax revenues (+0.26 percentage points of GDP). Meanwhile, amounts received from the EU (-0.42 percentage points of GDP, as 2023 represents the last year for attracting funds allocated through the 2014-2020 Multiannual Financial Framework) and non-tax revenues (-0.08 percentage points of GDP) are projected to decrease. Within tax revenues, increases are estimated in the collection of value added tax (VAT) (+0.35 percentage points of GDP), corporate income tax (+0.19 percentage points of GDP), personal income tax (+0.16 percentage points of GDP), other income taxes, profits, and capital gains (+0.08 percentage points of GDP), and excise taxes (+0.06 percentage points of GDP). These increases are partially offset by the reduction of other taxes on goods and services (-0.6 percentage points of GDP). In the structure of budget expenditures, significant increases are estimated in the expenditures for projects financed from European funds (+0.27 percentage points of GDP), personnel expenditures (+0.14 percentage points of GDP), other expenditures (+0.13 percentage points of GDP), and social assistance expenditures (+0.10 percentage points of GDP). Additionally, 0.17 percentage points of GDP are allocated to reserve funds, while more substantial decreases are projected for subsidies (-0.38 percentage points of GDP), other transfers (-0.22 percentage points of GDP), expenditures on goods and services (-0.19 percentage points of GDP), and capital expenditures (-0.08 percentage points of GDP).

The fiscal framework for the 2025-2027 period targets, at the end of the projection interval, a budget deficit level, both according to the cash methodology and the European methodology, below the 3% threshold set by the corrective arm of the Stability and Growth Pact. Thus, the cash deficit is projected to decrease by 0.25 percentage points of GDP in 2025, by 0.56 percentage points of GDP in 2026, and by 1.33 percentage points of GDP in 2027, reaching a level of 2.85% of GDP. The values projected by the MF for the deficit calculated according to the ESA 2010 methodology are similar to those for the cash deficit, except for 2025 when a deficit of 4.6% of GDP is forecasted (compared to 4.7% in cash terms). Regarding the structural deficit, according to the MF, it is expected to remain unchanged in 2025, then decrease by 0.2 percentage points of potential GDP in 2026 and by an additional 1.2 percentage points of potential GDP in 2027, reaching the level of 2.9% of potential GDP. This level denotes a deviation from the medium-term objective, represented by a structural deficit of 1% of potential GDP, by 1.9 percentage points. The decrease in the deficit in 2025 seems inexplicable, considering the full impact of the pension law. The fiscal strategy framework does not include measures to clarify this reduction in the deficit.

Analysing the deficit projection for 2024 and the scheduled trajectory for 2025-2027, the Fiscal Council considers, given the lack of credible correction measures, that the budget consolidation process raises many questions. Through the budget deviation in 2023 and the proposed targets for the 2024-2027 period, Romania is not on the agreed consolidation trajectory with the European Commission in official documents. At this point, an alternative trajectory has not been formally agreed upon with the European authorities.

Evaluation of the budget construction for 2024

The budget construction for 2024 aims to reduce the budget deficit according to the national methodology to 5.0% of GDP, representing a decrease of 0.94 percentage points from the projected level by the Ministry of Finance for 2023. This reduction is achieved in the budget planning by increasing budget revenues by 0.92 percentage points of GDP, simultaneously with a marginal decrease in budget expenditures by 0.02 percentage points of GDP.

I. Budget revenues

According to the cash methodology, budget revenues are projected to increase in nominal terms by approximately 12.6% (+65.4 billion lei) in 2024 compared to 2023, with their share in GDP expected to rise by 0.92 percentage points. More significant changes in the GDP share are anticipated in the following categories of budget revenues: funds received from the EU related to the 2021-2027 Multiannual Financial Framework (+1.27 pp), amounts related to non-repayable financial assistance allocated for the National Recovery and Resilience Plan (+1.24 pp), anticipated revenues from the digitalization of the National Agency for Fiscal Administration (+0.61 pp), insurance contributions (+0.56 pp), VAT (+0.35 pp), other taxes on goods and services (-0.6 pp), and funds received from the EU related to the 2014-2020 MFF (-2.93 pp).

The main factors influencing the forecasted dynamics of budget revenues in nominal terms for 2024, according to the Ministry of Finance, are:

- the projected macroeconomic framework for the next year takes into account a real GDP growth of 3.4%, a GDP deflator of 5.9%, an increase in the average number of employees by 1.6%, and a rise in the average gross wage earnings by 9.1%. As indicated in the macroeconomic framework assessment section, the FC has noted that the dynamics of the considered indicators in the budget revenue calculation are not likely to lead to an overall overestimation of the projections;
- the fiscal policy measures adopted, especially those introduced through Law no. 296/2023;
- the decrease in amounts drawn from the EU related to the previous Multiannual Financial Framework (2014-2020), partially offset by the planned increase in the

absorption of European funds allocated through the 2021-2027 MFF and through non-repayable financial assistance from the NRRP;

- the amount of funds considered from projected additional revenues expected to be collected through the improvement of collection efficiency / reduction of tax evasion / digitalization of the National Agency for Fiscal Administration.

The fiscal policy measures adopted through Law no. 296/2023 regarding certain fiscal measures for ensuring the long-term financial sustainability of Romania mainly include: (i) establishment of a minimum tax of 1% on turnover for companies that, in the previous year, report a turnover exceeding 50 million euros and calculate a profit tax lower than the minimum tax on turnover in the assessment year; (ii) introduction of an additional tax for credit institutions, calculated by applying a tax rate to turnover as follows: 2% from January 1, 2024, to December 31, 2025, and 1% starting January 1, 2026; (iii) introduction of an additional tax of 0.5% of adjusted total income for operators in the oil and natural gas sectors reporting a turnover exceeding 50 million euros in the previous year; (iv) establishment of two tax rates for micro-enterprises: 1% for micro-enterprises with revenues not exceeding 60,000 euros, and 3% for micro-enterprises with revenues over 60,000 euros or engaged in specified industries; (v) elimination of reduced VAT rates for a range of products and services; (vi) update of excise values for tobacco and alcoholic products and introduction of an excise on sugary non-alcoholic beverages; (vii) taxation of high-value real estate and movable properties; (viii) reduction of fiscal incentives in the construction, agriculture, food industry, and IT sectors; (ix) modification of the social health insurance contribution regime for income from independent activities and the retention of social health insurance contribution for meal and holiday vouchers.

It should be noted that this set of fiscal measures, despite sparking controversies, represents a significant step towards budget consolidation through increased tax revenues. Additionally, some of the adopted measures work towards reducing exceptions and loopholes in the tax regime, an approach that the FC has repeatedly advocated for, considering both fiscal fairness and the need to boost tax revenues. According to the Ministry of Finance, the budgetary impact of these fiscal policy measures is approximately 15.9 billion lei (0.92% of GDP), which the FC has taken note of. The detailed impact on categories of budget revenues is as follows: profit tax +1.8 billion lei, income and salary tax +0.6 billion lei, other income, profit, and capital gains taxes +2.2 billion lei, VAT +2.8 billion lei, excise taxes +1.2 billion lei, other taxes on goods and services +1.1 billion lei, and insurance contributions +6.3 billion lei.

The revenue projection for 2024 also includes the estimated impact by the Ministry of Finance of fiscal measures adopted through an emergency ordinance on certain fiscal-budgetary measures in the field of public spending, fiscal consolidation, combating tax evasion, amending and supplementing certain normative acts, as well as extending certain deadlines (the so-called "train ordinance") on the collections from profit tax (+0.7 billion lei) and excise taxes (+1.8 billion lei, considering the two-stage increase in excise taxes on energy products

with the consumer price index from January 1, 2024, and July 1, 2024, respectively). In addition, there is the impact of the increase in the contribution rate to the second pillar pensions to 4.75% (estimated by MF at -2.6 billion lei on insurance contributions) and the announced increase in the minimum gross national salary to 3,700 lei, starting July 1, 2024 (+0.3 billion lei on income and salary taxes, and +1.3 billion lei on insurance contributions). The FC has taken note of the budgetary impact estimated by the MF for the mentioned measures, which is included in the budget revenue projection. However, the FC emphasizes that the persistence of uncertainties regarding the fiscal measures that will actually be implemented in 2024 translates into uncertainties about the budget revenue projection.

In addition to the previously mentioned elements, the budget for 2024 is characterized by a more significant decrease in revenues from other taxes on goods and services (-0.6 pp of GDP, or -8.8 billion lei). According to the MF, this decline is the result of the budgetary classification mechanism highlighting revenues from the contribution to the Energy Transition Fund. These revenues (estimated by the MF at around 0.7 pp of GDP in 2023) are not included in the budget construction for 2024. The Fiscal Council acknowledges that such a fund should have been included in the general consolidated budget and advocates for transparency both regarding the amounts collected in this fund and their destinations.

At the same time, according to information provided by the Ministry of Finance, in the formulation of budget revenues for 2024, on one hand, additional revenues estimated to be collected as a result of the digitalization of the National Agency for Fiscal Administration were taken into account, amounting to 10.5 billion lei. On the other hand, sums totalling 8.5 billion lei were considered to result from an anticipated increase in the efficiency of collection / reduction of tax evasion. In the breakdown of budget revenues, the 8.5 billion lei is distributed as follows: profit tax (+0.6 billion lei), income and salary tax (+0.5 billion lei), VAT (+3.2 billion lei), excise taxes (+1 billion lei), insurance contributions (+2.2 billion lei), and non-tax revenues (+1 billion lei). In total, the anticipated amounts to be collected from these sources are substantial, representing 19 billion lei (approximately 1.1% of GDP).

The Fiscal Council has emphasized on numerous occasions that it is not prudent to include *ex-ante* hypothetical additional revenues in budget constructions based on the source of increased collection efficiency / reduction of tax evasion / digitalization of the tax administration. The principle of fiscal responsibility, as stated in Article 4 of the Fiscal Responsibility Law, requires the government to “manage fiscal policy prudently”. Quantifying *ex-ante* the potential additional revenues generated by the reforming and digitalization of the National Agency for Fiscal Administration is not possible because there is no performance history to support such calculations. The Report on the Macroeconomic Situation for 2024 and its projection for 2025-2027 also attests that considering these significant additional amounts “represents a major risk to the budget deficit”. The recent history regarding the effective improvement of revenue collection “does not provide an optimistic outlook regarding the materialization of additional amounts collected compared to the annual

evolution of macroeconomic aggregates"[25]. Additionally, the improvement in collection typically occurs in the context of profound reforms in tax administration that require legislative changes, as well as substantial financial, human, and time resources.

Both budgets in the last two years included in the revenue projection amounts sourced from increased collection efficiency, amounting to 10.65 billion lei in 2022 and 8.7 billion lei in 2023. However, the budget executions for these years did not indicate revenue growth significantly surpassing the relevant macroeconomic bases, and any improvement in collection efficiency was not clearly attributed. Furthermore, the current year revenue evolution reveals significant shortfalls in budgeted targets for most revenue categories. It is highly unlikely that even a partial realization of the additional 8.7 billion lei included in the budget construction at the beginning of the year will materialize.

Without a doubt, there is potential to generate additional revenue through improved collection, and the Fiscal Council has advocated in its analyses for enhancing collection rates as a significant source of revenue growth[26]. However, the existence of this potential does not necessarily mean that including hypothetical revenues in the budget construction, especially in a substantial amount and on a short-term basis, is reasonable or prudent. The potential realization of additional revenues from improved collection efficiency will be reflected in the budget execution results throughout the year and can be acknowledged during budget adjustments, contributing to an acceleration of the budget consolidation process.

Taking into account all these aspects, the Fiscal Council does not consider hypothetical revenues sourced from increased collection efficiency / digitalization of the National Agency for Fiscal Administration in its evaluation.

Lastly, the volume of these hypothetical revenues is substantial (around 1.1% of GDP). Given the aim to reduce the budget deficit by 0.94 percentage points of GDP in 2024, achieving the deficit target crucially depends on the highest possible realization of the additional amounts estimated from increased collection efficiency / digitalization of NAFA. Otherwise, there is a possibility that the deficit in 2024 may be higher than that in 2023, and the budget consolidation process may not take place as intended.

In conclusion, based on a prudent approach to the budget revenue projection for 2024, <u>the Fiscal Council considers the possibility of collecting lower revenues by approximately 19 billion lei, representing about 1.1% of GDP, compared to the targets assumed in the budget project</u>.

[25] https://mfinante.gov.ro/static/10/Mfp/buget2024/proiectbuget2024/Raportbuget2024.pdf, p. 110.
[26] See "Budget Consolidation and Higher Fiscal Revenues – A Vital Need for Romania's Stability and Economic Security", conducted by a Working Group under the coordination of the Fiscal Council (http://www.consiliulfiscal.ro/Analiza_sistem_fiscal_RO.pdf).

II. Budget expenditures

Budget expenditures, according to the cash methodology, are projected to increase in nominal terms by approximately 9.4% (representing +57.9 billion lei) in 2024 compared to 2023, with their share in GDP expected to decrease by 0.02 percentage points. Significant changes in the share of GDP are anticipated in the following budget expenditure categories: projects funded by non-repayable financial assistance from the National Recovery and Resilience Plan (+1.65 pp), projects funded by the 2021-2027 Multiannual Financial Framework (+1.39 pp), projects funded by the loan component of the NRRP (+0.28 pp), personnel (+0.14 pp), other expenditures (+0.13 pp), social assistance (+0.10 pp), goods and services (-0.19 pp), other transfers (-0.22 pp), subsidies (-0.38 pp), and projects funded by 2014-2020 MFF (-3.04 pp).

Essentially, the dynamics of budget expenditures as a percentage of GDP are primarily influenced by the increase in spending on projects financed from European funds (net impact of +0.27 pp), increases in personnel expenditures (due to salary raises), social assistance expenditures (in the context of the pension point indexing and the recalculation of pensions in payment), and other expenditures. These are counterbalanced by the decrease in subsidies (given that the amounts related to the compensation of energy bills are not reflected in the budget project), other transfers, and expenditures on goods and services.

According to the information provided by the Ministry of Finance, personnel expenditures are projected to increase by approximately 11.4%, representing +14.9 billion lei compared to 2023. This increase is related to measures adopted through the "train ordinance", which includes a 5% increase in the basic salaries of personnel paid from public funds (including allowances for local public office functions). There is an exception for education personnel, who will receive an average increase of 20% in two tranches (from January 1, 2024, and from June 1, 2024 – without specifying the breakdown of the increase). Additionally, starting in 2024, the phased payment of salary rights granted by court decisions will be implemented[27]. These increases are accompanied by a series of measures aimed at controlling personnel expenditures, such as maintaining the suspension of filling vacant or temporarily vacant positions in the public sector in 2024, compensating overtime with time off, not providing meal vouchers except for childcare vouchers etc. Additionally, measures to limit expenditures adopted by Law no. 296/2023 (restructuring public institutions, reducing the proportion of managerial public positions, limiting the granting of meal allowances and holiday vouchers etc.) also contribute to the impact, which is considered uncertain.

Following the analysis of the projected level of personnel expenditures, the Fiscal Council notes two significant risks regarding the adequacy of the proposed personnel expenditures for 2024: (i) uncertainties regarding the two tranches of salary increases in education; (ii)

[27] The Ministry of Finance has not provided the Fiscal Council with assessments regarding the impact of these staggered payments, and their volume represents a risk to personnel expenditures.

given that the 5% increase in public sector salaries is lower than the average inflation rate in 2023 (estimated at 10.5%), and considering the salary inequities in the public sector, there is a significant risk that in 2024, which is a busy election year, discretionary salary increases may still be granted in the public sector.

Expenditures on goods and services are projected to increase by 5.3%, representing +4.1 billion lei, a dynamic lower than both the projected nominal GDP growth (9.5%) and the anticipated average inflation for 2024 (6%). The Fiscal Council has previously warned in other opinions that such programming carries risks, considering that, in previous years, this budget aggregate has proven very difficult to control. A relevant example is provided by the current year, where the initial budget foresaw an increase in expenditures on goods and services of only 2.8% (+2 billion lei compared to the previous year's execution). However, the most recent data on the budget execution for 2023 shows an exceeding of the programmed level by approximately 3.5-4.5 billion lei. Thus, in a prudent approach, starting from a higher estimate of the necessary expenditures on goods and services for the current year, and considering the major difficulties in adhering to budget targets observed in previous years, the FC evaluates the proposed level in the budget construction for the next year as insufficient, estimating a likely additional need of about 2.5 billion lei. At the same time, the FC advocates for proper control of expenditures on goods and services, believing that this would be possible in the context of profound reforms in the public procurement system and progress towards improving the efficiency of this expenditure category.

Interest expenditures are planned to increase in 2023 by 9.5% (+3 billion lei), with their share in GDP maintained at the level of 2%. The Fiscal Council considers that the budget for 2024 proposes a more reasonable projection for interest expenditures to avoid the underestimation recorded in the current year. The budget for 2023 has programmed this aggregate at a level similar to the execution of 2022, but the most recent data for the current year shows an exceeding of the initially budgeted level for interest expenditures by approximately 2-3 billion lei. At the same time, the FC draws attention to the persisting risks of exceeding the programmed level for 2024, considering the increase in the public debt stock[28] – due to high budget deficits – as well as uncertainties regarding the future trajectory of interest rates on domestic and international financial markets.

[28] In recent years, the gross financing requirement, consisting of the level of the budget deficit, refinancing, and repayments of capital, has exceeded 10% of GDP. In 2020, it increased by about 5.5 percentage points (from 8.6% of GDP in 2019 to 14.1% of GDP in 2020). The increase was mainly driven by a 5-percentage-point increase in the budget deficit, while the share of refinancing and repayments of capital increased by 0.5 percentage points (from 4% to 4.5%). In the following two years, the share of the financing requirement in GDP followed a downward trend, reaching 11.1% of GDP in 2021 and 10.7% of GDP in 2022. The downward dynamics were determined by the decrease in the budget deficit (5.7% in 2022), while the share of refinancing and capital repayments in GDP rose slightly to 4.9%. Preliminary data for 2023 indicate a reversal of the trend from the past two years, with an increase in the financing requirement to around 11.7% of GDP, equivalent to about 186 billion lei (5.9% of GDP representing the share of the deficit and 5.8% representing the share of refinancing and repayments of capital). In 2023, the difference between the budget deficit and execution led to two revisions of the financing requirement throughout the year, from 160 to 180 billion and from 180 to 200 billion lei.

Regarding social assistance expenditures, they are planned to increase in 2024 compared to 2023 by 10.4%, representing +19.8 billion lei. This development occurs in the context of increasing the pension point in 2024 by 13.8% and recalculating pensions in payment starting from September – according to the new pension law, which results in an increase in the Social Assistance Budget expenditures by about 23 billion lei, although MF's initial estimates showed an impact of 24.5 billion lei (higher by 1.5 billion lei). The planned level of social assistance expenditures also includes the indexation of pensions and allowances outside the Social Assistance Budget by 13.8% (+3.9 billion lei, although this increase is not budgeted for farmers' pensions, which would have entailed an additional impact of about +0.5 billion lei), as well as the impact of increasing state allowances for children (+1 billion lei), allowances for persons with disabilities (+0.4 billion lei), and social aid (+0.1 billion lei) with the average inflation rate for 2023. It should be noted that the projection of allocations for social aid is based on the assumption of extending the application of the minimum inclusion income; otherwise, additional allocations of about 0.8 billion lei would be necessary in 2024. In terms of reducing social assistance expenditures compared to MF's estimated execution for the current year, the elimination of one-off support measures funded from the state budget (amounting to 3.3 billion lei in 2023) and the planned decrease in other social assistance expenditures by about 5.4 billion lei (including expenditures for compensating energy bills for individuals, found in the budget execution for 2023, but not included in the projection for 2024) are acting.

In light of the above, the FC identifies a need for additional allocations for social assistance expenditures of approximately 2 billion lei (representing the under-budgeting of the impact of the new pension law and the non-application of indexation for farmers' pensions). Additionally, it should be noted that the evolution of social assistance expenditures in the coming years is profoundly influenced by the impact of the new pension law. The FC considers, on the one hand, that the adoption of a pension law ensuring equity, predictability, and sustainability in the public pension system is commendable. On the other hand, the budgetary impact of this law is considerable in the coming years, and there is a significant risk that it may significantly deviate from the trajectory of achieving budget correction towards a deficit of 3% of GDP. Considering the state of the public budget, the FC believes that a phased recalculation of pensions in payment over several years would have been necessary, but this is no longer possible as it has been decided to grant fully recalculated pensions starting on September 1, 2024. In these conditions, to limit constraints on the budget deficit, the FC advocates for mitigating the impact of this law through relevant compensatory measures, not by including hypothetical revenues from increased tax collection / digitalization of NAFA in the budgetary framework.

Total public investment expenditures, from both domestic and external sources, are planned to increase in 2024 compared to the MF estimated level for 2023 by 26.6 billion lei (+28.5%), projected to reach 6.9% of GDP, which represents approximately +1 percentage point compared to the previous year. This growth is primarily supported by budgeting amounts for

projects funded by non-repayable financial assistance and loans related to the NRRP (+34.1 billion lei), along with an increase in capital expenditures (+3 billion lei) and a marginal increase in expenditures for programs with repayable financing (+0.2 billion lei). On the other hand, there is a significant decrease in projects funded by post-accession non-repayable external funds (-10.4 billion lei, due to the completion of the 2014-2020 MFF) and a minor reduction in other investment-related transfers (-0.2 billion lei).

