Romania

Fiscal Council

Annual Report

2023

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Fiscal Council, Casa Academiei Române, 13, Calea 13 Septembrie, Bucharest
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List of abbreviations

CEE	Central and Eastern Europe
CPI	Consumer Price Index
DESI	Digital Economy and Society Index
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EDP	Excessive Deficit Procedure
ESA 2010	European System of National and Regional Accounts 2010
EU	European Union
FC	Fiscal Council
FRL	Fiscal Responsibility Law no. 69/2010
FS	Fiscal Strategy
GCB	General consolidated budget
GDP	Gross Domestic Product
GEO	Government Emergency Ordinance
HICP	Harmonized Index of Consumer Prices
IMF	International Monetary Fund
MIEP	Ministry of Investments and European Projects
MF	Ministry of Finance
MFF	Multiannual Financial Framework
MTO	Medium-term objective
NAFA	National Agency for Fiscal Administration
NBR	National Bank of Romania
NCFI	National Centre for Financial Information
NCSP	National Commission for Strategy and Prognosis
NIS	National Institute of Statistics
NREF	Non-reimbursable external funds
NRRP	National Recovery and Resilience Plan
OP	Operational Program
Pp	percentage points
RRF	Recovery and Resilience Facility
SGP	Stability and Growth Pact
SME	Small and Medium Enterprises
SSC	Social Security Contribution
TSCG	Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (The Fiscal Compact)
TFEU	Treaty on the Functioning of the European Union
VAT	Value Added Tax
WB	World Bank

Table of contents

I. Summary 8

II. Macroeconomic framework in 2023 18

III. Fiscal policy in 2023 28

III.1. Main features of the fiscal-budgetary policy in 2023 28

III.2. The assessment of objectives, targets and budgetary indicators 30

III.3. The structural budget balance in Romania 42

III.4. Budget revenues 46

III.4.1. VAT and excise duties 47

III.4.2. Direct taxes 49

III.4.3. Social security contributions 51

III.5. Budget expenditures 52

III.5.1. Personnel and social assistance expenditures 55

III.5.2. Goods and services expenditures 64

III.5.3. Public investment expenditures 65

III.5.4. The contingency reserve fund and the intervention fund at Government's disposal 71

III.5.5. Arrears of the general consolidated budget 79

III.6. Public debt 80

IV. The absorption of EU funds 89

V. Tax collection and the structure of budget expenditures – international comparisons...... 96

V.1. Tax collection in Romania – international comparisons.. 96

V.2. Public expenditures – structure and sustainability 105

VI. 2024 – Macroeconomic and fiscal perspectives 110

VI.1. Macroeconomic framework 110

VI.2. Fiscal framework 120

Bibliography 120

Appendix – Glossary of terms 137

List of tables

Table 1: Main macroeconomic indicators in 2023 (Fiscal Strategy forecast versus actual) 27

Table 2: Nominal ceilings for GCB balance, total and personnel expenditure 36

Table 3: The evolution of the main budgetary aggregates during 2023 (billion lei) 37

Table 4: The evolution of public revenues and expenditures (cash methodology, % of GDP)..................39

Table 5: The evolution of public revenues and expenditures (ESA 2010, % of GDP) 40

Table 6: Social security contributions (million lei) 52

Table 7: Enforceable titles issued/paid on the account of the court decisions regarding the payment of salary differences for certain categories of public employees, million lei 55

Table 8: Quarterly evolution of GCB outstanding payments (0-360 days) in 2023 (million lei) 80

Table 9: Structural funds absorption by operational program for the 2014-2020 MFF as of June 2024 (million euro)...90

Table 10: Absorption of structural funds for the 2014-2020 MFF – comparison with other EU Member States as of June 2024...91

List of figures

Figure 1: The evolution of economic growth forecasts for 2023 19

Figure 2: Contributions to real GDP growth 19

Figure 3: GDP deflator decomposition 22

Figure 4: The evolution of real GDP, domestic demand and current account balance between 2005-2023 23

Figure 5: Structural deficit, fiscal impulse and the excess demand 42

Figure 6: VAT revenues in 2023 (billion lei)...47

Figure 7: Excise duty revenues in 2023 (billion lei) 48

Figure 8: Corporate income tax revenues in 2023 (billion lei) 49

Figure 9: Personal income tax revenues in 2023 (billion lei) 50

Figure 10: Social security contributions revenues in 2023 (billion lei) 51

Figure 11: Quarterly evolution of GCB revenues in 2023 (billion lei) 54
Figure 12: Quarterly evolution of GCB expenditures in 2023 (billion lei) 54
Figure 13: Personnel expenditures in 2023 (billion lei) 55
Figure 14: Average gross earnings in the private and public sectors between 2007-2023 (lei/month) ..57
Figure 15: The evolution of public sector employment between 2005-2023 58
Figure 16: Personnel expenditures as a share of total budget revenues in EU27 countries 59
Figure 17: Social assistance expenditure in 2023 (billion lei) 59
Figure 18: The evolution of revenues and expenditures from the social security budget (billion lei).....61
Figure 19: The evolution of the number of pensioners vs the number of employees (thousand persons) 62
Figure 20: The evolution of average pension (lei) between 2001-2023 63
Figure 21: Social assistance expenditures as a share of total budget revenues in EU27 countries 64
Figure 22: Goods and services expenditures in 2023 (billion lei) 64
Figure 23: Investment expenditures between 2009-2023...67
Figure 24: Capital expenditures in 2023 (billion lei) 68
Figure 25: Projects financed from post-accession NREF in 2023 (billion lei)...68
Figure 26: The evolution of expenditures with projects financed from the amounts representing non-reimbursable financial assistance and loans related to the NRRP in 2023 (billion lei)..............................69
Figure 27: Capital expenditures in 2023 and the 10-year average (% of GDP, ESA 2010)..........................70
Figure 28: Total contingency reserve fund allocation (billion lei)...74
Figure 29: Number of Government decisions regarding contingency reserve fund allocations 75
Figure 30: The beneficiaries of the contingency reserve fund (% of total allocations) 78
Figure 31: The yield curve for government bonds, issued in domestic currency between 2014 - 30 June 2024 83
Figure 32: Contributions to changes in the public debt-to-GDP ratio for the 2009-2023 period 86
Figure 33: Primary balance in EU member states, in 2021 and 2023 (% of GDP, ESA 2010)...................87
Figure 34: Evolution of EU funds absorption rate: Romania versus EU average, 2015 – June 2024 (2014-2020 MFF)..92

Figure 35: Budget revenues and fiscalevenues in 2023 (% of GDP, ESA 2010)……………………………………..96

Figure 36: VAT revenues in 2023 compared to the previous year (% of GDP) 98

Figure 37: VAT gap (% VTTL)..99

Figure 38: Social security contribution revenues in 2023 (% of GDP) 100

Figure 39: The evolution of social assistance and personnel expenditures as a share of total budget revenues (ESA 2010, %)..106

Figure 40: The share of personnel and social assistance expenditures (including pensions) in total budget revenues in EU27 and CEE between 2005-2023 (ESA 2010, %)..107

Figure 41: Social security budget balance (pensions, unemployment and health) and total budget balance (ESA 2010, % of GDP) 108

Figure 42: The share of investment expenditures in GDP and in total budget revenues (2012-2022 average, ESA 2010)..109

Figure 43: Economic growth forecasts for Romania in 2024 115

List of boxes

Box 1: Digital Economy and Society Index (DESI)..102

Box 2: The structural situation of the DESI index, Romania versus EU 27, in 2023...............................103

Box 3: The new economic governance framework of the European Union...124

I. Summary

The Fiscal Council (FC) is an independent authority, established by the Fiscal Responsibility Law no. 69/2010 (FRL), which supports the Government and the Parliament in designing and implementing fiscal-budgetary policies and promotes the transparency and sustainability of public finances. According to the FRL, the FC has among its prerogatives to elaborate an Annual Report that analyses the conduct of fiscal-budgetary policy during the previous year, against the framework set out in the Fiscal Strategy (FS) and the annual budget, and assesses the macroeconomic and fiscal developments as well as the objectives, targets and indicators included in the FS and in the annual budget.

In Romania, the real economic growth in 2023 was 2.1%, supported by the contribution of gross fixed capital formation, which recorded its highest value in recent years. Additionally, household consumption and government consumption both had positive contributions to economic growth, while inventory variation had a significant contractionary impact.

In Romania, the real economic growth was 2.1% in 2023. The level of public and private investments, along with a positive real dynamic in wage growth, more pronounced in the second semester, supported the economic activity. This positive effect was partially offset by still high inflation rates, particularly in the services sector, declining external demand, and uncertainties regarding geopolitical developments in the region. On the demand side, gross fixed capital formation had the largest contribution to the positive economic activity dynamics (+3.6 pp), followed by household consumption (+1.8 pp) and government consumption (+1 pp). These contributions were partially offset by the significant contractionary impact of inventory changes (-4.3 pp). On the supply side, the highest contributions to GDP growth came from the construction sector (+0.8 pp), the information and communications sector (+0.4 pp), and the agriculture, forestry, and fishing sector (+0.4 pp). Industry remained the only sector with a negative contribution to GDP growth (-0.5 pp).