As in previous years, it is noteworthy that an ambitious target has been set for investment expenditures, and they are projected to remain at a relatively high level over the medium term, anticipating an average of around 5.8% of GDP for the period 2025-2027. Additionally, considering the very low level of fiscal revenues in Romania, the intention to finance a significant portion of public investment expenditures from external funds is commendable. The amounts related to projects funded by post-accession non-repayable external funds, along with those related to the National Recovery and Resilience Plan, are expected to represent approximately 67.8% in 2024, 63% in 2025, 63.8% in 2026, and 31.7% in 2027 (due to the completion of the NRRP) of total investment expenditures.

However, it must be mentioned that planning high investment expenditures (especially at the level of capital expenditures and the loan component of the NRRP) can exert significant pressure on the budget deficit. Compensating or mitigating these pressures should be done through revenue increases and/or resource reallocations, considering the complicated state of the public budget.

In conclusion, regarding budget expenditures, the FC identifies an additional need for allocations in the categories of goods and services and social assistance, totalling approximately 4.5 billion lei, representing about 0.26% of GDP. Additionally, the FC has emphasized the presence of additional risks related to social assistance expenditures, as well as concerns about staying within the projected levels for personnel expenses and interest expenditures.

Considering the above, based on a cautious approach on budget revenues and expenditures, the FC assesses the budgetary framework for 2024 as compatible with a cash deficit of around 6.4% of GDP. The evaluation of the cash deficit takes into account the information available to the FC, uncertainties regarding the final form of measures adopted by authorities, and the assumption that there will be no forced reduction of expenditures. In these circumstances, the FC highlights the existence of significant risks to the consolidation process, according to the current budgetary framework.

Although the budget project targets a cash deficit of 5.0% of GDP, the FC believes that there are not enough credible budgetary adjustment measures that would lead to achieving this target. The FC emphasizes once again that it is not prudent to include *ex-ante* in the budgetary framework hypothetical revenues from increased collection efficiency, reduced tax evasion, or NAFA digitization, and therefore cannot consider them at this time. Additionally, the FC

has identified a need for additional allocations in the areas of goods and services and social assistance.

As the FC has repeatedly argued, the budget consolidation process is vital for Romania for reasons of stabilizing the level of public debt (given that the primary deficit is the main factor for bringing it onto a sustainable trajectory), reducing external vulnerabilities (by controlling the relatively high and unique external deficit in the region), maintaining stability of the national currency (preserving the leeway for monetary policy), and defending macroeconomic balances. The need for consolidation must be considered in correlation with Romania's financial rating, as a firm commitment to a credible fiscal consolidation plan is an essential premise for maintaining the country's credit rating and the confidence of international investors. Last but not least, correcting the budget deficit is a legal obligation from the perspective of European and national fiscal rules.

5. Medium-term fiscal perspectives – budgetary construction beyond 2024

The fiscal framework for the 2025-2027 period foresees a reduction in the budget deficit, according to the national methodology, by 2.15 percentage points of GDP. This reduction is from a target of 5.0% of GDP in 2024 to a projected level of 2.85% of GDP in 2027. In these circumstances, it should be noted that in 2027, the budget deficit falls below the 3% threshold stipulated by the corrective arm of the Stability and Growth Pact, deviating from the adjustment trajectory specified in the European Council's June 2021 Recommendation issued within the framework of the European Semester.

The commitments within the NRRP and the state of Romania's public budget imply, on the revenue side, the adoption of recommendations from the World Bank, other international institutions, and domestic analyses aimed at increasing tax revenues. On the expenditure side, there is the adoption of a new unitary salary law for the public sector. Measures stemming from these recommendations are not reflected in the projections for the 2025-2027 period.

In the 2025-2027 period, the adjustment is projected to be made exclusively on the expenditure side, with the share of budget revenues to GDP showing a downward trend. Specifically, the data indicates a decrease in the share of budget expenditures in GDP by about 4.15 pp in 2027 compared to 2024. This trend is accompanied by a downward dynamic in the share of budget revenues in GDP (-2.0 pp in 2027 compared to 2024).

On the revenues side, during the mentioned period, the decrease in their share of GDP is primarily determined by the downward trend in funds received from the EU, both in the MFF and the NRRP. Thus, in 2027 compared to 2024, the shares of the amounts received under the 2021-2027 MFF and the 2014-2020 MFF are lower by 0.20 and 0.62 percentage points (due to the conclusion of the 2014-2020 MFF). Additionally, a major impact on revenues is the decrease in the share of non-repayable financial assistance related to the NRRP by about 1.45 percentage points of GDP, due to the conclusion of the Recovery and Resilience Mechanism. These decreases are not offset by an increase in the share of tax revenues in GDP; the aggregate indicates a similar level in 2027 compared to 2024, at 15.95%. Furthermore, the share of social security contributions in GDP remains almost constant at 10.7% in 2027, compared to 10.6% in 2024. A minor but uncertain counterbalance to the decrease in the share of revenues from European funds can be observed in the non-tax revenues, whose share in GDP increases by 0.25 percentage points in 2027 compared to 2024. It is worth noting that in each year of the 2025-2027 period, an aggregate of additional revenues collected from digitization includes 10.5 billion lei. Additionally, each year from 2025 to 2027, additional sums of 8.5 billion lei from collection are introduced into the revenue aggregates, the effects of which are multiplied by relevant macroeconomic bases. This additional 19 billion lei is spread over the 2025-2027 interval. Overall, in the 2025-2027 period, the share of total revenues in GDP decreases from 33.5% in 2024 to 31.4% in 2027.

Under these circumstances, the FC does not see how a quasi-constant level of tax revenues as a percentage of GDP is maintained in the analysed horizon, 2025-2027. It is also reiterated that the deficit for 2025 does not reflect the impact of applying the pension law for the entire year; measures leading to the FS deficit are not mentioned either.

In accordance with the provisions of the National Recovery and Resilience Plan (milestone 205), Romania is required to adopt a revision of the fiscal framework, in line with the recommendations of the analysis of Romania's tax system, conducted with the support of technical assistance from the World Bank, published in March 2023[29]. The objectives of the recommendations formulated by the World Bank, as well as other international institutions and domestic analyses, aim to improve the structure of tax revenues, increase their share in GDP, eliminate gaps in the tax system, simplify tax rules, achieve a more efficient and equitable tax system, and modify property taxation. Fiscal reforms should be implemented by March 31, 2025. The recommendations proposed by the World Bank start from the premise of ensuring fiscal neutrality and aim at a more equitable distribution of the tax burden that leads to a reduction in the number of people in the informal sector, and the share of tax revenues moves towards the regional average of other countries in the region.

On the expenditure side, the adjustment is made at the level of personnel expenditures (-1.1 pp), goods and services (-0.3 pp), and interest expenditures (-0.35 pp). A more significant decrease is also observed at the level of expenditure aggregates related to projects funded by EU funds. Thus, in 2027, compared to 2024, the share of GDP representing non-repayable projects from the NRRP decreases by 1.85 pp, while the shares of 2014-2020 MFF and 2021-2027 MFF decrease by 0.85 pp (due to the conclusion of 2014-2020 MFF) and 0.11 pp, respectively. Except for the amounts received from the EU, all the expenditure aggregates mentioned above increase in nominal terms. In these conditions, the reduction in their share of GDP occurs against the backdrop of a faster growth in nominal GDP, estimated at 25.6% for the period 2024-2027, corresponding to an average annual growth rate of around 8.56%.

Regarding personnel expenditures, the projected levels for the 2025-2027 period assume, except for 2026, a nominal increase lower than the annual average inflation rates estimated for the same period: an increase of 3.2% compared to an average inflation of 4.0% in 2025, an increase of 3.9% compared to an average inflation of 2.9% in 2026, and an increase of 1.9% compared to an average inflation of 2.6% in 2027. In these conditions, over the projection horizon, the share of personnel expenditures decreases from 8.43% of GDP in 2024 to 7.33% of GDP in 2027, which is not plausible.

In this regard, it must be mentioned that the education and health sectors together account for approximately 48% of the workforce in the public sector (*Annex XVI*). Given that the allocations for these sectors are among the lowest in the EU, adjusting this aggregate through

[29] Report on the Fiscal System in Romania, including Comparative Analysis and Recommendations for Fiscal Framework Reform, World Bank, March 2023.

the inflation tax is both improbable and untimely. Moreover, according to the NRRP, in the second quarter of 2024, the Government must adopt a new unitary salary law that revises hierarchy coefficients, introduces new salary grids, and revises the bonus award system for the public sector. Following the labour dispute in education, the Government has accepted a 50% increase in coefficients for this sector in the new unitary salary law. This increase will lead to upward revisions of coefficients in other sectors as well, resulting in a high budgetary impact. In conclusion, from a historical perspective and considering social considerations and the mentioned arguments, fitting personnel expenditures within the projected levels is improbable.

The proposed adjustment at the level of expenditures on goods and services indicates a level of 4.42% of GDP in 2027. This would represent an absolute minimum for the 2008-2027 period, well below the average expenditures on goods and services of around 5.4% of GDP for the 2008-2023 period, and also below the projected level by the MF for the preliminary execution in 2023, which the FC considers insufficient. Such a development seems even more improbable, considering that the average annual growth rate of expenditures on goods and services in recent years (2019-2022) was about 13% in nominal terms. The preliminary execution for 2023 indicates an increase of about 6.6% compared to 2022, but this growth was moderated by the adoption of exceptional measures to restrict expenditures on goods and services that were not extended in the following years. For the 2025-2027 period, a deceleration of this aggregate is projected: a nominal increase of 2.83% in 2025, 10.05% in 2026, and 4.25% in 2027. The FC has reservations regarding the possibility of fitting expenditures on goods and services into the projected levels for this horizon.

Social assistance expenditures are projected to increase by 16.7% in 2025, 5.10% in 2026, and 8.9% in 2027. Thus, the share of social assistance expenditures in GDP increases in 2027 compared to 2024 by 0.76 pp. The growth rate is significantly higher than the average inflation rate forecasted for this period. It is influenced significantly by the new pension law, which includes a recalculation of pensions in payment to eliminate inequities. The impact of the recalculation is estimated, according to official data, at about 33.1 billion lei in 2025, 35 billion lei in 2026, and 36.3 billion lei in 2027. Considering the recalculation impact removed from the social assistance aggregate, the growth rates of 5.95% in 2025, 5.05% in 2026, and 9.73% in 2027 remain above the average inflation rate. The preliminary execution for 2023 indicates an increase in social assistance expenditures by about 8.9% compared to 2022, given an inflation rate above the forecasts in the 2025-2027 horizon. Therefore, considering the adjustment of social assistance expenditures with the inflation rate, we consider it likely to meet the projected targets.

The Fiscal Council has emphasized in its opinions and analyses that macroeconomic adjustment and fiscal consolidation require a significant increase in tax revenues, which are at an unacceptably low level compared to Romania’s needs and to EU benchmarks. Even though, as it has stated many times, the FC considers including hypothetical revenues from

improving collection efficiency in the fiscal projection as imprudent before their effective materialization, a profound reform of the tax administration leading to increased revenues from this source is urgently needed.

In conclusion, the FC appreciates that, in the absence of sufficiently concrete and credible policies supporting medium-term fiscal consolidation on the revenue side, as well as collection growth, the risk balance is significantly inclined towards recording deficits higher than those projected by the fiscal framework for the 2025-2027 period.

6. The absorption of European funds. The National Recovery and Resilience Plan

For Romania, European funds represent a key financial resource for economic and social development and strengthening resilience against adverse external shocks, through the lens of investment strategy and the implementation of structural reforms, maintaining internal and external macroeconomic balances, as well as ensuring the sustainability of public finances. The absorption of European funds contributes to counteracting the contractionary impact of the necessary macro-correction, in a period when Romania faces significant budgetary challenges.

The FC has consistently emphasized in its reports and opinions that it is of vital importance for Romania to capitalize on this historic opportunity, benefiting from the European Union's allocations of nearly 80 billion euros[30]: 31 billion euros from the Cohesion Policy[31] and approximately 20 billion euros from the Common Agricultural Policy under the EU's Multiannual Financial Framework for 2021-2027[32]. In addition to these, there are 12.1 billion euros in grants and 15 billion euros in the form of loans through the Recovery and Resilience Mechanism (RRM), the most significant financial facility within the NextGenerationEU framework[33].

National Recovery and Resilience Plan (NRRP). Despite some delays in operationalizing the necessary organizational structures for initiating the implementation of the NRRP (to ensure functions such as evaluation, management and control, contracting, authorization, and payment of expenses), and in concluding funding contracts with beneficiaries, by the end of May 2022, the Ministry of Investment and European Projects (MIEP) submitted the first payment request to the European Commission within the NRRP, totalling almost 3 billion

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[30] It should be emphasized that, by the end of 2023, according to the n+3 rule, Romania also benefits from European funds related to the 2014-2020 financial exercise. In the case of cohesion funds-OP, the actual absorption rate as of December 11, 2023, is 76% (18 billion euros reimbursed by the European Commission, in comparison to the allocations of 24 billion euros). More information can be found at https://mfe.gov.ro/stadiul-absorbtiei-fondurilor-ue/

[31] Regarding the 2021-2027 Multiannual Financial Framework, with the mention that the Partnership Agreement with the EU was only adopted by the European Commission in June 2022, the actual absorption rate of the allocation of 31 billion euros from structural and cohesion funds was practically zero at the end of November 2023 (Ministry of Finance, *Evolution of Financial Flows between Romania and the European Union as of November 30, 2023*).

[32] Taking into account the limited progress recorded in the implementation of the country-specific recommendations of the European Commission, including those issued in May 2023, efforts to increase the absorption of European funds should primarily focus on: improving economic governance efficiency, strategically planning investments in key areas, enhancing administrative capacity for project management, prioritizing large-scale projects and expediting their implementation, improving the efficiency of the public procurement system, and ensuring predictability in the legislative and institutional framework (European Commission, *Recommendation for a COUNCIL RECOMMENDATION on the 2023 National Reform Programme of Romania and delivering a Council opinion on the 2023 Convergence Programme of Romania*, COM 623 final, Brussels, 24.5.2023).

[33] Although Romania was initially allocated a sum of 14.2 billion euros from the grant component, the update of this amount according to Article 11(2) of EU Regulation 2021/241 led to a negative revision of the financial contribution by 2.1 billion euros. This component was reduced to 12.1 billion euros, necessitating a corresponding adjustment of the investments and measures initially envisaged in the NRRP.

euros. This amount included approximately 2 billion euros in grants and 0.9 billion euros in loans, along with supporting documents demonstrating the achievement of the 21 milestones/targets for the fourth quarter of 2021, primarily related to reforms and investments in energy efficiency, digital transformation, justice, anti-corruption efforts, support for the private sector, and the audit and control system related to the Recovery and Resilience Mechanism (RRM). Following the examination of these documents and additional clarifications requested, in September 2022, the European Commission published a positive preliminary assessment of the payment request[34]. After obtaining the opinion of the Economic and Financial Committee, in October 2022, the Commission authorized the disbursement of this first tranche, totalling 2.6 billion euros (1.8 billion euros from the grant component and 0.8 billion euros from the loan component, excluding pre-financing).

The second payment request, amounting to 3.2 billion euros (2.76 billion euros excluding pre-financing), was submitted to the European Commission with a delay of approximately two months in mid-December 2022[35]. This request aimed to fulfil a total of 51 milestones and targets related to the first and second quarters of 2022, focusing on reforms and investments in the areas of the electricity market, energy efficiency in buildings, digitalization, decarbonization, good governance, interoperability of databases for bureaucracy reduction, government cloud, and sustainable mobility. The European Commission publicly disclosed its preliminary assessment of Romania's second payment request at the end of June 2023[36]. The validation process for certain milestones (primarily: 97, 114, 129, 133, 430, 213, deemed unsatisfactorily achieved) was hindered by the response time to clarifications requested by EC experts, as well as requests for additional evidence during technical consultations. Following these consultations and discussions with the Commission's services, Romanian authorities made corrections and adjustments, including the urgent adoption of normative acts falling under the scope of problematic milestones. Ultimately, noting that milestones 129 and 133 (in the energy sector) were not satisfactorily achieved, the EC's assessment was only partially positive, triggering the suspension procedure for payments related to these two milestones (preliminarily assessed at around 53 million euros). A 6-month period was granted to fulfil these milestones, during which the Commission engaged in active dialogue with Romanian authorities. As a result, the EC transmitted its preliminary assessment to the Economic and Financial Committee, which typically issues an opinion within four weeks. Based on this opinion, through the Comitology Committee, the EC adopts the final decision regarding the disbursement of the tranche to Romania (excluding amounts related to the two unachieved milestones). The transfer of the amount of 2.8 billion euros (1.86 billion euros

[34] https://commission.europa.eu/system/files/2022-09/c_2022_6711_1_annexe_en.pdf
[35] https://ec.europa.eu/commission/presscorner/detail/en/mex_22_7792
[36] https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3496

from the grant component and 0.94 billion euros from the loan component[37]) corresponding to payment request No. 2 occurred at the end of September 2023[38].

With the clarification that the application of the consistency rule would not have allowed the submission of the third payment request until after the payment of the second request by the European Commission, this delay, totalling approximately six months (submission in December 2023 compared to the initial deadline in June 2023), was caused by the fact that, as of mid-October 2023, 11 milestones out of the 79 with deadlines in the third and fourth quarters of 2022 were not achieved[39]. It became evident that the authorization and payment for the third tranche could not occur by the end of 2023, and it would be deferred to 2024, thus depriving Romania of a significant inflow of funds for the year. This inflow could have contributed to adhering to the schedule assumed in the NRRP, better covering the external financing needs, and improving fiscal-budgetary parameters in 2023.

This period was also marked by the revision of the NRRP based on the provisions of Article 18 and Article 21 of Regulation (EU) 241/2021 on the Recovery and Resilience Mechanism. This revision involved a reduction in grants by 2.1 billion euros, offset in part by the inclusion of the RePowerEU chapter[40]. Romania was allocated a sum of 1.4 billion euros for this chapter. There were also changes to milestones and targets due to the invocation of objective circumstances, including the unforeseen increase of about 20% in the implementation costs of NRRP investments due to drastic increases in energy prices and construction material costs. Additionally, the revision involved the elimination/replacement of the 9.4% of GDP cap on pension expenditures.

With the explicit mention that, considering its economic situation, Romania is unable to finance all measures included in the NRRP from the national budget, the reduction of 2.1 billion euros in the grant component aimed at investments that posed the highest risk of non-achievement within the three years until the deadline of August 30, 2026[41]. The primary

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[37] https://mfe.gov.ro/pnrr-comisia-europeana-a-evaluat-pozitiv-a-doua-cerere-de-plata-transmisa-de-romania-in-cadrul-pnrr/

[38] European Commission, *NextGenerationEU: Commission disburses second payment of €2.76 billion to Romania under the Recovery and Resilience Facility*, EC Daily News, 29 / 09 / 2023.

[39] https://cursdeguvernare.ro/cererea-3-de-plata-pnrr-mai-sunt-11-jaloane-intarziate-un-an-dincolo-de-pensiile-speciale.html

[40] The change in the geopolitical context in the spring of 2022, marked by Russia's invasion of Ukraine and the economic impact of escalating energy prices, has highlighted the importance of energy security within the European Union. To address this major challenge and reduce dependence on imports of gas, coal, and oil from the Russian Federation, the European Commission launched the REPowerEU plan in May 2022. This plan aims to cover the financial resources needed for additional investments, estimated at 210 billion euros. All EU member states are required to include a new chapter in their National Recovery and Resilience Plans related to the reforms and investments associated with REPowerEU. They must submit revised plans to the European Commission, which may also contain other proposals for modifications or financing. By November 30, 2023, all revised national plans had been approved by the European Commission, including that of Romania. https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard/timeline.html?lang=en

[41] The majority of these investments were shifted to programs within the Cohesion Policy under the 2021-2027 Multiannual Financial Framework, which have a longer implementation horizon, specifically until 2030. (Source:

sector affected was the health sector (Component 12 of the NRRP), which experienced a reduction of approximately 750 million euros in the planned investments, particularly those related to the development of public hospital infrastructure[42].

Although delayed, driven by prolonged negotiations with both stakeholders and public institutions responsible for implementing the NRRP (initiated in March 2023[43]) and representatives of the European Commission, Romania successfully submitted the revised NRRP to the EC on September 8, 2023. The approval from the Commission occurred within a period of approximately two months, on November 21, 2023[44]. In December 2023, the EU Council adopted a new Implementing Decision (CID) for the revised NRRP, with slightly modified funding compared to the initial decision from October 2021, totalling 28.5 billion euros (13.6 billion euros in grants and 14.9 billion euros in loans[45]). Simultaneously, the Council recommended Romania to maintain nationally financed public investments, ensure effective governance, and strengthen administrative capacity to facilitate the rapid and consistent implementation of the NRRP, as well as the timely execution of cohesion policy[46].

It is important to highlight that the revised NRRP places a stronger emphasis on the green transition, allocating 44.1% (compared to 41% in the initial plan) of the available funds to measures supporting climate objectives. The REPowerEU chapter includes two new reforms and seven investments aimed at accelerating green energy production, improving energy efficiency in buildings, and retraining and upskilling the workforce in the green energy generation sector.

The delay in submitting payment request No. 3, implying the postponement of its evaluation by the European Commission and the authorization of the corresponding payment until the first half of 2024, could lead to disruptions in the implementation of the NRRP.

This situation may jeopardize compliance with subsequent deadlines for the submission/validation of the achievements of milestones and targets. Such a scenario would partially disturb the schedule of associated financial flows and exert additional pressure on the financial-budgetary stability of the country.

The European Commission had already drawn attention to such risks in its country report on Romania within the European Semester context – Spring 2023 package, published at the end

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https://mfe.gov.ro/romania-a-transmis-comisiei-europene-propunerea-de-ajustare-a-planului-national-de-redresare-si-rezilienta/).

[42] Part 1, Revised NRRP https://mfe.gov.ro/pnrr/

[43] https://mfe.gov.ro/comitetul-de-monitorizare-a-planului-national-de-redresare-si-rezilienta/

[44] https://mfe.gov.ro/comisia-europeana-a-aprobat-modificarea-planului-national-de-redresare-si-rezilienta-al-romaniei-in-valoare-de-28,5-mld-de-euro/

[45] https://www.consilium.europa.eu/en/press/press-releases/2023/12/08/recovery-fund-council-greenlights-amended-national-plans-for-13-member-states/

[46] European Union Council (2023). *IMPLEMENTING DECISION OF THE COUNCIL amending the Implementing Decision of October 29, 2021, approving the assessment of Romania's recovery and resilience plan*, File 2023/0428, Brussels, December 5.

of May of this year. The report noted that due to weak governance and limited public administration capacity, there is a risk of significant delays in the implementation of the plan. The report explicitly referred to delays caused by the extension of the period for the second payment request and the revision of the NRRP[47].

A report prepared by the European Parliament's Research Department on the implementation of recovery and resilience plans of EU member states, published in June 2023, positioned Romania among the few countries where increasing risks of delays were foreseen. The report recommended enhancing governance efficiency, strengthening administrative capacity, and accelerating the implementation of operational programs under the cohesion policy for the 2021-2027 financial exercise, in close complementarity and synergy with the NRRP[48]. Furthermore, in the annual report of the European Commission on the implementation of the Recovery and Resilience Mechanism at the level of EU countries, published in September 2023[49], it was stated that, in the case of Romania, the risk of delays in the implementation of the NRRP is on the rise.

[47] European Commission, *2023 Country Report – Romania*, Commission Staff Working Document SWD(2023) 623 final, Brussels, 24.5.2023.

[48] European Parliament, *Recovery and resilience plans in the 2023 European Semester. Progress and country-specific recommendations*, EPRS Briefing, June 2023.

[49] European Commission, *Annex to the Report from the Commission to the European Parliament and the Council on the implementation of the Recovery and Resiliency Facility: Moving forward*, COM(2023) 545 final, Annex 1 – Part 2/2, Brussels, 19.9.2023.

7. Spending reviews

The sustainability of public finances requires aligning available resources (budget revenues) with pressing needs; this can be achieved through increasing the productivity of public goods provided by the Government, reducing expenses, and/or generating additional income. Efficiency in public spending becomes a priority for national authorities.

Investigating efficiency involves comparing costs (efforts) and benefits (results), with an activity being more efficient when the outcome for a given effort is greater. Applying this idea to government expenditures, their efficiency entails providing the maximum potential benefit to the country's population, considering the amount spent in terms of "value for money". Determining the efficiency of public spending can involve either minimizing efforts (expenditures) to achieve the same result or maximizing the outcome (benefit) while maintaining a constant level of effort.

In this context, the sporadic use of Public Spending Reviews as a working tool at the government level in the European Union and OECD member states has expanded in numerous countries after the global financial crisis of 2008-2009. Subsequently, there has been an increasingly systematic examination of public spending, turning it into an essential management tool for improving budgetary performance. This trend has been further emphasized by the pressure resulting from the impact of the pandemic in 2020, the energy crisis, and high inflation in 2021 and 2022, coupled with escalating geopolitical tensions.

The European Commission and the OECD emphasize the importance of these types of analyses in the budgetary process, particularly in the case of performance-based budgeting. According to the latest survey conducted by the OECD among its member states, as of 2020, out of 39 states, only 6 did not conduct any form of Spending Review analysis, not even occasionally. In 26 of the surveyed states, there is a centralized unit for the analysis of public expenditures, with 18 of them being part of the ministry of finance. In 4 states, the analysis unit is directly subordinated to the head of state, while in Spain, the responsible unit is an independent fiscal institution. Before the onset of the health crisis caused by Covid, the main objectives targeted by public spending analyses were aligning expenditures with government priorities, improving efficiency within programs and public policies, and, ultimately, controlling the overall level of expenditures[50].

At the EU level, considering Spending Review as a valuable tool for improving the quality of public finances, the Eurogroup approved in 2016 a set of common principles that should be followed by the euro area member states, such as (Eurogroup, 2016[51]): a strong and sustained political commitment at a high national level; the design and implementation of Spending Review should include objectives with quantified targets; monitoring and communication of

[50] OECD (2020). *Spending review dataset*, OECD Database on spending review practices.
[51] Eurogroup statement (2016). *Thematic discussions on growth and jobs: common principles for improving expenditure allocation*, Eurogroup Press release, September 9.

progress and results of Spending Review to the public; conclusions and implementation of Spending Review results should be in line with annual and multi-year budget planning.

These audits of public spending, depending on the scope of the expenditure analysis, are divided into two categories: "Comprehensive Spending Review", which covers a significant portion of total public expenditures (at least ¾) over a specified period, with the aim of prioritizing programs based on policy objectives and/or performance, and "Selective Spending Review", which targets only specific types of public expenditures. The majority of selective spending analyses in European countries have been conducted in four main areas: education, health, social protection, and economic activities (e.g., transportation, postal services). Additionally, selective spending reviews are also conducted for other activities, such as security, emergency situations, and defence. These areas are the most commonly encountered in practice among EU member states.

In the same vein, many countries concurrently practice both types of expenditure analysis in the same year (e.g., Estonia, Finland, Latvia, Luxembourg, Portugal). Another example is the Netherlands, which conducts a comprehensive spending review once every 10 years, using selective spending analysis in the interim period. Typically, these expenditure analyses are undertaken by the ministries of finance in collaboration with other relevant ministries and public entities.

For Romania, the issue of public expenditure efficiency is extremely acute, given that their low levels compared to other EU member states deprive citizens of the necessary quantity and quality of public goods and services. Indiscriminate cutting of public expenditures, beyond a critical threshold, can cause significant harm, leading to a sudden leap into inefficiency.

The use of this practice of conducting Public Spending Reviews at the level of Romania is welcomed in the context of the positive impact that the results of these analyses can have on the allocation process of limited public financial resources. These reviews help highlight the reasons and sources of reduced efficiency in certain public sectors, aligning the financial effort from public funds with the expected outcomes of resource allocation. Such public spending analyses can contribute to better annual budget planning and multi-year planning, considering that the results of resource allocations may manifest with a temporal lag of several years, depending on the targeted public sector.

Last but not least, the low level of revenues in the public budget structure calls for a better allocation of financial resources, especially in sectors characterized by chronic underfunding. These are sectors from which society as a whole expects improvement in outcomes, primarily from a qualitative perspective (education, health etc.).

Based on these fundamental reasons, within the National Recovery and Resilience Plan – Component 8, O3 (Improving the efficiency of public spending), Reform 3 (Improving the

budget planning mechanism), two milestones (201 and 203) are outlined regarding spending reviews in the education and health sectors (T2 2023). This involves conducting spending reviews in these areas. Furthermore, it includes the implementation of measures resulting from these analyses in the 2024 budget of the authorizing officers analysed and the completion of an independent *ex-post* evaluation, overseen by the Romanian Fiscal Council (in accordance with milestones 199 and 204 in the NRRP, through the extension of its mandate according to Government Emergency Ordinance no. 187/2022).

The Government approved in November and December 2023, through memoranda, the analysis reports and cost-efficiency measures for health and education. These reports were conducted by the Ministry of Finance in collaboration with the Ministry of Health and the National Health Insurance House for the health sector, and the Ministry of Education for the education sector. The working groups involved representatives from the World Bank.

The results of the analysis of public expenditures in the fields of health and education have materialized in the proposal of 5 and 6 efficiency measures, respectively. Each measure has specified objectives and actions to be taken, estimated benefits, specific aspects, monitoring indicators, responsible institutions, and the implementation schedule. Additionally, the analysis of public expenditures in the field of education includes the development, on an annual basis, of a monitoring report on the degree of implementation to inform the Government and the Fiscal Council. For both health and education, the implementation of all measures begins in the year 2024, with the corresponding implications on budget projections.

From the perspective of a systematic approach, which is absolutely necessary in the case of Romania, the importance of Spending Review is highlighted by the fact that, according to milestone 202 of the National Recovery and Resilience Plan, the Government approved, in July 2023, the Public Expenditure Analysis Strategy for 2024-2030 and a schedule that practically involves all ministries, as well as other relevant public entities. The expenditure analyses target specific, selectively chosen areas, but in most cases they are structured either vertically or horizontally within the domain, encompassing both quantitative and qualitative aspects. The ultimate goal is to implement measures derived from budget projections with the aim of enhancing the efficiency of public spending.

Conclusions

- Romania's most acute problem (beyond external deficits and institutional weaknesses) is the budget deficit which, in 2023, remained around 6% of GDP. Romania is subject to the excessive deficit procedure and probably has the highest structural deficit in the EU.
- The correction of the deficit must be primarily addressed on the revenue side. In an EU member state with extremely low tax revenues, approximately 27% of GDP, while the EU average exceeds 40% of GDP, with massive and chronic underfunding of education and public health, with tax evasion and tax avoidance almost institutionalized, and with a VAT gap exceeding 36%, compared to the EU average of approximately 5%, this is the sensible and logical alternative.
- Romania needs to spend more efficiently and that is why spending reviews, similar to those conducted in the OECD, are necessary. Such analyses have been developed for health and education in 2023.
- The fiscal measures adopted by the Government in 2023 would have an impact of approximately 1% of GDP in 2024. Additional measures are necessary to reduce the budget deficit to 3% of GDP in the coming years.
- The new pension law is necessary to eliminate blatant inequalities and to account for the aging population. However, the immediate and medium-term impact is severe, significantly increasing the deficit through the introduction of permanent expenditures.
- There is a need to continue the tax reform. Tax evasion and tax optimizations must be fought without compromise. The tax reform also involves labour market reforms, as it is heavily distorted.
- European funds can mitigate the inevitable contractionary effect of correcting the budget deficit.
- Failure to achieve a credible adjustment, supported by transparent measures that address the existing shortcomings of the current fiscal framework (regressivity/high tax evasion, influenced by both flawed legislation and inefficient institutional architecture), could lead to disorderly developments in the economy.
- The most recent data on the 2023 budget execution indicates that the cash budget deficit would exceed the target set in the initial budget (4.4% of GDP) by 39-40 billion lei, approaching the level of 6.8% of GDP. However, given the significant underexecution of capital expenditures, there are indications that the 2023 cash budget deficit could be around 6% of GDP.
- The budget construction for 2024 aims at a cash budget deficit target of 5.0% of GDP, representing a decrease of 0.94 pp from the level estimated by the Ministry of Finance for 2023 (5.94% of GDP). The corresponding deficit target in ESA 2010 terms is 4.9% of GDP.

- Regarding the inclusion of hypothetical revenues of 19 billion lei in the budget projection, stemming from the desired improvement in collection efficiency/the digitalization of the tax administration, the Fiscal Council (FC) cannot consider them due to the prudence principle. Consequently, the FC considers it possible that lower revenues will be collected by approximately 19 billion lei, representing around 1.1% of GDP, compared to the targets assumed in the budget draft.
- The planned dynamics of budget expenditures, expressed as a percentage of GDP, is primarily the result of an increase in spending on projects financed by European funds, personnel expenditures, social assistance, and other expenditures. This is counterbalanced by a decrease in subsidies, other transfers, and expenditures on goods and services.
- The FC estimates it as probable that an additional budget allocation of approximately 4.5 billion lei is needed for expenditures on goods and services and social assistance, representing around 0.26% of GDP.
- **Based on a prudent approach to revenues and expenditures, the FC considers the budget construction for 2024 to be compatible with a cash deficit of around 6.4% of GDP. The assessment of the cash deficit takes into account the information available to the FC, uncertainties regarding the final form of the measures adopted by authorities, and the assumption that there will be no forced reduction in expenditures.**
- Under these conditions, the FC signals the existence of major risks regarding the consolidation process, according to the current budget construction.
- According to the medium-term fiscal-budgetary framework, budget consolidation during the period 2025-2027 will be achieved exclusively on the expenditure side, the proportion of budget revenues in GDP exhibiting a downward trend during the analysed period.
- The FC has emphasized in its opinions and analyses that macroeconomic adjustment and fiscal consolidation require a significant increase in tax revenues.
- The FC has consistently emphasized in its reports and opinions that European funds represent a key financial resource for Romania’s economic development.
- The FC considers that, in the absence of sufficiently concrete and credible policies supporting medium-term fiscal-budgetary consolidation on the revenue side, as well as an increase in collection efficiency, the risk balance is clearly tilted towards recording deficits higher than those anticipated by the 2025-2027 fiscal-budgetary framework.

The opinions and recommendations formulated above by the Fiscal Council were approved by the Chairman of the Fiscal Council, according to the provisions of art. 56, para (2), letter d) of Law no. 69/2010 republished, after being agreed by Council members, through vote, in the meeting of December 19, 2023.

December 19, 2023

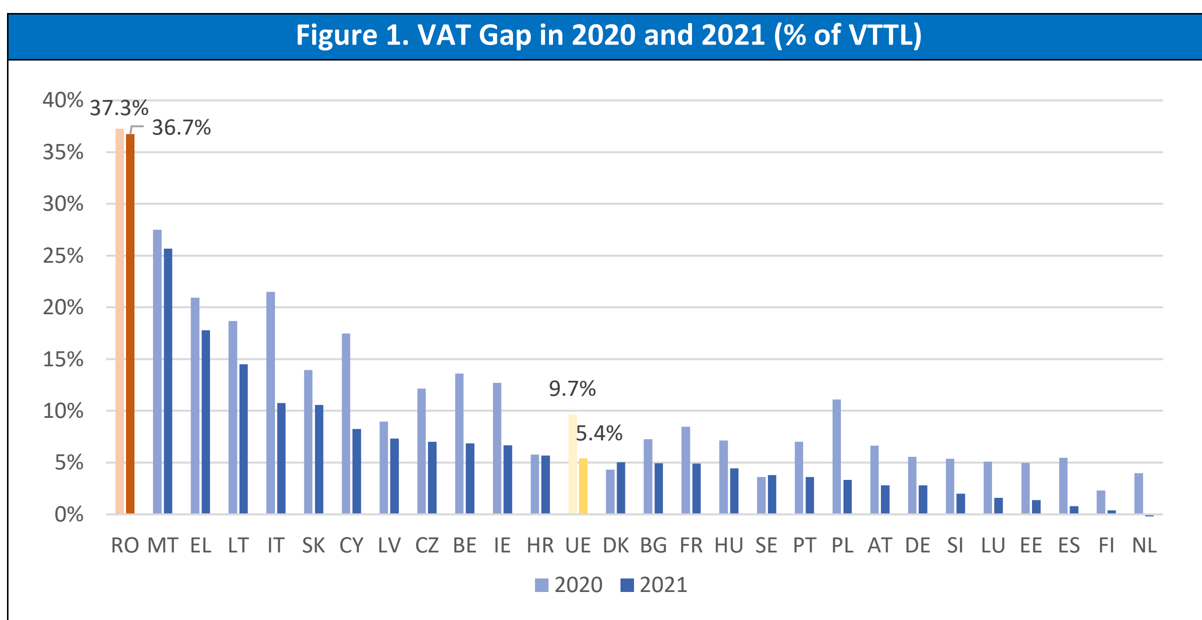
Chairman of the Fiscal Council

Professor Daniel DĂIANU

Annex I – VAT Gap

One of the structural issues in Romania's fiscal system is the deficient collection of value added tax (VAT), especially considering the country's consistently low levels of fiscal revenue each year (approximately 27%, second to last in the EU after Ireland). This situation results in an insufficient fiscal space for the state to provide crucial public goods for its citizens and for the efficient expression of public finance functions[52] (stabilization, allocation, and redistribution) in the economy. According to the data from the European Commission[53], Romania recorded a VAT revenue level of 6.7% of GDP in 2022 (ranking 24th among EU member states), representing about 25% of the total public budget revenue. This ranking is a consequence of historically low VAT collection yields compared to other EU member states, with a collection gap exceeding 30% from 2000 until present. The latest annual report on the VAT collection gap by the European Commission[54] confirms this fact, indicating that Romania has a VAT collection deficit (calculated as the difference between theoretically collectible VAT – VTTL – and actually collected VAT) of 36.7%, which is over 10 percentage points higher than the next-ranked Malta and significantly higher than the EU average of 5.4% (*Figure 1*).

Figure 1. VAT Gap in 2020 and 2021 (% of VTTL)



Source: European Commission, CASE, Poniatowski, G., Bonch-Osmolovskiy, M., Śmietanka, A., Sojka, A., VAT gap in the EU – Report 2023, Publications Office of the European Union, Luxembourg, 2023.

In recent years, countries in the region have made significant progress in combating VAT tax evasion, improving their collection efficiency substantially through the digitalization of national tax administration systems. As of 2021, the VAT collection gaps for some of these countries are as follows: Czech Republic 7%, Bulgaria 4.9%, Hungary 4.4%, and Poland 3.3%. Furthermore, the magnitude of the collection gap becomes apparent when analysing

[52] Musgrave (1959).
[53] https://ec.europa.eu/eurostat/databrowser/view/gov_10a_taxag__custom_8802344/default/table?lang=en
[54] https://taxation-customs.ec.europa.eu/taxation-1/value-added-tax-vat/vat-gap_en

absolute figures, where Romania records a deficit of approximately 9.7 billion euros, ranking second after Italy, which has a deficit of 14.6 billion euros. In comparison, Italy is an economy with a GDP approximately seven times larger than that of Romania, highlighting the economic security challenge faced by the public budget.

Successful examples from the CEE Region (*Table 1*) in combating tax evasion from 2013-2021 include Latvia (18 percentage points reduction in the VAT collection gap), Hungary (17.6 percentage points reduction in the VAT collection gap), Poland (22 percentage points reduction in the VAT collection gap), and Slovakia (22 percentage points reduction in the VAT collection gap). These countries share a common denominator in their efforts, namely the digitization of tax administrations.

Table 1. Centralization of efforts in the digitalization of tax administrations in CEE countries

Country	The undertaken steps
Latvia	**2011**: Introduction of the obligation for VAT payers to submit detailed data through the Electronic Declaration System. **2016**: Implementation of an internal reverse taxation system targeting certain IT and electronic equipment, cereals, and precious metals with high-risk for fraudulent trading. **2017**: Expansion of the previous measure by applying reverse taxation to the supply of scrap metal and semi-finished metal products. **2018**: Initiation of a reform process coordinated by the World Bank to monitor the VAT gap and improve the efficiency of the audit process. **2018**: Specification of reporting obligations for all transactions starting from 150 euros, as well as the expansion of tax authorities' rights to suspend the economic activity of a taxpayer who has not paid outstanding tax liabilities subject to recovery. **2019**: Further extension of the tax administration's powers through additional rights to initiate procedures for deregistration from the VAT register.
Hungary	**2014**: Introduction of electronic cash registers for the HORECA and retail sectors (by 2016, over 200,000 cash registers were connected to the tax administration infrastructure). **2015**: Commencement of real-time monitoring of the movement of high-risk goods through the EKAER system. **2013, 2015, and 2017**: Expanded implementation of the reverse taxation system. **2018**: Introduction of the real-time reporting requirement, whereby companies in this country are obligated to report data on all invoices with a VAT value exceeding 300 euros. **2020**: Expansion of the previous measure by eliminating the 300 euros threshold.

	2021: Extension of the two previous measures by the obligation to report not only issued invoices but also received ones.
Poland	**2016**: Introduction of the SAF-T system for large corporations, but by 2020, this system was extended to 1.6 million taxpayers. **2017**: Implementation of the SENT system for monitoring the movement of goods and collecting data from third parties. **2013, 2015, and 2017**: Expanded implementation of the reverse taxation system. **2018**: Initiation of a clearinghouse computer system designed to combat tax fraud through information exchange between the tax administration and the banking system. **2018**: Introduction of a split payment mechanism, limited to B2B transactions. **2019**: Expansion of the split payment system for all invoices exceeding 3,300 euros for certain categories of goods and services. **2019**: The Ministry of Finance in Poland begins issuing the White List of Taxpayers, facilitating the verification of suppliers.
Slovakia	**2014**: Introduction of the obligation to complete VAT declarations with detailed transaction data for all VAT payers and all domestic and intra-community transactions. **2014**: Implementation of a reverse taxation mechanism that includes, among other things, some iron and steel products, agricultural products, mobile phones, and devices such as microprocessors and central processing units.

Source: European Commission, CASE, Poniatowski, G., Bonch-Osmolovskiy, M., Śmietanka, A., Sojka, A., VAT gap in the EU – Report 2023, Publications Office of the European Union, Luxembourg, 2023.