In 2023, the annual inflation rate followed a sharply declining trajectory, and the current account deficit decreased by 2.2 pp compared to 2022, reaching 7% of GDP. However, the Romanian economy continues to be characterized by a high level of twin deficits, which poses significant challenges to the country's economic stability.

In 2023, the annual inflation rate followed a sharply descending trajectory, dropping from 16.37% at the end of 2022 to 6.61% in December 2023. However, the decrease in the GDP deflator compared to the previous year was marginal (-1 pp), due to significant variations within its components. The current account deficit stood at 7% of GDP at the end of 2023, down by 2.2 pp from the previous year. The coverage of the current account deficit through non-debt-generating flows increased to 58.9% in 2023, up from 52.5% the previous year. It should be noted that the average current account deficits recorded over the past three years is 7.8% of GDP, significantly exceeding the 4% alert threshold set by the European scoreboard, highlighting a major external macroeconomic imbalance and a heightened vulnerability to

shocks.

The labour market showed positive trends, with the average number of employees increasing by 1.1% compared to the previous year, while the ILO unemployment rate remained at 5.6%. The gross average wage continued its upward trend from previous years, registering a nominal increase of 13.8% compared to 2022. Against the backdrop of the disinflationary trend, real wages rose by 3.7%.

In December 2023, non-governmental credit registered a 0.2% real decrease compared to the same period of the previous year, driven by the reduction in the component of loans granted in lei. The marginal real decrease in non-governmental credit can be explained by the high level of the reference interest rate, aimed at supporting the disinflationary trend. In 2023, labour market data showed a slight increase in the average number of employees to 5.269 million persons (+1.1% compared to the previous year), as well as an ILO unemployment rate of 5.6%, a value similar to the previous year. The average gross wage across the economy was 6,971 lei (+13.8% compared to 2022). The average net wage was 4,352 lei (+14.5% compared to 2022), while the real wage increased by 3.7%.

The budget execution results for 2023 indicate a cash deficit of 5.6% of GDP and a deficit of 6.6% of GDP according to ESA 2010 methodology, significantly exceeding the target set in the initial budget (4.4% according to both methodologies). This outcome was driven by a substantial shortfall in revenue targets outlined in the initial budget, while deviations from the established spending ceilings were less pronounced due to measures adopted towards the end of the year to limit expenditures.

The general consolidated budget for 2023 targeted a deficit of 4.4% of GDP, both in cash terms and according to the ESA 2010 methodology, based on the assumptions of a real GDP growth of 2.8% and a GDP deflator of 8.2%. In the medium term, given Romania's placement under the excessive deficit procedure, the fiscal-budgetary strategy projected to reach and maintain the budget deficit, in ESA 2010 terms, below the 3% of GDP reference level by 2024.

The 2023 budget execution results indicate a deficit of 89.9 billion lei, according to national methodology, 21.6 billion lei above the target set in the initial budget (68.3 billion lei). As a percentage of GDP, the budget deficit exceeded the planned level (4.4%), both in cash terms (5.6%) and in ESA 2010 terms (6.6%), due to a significant underachievement of the revenue targets set in the initial budget. The breaches of budgetary expenditure ceilings were more limited, as measures were adopted towards the end of the year to curb them. On June 19, 2024, the EU Council concluded that Romania had not taken effective action in response to the Council Recommendation of June 18, 2021, to align with the established trajectory for reducing the budget deficit by 2024. Thus, the higher-than-expected nominal GDP growth fuelled a significant increase in public revenues, which, however, was directed towards supporting higher public expenditures rather than budget consolidation, as would have been appropriate and in line with the EC's recommendations.

Investment expenditures, according to national methodology, reached 6.3% of GDP in 2023, which is 1.2 pp higher than the level recorded in the previous year. The upward investment trend observed in recent years can be sustained in the medium term, provided Romania achieves high absorption rates of European funds. This would allow for a high pace of economic growth alongside the process of fiscal consolidation.

In 2023, investment expenditures represented 6.3% of GDP, according to national methodology, 1.2 pp above the level recorded in the previous year, driven by a 14.6% increase in nominal GDP. Compared to 2022, a nominal increase of 28.1 billion lei was noted across all components: projects funded by post-accession external non-reimbursable funds (+22.7 billion lei), projects financed through the non-reimbursable financial assistance and loans under the National Recovery and Resilience Plan – NRRP (+5.1 billion lei), while domestic sources increased by approximately 0.4 billion lei compared to 2022.

Given the significant volume of European funds available to Romania through the 2021-2027 MFF (Multiannual Financial Framework) and the NRRP, maximizing the absorption of these funds is an essential prerequisite for maintaining the upward investment trend of recent years in the medium term. This would allow for sustained high economic growth, while simultaneously achieving budget consolidation. Moreover, a firm application of the existing legal framework and better prioritization of public investments, focusing on research, development, and innovation in strategic areas, as well as on physical and digital infrastructure, can contribute to reducing infrastructure gaps, minimizing polarization and regional disparities, and improving the competitiveness of the Romanian economy.

Similar to previous years, Romania recorded a very low level of budget and fiscal revenues relative to GDP in 2023, positioning itself at the bottom of the EU member states in this regard.

In 2023, Romania recorded a budget revenue-to-GDP ratio of 33.6%, according to the ESA 2010 methodology, well below the European average of 43.3% (a gap of 9.7 pp), one of the lowest among EU member states, followed only by Malta and Ireland. The level of fiscal (tax) revenues (including social contributions) decreased from 27.2% of GDP in 2022 to 26.6% of GDP in 2023, placing Romania in the second-to-last position, with a gap of 10.2 pp compared to the EU average (36.8% of GDP). The fiscal revenue share of GDP in Romania is significantly lower than in other countries with similar economies, such as Slovenia (37.2%), Poland (35.7%), the Czech Republic (35.5%), and Hungary (35%). Moreover, in Romania, the fiscal revenue-to-GDP ratio is declining, while in the aforementioned countries, the trend has been increasing compared to 2022.

Romania's positioning among the last countries in the EU27, in terms of budget and fiscal revenues as a percentage of GDP, is both the result of an expansionary fiscal policy and major errors in the construction of the fiscal regime, as well as the weak digitalization of NAFA. Digital transformation solutions have been implemented in Romania only partially and with significant delays. Consequently, there is a need to increase investments in fiscal infrastructure and, especially, in digital technology, as these have the potential to improve the functioning of public institutions, thereby boosting fiscal revenues.

Romania's positioning among the last countries in the EU27, in terms of budget and fiscal revenues as a percentage of GDP, is both the result of an expansionary fiscal policy and major errors in the construction of the fiscal regime, as well as the weak digitalization of the National Agency for Fiscal Administration (NAFA). Modern solutions specific to digital transformation have only been partially implemented in Romania, and with significant delays. The NAFA reform through digitalization, as outlined in the NRRP, acknowledges that, to correct the budget deficit, there is a need for a rapid increase in the efficiency of public revenue collection and an improvement in relations with taxpayers.

From the perspective of the Digital Economy and Society Index[1], Romania has made some progress, but remains among the last countries in the EU. The government administration, including the fiscal administration, is still in an early stage of digitalization, with unfavourable results in terms of public services and budgetary revenues. Consequently, there is a need to increase investments in fiscal infrastructure and, especially, in digital technology, which has the potential to improve the functioning of public institutions and positively impact fiscal revenue growth. The digitalization process can be intensified by involving key stakeholders in the development and delivery of policies for digital skills, strengthening efforts for upskilling and reskilling, and attracting and retaining ICT specialists.

In an attempt to control public expenditures, the Government approved a series of measures in 2023 that turned the contingency reserve fund into a discretionary tool for adjusting the general consolidated budget, thereby circumventing the adoption of formal budget revisions. Thus, a record amount of 32.08 billion lei was allocated from the contingency reserve fund, almost 47 times higher than the level initially budgeted for 2023.

In an attempt to control public expenditures, the Government approved a series of measures in 2023 that turned the contingency reserve fund into a discretionary tool for adjusting the general consolidated budget, thereby circumventing the adoption of formal budget revisions. Thus, a record amount of 32.08 billion lei was allocated from the contingency reserve fund, almost 47 times higher than the level initially budgeted for 2023 (685.7 million lei), representing 5.2% of total general consolidated budget expenditures and 2.03% of GDP. From the beginning of the year until September 14, 2023, when the legislative framework governing the contingency reserve fund was modified, only 0.45 billion lei had been allocated from the fund. The remaining approximately 31.64 billion lei was allocated after the adoption of the new legislative framework. While between 2007 and 2022 the contingency reserve fund allocations ranged from a minimum of

[1] See *Box 1*, chapter V.I.

0.53 billion lei in 2015 to a maximum of 7.96 billion lei in 2020, the 2023 allocations were more than four times the previous maximum, recorded in the first year of the pandemic, and almost nine times higher than in the previous year.

The Fiscal Council emphasizes that using the contingency reserve fund instead of formal budget revisions sets a precedent that poses major risks, ranging from a lack of transparency in budget execution to discretionary use and an increased reliance on exemptions from fiscal rules.

The Fiscal Council reiterates its previous reports' recommendation to explicitly identify the expenditures that can be committed from the contingency reserve fund, along with greater transparency, including periodic reporting to Parliament on how and to what extent the contingency reserve fund is being used. Additionally, given the special situation observed in 2023, the Fiscal Council emphasizes that using the contingency reserve fund instead of formal budget revisions sets a precedent that poses major risks, ranging from a lack of transparency in budget execution to discretionary use and an increased reliance on exemptions from fiscal rules.

Since 2016, the adoption of discretionary increases in permanent expenditures has led to a growing rigidity in the structure of budget expenditures. In 2023, there was an attempt to keep personnel and social assistance expenditures under control, with the share of these expenditures in total budget revenues showing a marginal increase for the first category and a decrease for the second.

Since 2016, with the implementation of the new Fiscal Code, which led to a significant fiscal relaxation (resulting in reduced budget revenues), there has been an increasing reliance on discretionary increases in permanent expenditures, leading to a growing rigidity in the structure of budgetary expenditures. In 2023, there was a marginal increase in the ratio of personnel expenditures to total budget revenues, from 29.7% to 29.8%, with Romania being surpassed only by Malta (30.2%) and Latvia (30%) in the EU ranking. In contrast, the ratio of social assistance expenditures to budget revenues continued a downward trend, decreasing by 1.7 pp, from 38.9% in 2022 to 37.2% in 2023. This development was driven by a slower growth rate of this category of expenditures compared to the growth rate of budget revenues, indicating an effort to control social assistance expenditures throughout 2023.

In 2023, personnel and social assistance expenditures amounted to 84.6% of fiscal revenues (including social contributions). Reducing the structural budget deficit requires increasing the level of fiscal revenues as well as exercising caution regarding the increase in permanent expenditures.

After reaching a peak in 2020, when personnel and social assistance expenditures equalled 95.3% of fiscal revenues (including social contributions) and 25.6% of GDP, the years 2021 and 2022 saw a reduction in these ratios. By the end of 2022, the share of personnel and social assistance expenditures was 84.4% of total fiscal revenues and 23.1% of GDP. In 2023, the share of personnel and social assistance expenditures in total fiscal revenues marginally increased to 84.6%, reversing the favourable trend observed in previous years. This development was driven by an 11.6% increase in expenditures on salaries and social assistance, while fiscal

revenues grew by 11.4%. Conversely, due to a faster growth rate of nominal GDP, the share of personnel and social assistance expenditures decreased to 22.5% of GDP.

In 2024, an improvement in economic activity is anticipated compared to the previous year. The European Commission forecasts a 3.3% economic growth for Romania, surpassing the IMF's projection of 2.8%. The NBR anticipates a decrease in the CPI inflation rate to 4% by the end of 2024.

The European Commission anticipates a real GDP growth of 3.3% in Romania for 2024, surpassing the IMF's forecast of 2.8%. For 2025, both the trend and the ranking of the growth rate reverse, with the European Commission predicting a deceleration to 3.1%, below the IMF's projected 3.6%, which, in contrast, expects an acceleration in economic growth toward the end of the forecast period. The factors driving the upward trajectory of GDP in the coming years are expected to be private consumption, driven by an increase in real disposable income, and robust investment. European funds are projected to strongly support public investments, especially in infrastructure, while net exports are anticipated to have a negative contribution to economic growth. The latest NBR (National Bank of Romania) projections place the annual CPI inflation rate at 4% by the end of 2024. The descending trend in inflation is attributed to the core inflation component, which is expected to decrease gradually and, subsequently, at a slower pace.

For 2024, the Government's economic growth forecast of 3.4% may be characterized by moderate optimism. Given that the risks to the evolution of the GDP deflator can be considered balanced, the nominal GDP evolution for the current year reflects the risks associated with the real GDP evolution, indicating a slight optimism in the NCSP's projections.

In the opinion issued on the 2024 budget draft and the 2024-2026 fiscal strategy, the FC considered that the projected values for real growth were slightly overestimated, reflecting an overall optimistic trend. However, this was offset by an underestimation of the GDP deflator over the projection horizon, resulting in a nominal GDP projection with a high degree of plausibility.

Recent information suggests that the Government's 3.4% economic growth forecast for 2024 may be characterized by moderate optimism and could undergo downward revisions, given the new GDP data and the very high uncertainty regarding domestic and external economic developments. Conversely, the National Commission for Strategy and Prognosis – NCSP's spring forecast has revised the GDP deflator projection upwards, so the risks to this indicator's performance can be considered balanced. Consequently, the nominal GDP forecast for the current year reflects the risks associated with the real GDP forecast, indicating a slight optimism in the NCSP's projections.

The 2024 budget draft targeted a deficit of 5% of GDP according to national methodology and 4.9% of GDP according to ESA 2010 methodology. Given a prudent assessment of revenue and expenditure projections, the FC indicated, in its opinion on the 2024 budget proposal, that it is consistent with a cash deficit around 6.4% of GDP.

The 2024 budget draft targeted a deficit of 5% of GDP according to national methodology and 4.9% of GDP according to ESA 2010 methodology, implying a decrease of 0.6 pp and 1.7 pp of GDP, respectively, compared to 2023. The planned reduction in the deficit was expected to be achieved mainly through an increase in the share of budget revenues in GDP, driven by the projected macroeconomic framework, fiscal policy measures adopted at the end of 2023, hypothetical revenues from improved collection efficiency/digitalization of NAFA (estimated by the Ministry of Finance at 19 billion lei), and projections for the absorption of European funds. On the other hand, the share of budget expenditures in GDP was planned to decrease marginally, with the increase in expenditures for projects funded by European funds, personnel expenses, social assistance, and other expenditures being offset by reductions in subsidies, other transfers, and expenditures on goods and services. Given a prudent assessment of revenue and expenditure projections, the FC indicated, in its opinion on the 2024 budget proposal, that it is consistent with a cash deficit around 6.4% of GDP.

Medium-term budgetary consolidation is expected to be achieved exclusively through expenditure measures, with the share of budget revenues in GDP indicating a downward trend over the analysed period. The FC has noted that, in the absence of sufficiently concrete and credible policies to support medium-term fiscal consolidation on the revenue side, as well as improvements in revenue collection, the balance of risks is clearly tilted towards higher deficits than those projected by the fiscal-budgetary framework for the 2025-2027 period. Furthermore, the FC emphasized that macroeconomic adjustment and fiscal

According to the projected medium-term fiscal-budgetary framework, budgetary consolidation during the 2025-2027 period will be achieved exclusively on the expenditure side (with the share of expenditures in GDP decreasing from 38.8% in 2024 to 34.7% in 2027), while the share of budget revenues in GDP is expected to trend downward (from 33.8% in 2024 to 31.8% in 2027). The FC has assessed that, in the absence of sufficiently concrete and credible policies to support medium-term fiscal-budgetary consolidation on the revenue side, as well as to increase the collection rate, the risk balance is clearly tilted towards experiencing higher deficits than those anticipated by the fiscal-budgetary framework for the 2025-2027 period.

Additionally, the FC emphasized that macroeconomic adjustment and fiscal consolidation require a significant increase in fiscal revenues, which are currently at an inadmissibly low level relative to Romania's needs and compared to EU benchmarks. Budgetary correction cannot be achieved solely through expenditure reductions. Through fiscal and labour market reforms, as well as improved revenue collection, Romania could achieve fiscal revenues significantly above 30% of GDP by the 2027-2028 horizon. Such a level is necessary, given current and future challenges.

consolidation require a significant increase in fiscal revenues.

Implementing a multiannual fiscal consolidation plan and effectively utilizing European funds available to Romania are the foundations for a gradual adjustment that minimizes associated economic and social costs and stimulates sustainable economic growth.

Given the budget execution for the first six months of 2024 and other data, the FC estimates that the deficit is likely to exceed 7% of GDP, with a risk of approaching 8% of GDP.

The budget execution for the first six months of 2024 recorded a deficit of 3.6% of GDP, nearly 1.3 percentage points higher than the same period in the previous year. This increase was driven by a sharp rise in budget expenditures, which was partially offset by higher-than-expected budget revenues. The FC assessment at the time of the opinion on the budget project estimated the cash deficit for the current year at around 6.4% of GDP. Based on the budget execution for the first six months and other data, the FC estimates that the deficit is likely to exceed 7% of GDP this year, with a risk of approaching 8% of GDP. This is due in part to the new pension law and wages increases granted in the public sector, which will generate additional costs in the second half of 2024, as well as the seasonal nature of budget execution, which is characterized by the concentration of certain categories of expenditures in the final months of the year.

As of the end of March 2024, according to official data published by Eurostat, the public debt-to-GDP ratio reached 51.6%, surpassing the second alert threshold set by the Fiscal Responsibility Law.