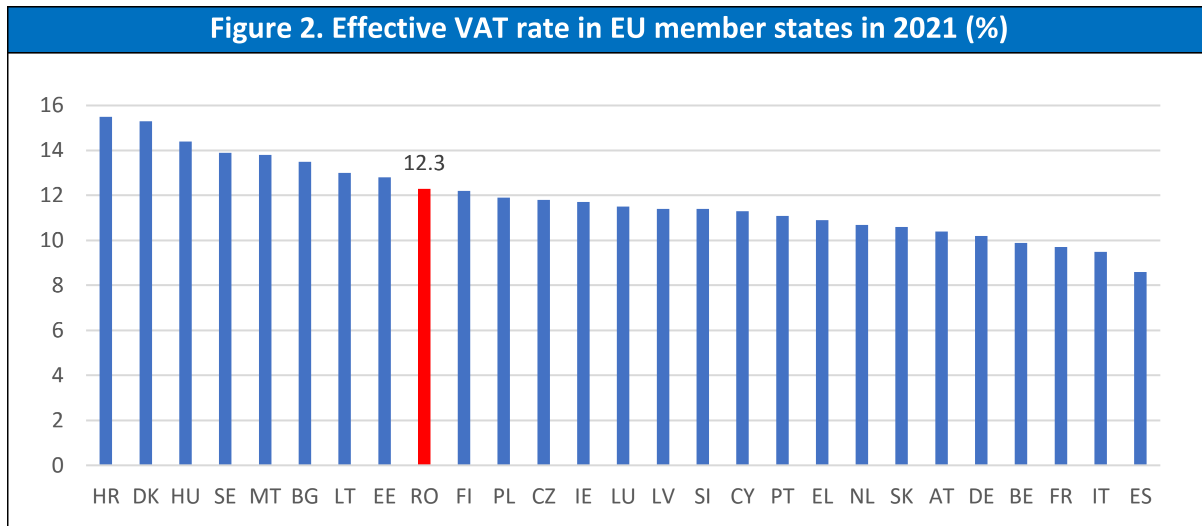
In the case of Romania, the decision to terminate the assistance project for the digitization and restructuring of the tax administration system with the World Bank in 2018[55] effectively represented a hindrance to the reform process in the digitalization domain. The objectives of this program aimed at enhancing the effectiveness and efficiency of tax and social contribution collection and improving tax compliance, including reducing the burden on taxpayers. A similar project was implemented in Bulgaria, and the results were remarkable, with the country achieving a better VAT collection performance, reflected in a VAT gap of 4.9%, below the EU average of 5.4%.

According to the EC report, despite favourable national conditions for improving VAT collection in recent years, including a cumulative real economic growth of 34% between 2013 and 2021 and a reduction in the standard VAT rate by 5 percentage points, there have been no visible effects in terms of narrowing the collection gap. Considering Romania's current effective VAT rate of 12.3%, ranking 9th in the EU (*Figure 2*), it can be argued that the level of taxation is not the primary cause of the enormous collection deficit. Potential increases in

[55] http://www.consiliulfiscal.ro/RA%20CF%202019.pdf

standard VAT rates could have detrimental effects on individuals with low incomes, as the majority of their earnings are directed towards consumption. This could result in a more regressive tax system[56] than the present one, deepening the gaps between social classes and creating undesirable tensions among them.

Figure 2. Effective VAT rate in EU member states in 2021 (%)



Source: European Commission, CASE, Poniatowski, G., Bonch-Osmolovskiy, M., Śmietanka, A., Sojka, A., VAT gap in the EU – Report 2023, Publications Office of the European Union, Luxembourg, 2023.

A study conducted by a group of experts in 2022[57] reveals that the VAT collection gap is caused by a range of factors, with the inadequate digitization of the National Agency for Fiscal Administration (NAFA) being a significant contributor. Nationally, effective solutions implemented in most European countries, such as connecting cash registers to the servers of the National Financial Information Centre (NFIC), operationalized only in 2021, or e-Invoicing, have been only partially implemented and faced significant delays and challenges. Furthermore, the use of the latest Artificial Intelligence (AI) techniques for fiscal risk analysis is still in the discussion stage. The lack of digitization in the tax administration system creates favourable conditions for fraud, especially given the way VAT operates through the "transitional regime"[58], allowing carousel fraud to take place. The European Commission, through EU Directive 2018/1695, addressed this issue, allowing member states to apply reverse taxation mechanisms[59] in all B2B transactions. This process could benefit the improvement of collection efficiency in countries like Romania, where the collection capacity is relatively low, by: i) completely eliminating carousel fraud; ii) completely eliminating VAT refunds and associated costs of tax inspections, as well as the risk of unjustified refunds; iii) increasing collection by reducing the number of taxpayers who actually have VAT to pay, and

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[56] Indirect taxes, especially VAT, contribute to this regressive system.
[57] http://www.consiliulfiscal.ro/Analiza_sistem_fiscal_RO.pdf
[58] This approach involves a hybrid treatment, namely: i) staggered payments for B2B transactions (transactions between economic operators) and B2C transactions (transactions between economic operators and final consumers) within the territory of the same state, excluding certain categories of high-risk evasion goods (such as cereals, scrap metal, real estate, energy, computers, and mobile phones), for which reverse taxation is applied; and ii) reverse taxation for B2B transactions between member states.
[59] It cannot be generalized without unanimity among the member states.

iv) reducing the number of disputes in courts, most of which are related either to the obligation to collect or the right to deduct VAT in B2B transactions. Among the solutions suggested by the expert group at that time, which can still be implemented to generate additional revenues of around 1-2% of GDP, are: i) digitalization of the VAT administration process by implementing e-Invoicing for all B2B transactions and correlating the information received from this system with that obtained from cash registers already connected to NFIC; ii) improving border control through the use of modern scanning methods at customs, as well as quantitative methods to reduce the phenomenon of undervaluation of declared values at customs points; iii) generalizing reverse taxation conditions in accordance with EU Directive 2018/1695, and iv) basing NAFA controls on the results of risk assessments using big data analysis techniques, where NAFA collects data about taxpayers and subsequently focuses control activities on those business areas with high risks of VAT evasion, non-issuance of fiscal receipts, or non-issuance of invoices. In this regard, the implementation of SAF-T by the authorities is an important step forward.

Another matter of major importance for reducing VAT evasion involves different thresholds for micro-enterprises and VAT. Reducing the eligibility threshold for a company to be categorized as a micro-enterprise to match the VAT threshold is a significant measure, applied in most EU states, with results in combating tax system circumvention. Furthermore, this measure would also serve to discourage unnecessary expense deductions for the proper functioning of the enterprise, with immediate effects in reducing tax evasion.

Annex II – Recommendations from international financial institutions regarding fiscal framework reform

In the National Recovery and Resilience Plan, within the pillar of Smart, Sustainable, and Inclusive Economic Growth, an important component is represented by tax reforms and pension system reform.

In terms of fiscal reforms, the most important measures focus on **the reform of the National Agency for Fiscal Administration (NAFA) through digitization, the modernization of the customs system, and the implementation of electronic customs. Additionally, efforts include improving the budgetary planning mechanism, revising the fiscal framework, establishing and operationalizing the National Development Bank, enhancing tax administration processes, and ensuring the capacity to respond to current and future information challenges for the Ministry of Finance and NAFA. According to the NRRP, the implementation of these measures should lead to an increase in the share of tax revenues in GDP by 3 percentage points and a reduction of the VAT gap by 5 percentage points**. Both indicators are referenced to the average value of 2019 and 2020.

An important set of measures focuses on the digitization of NAFA. According to the National Recovery and Resilience Plan, the milestones included in this component should lead to **an increase in the revenues collected by the tax administration by at least 2.5 percentage points of GDP and a reduction of the VAT collection gap by 5 percentage points**.

As part of the component regarding **the revision of the fiscal framework, four measures are included**: (i) an analysis of Romania's tax system with the aim of formulating recommendations to ensure that the fiscal system contributes to the promotion and maintenance of sustainable economic growth; (ii) amendments to the Tax Code that gradually reduce the scope of the special tax regime applicable to micro-enterprises; (iii) amendments to the Tax Code to reduce and/or eliminate other tax incentives to simplify the tax system, make it more efficient, transparent, and equitable, and the enactment of legislation to expand environmental taxation; (iv) amendments to the Tax Code that gradually reduce tax incentives for personnel employed in the construction sector.

The first step in the revision of the tax system was accomplished by achieving milestone 205, which involved the analysis of Romania's tax system. This analysis was conducted, with the support of technical assistance, by the World Bank and was published in March 2023. It is noteworthy that, in the description of the milestone regarding changes to the Tax Code, it is specified that these changes will be made taking into account the recommendations formulated in the analysis of Romania's tax system.

The objectives of the recommendations formulated by the World Bank aim to improve the structure of tax revenues, increase the share of tax revenues in GDP by 0.5 percentage points in 2025 compared to 2019, eliminate gaps in the tax system, simplify tax rules,

achieve a more efficient and equitable tax system, and modify property taxation. The fiscal reforms should be implemented by March 31, 2025. The following table summarizes the recommendations for revising the fiscal framework proposed by the World Bank in the mentioned study.

Table 2. The recommendations proposed by the WB for the revision of the fiscal framework

Review areas and proposed schedule	Proposed reforms	Scenarios	Impact and observations
Income tax for individuals and social insurance contributions (2025-2028)	• Introduction of a progressive system for personal income tax rates. • Elimination of exemptions for personal income tax (construction, agriculture, and IT). • Elimination of the health contribution (financing healthcare through general taxation) and/or introduction of a refundable income tax credit for low-income workers.	• Scenario 1: maintaining the current tax rates, eliminating exemptions for personal income tax, and increasing the basic allowance (personal deduction). Fiscally neutral impact, as the increase in the deduction is offset by the elimination of exemptions. • Scenario 2: raising the income tax from 10% to 13% and introducing a refundable tax credit for reduced salary incomes. • Scenario 3: eliminating the deductibility of social security contributions, introducing three progressive rates for personal income tax on labour (6% for incomes up to 80,000 lei/year; 12% for incomes between 80,001 lei/year and 189,000 lei/year; 18% for incomes above 189,000 lei/year) and introducing a refundable tax credit for reduced salary incomes. • Scenario 4: eliminating the social health insurance contribution, eliminating the deductibility of social security contributions, and introducing three progressive rates for personal income tax on labour (10% for incomes up to 42,000 lei/year; 20% for incomes between 42,001 lei/year and 100,000 lei/year; 25% for incomes over 100,000 lei/year).	• All scenarios are implemented under the condition of ensuring a neutral impact. • The proposed measures ensure a fairer distribution of the tax burden, encourage labour market participation, and reduce the number of individuals in the informal sector.
Tax on capital (2023-2025)	• Introduction of an equitable capital gains tax system.	• Taxation at 10% on all capital gains. • Granting exemptions for capital gains from owner-occupied properties. • Elimination of the tax on residential property sales transactions.	• No data is provided.
Corporate income tax (2023-2024)	• Simplifying tax incentives for research and development. • Eliminating current tax exemptions. • Conducting a review of the efficiency of the tax exemption for reinvested profits.	• Simplifying tax incentives for research and development to a single deduction. • Eliminating the tax exemption for newly established enterprises. • Abolishing the reduction of corporate income tax for companies increasing their share capital. • Replacing the tax exemption for reinvested profits with an investment tax credit.	• No data is provided.
Micro-enterprise regime (2023-2025)	• Reducing the eligibility threshold for micro-enterprises. • Reassessing the corresponding rate of turnover tax and, if necessary, adjusting the rate.	• Gradual reduction of the threshold for micro-enterprises towards the VAT registration threshold. • Measures to prevent the division of micro-enterprises. • Simplifying the regime by transitioning to a pure turnover tax without allowing adjustments.	• No data is provided.

		• Evaluating the average profit margins of micro-enterprises to adjust tax rates.	
Taxation of energy (2024-2030)	• Increase in excise rates on fossil fuels. • Phasing out of subsidies for fossil fuels. • Additional carbon taxation. • Compensation for vulnerable groups.	• Scenario 0: Complete and gradual elimination of all subsidies for fossil fuels, exemptions, and price controls. • Scenario 1: Introduction of a carbon price covering both climate and non-climate externalities. • Scenario 2: Introduction of a carbon price covering non-climate externalities (local air pollution, congestion, accidents, and road damage). • Scenario 3 (illustrative): Introduction of a carbon price of 185 USD/ton CO2 in 2023 (in line with the Paris Agreement).	• Revenue impact ranging from 0.4% of GDP (Scenario 0) to 2% of GDP (Scenario 3). • These revenues should be redirected into the economy (in the form of cash transfers) to offset the negative impact on GDP resulting from higher carbon prices.
Property taxation (2025)	• Transition to a market value-based property tax system. • Limitation of the use of tax incentives for property tax. • Reassessment of the entire rate structure to increase total property tax revenue beyond the current level.	• Updating the market value of properties every 3-6 years. • Merging land and building taxes into a single tax. • Equalization of tax rates for residential and non-residential buildings. • Setting tax rates to ensure an increase from 0.5% of GDP in property taxation to around 1% of GDP (EU average). • Granting targeted and clearly defined exemptions (elderly individuals, individuals with low incomes, government buildings, and public utility buildings).	• Approximately 0.5% of GDP if rates are set to increase the share of property taxation to 1% of GDP – the EU average – compared to the current 0.5% of GDP.
VAT (2025)	• Eliminating reduced VAT rates.	• Single VAT rate on the broadest possible base.	• No data is provided.

Source: Report on the Fiscal System in Romania, Including Comparative Analysis and Recommendations for Fiscal Framework Reform, World Bank, March 2023.

In general, the World Bank's proposals regarding personal income tax and property tax align closely with studies conducted by the International Monetary Fund (IMF) within the technical assistance provided to Romania for the reform of the taxation framework. The following table summarizes the recommendations for revising the fiscal framework proposed by the IMF.

Table 3. IMF's proposals regarding property taxation and personal income taxation

Review areas	**Proposed reforms**	**Scenarios**	**Impact and observations**
Income tax for individuals	• Transition from a flat tax rate to differentiated tax rates. • Introduce a tax credit to support low-income individuals and encourage increased labour market participation. • Limit tax credits to low incomes. • Higher tax rates for high incomes. • Eliminate exemptions related to personal income tax. • Review the definition framework for microenterprises. • Similar tax rates for self-employed individuals as for employees.	• Introduce a 20% rate for the top decile of income distribution. • Maintain a 10% rate for individuals with incomes outside the top decile. • Introduce tax credits for individuals in the lower decile of income distribution. • Scenarios with rates of 16%/20% or 16%/25% may be considered, depending on the authorities' objectives.	• The scenario of 10%/20% would increase the share of personal income tax in GDP by 1 percentage point. • Eliminating exemptions related to personal income tax is equivalent to 0.6% of GDP.

Property taxation	• Transition to a market value-based taxation model for both residential and non-residential properties.	• Use market values for taxing both residential and non-residential properties. • Agricultural land will continue to be taxed based on predetermined values. • Taxation as a single property of land and building with a unified assessment. • Set tax rates to achieve a property tax share of 1% of GDP. • Ensure a level of autonomy for local authorities by setting a single property tax, selected within specified intervals by the central authority. • Avoid differentiation between residential and non-residential properties. • Do not introduce progressive rates for multiple properties. • Establish clear criteria for exceptions from property tax payments (schools, churches, low-income individuals, public properties), with periodic assessment of these exceptions. • Reintroduce a property tax for private entities in the telecommunications and energy infrastructure sectors. • Establish a registry of sale prices within the National Institute of Statistics (INS) and develop an automated market value determination model. • Create valuation departments for properties within major municipalities.	• The market value-based taxation model should lead to an increase in the share of property taxes from 0.5% of GDP to 1% of GDP.

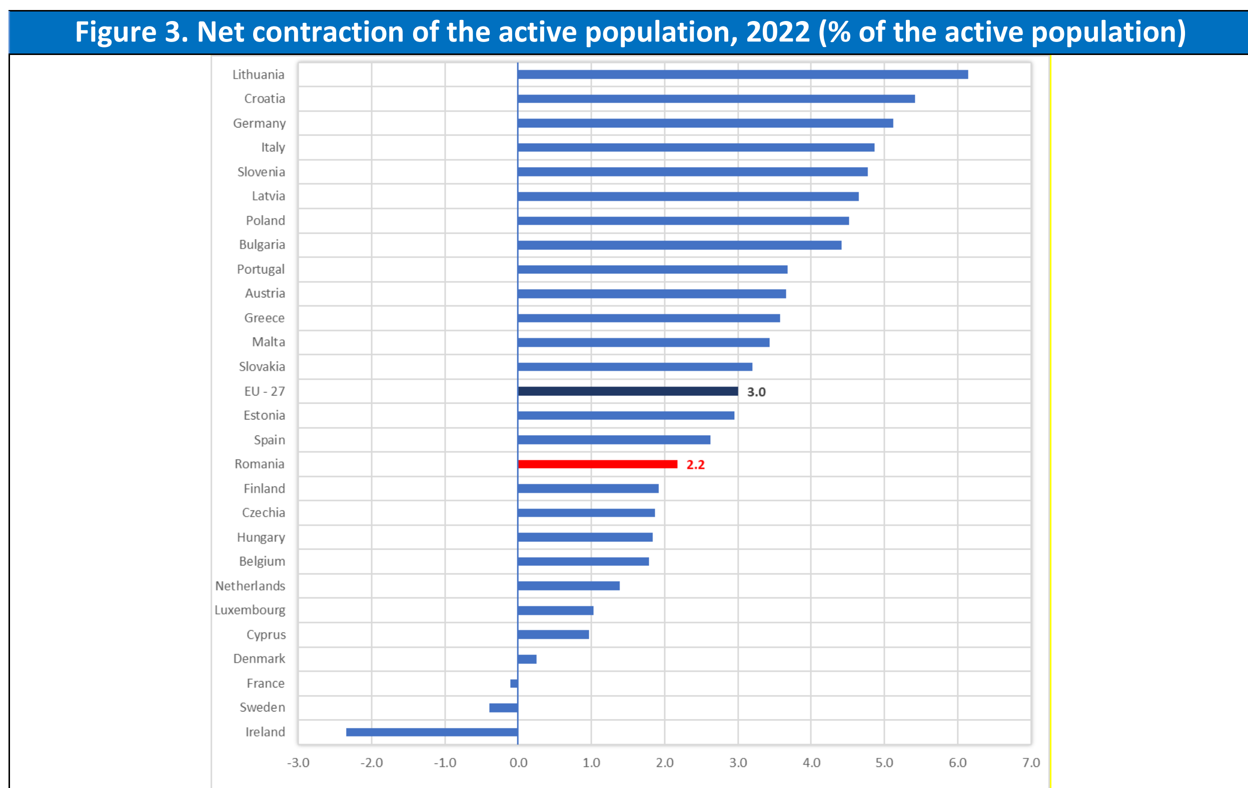
Source: IMF Country Report No. 22/198 and IMF Country Report No. 22/199

Annex III – Analysis of the active population in terms of pension system sustainability

Europe has been on a long-term trend of population aging, which puts additional pressure on the budget consolidation process. Analysing the net contraction of the active population (The Economist: net shrinkage of the available labour force), calculated as the difference between the number of individuals aged 60 to 64, approaching retirement, and the number of individuals in the age group 15-19, who are about to enter the labour market, Germany (2,167,064) and Italy (1,187,167) stand out with a significant net shrinkage. Romania ranks 6th, with a gap of 177,819 individuals. As of 2022, three EU member states had this negative gap, meaning that young people entering the workforce exceeded the number of individuals approaching retirement, namely Ireland (-60,009), France (-32,052), and Sweden (-21,162).

By reporting the net contraction to the total active population (*Figure 3*), Germany (5.1%) and Italy (4.9%) rank 3rd and 4th, respectively, with the first two positions being occupied by Lithuania (6.1%) and Croatia (5.4%). Romania seems to fare better in this indicator, namely ranking 16th, with a gap of 2.2% of the active population. However, the Romanian labour market presents major structural issues, with only about 2/3 of the active population being effectively employed with legal forms.

Figure 3. Net contraction of the active population, 2022 (% of the active population)



Source: Eurostat, FC's calculations

Another indicator that can highlight the vulnerability to the public pension system is the ratio between the actual number of contributors and the active population (aged 20-64). Romania ranks last in this classification (*Figure 4*), with a share of 48.3% in 2019, compared to the EU

average of 74.3%, according to data from the Ageing Report 2021 edition[60]. According to the same report, in 2025, the first year for which forecast indicators for the population were made, Romania remains at the bottom of the EU ranking for this indicator. Among the main causes explaining these results is the high burden of labour taxation compared to capital taxation, leading many taxpayers to use loopholes and alternatives to avoid labour taxation, opting for other, "friendlier" forms of taxation. Solutions to address these distortions are found in the IMF and World Bank reports (included in ***Annex II***) and in the study conducted by a group of experts in 2022, "Budget Consolidation and Increasing Tax Revenues – A Vital Necessity for Romania's Economic Stability and Security"[61].

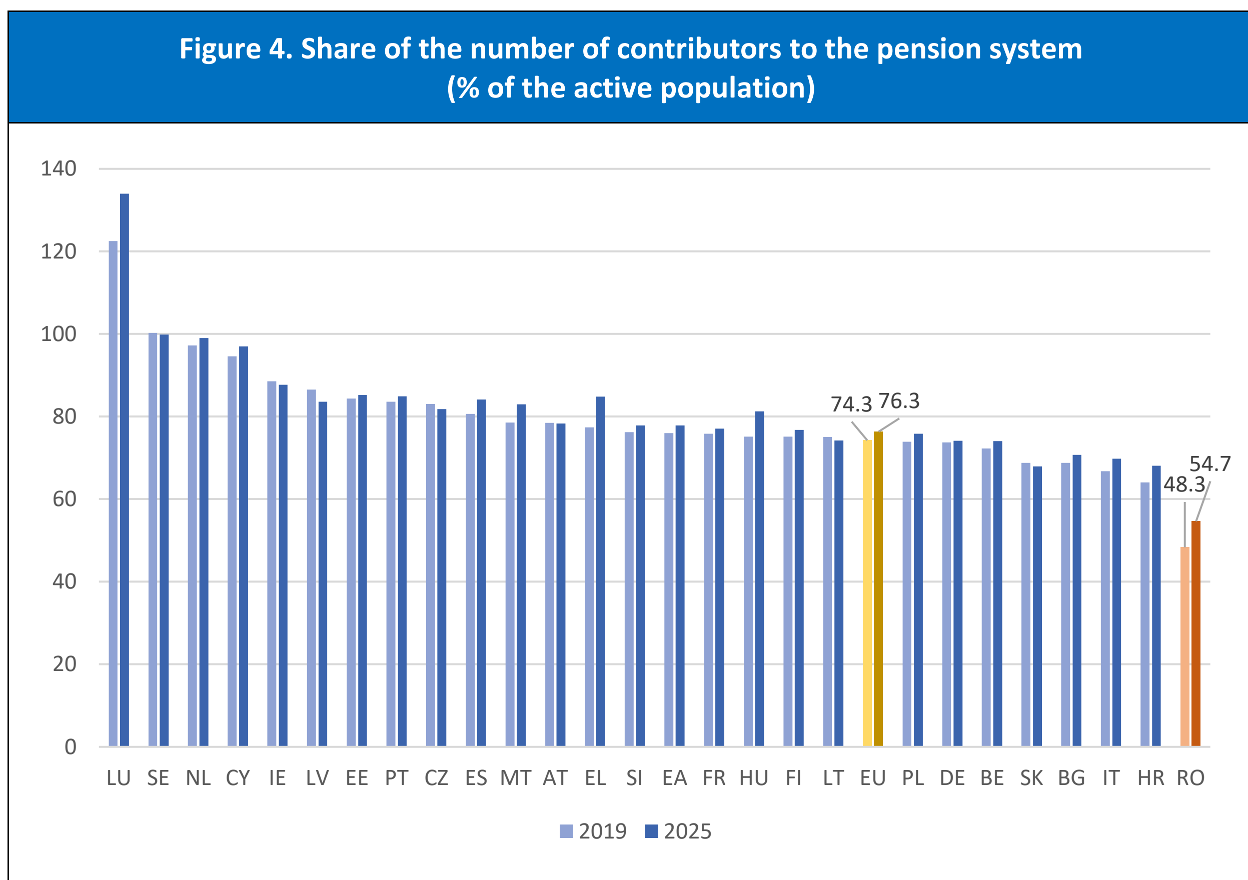


Figure 4. Share of the number of contributors to the pension system (% of the active population)

Source: *Ageing Report 2021*

For 2023, out of the total population aged 15 to 64 (*Table 4*), the active population[62] represents 66.5%, meaning that the remaining 33.5% are inactive individuals. With an unemployment rate of 5.6%, the employed population constitutes 94.4% of the active population, approximately 7.7 million people out of 8,137,273.

[60] https://economy-finance.ec.europa.eu/publications/2021-ageing-report-economic-and-budgetary-projections-eu-member-states-2019-2070_en

[61] http://www.consiliulfiscal.ro/Analiza_sistem_fiscal_RO.pdf

[62] The economically active population includes all individuals who provide available labour for the production of goods and services, including the employed population and the unemployed.

Out of the employed population, wage earners (including those working informally) number around 6.6 million. Considering that the actual number of wage earners is approximately 5.1 million, it follows that nearly 1.5 million individuals are in the underground, non-taxable economy. From the total number of wage earners, about 1.9 million are paid the minimum wage, leading to very low tax revenues.

Deducting those working in the public sector, namely public employees (paid from public funds), from the total number of wage earners, it results that approximately 3.8 million employees are in the private sector with legal forms of employment.

Table 4. Labour market in Romania, 2021-2023

	2021	2022	2023
Total population, 15-64 years old	**12,358,400**	**12,248,400**	**12,236,200**
Economically active population, 15-64 years	***8,214,682***	***8,270,813***	***8,137,273****
Employed population	*7,755,487*	*7,806,452*	*7,682,664**
Wage earners (including working off the books)	6,584,381	6,657,363	6,599,987*
Total number of wage earners	5,516,391	5,607,145	5,117,289**
- receiving the minimum wage	1,290,000	1,970,000	1,867,588
- public sector employees	1,249,912	1,268,594	1,276,748
Unemployed individuals	*459,195*	*464,360*	*454,610**
Inactive individuals	***4,143,718***	***3,977,587***	***4,098,927***
Discouraged workers	*137,209*	*140,741*	*147,712**
Inactive individuals not willing to work	*4,006,509*	*3,836,846*	*3,951,216*

Source: National Institute of Statistics (INSSE), AMECO, Ministry of Finance, Ministry of Labour and Social Solidarity, FC's calculations

**Average for the first two quarters of the year*

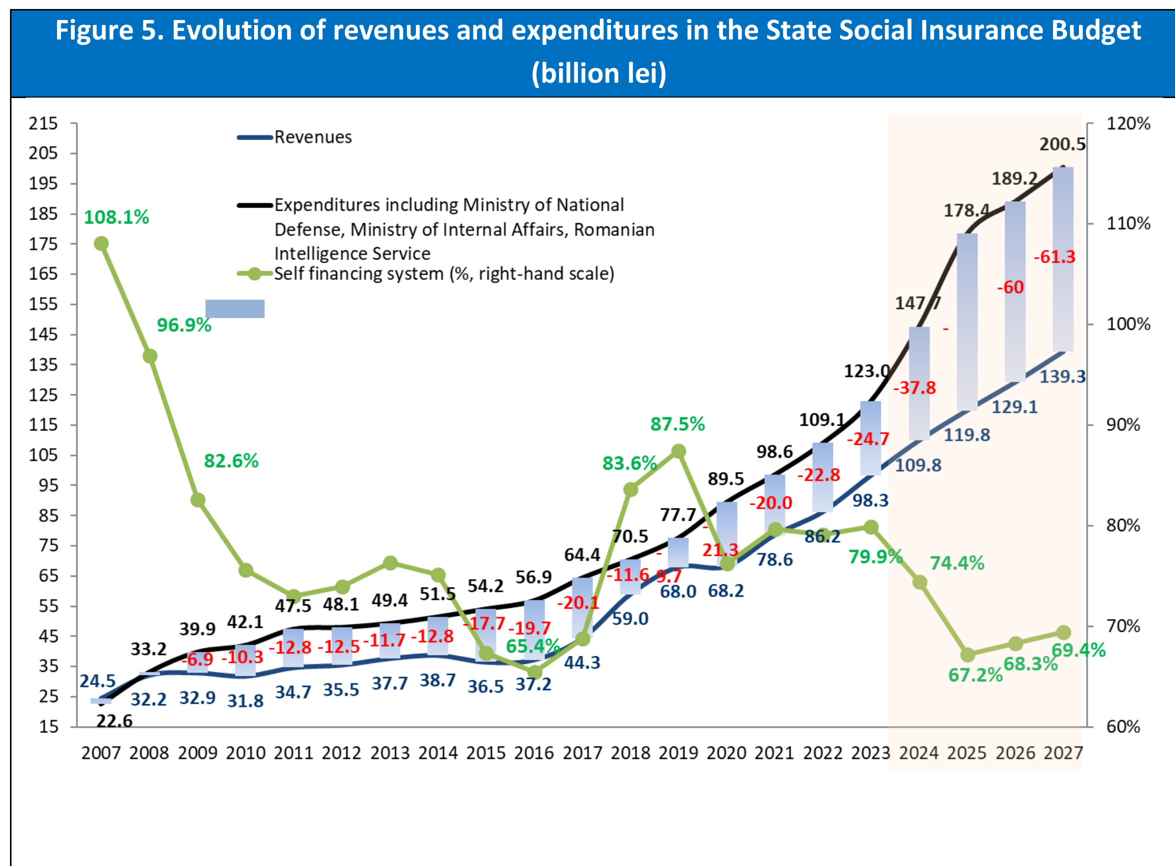
***Average January-September 2023*

The analysis of the active population becomes particularly relevant in the context of the adoption of the new pension law and the significant budgetary impact it will have in the coming years. *Figure 5* depicts the evolution of revenues and expenditures in the state social insurance budget, as well as the degree of self-financing of the public pension system (expressed as the ratio between revenues and expenditures). Although the FC acknowledges that the new pension law is necessary to correct glaring inequalities within the social assistance system, to account for the aging population, and to contribute to the sustainability of the public pension system, the increase in the deficit of the public pension system by 53.2% in 2024 and 55% in 2025, reaching 3.12% of GDP, represents a high fiscal risk.

As for the self-financing degree of the system, it is approximately 80% in 2023, but a sharp decline is projected on the forecast horizon, reaching 67.2% in 2025, a level close to the minimum recorded in 2016, which was 65.4%. In the following years, the self-financing degree of the system will marginally improve compared to 2025, reaching a value of 69.4% at the end of the forecast horizon.

Solutions to reduce the deficit in the state social insurance budget involve a fair realignment of the mix between labour and capital taxation, as well as public policies to decrease emigration, which in Romania occurs mainly in the age group of 20-40 years (+42% in 2022), of significant importance in ensuring the necessary human capital in the years to come.

Figure 5. Evolution of revenues and expenditures in the State Social Insurance Budget (billion lei)



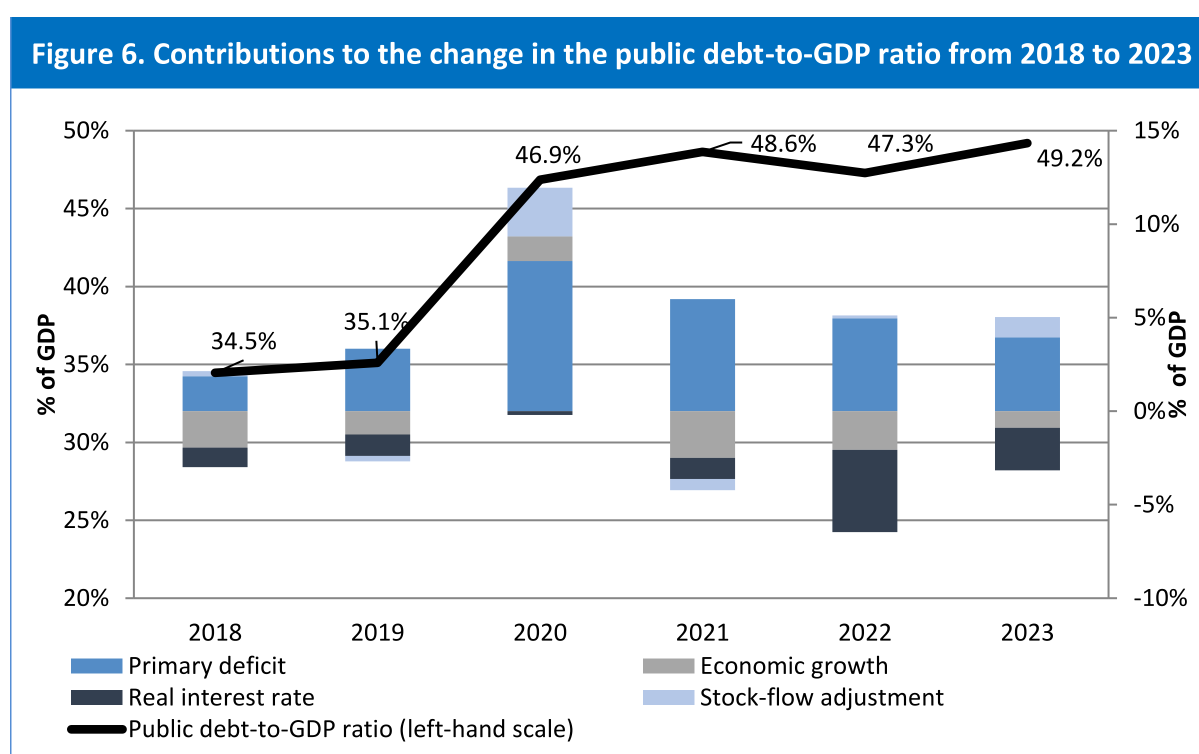
Source: Ministry of Finance (cash standards)

Note: In addition to the expenditures of the state social insurance budget, the 2016-2023 period also includes expenditures related to state military pensions. According to Law no. 223/2015, starting from January 1, 2016, the funds necessary for the payment of state military pensions and other social insurance rights due to military pensioners are ensured from the state budget through the budgets of the institutions: the Ministry of National Defence, the Ministry of Internal Affairs, and the Romanian Intelligence Service.

Annex IV – Public debt: evolution, cost, and structure

After a significant increase in public debt in 2020, by approximately 11.8 percentage points, its share fluctuated around 48% of GDP (*Figure 6*). In 2022, although the primary deficit acted significantly to increase the share of public debt in GDP (+5 pp), real economic growth (-2.1 pp, while maintaining robust economic growth) and the real interest rate (-4.4 pp, in the context of accelerated inflation) counteracted this effect. Thus, the share of public debt decreased to 47.3% of GDP. In 2023, according to estimative data, the share of public debt in GDP increased by approximately 1.9 pp, reaching the threshold of 49.2% of GDP. Similar to the previous year, the high primary deficit is the main factor that contributed to the increase in the share of public debt in GDP (+3.9 pp), while the real interest rate (-2.3 pp) and economic growth (-0.9 pp) mitigated this effect.

Figure 6. Contributions to the change in the public debt-to-GDP ratio from 2018 to 2023



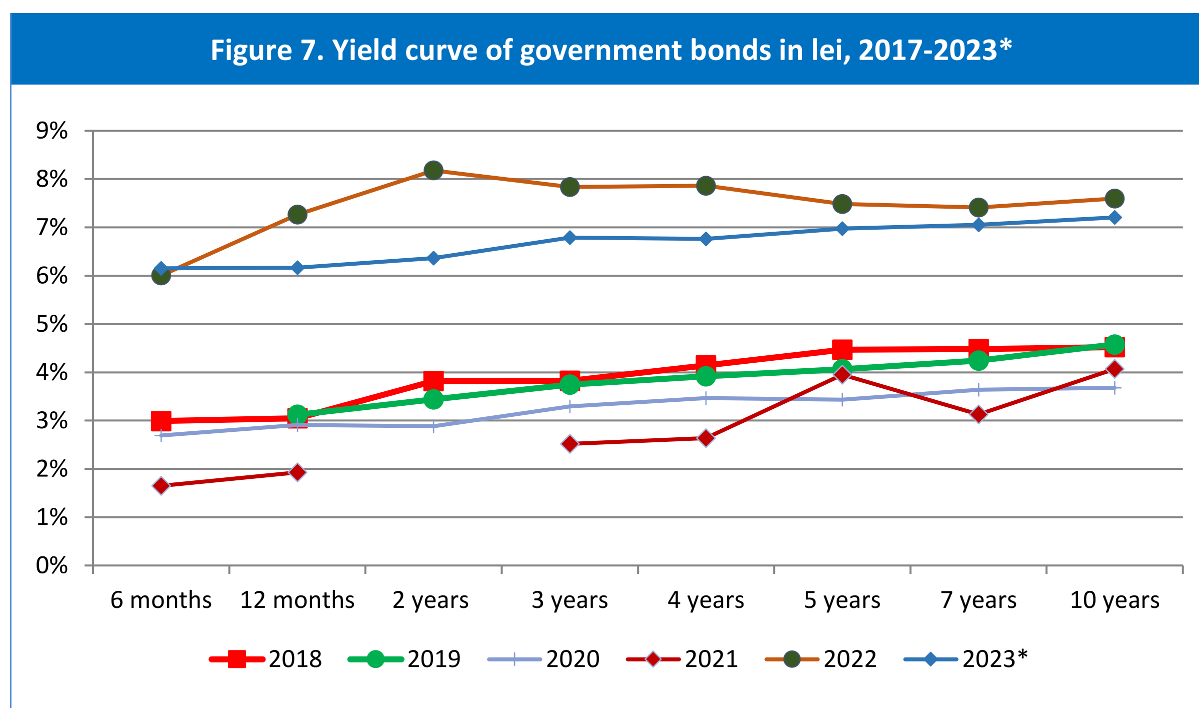
Source: Eurostat, FC's calculations

In the event that budget deficit targets for the 2024-2027 period remain elevated, and the favourable differential between the real economic growth rate and the financing cost, represented by the real interest rate, diminishes, it is expected that the share of public debt in GDP will maintain its upward trend and exceed the 50% of GDP level in the coming years.

The increase in the share of public debt in GDP was negatively influenced by the high financing cost in both domestic and foreign currency in 2022 and 2023. The decreasing trend of sovereign yields, observed in 2020 and 2021, was strongly reversed in 2022, with the average cost of attracting new loans in domestic currency increasing by around 5 pp for maturities up to 4 years and by about 3.5 pp for 5 and 10-year maturities, compared to the previous year (*Figure 7*). The evolution of the cost of attracting new loans in domestic currency was

significantly influenced by the rapid increase in the inflation rate and its persistence, as well as by high geopolitical uncertainty. In 2023, there was a minor decrease in yields, driven by the moderation of inflation increases and the central bank's conclusion of the reference interest rate hiking cycle. Thus, yields decreased by approximately 1 pp for maturities up to 4 years and by about 0.5 pp for 5 and 10-year maturities. In 2024, if the inflation rate continues its downward trend, it is possible that the declining trend in sovereign yields will continue.

Figure 7. Yield curve of government bonds in lei, 2017-2023*



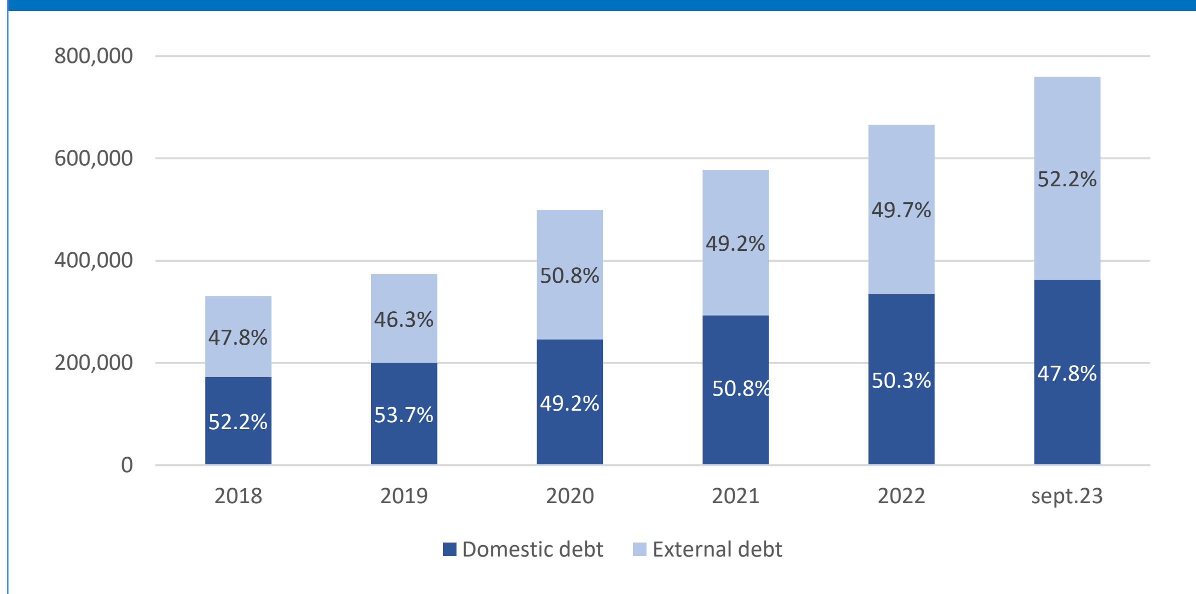
*Source: National Bank of Romania (*December 14, 2023)*

In 2023, the cost of issuing debt on foreign markets showed an upward trend compared to 2022. In 2022, three issuances in dollars were launched, with a cumulative value of $4.3 billion and maturities at 5, 10, and 30 years. The yield of the 10-year maturity issuance was about 3.5 pp higher than the 2022 issuance, i.e., 7.2% in 2023 and 3.7% in 2022. In euros, two issuances with a cumulative value of 3.35 billion euros were launched, with maturities at 5 and 10 years. The yield of the 10-year maturity issuance was approximately 6.5%.

The evolution of the debt cost also influenced the debt service. Thus, the decline in sovereign yields in 2020 and 2021 led to a decrease in the share of debt service in total debt from 15.9% in 2019 to 12.5% in 2021. However, in 2022, the share of debt service increased by about 4.1 pp compared to the previous year, reaching approximately 16.6%. In September 2023, the data shows a debt service share of about 13.8% of total debt, a decrease compared to the previous year.

The debt structure, according to the EU methodology, shows balanced weights for internal and external debt from 2018 to 2023 (*Figure 8*). Thus, the share of internal debt in total debt varied between 46% (in 2019) and 52% (in September 2023), and the share of external debt reflected the inverse, ranging between 54% (in 2019) and 48% (in September 2023).

Figure 8. Share of domestic and external debt in total government debt (million lei, according to EU methodology)



Source: Ministry of Finance

In recent years, the gross financing needs, consisting of the level of the budget deficit, refinancing, and capital repayments, exceeded 10% of GDP. In 2020, it increased by approximately 5.5 pp (from 8.6% of GDP in 2019 to 14.1% of GDP in 2020). The increase was mainly due to a 5 pp increase in the budget deficit, while the share of refinancing and capital repayments increased by 0.5 pp (from 4% to 4.5%). In the following two years, the share of financing needs in GDP followed a downward trend, reaching 11.1% of GDP (2021) and 10.7% of GDP (2022). The downward dynamics were driven by a decrease in the budget deficit (5.7% in 2022), while the share of refinancing and capital repayments in GDP rose slightly to 4.9%. Preliminary data for 2023 indicates a reversal of the trend in the last two years, with an increase in financing needs to approximately 11.7% of GDP, equivalent to around 186 billion lei (5.9% of GDP representing the deficit share and 5.8% representing the share of refinancing and capital repayments). In 2023, the difference between the budget deficit and execution led to two revisions of the financing needs throughout the year, from 160 to 180 billion and from 180 to 200 billion lei.