The unfavourable dynamics of the budget execution, in the first part of 2024, is also reflected in the increase in the public debt-to-GDP ratio. Official data published by Eurostat[2] indicate a public debt ratio of 51.6% of GDP at the end of March 2024, exceeding the second alert threshold of 50% set by the Fiscal Responsibility Law (FRL). In this situation, according to Article 13, Paragraph (2) of the FRL, the Government is required to present and implement a program to reduce the public debt ratio as a percentage of GDP, which must be approved through legislative measures. The medium-term fiscal structural plan, that the Government will submit to Brussels in September 2024, primarily driven by the need for fiscal consolidation, would inherently include measures to limit public debt.

In this context, the process of fiscal consolidation is both urgent and inevitable. The adoption of the new EU economic governance framework in April 2024 will

In this context, the process of fiscal consolidation is both urgent and inevitable. The adoption of the new EU economic governance framework in April 2024 will support this consolidation process. Romania is expected to propose a medium-term fiscal structural plan which will include the committed reforms and investments

[2] https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-22072024-ap

support this consolidation process. Romania is expected to propose a medium-term fiscal structural plan which will include the committed reforms and investments aimed at ensuring the reduction of the budget deficit below 3%.

aimed at ensuring the reduction of the budget deficit below 3%. Therefore, in the coming period, Romania will need to implement measures to reduce the structural deficit, targeting both an increase in the share of fiscal revenues in GDP and improved efficiency of budget expenditures.

The new economic governance framework retains the reference values of 3% for the budget deficit-to-GDP ratio and 60% for the public debt-to-GDP ratio. It introduces a unique operational indicator – the trajectory of net expenditures – for member states not within these reference values. Based on the trajectory of net expenditures, each member state will adopt a fiscal structural plan, which will include reforms and investments and will promote sound fiscal policy.

The new economic governance framework retains the two main references proposed in the Maastricht Treaty: a budget deficit of less than 3% of GDP and a public debt below 60% of GDP. It introduces a single operational indicator – the trajectory of net expenditures – to ensure that these two references are maintained within sustainable and balanced limits. Based on the trajectory of net expenditures, each member state will commit to a medium-term fiscal structural plan, which will include reforms and investments and will promote a sound fiscal policy. Member states may also target an additional set of reforms and investments, with the adjustment period potentially extended to seven years. The new economic governance framework grants independent fiscal institutions an advisory role in reviewing macroeconomic forecasts and assumptions underlying the trajectory of net expenditures, in analysing the compliance of budgetary data with the net expenditure trajectory, and in the excessive deficit procedure. Additionally, the functions of independent fiscal institutions are clarified, based on the premise that they are a key pillar of budgetary frameworks. A more detailed analysis of the role of independent fiscal institutions in the new EU economic governance architecture can be found in the publications available on the Fiscal Council's website[3].

[3] Dăianu, D. 2023. A New EU Economic Governance and Fiscal Framework: what role for the national independent fiscal institutions (IFIs)?, *SUERF Policy Brief*, 532, February, https://www.consiliulfiscal.ro/IFIs%20role.pdf; Dăianu, D. 2024. National independent fiscal institutions need to be stronger to perform effectively. *Intereconomics*, 59(2), 112-118, https://www.consiliulfiscal.ro/2024%20-%2001%20-%2018%20ian%20-%20National%20Independent%20Fiscal%20Institutions%20(IFIs)%20need%20to%20be%20stronger.pdf

By September 20, 2024, the Government must develop the fiscal structural plan, which will include, based on the net expenditure trajectory, fiscal commitments, targeted reforms, and investments.

By September 20, 2024, the Government must develop the fiscal structural plan, which will include, based on the net expenditure trajectory provided by the European Commission, fiscal commitments, targeted reforms, and investments. The fiscal structural plan must ensure, by the end of the adjustment period, a reduction in the budget deficit-to-GDP ratio below the reference value, a gradual reduction in the public debt-to-GDP ratio, and sustainable economic growth.

II. Macroeconomic framework in 2023

In Romania, the real economic growth was 2.1% in 2023[4]. The high level of public and private investments, coupled with a positive real wage growth, particularly more pronounced in the second half of the year, which had a favorable effect on household consumption, supported economic activity. This positive effect was partially offset by persistently high inflation rates, especially in the services sector, which led to high interest rates for an extended period, declining external demand, and uncertainties regarding geopolitical developments in the region.

On the demand side, economic growth was supported by the contribution of gross fixed capital formation, which reached its highest level in recent years. Additionally, household consumption and government consumption made positive contributions to economic growth, although the contribution of household consumption slowed compared to the previous year, while the contribution of government consumption increased. These contributions were partially offset by the significant negative dynamic in inventory changes. On the supply side, the construction sector, information and communications, and agriculture, forestry, and fishing had the highest contributions to real GDP growth, while industry registered a negative contribution.

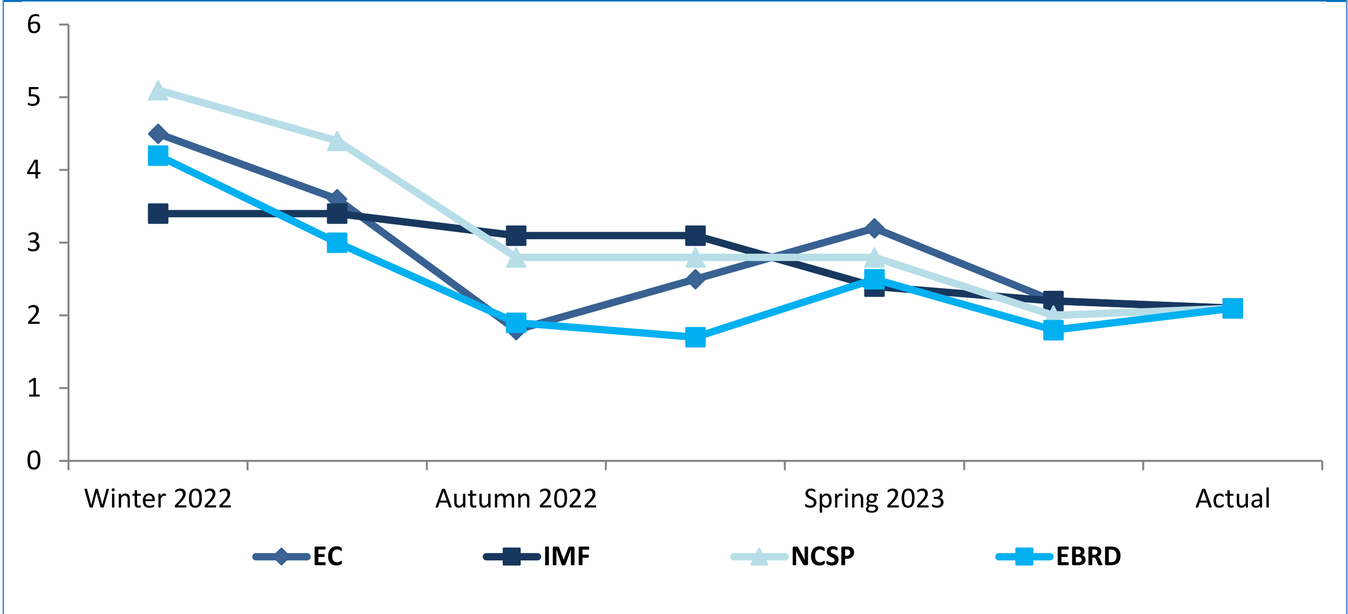
Within the EU, Malta (5.6%), Croatia (2.8%), and Spain (2.5%) recorded the highest economic growth rates, while France (0.7%), Poland (0.2%), and the Netherlands (0.1%) experienced marginal growth. Sweden (-0.2%), the Czech Republic (-0.3%), and Germany (-0.3%) saw slight declines, whereas Luxembourg (-1.1%), Estonia (-3.0%), and Ireland (-3.2%) had the most pronounced negative growth rates. Romania, with 2.1% growth, ranks 6th among the 27 EU member states based on real growth in 2023, while the average GDP growth in the EU stood at around 0.7%, similar to that of the Eurozone[5].

The analysis of the data included in *Figure 1* reveal that international financial institutions (EC, IMF and EBRD) anticipated, in 2022, an economic growth for 2023 in the range of 1.8% to 5.1%. The IMF's forecast, characterized by the lowest degree of variability, indicated a 3.4% growth in the Spring of 2022, which was later revised to 3.1% in the Autumn of 2022. The initial forecasts of the NCSP, the EC and the EBRD, in early 2022, were 5.1%, 4.5% and 4.2%, respectively. However, as uncertainties surrounding geopolitical tensions and inflation dynamics intensified, all three institutions revised their growth forecasts downward to 2.8%, 1.8% and 1.9% by the end of 2022. By the end of the first quarter of 2023, after some easing of inflationary uncertainties, the forecasts were revised again, showing an economic growth between 2.4% (IMF) and 3.2% (EC). As the data for 2023 accumulated and revealed a sharper-than-expected slowdown in economic activity, forecasts in the fall of 2023 were adjusted downward, ranging from 1.8% (EBRD) to 2.2% (EC and IMF). Ultimately, the GDP growth rate stood at 2.1%, close to the projections of NCSP, IMF and EC.

[4] According to the GDP preliminary estimates, published by NIS on April 9, 2024.

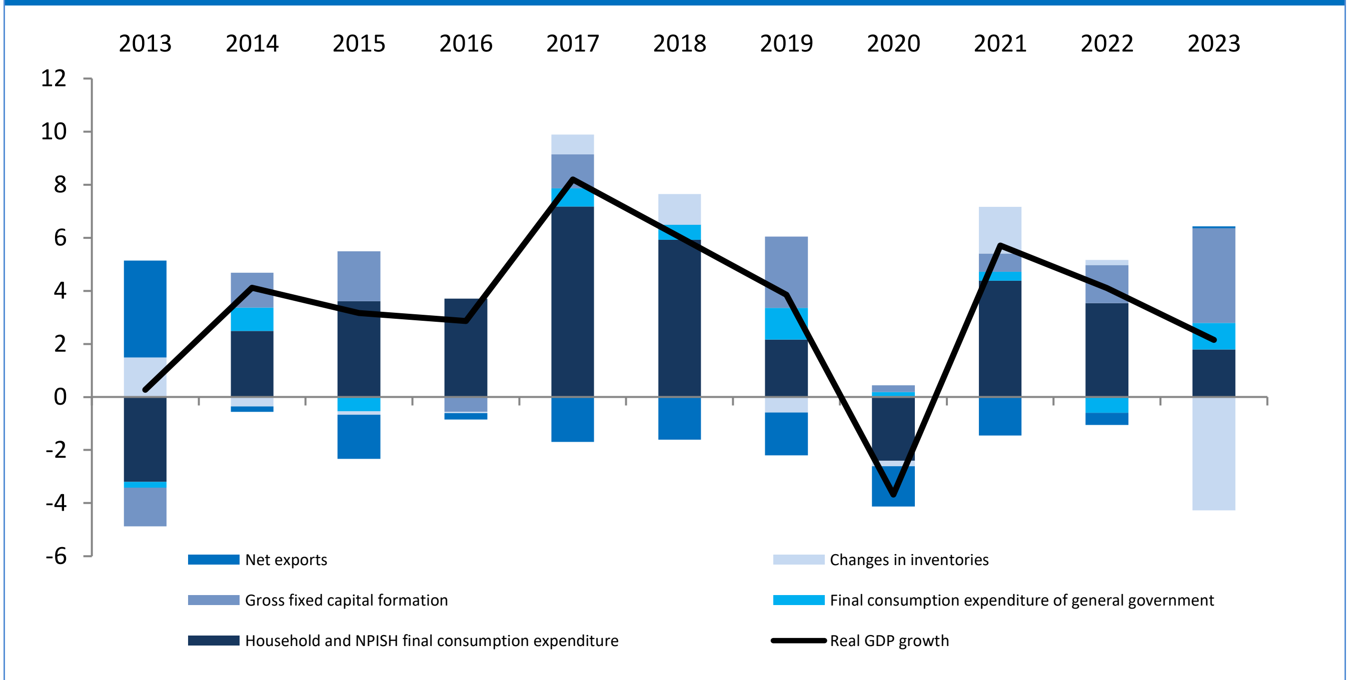
[5] According to the GDP preliminary estimates, published by Eurostat and accessed on June 19, 2024.

Figure 1: The evolution of economic growth forecasts for 2023



Source: EC, International Monetary Fund (IMF), National Commission for Strategy and Prognosis (NCSP), European Bank for Reconstruction and Development (EBRD)

Figure 2: Contributions to real GDP growth



Source: Eurostat, Fiscal Council's calculations

On the demand side (see *Figure 2*), gross fixed capital formation made the largest contribution to the positive economic activity (+3.6 pp), along with household consumption (+1.8 pp), and government consumption (+1.0 pp). These contributions were partially offset by the significant contractionary impact of changes in inventories (-4.3 pp).

Compared to the previous year, the contribution of household consumption to GDP growth decelerated by approximately 1.7 pp. Despite the disinflationary trend, inflation rates remained high, surpassing initial estimates for non-food goods and services, and interest rates remained elevated. The slowdown in household consumption was offset by the dynamics of government consumption, whose contribution to GDP growth increased by 1.6 pp. Overall, the real growth rate of final consumption, which provides a clearer picture of domestic economic activity, was about 3.3%, down by 1 pp compared to the previous year, contributing 2.8 pp to GDP growth, which was 0.1 pp lower than in 2022.

Gross fixed capital formation increased its contribution to GDP growth by 2.2 pp, supported by the acceleration of public investments funded both by national and non-reimbursable external funds, with a more significant dynamic for non-reimbursable external funds in the fourth quarter of 2023. From October to December 2023, investments funded by national and non-reimbursable external funds rose by 71% and 95%, respectively, compared to January-September 2023. Compared to 2022, investments funded by national funds increased by 9.5%, while those funded by non-reimbursable external funds grew by 67%.

Changes in inventories, historically characterized by significant variations, had a negative contribution to economic growth (-4.3 pp). This represented the second-largest negative contribution to GDP growth in the period 2001-2023, after the -6.1 pp recorded in 2007.

On the supply side, nearly all economic sectors supported GDP growth, though some had marginal contributions, as follows:

- construction (+0.8 pp), with a weight of 8.0% to GDP formation, driven by a significant increase in civil engineering construction;
- information and communication (+0.4 pp), with a weight of 7.1% to GDP formation, due to the ongoing trend of economic digitalization;
- agriculture, forestry and fishing (+0.4 pp), with a weight of 3.9% to GDP formation, supported by favourable weather conditions in the agricultural year;
- professional, scientific, and technical activities; administrative and support service activities (+0.3 pp), with a weight of 8.2% to GDP formation;
- retail and wholesale trade (+0.1 pp), with a weight of 20.4% to GDP formation;
- real estate transactions (+0.1 pp), with a weight of 7.3% to GDP formation;
- public administration, defence, education, human health and social work activities (+0.1 pp), with a weight of 12% to GDP formation;
- entertainment, cultural and recreational activities; household repair services and other services (+0.1 pp), with a weight of 2.8% to GDP formation.

In contrast, the industrial sector, with a weight of 19.6% to GDP formation, had a negative contribution to GDP growth (-0.5 pp), given that economic growth in Germany, Romania's main trading partner, was negative.

In 2023, the annual inflation rate followed a pronounced downward trajectory. While inflationary pressures were high in 2022, with the annual inflation rate peaking at 16.37% at the end of the year, 2023 saw a reversal of this trend, with the annual inflation rate decreasing to 6.61% by December 2023.

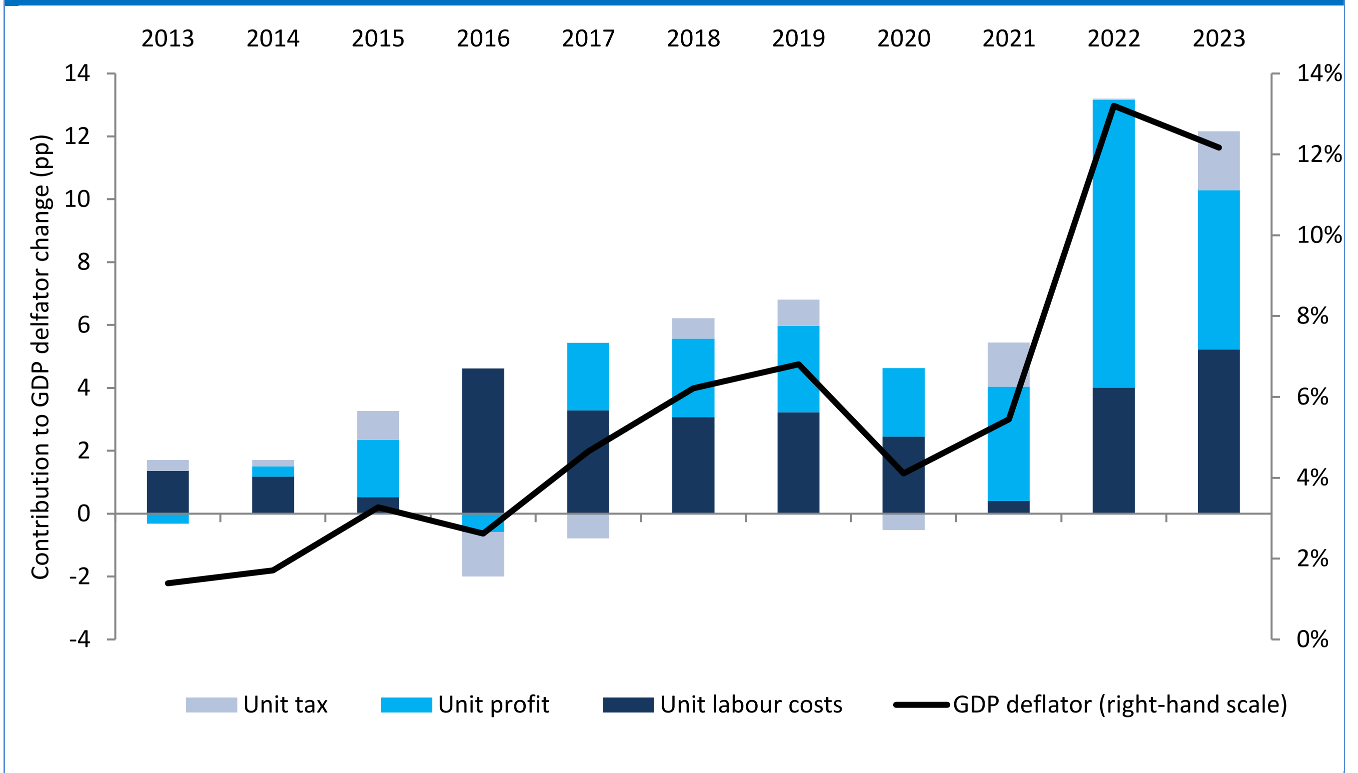
The average inflation rate for 2023 was 10.4%, compared to 13.8% in 2022. The decrease of energy and commodity prices, the expansion of the public support scheme for the energy market and the measure to cap the commercial mark-ups on basic food products supported the disinflationary trend observed in 2023.