Table 5. Country ratings for Romania and countries in the region according to major rating agencies

Agency/Country	Fitch		Moody's		Standard & Poors	
	Rating	Year	Rating	Year	Rating	Year
RO	BBB-	2011	Baa3	2006	BBB-	2014
BG	BBB	2017	Baa1	2020	BBB	2019
CZ	AA-	2018	Aa3	2019	AA-	2011
HU	BBB	2019	Baa3	2016	BBB	2019
PL	A-	2007	A2	2002	A-	2018

Source: CIA, The World Factbook (https://www.cia.gov/the-world-factbook/field/credit-ratings/)

Annex V	MF projections 2023	Initial budget 2024	Initial budget 2024 - MF projections 2023	Initial budget 2024 - MF projections 2023 (%)	Initial budget 2024 (% of GDP)	MF projections 2023 (% of GDP)	Initial budget 2024 - MF projections 2023 (% of GDP)
	1	2	3 = 2- 1	4 = 3/1	5	6	7 = 5-6
TOTAL REVENUE	**520,773.05**	**586,130.60**	**65,357.55**	**12.55%**	**33.81%**	**32.89%**	**0.92%**
Current revenue	449,745.85	505,180.62	55,434.76	12.33%	29.14%	28.40%	0.74%
Tax revenue	248,384.31	276,389.78	28,005.47	11.28%	15.94%	15.69%	0.26%
Taxes on profit, wages, income and capital gains	74,234.74	88,633.82	14,399.08	19.40%	5.11%	4.69%	0.42%
Corporate income tax	29,304.24	35,344.05	6,039.81	20.61%	2.04%	1.85%	0.19%
Personal income tax	39,591.40	46,061.65	6,470.25	16.34%	2.66%	2.50%	0.16%
Other taxes on income, profit and capital gains	5,339.10	7,228.12	1,889.02	35.38%	0.42%	0.34%	0.08%
Property tax	7,239.30	8,290.70	1,051.40	14.52%	0.48%	0.46%	0.02%
Taxes on goods and services	163,882.09	176,159.82	12,277.72	7.49%	10.16%	10.35%	-0.19%
VAT	103,571.40	119,407.05	15,835.65	15.29%	6.89%	6.54%	0.35%
Excises	36,301.09	40,765.33	4,464.24	12.30%	2.35%	2.29%	0.06%
Other taxes on goods and services	16,776.40	8,009.50	-8,766.90	-52.26%	0.46%	1.06%	-0.60%
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	7,233.20	7,977.94	744.74	10.30%	0.46%	0.46%	0.00%
Taxes on foreign trade and international transactions (customs duty)	1,695.98	1,835.05	139.08	8.20%	0.11%	0.11%	0.00%
Other tax revenue	1,332.20	1,470.39	138.19	10.37%	0.08%	0.08%	0.00%
Social security contributions	158,342.31	183,065.82	24,723.51	15.61%	10.56%	10.00%	0.56%
Nontax revenue	43,019.23	45,725.01	2,705.78	6.29%	2.64%	2.72%	-0.08%
Additional revenues collected from digitization		10,500.00	10,500.00		0.61%	0.00%	0.61%
Capital revenue	1,354.20	1,434.03	79.83	5.89%	0.08%	0.09%	0.00%
Grants	11.16	10.30	-0.86	-7.67%	0.00%	0.00%	0.00%
Amounts received from the EU on account of payments made 2021-2027	10,132.11	33,198.23	23,066.12	227.65%	1.91%	0.64%	1.27%
Amounts collected in the single account, at the state budget			0.00		0.00%	0.00%	0.00%
Other funds from the EU		0.55	0.55		0.00%	0.00%	0.00%

Amounts received from the EU/other donors in the account of payments made and pre-financing for 2014-2020 financial framework	56,216.06	10,694.42	-45,521.64	-80.98%	0.62%	3.55%	-2.93%
Amounts related to the non-reimbursable financial assistance allocated to NRRP	3,313.67	25,112.46	21,798.79	657.85%	1.45%	0.21%	1.24%
TOTAL EXPENDITURE	**614,812.29**	**672,765.69**	**57,953.39**	**9.43%**	**38.80%**	**38.83%**	**-0.02%**
Current expenditure	575,345.07	630,888.63	55,543.55	9.65%	36.39%	36.33%	0.05%
Personnel	131,267.39	146,208.44	14,941.05	11.38%	8.43%	8.29%	0.14%
Goods and services	77,462.47	81,569.25	4,106.78	5.30%	4.70%	4.89%	-0.19%
Interest	31,809.10	34,837.81	3,028.71	9.52%	2.01%	2.01%	0.00%
Subsidies	17,684.32	12,750.31	-4,934.00	-27.90%	0.74%	1.12%	-0.38%
Total Transfers	316,151.31	351,394.31	35,243.00	11.15%	20.27%	19.97%	0.30%
Transfers for public entities	3,037.47	3,728.61	691.14	22.75%	0.22%	0.19%	0.02%
Other transfers	30,514.27	29,586.5455	-927.72	-3.04%	1.71%	1.93%	-0.22%
Projects funded by external post accession grants	12,622.68	37,913.40	25,290.72	200.36%	2.19%	0.80%	1.39%
Social assistance	189,777.91	209,545.96	19,768.05	10.42%	12.09%	11.98%	0.10%
Projects funded by 2014-2020 external post accession grants	61,628.61	14,728.69	-46,899.93	-76.10%	0.85%	3.89%	-3.04%
Other expenditure	11,243.87	14,505.18	3,261.31	29.01%	0.84%	0.71%	0.13%
Projects with financing from the amounts representing the non-reimbursable financial assistance related to NRRP	4,075.92	33,053.93	28,978.01	710.96%	1.91%	0.26%	1.65%
Projects financed from the amounts related to the loan component of NRRP	3,250.59	8,332.00	5,081.41	156.32%	0.48%	0.21%	0.28%
Reserve funds		3,000.00	3,000.00	#DIV/0!	0.17%	0.00%	0.17%
Expenditure funded from reimbursable funds	970.48	1,128.50	158.02	16.28%	0.07%	0.06%	0.00%
Capital expenditures	39,467.22	41,877.06	2,409.84	6.11%	2.42%	2.49%	-0.08%
Payments made in previous years and recovered in the current year			0.00	#DIV/0!	0.00%	0.00%	0.00%
EXCEDENT(+) / DEFICIT(-)	**-94,039.24**	**-86,635.09**	**7,404.16**	**-7.87%**	**-5.00%**	**-5.94%**	**0.94%**

Source: MF

Annex VI	FS projection 2024 (mil. lei)	FS projection 2025 (mil. lei)	FS projection 2025 - FS projection 2024 (mil. lei)	FS projection 2025 - FS projection 2024 (%)	FS projection 2024 (% of GDP)	FS projection 2025 (% of GDP)	FS projection 2025 - FS projection 2024 (% of GDP)
	1	2	3=2-1	4=3/1	5	6	7=6-5
TOTAL REVENUE	**586,130.6**	**612,527.1**	**26,396.5**	**4.5%**	**33.8%**	**32.6%**	**-1.24%**
Current revenue	**505,180.6**	**549,382.5**	**44,201.9**	**8.7%**	**29.1%**	**29.2%**	**0.08%**
Tax revenue	**276,389.8**	**299,945.1**	**23,555.3**	**8.5%**	**15.9%**	**15.9%**	**0.01%**
Taxes on profit, wages, income and capital gains	**88,633.8**	**96,313.2**	**7,679.3**	**8.7%**	**5.1%**	**5.1%**	**0.01%**
Corporate income tax	35,344.1	37,960.2	2,616.2	7.4%	2.0%	2.0%	-0.02%
Personal income tax	46,061.7	50,721.3	4,659.6	10.1%	2.7%	2.7%	0.04%
Other taxes on income, profit and capital gains	7,228.1	7,631.7	403.6	5.6%	0.4%	0.4%	-0.01%
Property tax	**8,290.7**	**9,109.8**	**819.1**	**9.9%**	**0.5%**	**0.5%**	**0.01%**
Taxes on goods and services	**176,159.8**	**191,012.4**	**14,852.6**	**8.4%**	**10.2%**	**10.2%**	**0.00%**
VAT	119,407.1	129,546.2	10,139.2	8.5%	6.9%	6.9%	0.00%
Excises	40,765.3	44,222.9	3,457.5	8.5%	2.4%	2.4%	0.00%
Other taxes on goods and services	8,009.5	8,601.9	592.4	7.4%	0.5%	0.5%	0.00%
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	7,977.9	8,641.4	663.4	8.3%	0.5%	0.5%	0.00%
Taxes on foreign trade and international transactions (customs duty)	**1,835.1**	**1,990.4**	**155.4**	**8.5%**	**0.1%**	**0.1%**	**0.00%**
Other tax revenue	**1,470.4**	**1,519.3**	**48.9**	**3.3%**	**0.1%**	**0.1%**	**0.00%**
Social security contributions	**183,065.8**	**200,332.2**	**17,266.4**	**9.4%**	**10.6%**	**10.7%**	**0.09%**
Nontax revenue	**45,725.0**	**49,105.3**	**3,380.3**	**7.4%**	**2.6%**	**2.6%**	**-0.03%**
Additional revenues collected from digitization	**10,500.0**	**10,500.0**	**0.0**	**0.0%**	**0.6%**	**0.6%**	**-0.05%**
Capital revenue	**1,434.0**	**1,486.8**	**52.8**	**3.7%**	**0.1%**	**0.1%**	**0.00%**
Grants	**10.3**	**1.8**	**-8.5**	**-82.3%**	**0.0%**	**0.0%**	**0.00%**
Amounts received from the EU on account of payments made 2021-2027	**33,198.2**	**33,463.7**	**265.5**	**0.8%**	**1.9%**	**1.8%**	**-0.14%**
Financial operations	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
Amounts collected in the single account, at the state budget	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
Other funds from the EU	**0.6**	**0.0**	**-0.6**	**0.0%**	**0.0%**	**0.0%**	**0.00%**

Amounts received from the EU/other donors in the account of payments made and pre-financing for 2014-2020 financial framework	**10,694.4**	**3,996.9**	**-6,697.5**	**-62.6%**	**0.6%**	**0.2%**	**-0.40%**
Amounts related to the non-reimbursable financial assistance allocated to NRRP	**25,112.5**	**13,695.4**	**-11,417.1**	**-45.5%**	**1.4%**	**0.7%**	**-0.72%**
TOTAL EXPENDITURE	**672,765.7**	**701,706.3**	**28,940.6**	**4.3%**	**38.8%**	**37.3%**	**-1.49%**
Current expenditure	**630,888.6**	**660,580.5**	**29,691.9**	**4.7%**	**36.4%**	**35.1%**	**-1.26%**
Personnel	146,208.4	150,850.3	4,641.8	3.2%	8.4%	8.0%	-0.41%
Goods and services	81,569.3	83,876.4	2,307.2	2.8%	4.7%	4.5%	-0.24%
Interest	34,837.8	36,022.6	1,184.8	3.4%	2.0%	1.9%	-0.09%
Subsidies	12,750.3	13,075.6	325.3	2.6%	0.7%	0.7%	-0.04%
Total Transfers	**351,394.3**	**375,219.1**	**23,824.8**	**6.8%**	**20.3%**	**20.0%**	**-0.32%**
Transfers for public entities	3,728.6	3,481.1	-247.5	-6.6%	0.2%	0.2%	-0.03%
Other transfers	29,586.5	29,633.5	46.9	0.2%	1.7%	1.6%	-0.13%
Projects funded by external post accession grants	37,913.4	39,180.3	1,266.9	3.3%	2.2%	2.1%	-0.10%
Social assistance	209,546.0	244,525.9	34,979.9	16.7%	12.1%	13.0%	0.92%
Projects funded by 2014-2020 external post accession grants	14,728.7	5,660.0	-9,068.7	-61.6%	0.8%	0.3%	-0.55%
Other expenditure	14,505.2	14,954.1	449.0	3.1%	0.8%	0.8%	-0.04%
Projects with financing from the amounts representing the non-reimbursable financial assistance related to NRRP	33,053.9	22,254.2	-10,799.8	-32.7%	1.9%	1.2%	-0.72%
Projects financed from the amounts related to the loan component of NRRP	8,332.0	15,530.0	7,198.0	86.4%	0.5%	0.8%	0.35%
Reserve funds	**3,000.0**	**500.0**	**-2,500.0**	**-83.3%**	**0.2%**	**0.0%**	**-0.15%**
Expenditure funded from reimbursable funds	**1,128.5**	**1,036.6**	**-91.9**	**-8.1%**	**0.1%**	**0.1%**	**-0.01%**
Capital expenditures	**41,877.1**	**41,125.7**	**-751.3**	**-1.8%**	**2.4%**	**2.2%**	**-0.23%**
Financial operations	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
Payments made in previous years and recovered in the current year	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
EXCEDENT(+) / DEFICIT(-)	**-86,635.1**	**-89,179.1**	**-2,544.1**	**2.9%**	**-5.0%**	**-4.7%**	**0.25%**

Source: MF

Annex VII	**FS projection 2025 (mil. lei)**	**FS projection 2026 (mil. lei)**	**FS projection 2026 - FS projection 2025 (mil. lei)**	**FS projection 2026 - FS projection 2025 (%)**	**FS projection 2025 (% of GDP)**	**FS projection 2026 (% of GDP)**	**FS projection 2026 - FS projection 2025 (% of GDP)**
	1	**2**	**3=2-1**	**4=3/1**	**5**	**6**	**7=6-5**
TOTAL REVENUE	**612,527.1**	**661,052.1**	**48,525.0**	**7.9%**	**32.6%**	**32.5%**	**-0.04%**
Current revenue	**549,382.5**	**598,910.8**	**49,528.3**	**9.0%**	**29.2%**	**29.5%**	**0.26%**
Tax revenue	**299,945.1**	**324,232.1**	**24,287.0**	**8.1%**	**15.9%**	**16.0%**	**0.00%**
Taxes on profit, wages, income and capital gains	**96,313.2**	**104,544.6**	**8,231.5**	**8.5%**	**5.1%**	**5.1%**	**0.02%**
Corporate income tax	37,960.2	41,192.6	3,232.4	8.5%	2.0%	2.0%	0.01%
Personal income tax	50,721.3	55,369.3	4,648.0	9.2%	2.7%	2.7%	0.03%
Other taxes on income, profit and capital gains	7,631.7	7,982.8	351.1	4.6%	0.4%	0.4%	-0.01%
Property tax	**9,109.8**	**10,067.5**	**957.7**	**10.5%**	**0.5%**	**0.5%**	**0.01%**
Taxes on goods and services	**191,012.4**	**205,897.5**	**14,885.2**	**7.8%**	**10.2%**	**10.1%**	**-0.03%**
VAT	129,546.2	139,738.1	10,191.8	7.9%	6.9%	6.9%	-0.01%
Excises	44,222.9	47,997.3	3,774.5	8.5%	2.4%	2.4%	0.01%
Other taxes on goods and services	8,601.9	8,871.4	269.6	3.1%	0.5%	0.4%	-0.02%
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	8,641.4	9,290.7	649.3	7.5%	0.5%	0.5%	0.00%
Taxes on foreign trade and international transactions (customs duty)	**1,990.4**	**2,151.0**	**160.6**	**8.1%**	**0.1%**	**0.1%**	**0.00%**
Other tax revenue	**1,519.3**	**1,571.4**	**52.1**	**3.4%**	**0.1%**	**0.1%**	**0.00%**
Social security contributions	**200,332.2**	**216,282.3**	**15,950.1**	**8.0%**	**10.7%**	**10.6%**	**-0.01%**
Nontax revenue	**49,105.3**	**58,396.5**	**9,291.2**	**18.9%**	**2.6%**	**2.9%**	**0.26%**
Additional revenues collected from digitization	**10,500.0**	**10,500.0**	**0.0**	**0.0%**	**0.6%**	**0.5%**	**-0.04%**
Capital revenue	**1,486.8**	**1,545.0**	**58.2**	**3.9%**	**0.1%**	**0.1%**	**0.00%**
Grants	**1.8**	**1.8**	**0.0**	**1.0%**	**0.0%**	**0.0%**	**0.00%**
Amounts received from the EU on account of payments made 2021-2027	**33,463.7**	**37,499.2**	**4,035.5**	**12.1%**	**1.8%**	**1.8%**	**0.07%**
Financial operations	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
Amounts collected in the single account, at the state budget	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
Other funds from the EU	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**

Amounts received from the EU/other donors in the account of payments made and pre-financing for 2014-2020 financial framework	**3,996.9**	**2.7**	**-3,994.2**	**-99.9%**	**0.2%**	**0.0%**	**-0.21%**
Amounts related to the non-reimbursable financial assistance allocated to NRRP	**13,695.4**	**12,592.6**	**-1,102.8**	**-8.1%**	**0.7%**	**0.6%**	**-0.11%**
TOTAL EXPENDITURE	**701,706.3**	**746,044.3**	**44,338.0**	**6.3%**	**37.3%**	**36.7%**	**-0.60%**
Current expenditure	**660,580.5**	**699,505.6**	**38,925.1**	**5.9%**	**35.1%**	**34.4%**	**-0.71%**
Personnel	150,850.3	156,750.5	5,900.2	3.9%	8.0%	7.7%	-0.31%
Goods and services	83,876.4	92,319.8	8,443.3	10.1%	4.5%	4.5%	0.08%
Interest	36,022.6	36,380.1	357.5	1.0%	1.9%	1.8%	-0.13%
Subsidies	13,075.6	13,245.9	170.3	1.3%	0.7%	0.7%	-0.04%
Total Transfers	**375,219.1**	**399,272.7**	**24,053.6**	**6.4%**	**20.0%**	**19.6%**	**-0.31%**
Transfers for public entities	3,481.1	3,488.8	7.7	0.2%	0.2%	0.2%	-0.01%
Other transfers	29,633.5	30,211.9	578.4	2.0%	1.6%	1.5%	-0.09%
Projects funded by external post accession grants	39,180.3	45,499.7	6,319.4	16.1%	2.1%	2.2%	0.16%
Social assistance	244,525.9	257,079.3	12,553.4	5.1%	13.0%	12.6%	-0.35%
Projects funded by 2014-2020 external post accession grants	5,660.0	31.3	-5,628.7	-99.4%	0.3%	0.0%	-0.30%
Other expenditure	14,954.1	13,716.5	-1,237.6	-8.3%	0.8%	0.7%	-0.12%
Projects with financing from the amounts representing the non-reimbursable financial assistance related to NRRP	22,254.2	22,992.1	737.9	3.3%	1.2%	1.1%	-0.05%
Projects financed from the amounts related to the loan component of NRRP	15,530.0	26,253.1	10,723.1	69.0%	0.8%	1.3%	0.47%
Reserve funds	**500.0**	**500.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
Expenditure funded from reimbursable funds	**1,036.6**	**1,036.6**	**0.0**	**0.0%**	**0.1%**	**0.1%**	**0.00%**
Capital expenditures	**41,125.7**	**46,538.7**	**5,413.0**	**13.2%**	**2.2%**	**2.3%**	**0.10%**
Financial operations	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
Payments made in previous years and recovered in the current year	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
EXCEDENT(+) / DEFICIT(-)	**-89,179.1**	**-84,992.2**	**4,186.9**	**-4.7%**	**-4.7%**	**-4.2%**	**0.56%**

Source: MF

Annex VIII	FS projection 2026 (mil. lei)	FS projection 2027 (mil. lei)	FS projection 2027 - FS projection 2026 (mil. lei)	FS projection 2027 - FS projection 2026 (%)	FS projection 2026 (% of GDP)	FS projection 2027 (% of GDP)	FS projection 2027 - FS projection 2026 (% of GDP)
	1	2	3=2-1	4=3/1	5	6	7=6-5
TOTAL REVENUE	**661,052.1**	**693,070.0**	**32,017.9**	**4.8%**	**32.5%**	**31.8%**	**-0.72%**
Current revenue	**598,910.8**	**643,657.4**	**44,746.5**	**7.5%**	**29.5%**	**29.5%**	**0.07%**
Tax revenue	**324,232.1**	**347,441.0**	**23,208.9**	**7.2%**	**16.0%**	**15.9%**	**-0.01%**
Taxes on profit, wages, income and capital gains	**104,544.6**	**112,159.1**	**7,614.5**	**7.3%**	**5.1%**	**5.1%**	**0.00%**
Corporate income tax	41,192.6	44,445.7	3,253.1	7.9%	2.0%	2.0%	0.01%
Personal income tax	55,369.3	59,403.4	4,034.1	7.3%	2.7%	2.7%	0.00%
Other taxes on income, profit and capital gains	7,982.8	8,310.1	327.3	4.1%	0.4%	0.4%	-0.01%
Property tax	**10,067.5**	**11,125.3**	**1,057.8**	**10.5%**	**0.5%**	**0.5%**	**0.02%**
Taxes on goods and services	**205,897.5**	**220,226.9**	**14,329.4**	**7.0%**	**10.1%**	**10.1%**	**-0.02%**
VAT	139,738.1	149,794.0	10,055.9	7.2%	6.9%	6.9%	0.00%
Excises	47,997.3	51,411.9	3,414.6	7.1%	2.4%	2.4%	0.00%
Other taxes on goods and services	8,871.4	9,090.8	219.3	2.5%	0.4%	0.4%	-0.02%
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	9,290.7	9,930.2	639.5	6.9%	0.5%	0.5%	0.00%
Taxes on foreign trade and international transactions (customs duty)	**2,151.0**	**2,306.3**	**155.3**	**7.2%**	**0.1%**	**0.1%**	**0.00%**
Other tax revenue	**1,571.4**	**1,623.4**	**52.0**	**3.3%**	**0.1%**	**0.1%**	**0.00%**
Social security contributions	**216,282.3**	**233,177.9**	**16,895.6**	**7.8%**	**10.6%**	**10.7%**	**0.06%**
Nontax revenue	**58,396.5**	**63,038.5**	**4,642.0**	**7.9%**	**2.9%**	**2.9%**	**0.02%**
Additional revenues collected from digitization	**10,500.0**	**10,500.0**	**0.0**	**0.0%**	**0.5%**	**0.5%**	**-0.03%**
Capital revenue	**1,545.0**	**1,601.0**	**56.0**	**3.6%**	**0.1%**	**0.1%**	**0.00%**
Grants	**1.8**	**1.6**	**-0.2**	**-10.9%**	**0.0%**	**0.0%**	**0.00%**
Amounts received from the EU on account of payments made 2021-2027	**37,499.2**	**37,308.5**	**-190.6**	**-0.5%**	**1.8%**	**1.7%**	**-0.13%**
Financial operations	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
Amounts collected in the single account, at the state budget	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
Other funds from the EU	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**