According to the 2023-2025 Fiscal Strategy, the inflation rate was projected to be 8.0% by the end of 2023, with the average rate expected to be 9.6%. The differences between the actual values and these projections were -1.4 pp and +0.8 pp, respectively. The decrease in the inflation rate in December 2023, below the forecast from the 2023-2025 FS, was driven by a more pronounced-than-expected slowdown in energy prices, especially in the latter part of the year. On the other hand, the average annual inflation rate, which was higher than forecasted in the 2023-2025 FS, was due to an unexpected rise in the prices of non-food items and services. The variations in these prices remained high in the latter part of the year, with the average inflation rate being a more persistent indicator.

A larger difference between the forecast in the 2023-2025 FS and the actual value can be observed in the case of the GDP deflator – which measures the price dynamics across the entire economy, not just for final goods and services. For 2023, the deflator was projected to be 8.2%, while the actual value was 12.2%. Compared to the previous year, the deceleration of the deflator was marginal (-1 pp) due to high real variations in its components: labour costs, profits and taxes. Analysis of *Figure 3* reveals that, compared to the previous year, there was an intensification of wage pressures, which led to an increase of about 1.2 pp in the contribution of unit labour costs to the GDP deflator variation (from 4 pp in 2022 to 5.2 pp in 2023). Regarding unit profits, there was a reduction in their contribution to the deflator variation by about 4.1 pp (from 9.2 pp in 2022 to 5.1 pp in 2023), while the contribution of unitary taxes to the deflator variation increased by about 1.8 pp compared to the previous year.

As previously mentioned, 2023 was characterized by a significant decrease in inflation. In the first part of the year, the disinflationary trend was slower, with the annual inflation rate falling to 14.53% by the end of the first quarter. In the second quarter, inflation decelerated more rapidly due to disinflationary base effects, coupled with corrections in energy prices. The deceleration continued at a slower pace in the third quarter, with the annual inflation rate dropping to 8.83% in September 2023. On the one hand, the cap on the mark-ups of basic food products reduced price increases in this category. On the other hand, rising labour costs and high profit margins led to the persistence and even increase in price variations for non-food items and services (for example, the average annual price variation for non-food items and services was 11.80% and 11.20% in the third quarter of 2023, compared to 11.53% and 10.90% in the previous quarter). The final quarter of the year saw a more rapid moderation in price increases, with the inflation rate dropping to 6.61% in December 2023. The largest contributions to the reduction in the inflation rate were the decrease in energy prices and the marginal variation in food prices. Conversely, price increases for non-food items and services remained high. It is also noteworthy that, in this context, the adjusted Core2 inflation rate was higher than the CPI inflation rate in 2023: 14.7% at the end of the first quarter; 13.5% at the end of the second quarter; 11.4% at the end of the third quarter; and 8.4% at the end of the year.

Figure 3: GDP deflator decomposition



Source: Eurostat, Fiscal Council's calculations

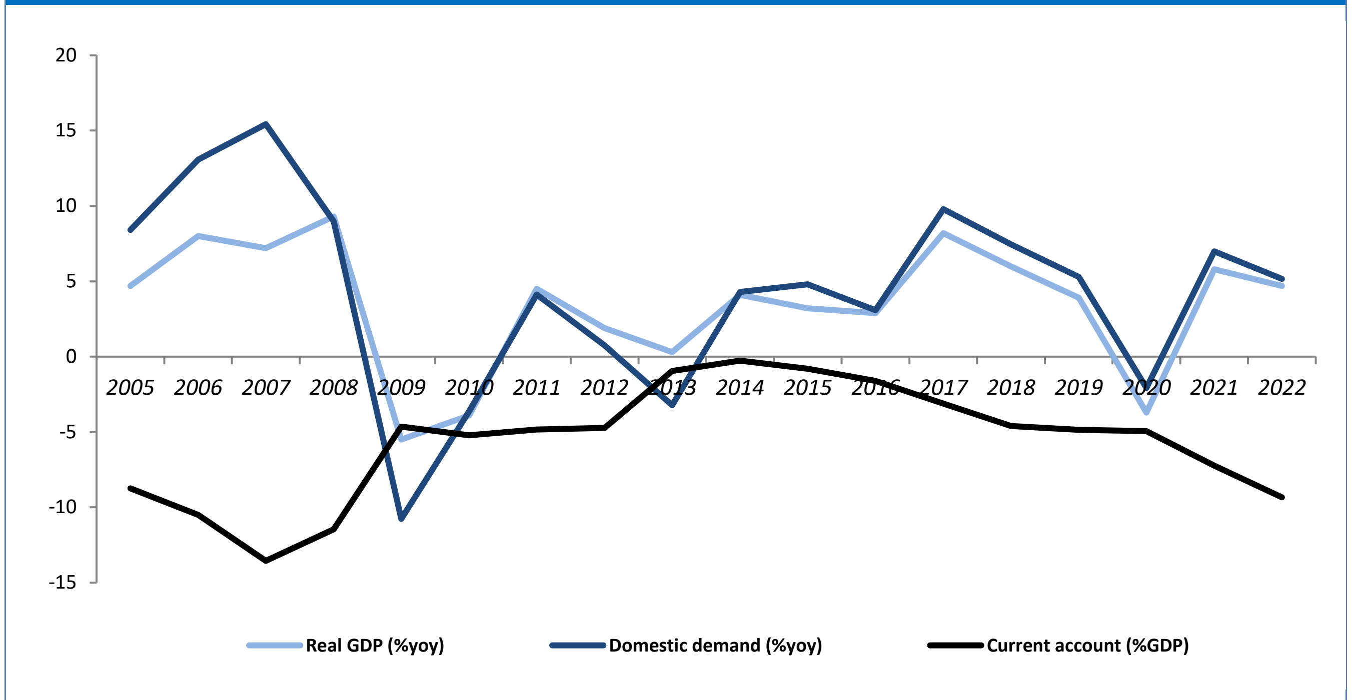
In 2023, against the backdrop of the disinflationary trend, the NBR concluded its cycle of tightening monetary conditions. Compared to 2022, when the reference interest rate was increased, in all eight meetings of the Board, by a total of 5 pp, in 2023, there was only one interest rate hike, from 6.75% to 7%, in the January meeting of the NBR's Board. Subsequently, the reference interest rate was kept unchanged, with the NBR aligning with the dominant trend among central banks to maintain high interest rates for an extended period. Regarding the minimum reserve requirements (MRR), the rate was maintained at 8% for liabilities in the national currency, while for liabilities in foreign currency, the MRR rate was 5%.

The current account deficit[6], as an indicator of Romania's external position, stood at 7.0% of GDP at the end of 2023 (see *Figure 4*), decreasing by approximately 2.2 pp compared to the previous year. Thus, 2023 marked a turning point in the trajectory of the widening current account deficit observed from 2015 to 2022. An important role in reducing the current account deficit was played by the favourable terms of trade, due to a broader variation in export prices compared to import prices[7].

[6] Data source: NBR, interactive database.

[7] According to NIS data on the unit value indices in international trade in 2023.

Figure 4: The evolution of real GDP, domestic demand and current account balance between 2005-2023



Source: NBR, Eurostat, Fiscal Council's calculations

Despite this, the level of the current account deficit remains high and raises concerns about the evolution of external imbalances and competitiveness. The European scoreboard sets an alert threshold when the average current account deficit over the past three years exceeds 4% of GDP. In Romania's case, this average reached 7.8% of GDP in 2023, with the 4% of GDP threshold being exceeded in each of the last three years. Consequently, the Romanian economy is characterized by a high level of twin deficits, which poses significant challenges to the country's economic stability. It is noteworthy that, unlike in years when the budget deficit exceeded the current account deficit[8], in 2023, the current account deficit was approximately 1.3 pp higher than the budget deficit, according to national methodology.