Amounts received from the EU/other donors in the account of payments made and pre-financing for 2014-2020 financial framework	**2.7**	**1.5**	**-1.2**	**-45.9%**	**0.0%**	**0.0%**	**0.00%**
Amounts related to the non-reimbursable financial assistance allocated to NRRP	**12,592.6**	**0.0**	**-12,592.6**	**-100.0%**	**0.6%**	**0.0%**	**-0.62%**
TOTAL EXPENDITURE	**746,044.3**	**755,236.5**	**9,192.2**	**1.2%**	**36.7%**	**34.7%**	**-2.05%**
Current expenditure	**699,505.6**	**686,773.5**	**-12,732.1**	**-1.8%**	**34.4%**	**31.5%**	**-2.90%**
Personnel	156,750.5	159,730.1	2,979.6	1.9%	7.7%	7.3%	-0.38%
Goods and services	92,319.8	96,250.8	3,931.1	4.3%	4.5%	4.4%	-0.13%
Interest	36,380.1	36,433.0	52.9	0.1%	1.8%	1.7%	-0.12%
Subsidies	13,245.9	13,403.1	157.2	1.2%	0.7%	0.6%	-0.04%
Total Transfers	**399,272.7**	**379,854.8**	**-19,417.9**	**-4.9%**	**19.6%**	**17.4%**	**-2.21%**
Transfers for public entities	3,488.8	3,524.3	35.5	1.0%	0.2%	0.2%	-0.01%
Other transfers	30,211.9	34,622.3	4,410.4	14.6%	1.5%	1.6%	0.10%
Projects funded by external post accession grants	45,499.7	45,332.6	-167.1	-0.4%	2.2%	2.1%	-0.16%
Social assistance	257,079.3	279,986.2	22,906.9	8.9%	12.6%	12.8%	0.20%
Projects funded by 2014-2020 external post accession grants	31.3	1.5	-29.9	-95.3%	0.0%	0.0%	0.00%
Other expenditure	13,716.5	14,911.7	1,195.2	8.7%	0.7%	0.7%	0.01%
Projects with financing from the amounts representing the non-reimbursable financial assistance related to NRRP	22,992.1	1,476.2	-21,515.9	-93.6%	1.1%	0.1%	-1.06%
Projects financed from the amounts related to the loan component of NRRP	26,253.1	0.0	-26,253.1	-100.0%	1.3%	0.0%	-1.29%
Reserve funds	**500.0**	**500.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
Expenditure funded from reimbursable funds	**1,036.6**	**601.6**	**-435.0**	**-42.0%**	**0.1%**	**0.0%**	**-0.02%**
Capital expenditures	**46,538.7**	**68,463.0**	**21,924.3**	**47.1%**	**2.3%**	**3.1%**	**0.85%**
Financial operations	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
Payments made in previous years and recovered in the current year	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.00%**
EXCEDENT(+) / DEFICIT(-)	**-84,992.2**	**-62,166.5**	**22,825.7**	**-26.9%**	**-4.2%**	**-2.9%**	**1.33%**

Source: MF

Annex IX

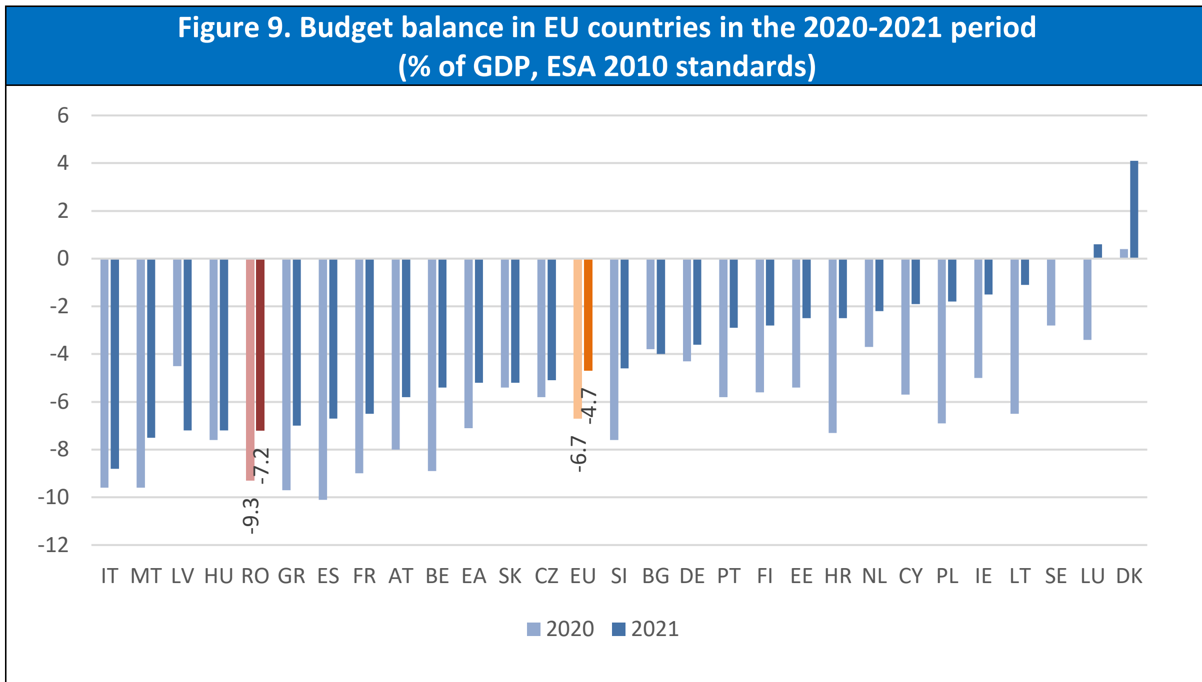


Figure 9. Budget balance in EU countries in the 2020-2021 period (% of GDP, ESA 2010 standards)

Source: AMECO

Note: In the case of Romania, the level of the budget balance is the one estimated by MF.

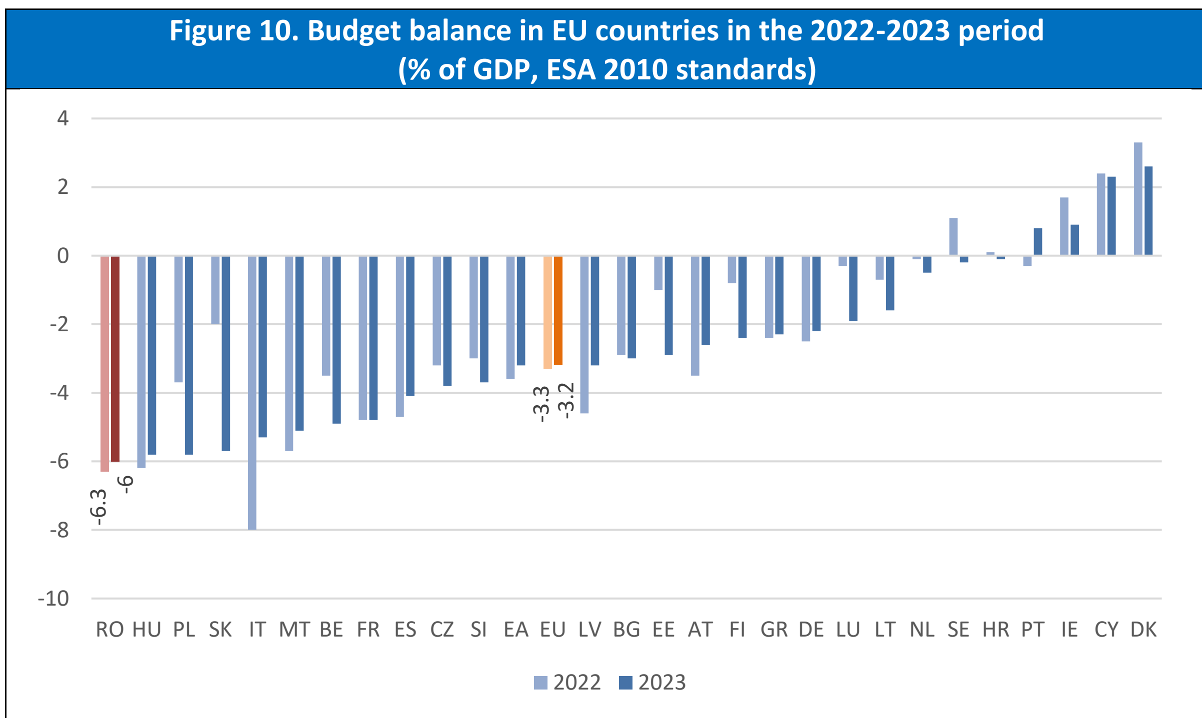
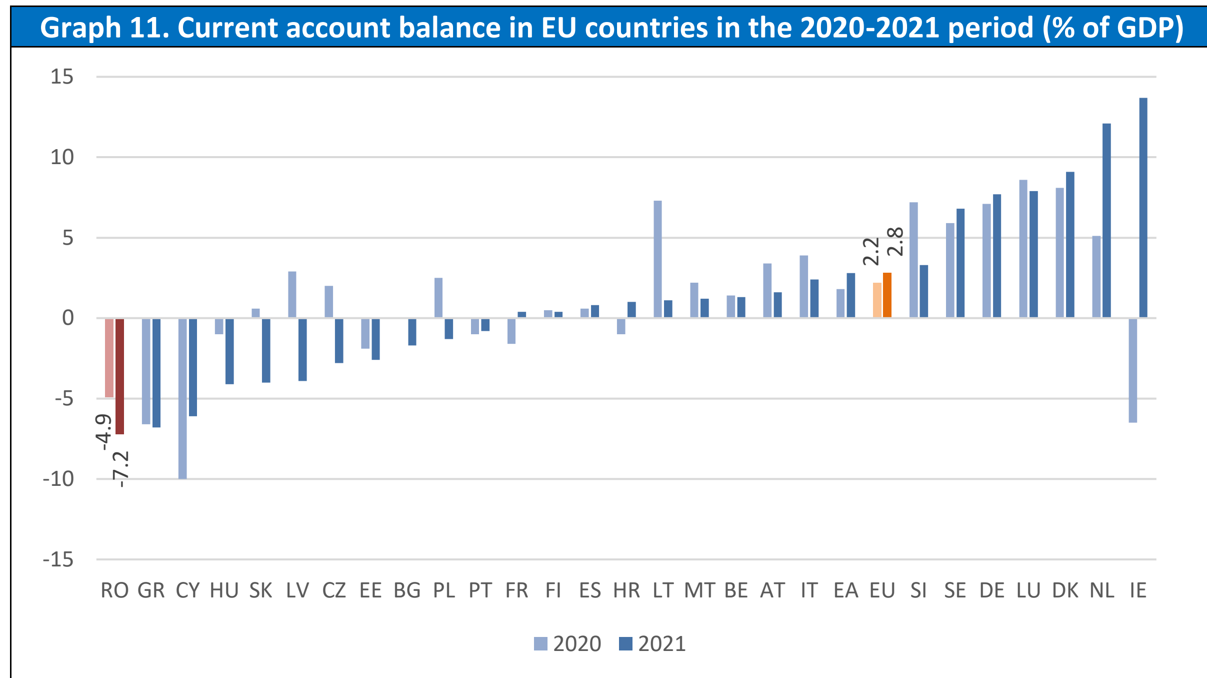


Figure 10. Budget balance in EU countries in the 2022-2023 period (% of GDP, ESA 2010 standards)

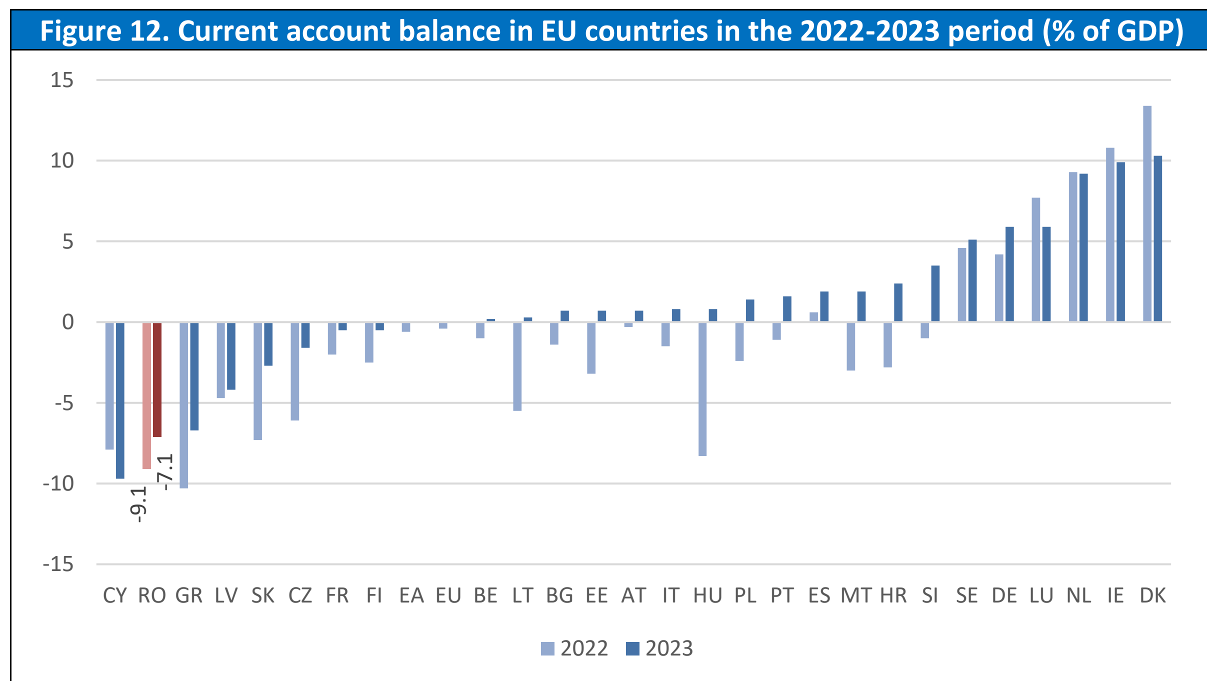
Source: AMECO

Note: In the case of Romania, the level of the budget balance is the one estimated by MF.

Annex X



Source: AMECO



Source: AMECO

Annex XI

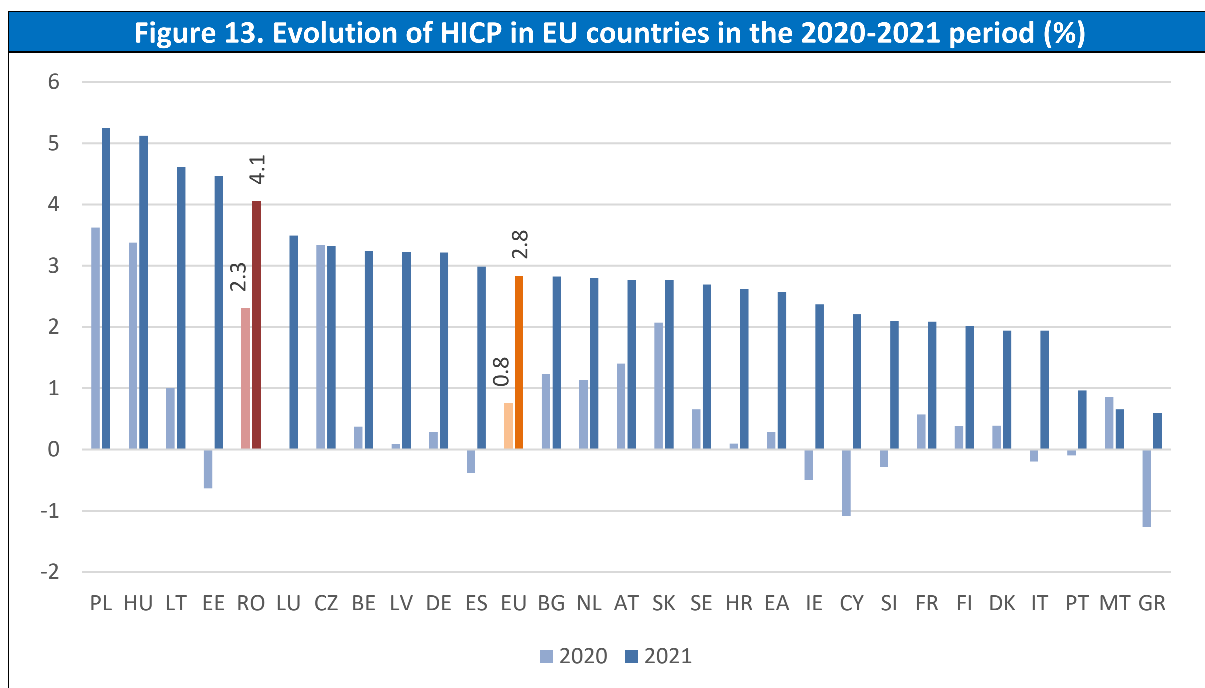


Figure 13. Evolution of HICP in EU countries in the 2020-2021 period (%)

Source: AMECO

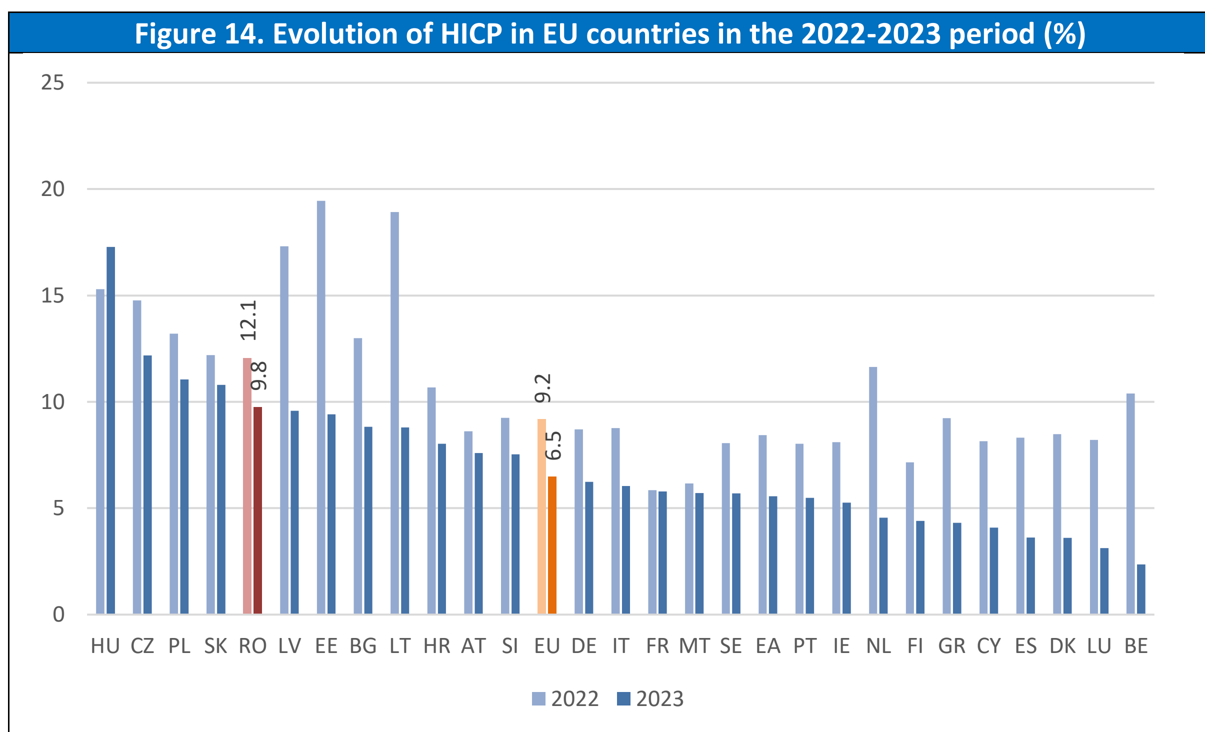


Figure 14. Evolution of HICP in EU countries in the 2022-2023 period (%)