The reduction in the current account deficit was driven by a decrease in the goods and services balance deficit, which fell from €19.0 billion in 2022 to €15.5 billion in 2023 (equivalent to an 18.4% reduction). This dynamic was primarily supported by the evolution of the goods balance, where the deficit decreased by €3.0 billion (from €32 billion in 2022 to €29 billion in 2023), following an increase of €8.9 billion in the previous year. The contribution of the surplus balance of services to the reduction in the current account deficit declined compared to the previous year, as its value increased by only €0.4 billion (from €13.1 billion in 2022 to €13.5 billion in 2023), following a rise of €3.7 billion in 2022.

The primary income balance contributed to the deepening of the current account deficit, with its deficit increasing by €0.2 billion (from €8.5 billion in 2022 to €8.7 billion in 2023). However, its contribution to the increase in the current account deficit was reduced compared to 2022, when the negative balance

[8] For example, in the years 2009-2010, 2013-2014, 2016 and 2020.

grew by €3.7 billion. The secondary income balance remained in surplus, but its contribution to reducing the current account deficit decreased. This is because its surplus grew by €0.2 billion (from €1.4 billion in 2022 to €1.6 billion in 2023), compared to a surplus increase of €0.4 billion in the previous year.

Analysing the current account evolution from the perspective of the saving-investment balance, it can be noticed that the savings rate, as a percentage of GDP, increased by 0.8 pp, from 17.9% in 2022 to 18.7% in 2023. Conversely, the investment rate decreased by 1.4 pp, from 27.1% in 2022 to 25.7% in 2023. This explains the reduction in the current account deficit from 9.2% of GDP in 2022 to 7.0% of GDP in 2023.

Regarding the financing of the current account deficit (amounting to €22.6 billion), it was primarily covered through the financial account of the balance of payments (€11.9 billion) and, to a lesser extent, through the capital account (€6.8 billion). Within the financial account, net direct investments (in the form of equity participation, including net reinvested profits, as well as debt instruments) played a significant role in the available financing, amounting to €6.6 billion. However, this figure decreased by approximately 25% compared to the previous year, when it was €8.8 billion, primarily due to a reduction in the net value associated with debt instruments by €2.1 billion. The value of equity investments, including reinvested profits, decreased marginally from €6.7 billion in 2022 to €6.5 billion in 2023. Within the capital account, the balance slightly declined from €7 billion in 2022 to €6.8 billion in 2023, due to a reduction of €0.3 billion in capital transfers from public administration, which include European funds under the MFF and grants from the NRRP. In this context, the coverage of the current account deficit through non-debt-generating flows (considered to be the balance of the capital account and, from the financial account, only "Equity Participation of a direct investment nature, including reinvested earnings") increased to 58.9% in 2023, up from 52.5% in the previous year, due to a more significant reduction in the current account deficit.

In 2023[9], Romania's gross external debt increased by 18.2% compared to the previous year, reaching approximately €170 billion by the end of December. Its share of GDP rose by 1.8 pp from December 2022, reaching 52.4%. This trend contrasts with the period from 2013 to 2022, during which, with the exception of 2020, the share of external debt in GDP had been gradually decreasing. On the other hand, given the continued high twin deficits, it is possible that the trend of increasing external debt may continue in the coming years.

By the end of 2023, 71.6% of Romania's external debt was on long-term, a slight increase from 68.6% previously, due to a 23.4% nominal rise (from €98.6 billion in 2022 to €121.8 billion in 2023). A slower growth rate is noticeable for short-term external debt, which increased by €3.1 billion (+6.8%) in 2023, reaching €48.3 billion. Its share of total external debt decreased by 3.0 pp to 28.4%. The increase in the share of long-term debt in total external debt in 2023 contrasts with the trends of recent years, which were characterized by a decrease in the share of long-term debt (around 80% in the 2013-2014 period) in favour of short-term external debt.

[9] Data source: NBR, interactive database.

The dynamic of long-term debt in 2023 was primarily driven by the increase in the volume of debt securities issued by the public administration (+€18.3 billion), public administration loans (+€0.9 billion), debt securities issued by deposit-taking institutions excluding the central bank (+€2.2 billion), and loans contracted by other sectors (+€1.3 billion).

Direct external public debt increased by €19.1 billion at the end of 2023 compared to 2022, driven by a significant rise in the volume of long-term debt securities issued by the public administration. Consequently, the share of external public debt in total external debt increased from 57.8% in 2022 to 62% in 2023. Meanwhile, the share of external debt held by the central bank decreased marginally in 2023, from 3.4% to 2.7% of total external debt. As a result, the proportion of private external debt in total direct external debt decreased from 38.8% in 2022 to 35.4% in 2023.

Non-governmental credit[10] recorded a real decrease of 0.2% in December 2023 compared to the same period of the previous year (in nominal terms, non-governmental credit increased by 6.4%). The domestic currency component of non-governmental credit decreased by 0.8% in real terms (in nominal terms, it grew by 5.8%), while foreign currency loans, converted into lei, registered a real increase of 1.2% (7.9% in nominal terms). The marginal real decrease in non-governmental credit can be attributed to the maintenance of a high reference interest rate aimed at supporting the disinflationary trend. The slight increase in foreign currency loans was driven by rising demand from the non-financial sector, stimulated by the interest rate differential between the national currency and the euro, and by the fact that the European Central Bank concluded its interest rate hike cycle in September 2023, in contrast to January 2023 for the NBR.

With regard to the domestic currency loans granted to households, there was a real decrease of 2.6% in 2023 (in nominal terms, +3.8%). Foreign currency loans, expressed in lei, granted to households, experienced a more significant real decrease of 18.6%, corresponding to a nominal contraction of 13.2% during the same period. Domestic currency loans granted to non-financial companies and non-monetary financial institutions increased by 1.8% in real terms (+8.5% in nominal terms), while foreign currency loans, expressed in lei, grew by 6.8% in real terms (+13.8% in nominal terms). Government programs continued to support the dynamics of loans granted to the non-financial sector, as the share of government-guaranteed loans in the total loans granted to non-financial companies rose by about 3 pp compared to the previous year, reaching 20%. Conversely, the share of loans granted through the "New Home" program in the total mortgage loans continued to decline[11], reaching approximately 30% in 2023, compared to around 47% in 2018, with the program's allocation ceiling remaining unchanged at 1.5 billion lei.

The non-performing loan ratio continued its downward trend from previous years, reaching 2.3% in December 2023, compared to 2.7% in December 2022. The provision coverage ratio reached 67.3% at the end of 2023, down from 68.4% in 2022 – significantly above the European average of 42.3%. Additionally, from a macroprudential perspective, there is a comfortable level of liquidity in the banking

[10] Data source: NBR, interactive database.

[11] According to the Financial Stability Report of the National Bank of Romania, December 2023.

system, with the liquidity coverage ratio standing at 281%[12] at the end of the third quarter of 2023. Moreover, the loan-to-deposit ratio for individuals and non-financial companies was approximately 68%, decreasing by 3 pp compared to the previous year, highlighting issues in credit absorption at both the firm and household levels. For companies, the underlying issue is the capitalization problems in the real sector – about 30% of non-financial companies had capital below the regulatory limit[13] –, leading to a reduced number of bankable economic agents. At the household level, the significantly low loan-to-deposit ratio reflects high income inequality – Romania ranks fourth among EU countries in this regard –, which diminishes the appetite for bank loans as well as the creditworthiness of potential borrowers.

In 2023, labour market data revealed a slight increase in the average number of employees to 5.269[14] thousand (+1.1% compared to the previous year), as well as an ILO unemployment rate of 5.6%, a figure similar to the previous year. The average gross wage across the economy was 6,971 lei[15] (+13.8% compared to 2022). The average net wage was 4,352 lei (+14.5% compared to 2022), and the real wage increased by 3.7%.

Given the requirement for the FC to include in its annual report an *ex-post* evaluation of the macroeconomic and budgetary forecasts contained in the fiscal strategy that is the subject of the report (according to Article 61 of the FRL), *Table 1* presents the main macroeconomic forecasts from the 2023-2025 FS, compared to the actual values achieved for 2023, based on the most recent available data.

[12] According to the Financial Stability Report of the National Bank of Romania, June 2024.

[13] According to the Financial Stability Report of the National Bank of Romania, December 2023.

[14] According to the NCSP spring forecast, April 2024.

[15] According to the NCSP spring forecast, April 2024.

Table 1: Main macroeconomic indicators in 2023 (Fiscal Strategy forecast versus actual)		
	Fiscal strategy 2023-2025	Actual 2023
	%, change, year on year	
Gross domestic product		
GDP (mil. lei)	1,552,141	1,605,591
Real GDP	2.8	2.1
GDP deflator	8.2	12.2
GDP components		
Final consumption	2.4	3.5
Private consumption expenditure	2.7	2.8
Government consumption expenditure	1.2	6.0
Gross fixed capital formation	6.2	14.4
Exports of goods and services (volume)	4.5	-1.4
Imports of goods and services (volume)	5.4	-1.4
Inflation		
December 2022	8.0	6.6
Annual average	9.6	10.4
Labor market		
ILO unemployment rate (end of period)	5.3	5.6
Average number of employees	1.5	1.1
Net average wage	11.4	14.5

Source: NCSP, Eurostat, MF

Thus, in 2023, nominal GDP was 3.4% higher than the forecast in the 2023-2025 FS, given that the GDP deflator exceeded the initial estimates by 4 pp. Real economic growth was 0.7 pp lower compared to the forecast in the FS (2.1% versus 2.8%). Regarding the main components of GDP, actual growth rates were higher than estimates for final consumption (+1.1 pp) and gross fixed capital formation (+8.2 pp), while they were lower for exports of goods and services (-5.9 pp) and imports of goods and services (-6.8 pp). It is noteworthy that the positive effect of the increase in gross fixed capital formation was offset by the negative variation in inventories, resulting in a 2.6% decrease in gross capital formation volume compared to the previous year. On the labour market, the differences between actual values and those forecasted in the FS are smaller: +0.3 pp for the ILO unemployment rate, -0.4 pp for the growth rate of the average number of employees, and +3.1 pp for the dynamics of net wages.