Source: AMECO

Annex XII

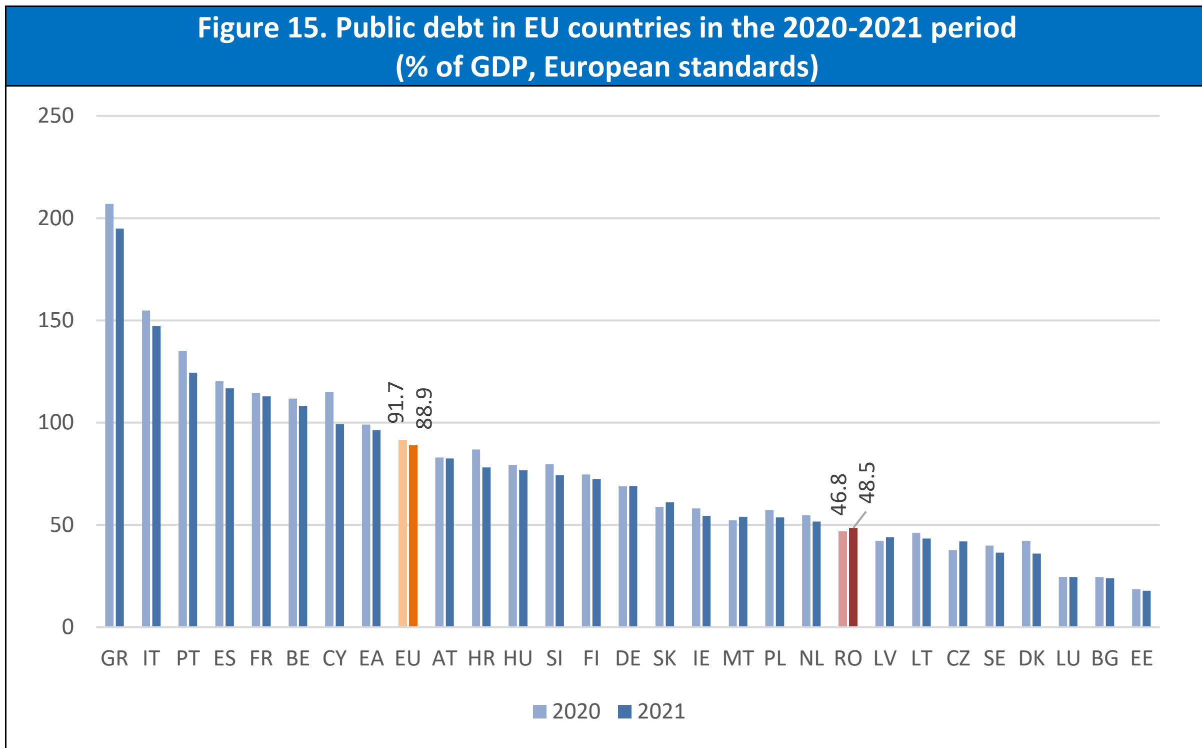


Figure 15. Public debt in EU countries in the 2020-2021 period (% of GDP, European standards)

Source: AMECO

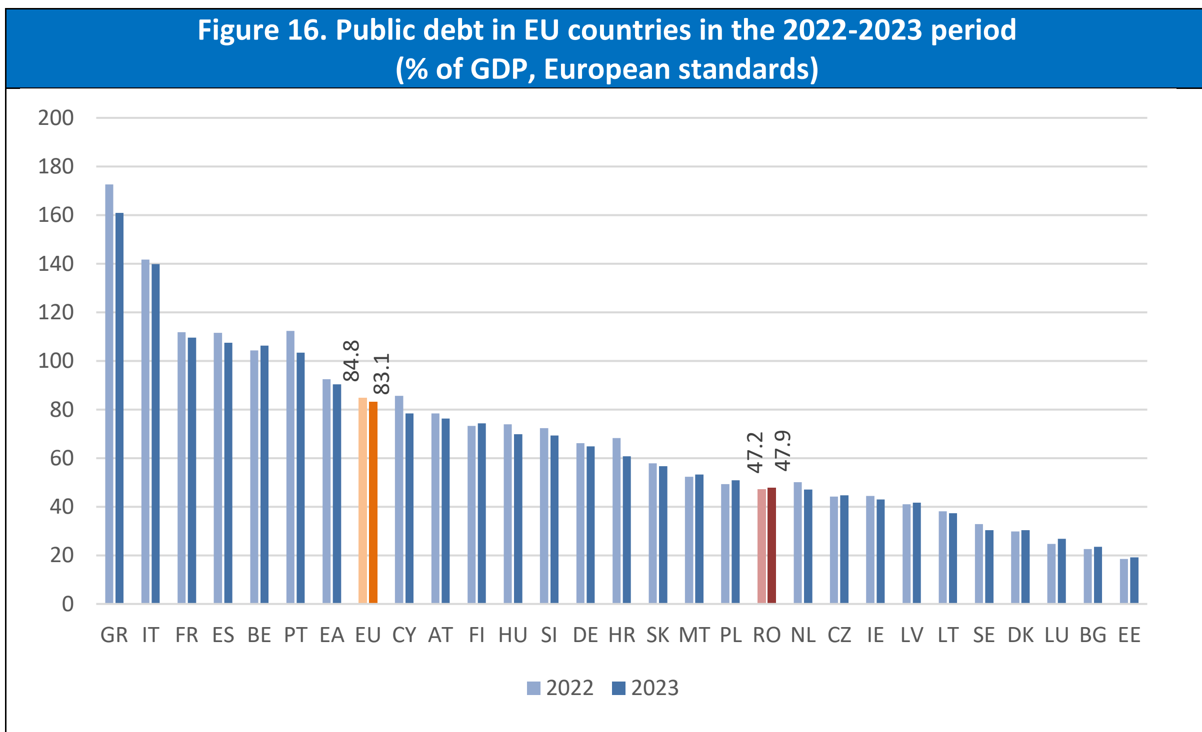
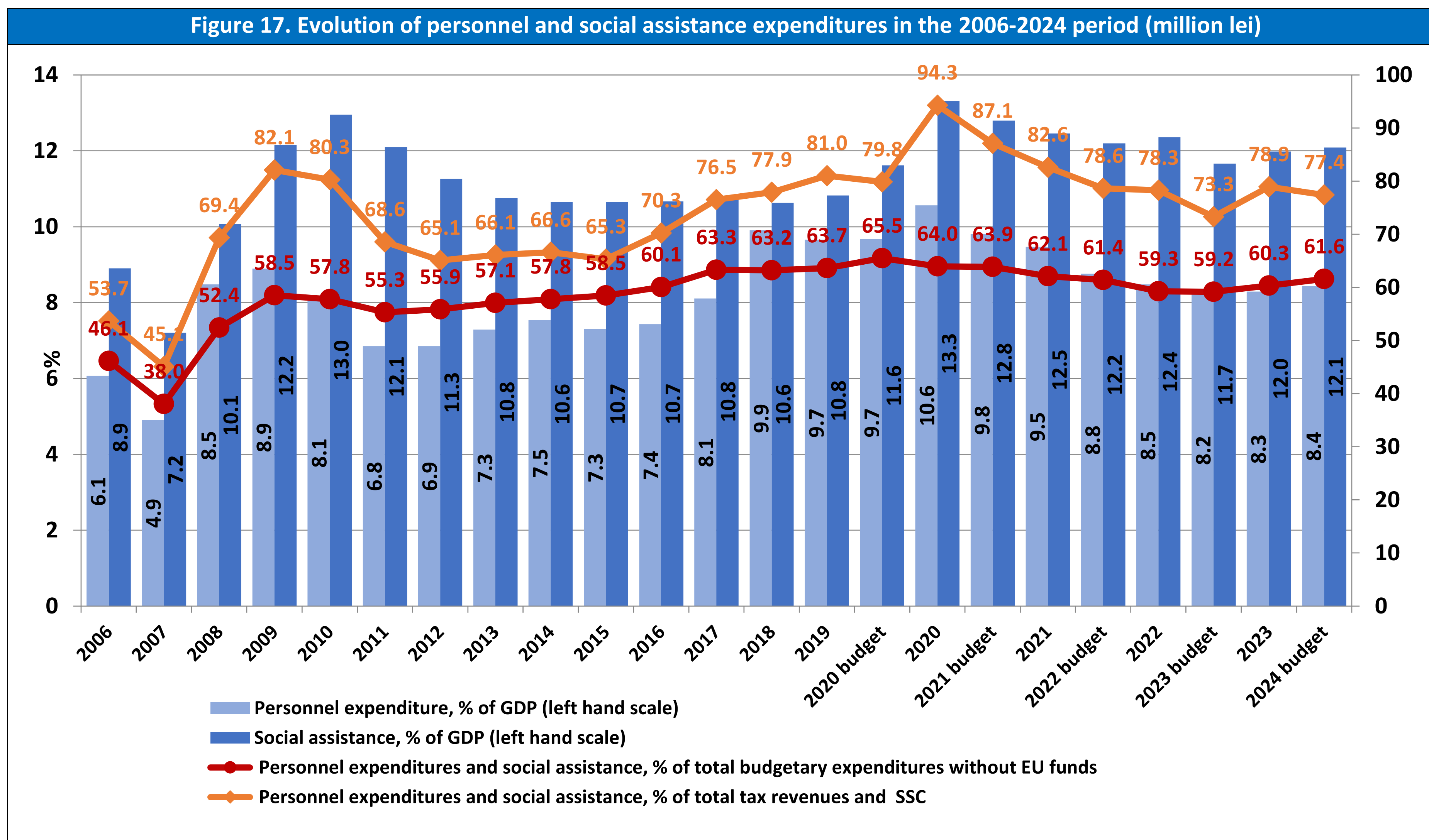


Figure 16. Public debt in EU countries in the 2022-2023 period (% of GDP, European standards)

Source: AMECO

Annex XIII



Source: MF, FC's calculations

Annex XIV

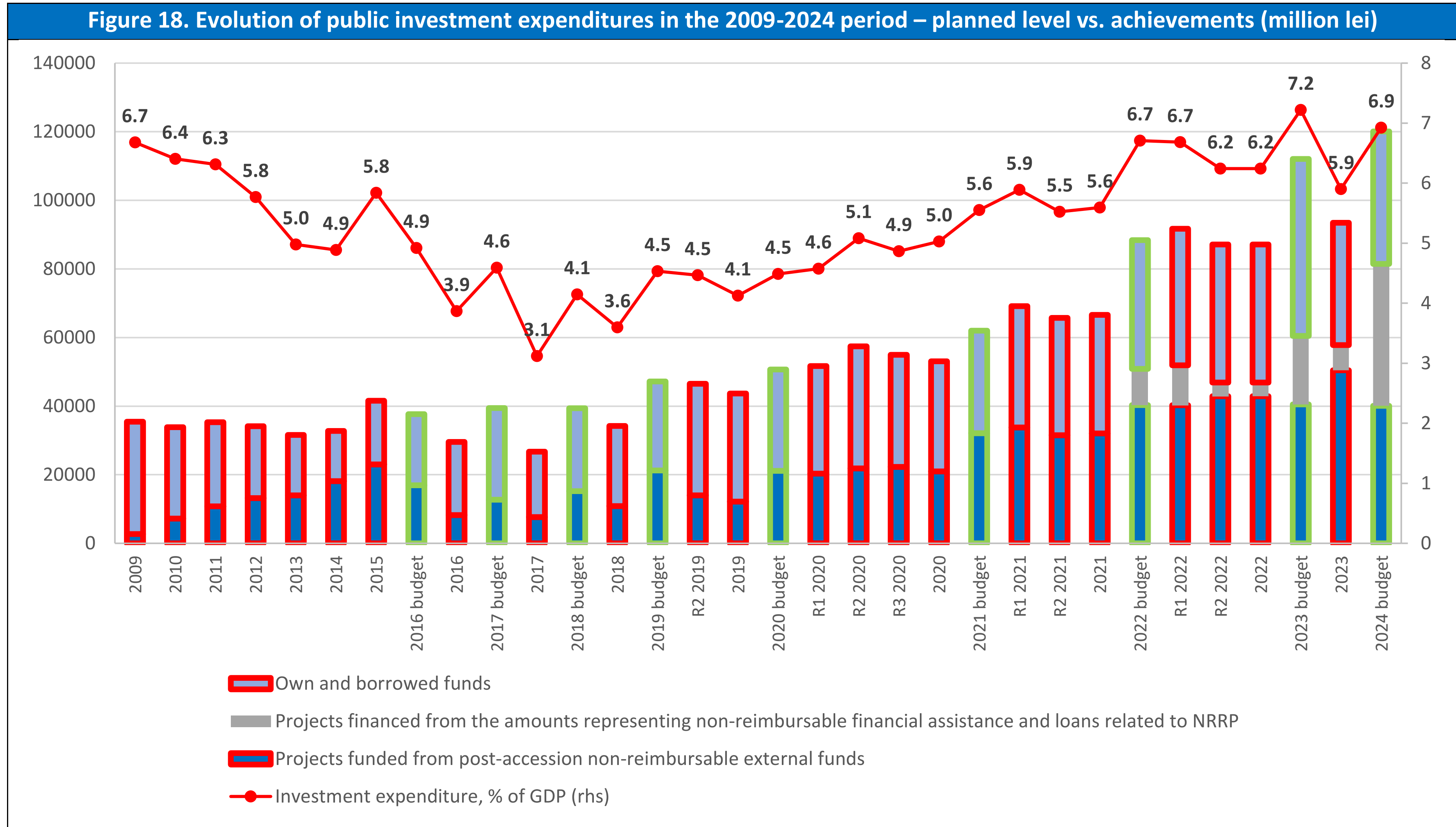


Figure 18. Evolution of public investment expenditures in the 2009-2024 period – planned level vs. achievements (million lei)

Source: MF, FC's calculation

Annex XV

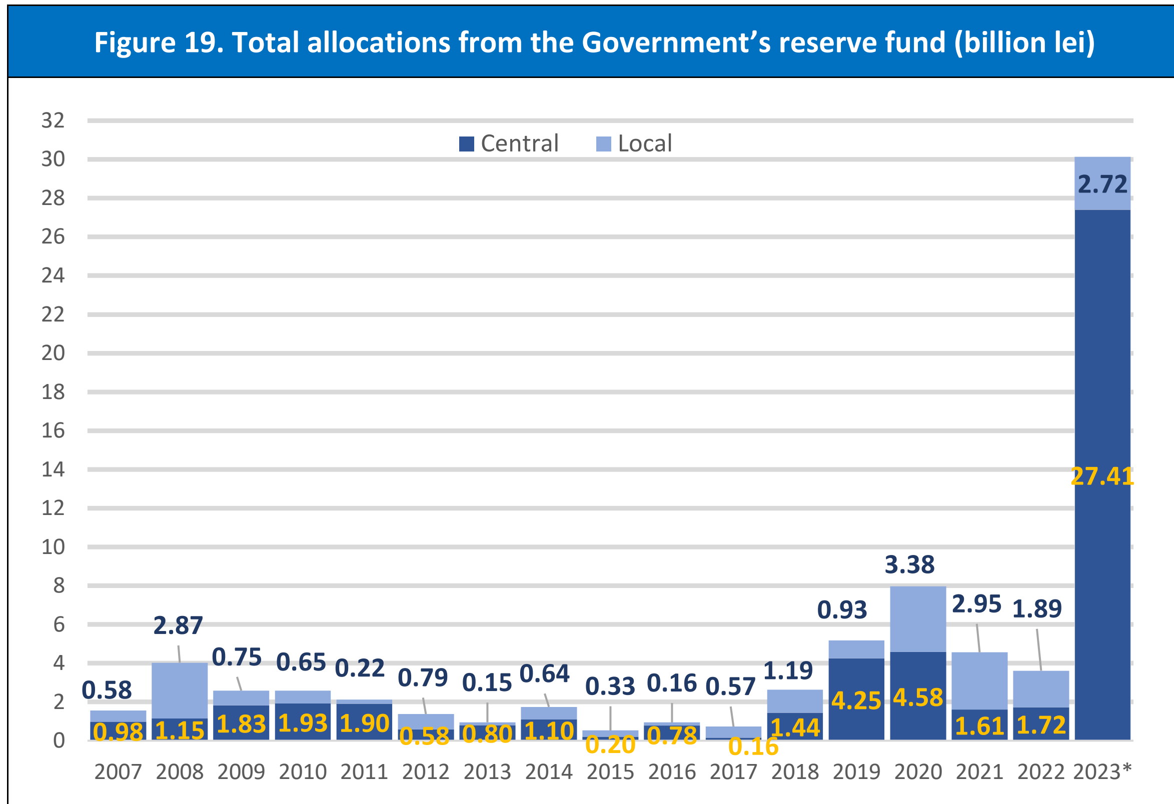


Figure 19. Total allocations from the Government's reserve fund (billion lei)

Source: FC's calculations based on Government decisions allocating funds from the reserve fund
** Government decisions from the beginning of the year until December 15, 2023*

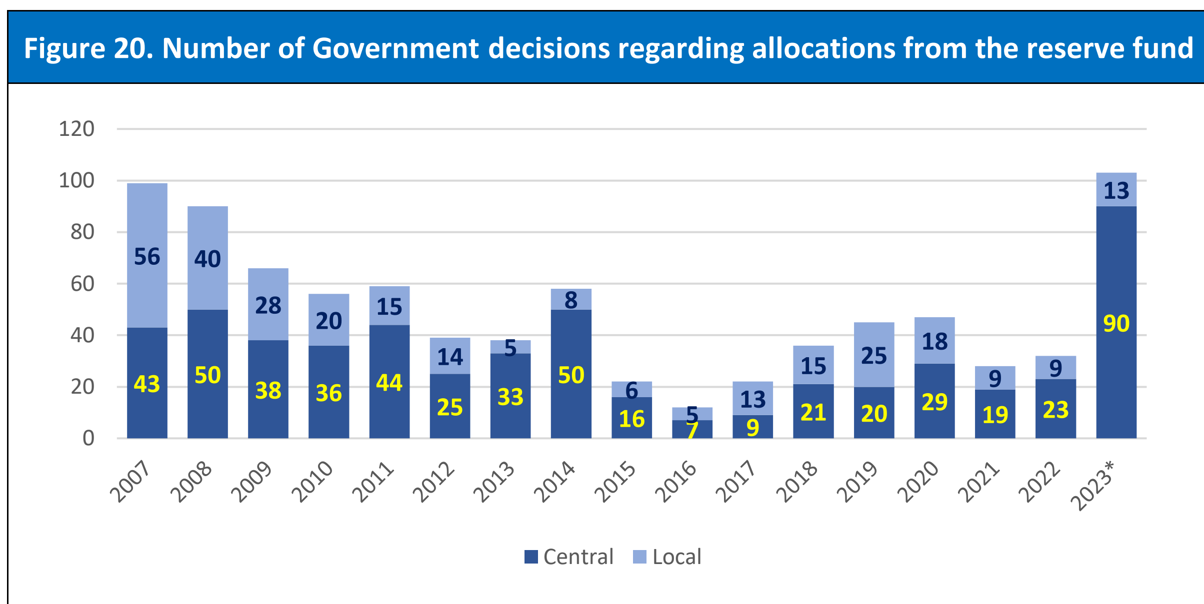


Figure 20. Number of Government decisions regarding allocations from the reserve fund

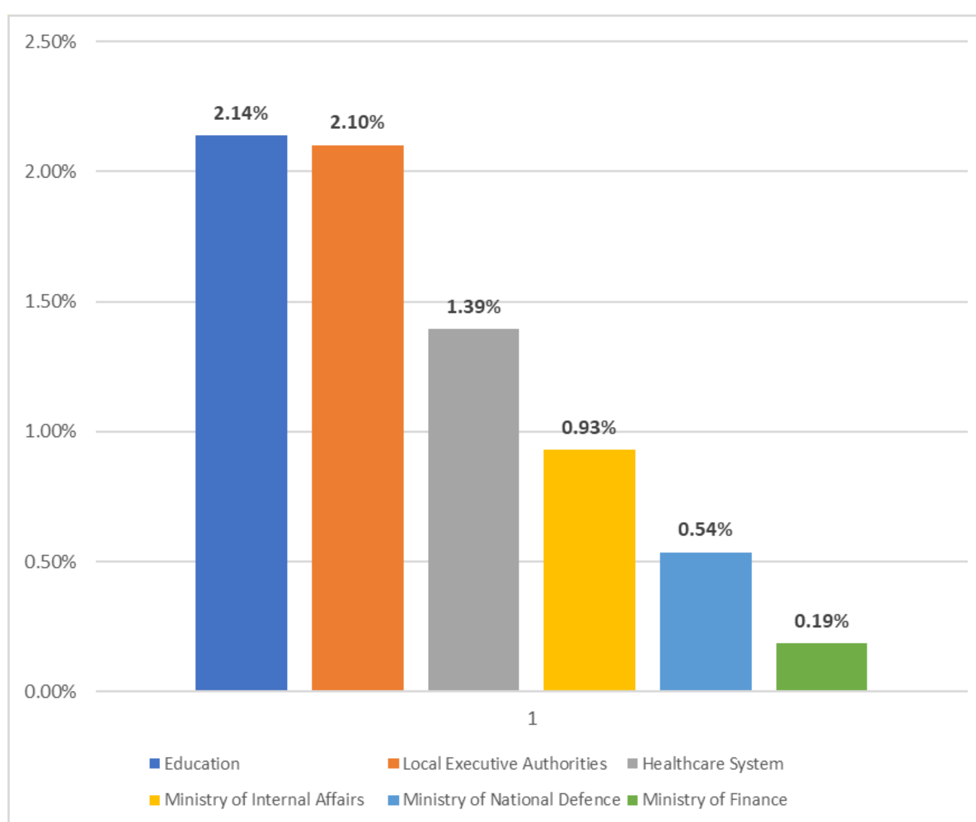
Source: FC's calculations based on Government decisions allocating funds from the reserve fund
** Government decisions from the beginning of the year until December 15, 2023*

Annex XVI

Table 6. Distribution of the number of occupied positions in the main components of the public sector, October 2023		
TOTAL positions, of which:	**1,289,405**	**100.00%**
Education	373,344	28.95%
Local Executive Authorities	280,947	21.79%
Healthcare System	245,921	19.07%
Ministry of Internal Affairs	124,348	9.64%
Ministry of National Defence	71,555	5.55%
Ministry of Finance	24,906	1.93%
Others (each component having less than 1.1% of total positions)	168,384	13.06%

Source: MF, FC's calculations

Figure 21. Personnel expenditures in the main components of the public sector in 2023* (% of GDP)



Source: MF, INSSE, FC's calculations
** Based on data available in September and October.*