III. Fiscal policy in 2023

III.1. Main features of the fiscal-budgetary policy in 2023

After the year 2022 continued the trend of reducing the budget deficit, bringing it down to 5.76% of GDP according to the cash methodology, and to 6.3% of GDP in ESA terms, the year 2023 marked a significant deviation from the fiscal consolidation targets. The main features of the fiscal-budgetary policy for 2023 will be summarized below and will be detailed further in this report:

- The budget construction for 2023 set a target deficit of 4.4% of GDP according to both cash methodology and the ESA 2010 methodology. The projected reduction in the deficit compared to the previous year was to be supported by an increase in the share of budget revenues in GDP, simultaneously with a decrease in the share of expenditures. The increase in budget revenues was expected to be achieved based on the macroeconomic framework projected for 2023, the fiscal policy measures adopted, the amounts considered, sourced from improved collection efficiency/reduced tax evasion, and NRRP projects. On the other hand, the reduction in the share of budget expenditures in GDP was due to a nominal decrease in subsidies and moderate nominal growth rates that were substantially lower than the projected nominal GDP dynamics for social assistance, goods and services, personnel, and interest expenses. At that time, based on a prudent approach to revenues and expenditures, the Fiscal Council assessed the budget construction for 2023 as compatible with a cash deficit around 5.7% of GDP.
- The analysis of the medium-term budget projection showed that the consolidation process for 2024-2026 period was expected to be achieved primarily on the expenditure side. The Fiscal Council raised questions about the realism of this approach, noting that, in the absence of credible policies to support fiscal consolidation in the medium term through increased fiscal revenues, the balance of risks was tilted towards higher deficits than those anticipated.
- From the first quarter of 2023, the budget execution showed a trend of exceeding the budget deficit target. The revenue dynamics revealed growth rates lower than those anticipated for the relevant macroeconomic bases, while the expenditure execution created the premises for exceeding the budgeted targets for social assistance, interest, goods, and services aggregates. The pressure on expenditures increased following the wage raises granted in the education sector, and later decisions were made to raise wages in other public sectors as well. In this context, in its annual report published in 2023, considering the unfavorable evolution of the budget execution and based on the assumption that no corrective measures would be taken to address the budgetary slippage, the Fiscal Council revised its deficit projection upwards, estimating that it was likely to exceed 6% of GDP.
- Although the budget execution in the first quarters of 2023 indicated significant deviations from the targets set in the initial budget, and despite usual practice, no budget revisions were adopted in the second half of the year. Instead, a series of emergency ordinances were adopted, aimed at using the budgetary reserve fund to balance the budgets of central and local authorities,

effectively transforming it from a tool dedicated to exceptional situations into a budget adjustment instrument for financing the current and capital expenditures of the main authorizing officers. Additionally, Law no. 296/2023 regarding certain fiscal-budgetary measures for ensuring Romania's long-term financial sustainability was adopted, introducing measures to increase budget revenues, most of which took effect on January 1, 2024, as well as measures to reduce public expenditures.

- In October 2023, through the Position Note regarding the Restriction of Public Expenditures, the FC highlighted that the use of the reserve fund effectively replaces budgetary adjustments and sets a precedent with major risks, from lack of transparency in budget execution to discretionary use and increased reliance on fiscal rule deviations. Additionally, the FC emphasized that spending limit measures had the potential to reduce the deficit by generating arrears, creating further pressure on the 2024 budget execution. Regarding the revenue-raising measures adopted by Law No. 296/2023, the FC acknowledged that they were a step towards a fair fiscal regime, but their impact was insufficient for ensuring sustainable fiscal consolidation.
- The 2023 budget execution, according to the cash methodology, recorded a deficit of 5.6% of GDP (1.2 pp above the target set in the initial budget) and 6.6% of GDP according to the ESA 2010 methodology (2.2 pp above the target set in the initial budget), confirming the Fiscal Council's assessments of the weaknesses in the initial budget and deviating significantly from the deficit reduction trajectory established under the excessive deficit procedure.
- The fiscal and budgetary developments in 2023 also impacted public debt, with its share of GDP rising by about 1.3 pp from 47.5% in 2022 to 48.8% in 2023. The main factor driving the increase in the public debt-to-GDP ratio was the high primary deficit (+4.6 pp), coupled with the stock-flow adjustment effect (+0.7 pp). These influences were partially offset by economic growth (-0.9 pp) and the real interest rate (-3 pp).
- In these conditions, it is absolutely necessary for Romania to continue the process of budgetary consolidation for reasons of stabilizing the level of public debt, reducing internal and external vulnerabilities, maintaining national currency stability, and safeguarding macroeconomic balances. At the same time, budgetary consolidation must also include measures to increase fiscal revenues, which are at an inadmissibly low level relative to Romania's needs and compared to EU benchmarks; budgetary correction cannot be achieved solely through spending cuts. Implementing a multi-year fiscal consolidation plan and effectively utilizing European funds available to Romania are the foundations for a gradual adjustment that minimizes associated economic and social costs and stimulates sustainable economic growth.

III.2. The assessment of objectives, targets and budgetary indicators

According to article 61, paragraph (2) of the Fiscal Responsibility Law no 69/2010 republished (FRL), the Fiscal Council's annual report must contain: "an analysis of the fiscal policy implemented during the previous year compared to the objectives that were set out in the fiscal strategy and the annual budget" and will include:

a) an ex-post evaluation of the macroeconomic and budgetary forecasts set out in the fiscal strategy and the annual budget to which the annual report corresponds, including the reporting, where applicable, of any persistent deviations in the same direction of macroeconomic forecasts compared to actual data, which were recorded over a period of at least 4 consecutive years;

b) an assessment of objectives, targets and indicators set out in the fiscal strategy and annual budget to which the annual report corresponds;

c) an assessment of the Government's compliance with the principles and rules of this law during the previous budget year;

d) opinions and recommendations of the Fiscal Council aimed at improving the conduct of fiscal policy during the current year, according to the principles and rules of this law.

In the characterization of the fiscal-budgetary policy for 2023, the following will be analyzed: the initial budget for 2023, the measures regarding the reduction of public spending (which were taken by the Government instead of the usual budget revisions carried out during the year), compliance with fiscal rules in the budgeting process, and the execution of the budget.

1. The initial budget for 2023

According to the provisions of art. 26, paragraphs (1) and (2) of the FRL, by July 31 of each year, the Ministry of Finance (MF) has the obligation to submit to the Government the Fiscal Strategy for the next 3 years, accompanied by the law for the approval of the ceilings specified in the fiscal-budgetary framework. The Fiscal strategy for the 2023-2025 period was sent simultaneously with the budget proposal [16], which involved an identical fiscal-budgetary framework for 2023 in the two above-mentioned documents. Under these circumstances, the obligation of the Fiscal Council to evaluate in the annual report the objectives, targets and indicators established by the Fiscal Strategy and by the budget is reduced exclusively to an *ex-post* analysis of the projections included in the initial budget. Therefore, monitoring the *ex-ante* compliance with the rules regarding the limits established for the budgetary indicators provided for by the law on ceilings is, similar to the situation in previous years, irrelevant. Considering the repeated non-compliance with the legal calendar for the elaboration and approval of the FS in recent years, the Fiscal Council notes that the perpetuation of this situation reduces

[16] On November 30, 2022, the Ministry of Finance submitted to the Fiscal Council, through letters 467618/29.11.2022 and 467619/29.11.2022, the draft of the general consolidated budget for 2023, the draft Law for the approval of ceilings for certain indicators specified in the fiscal-budgetary framework for 2023, along with the Explanatory Memorandum, the Fiscal-Budgetary Strategy for the 2023-2025 period, the Report on the macroeconomic situation for 2023 and its projection for the 2024-2026 period, the draft of the state budget law for 2023, the Explanatory Memorandum, and the draft of the social security budget law for 2023.

the relevance of the ceilings established for budgetary indicators and undermines the guiding role that a medium-term fiscal strategy must have for the budget, as it (the FS) remains recurrently dependent on short-term objectives.

The Fiscal Strategy for the 2023-2025 period set a cash budget deficit of 4.4% of GDP for 2023, representing a decrease of 1.34 percentage points compared to the level of 5.74% of GDP estimated at that time for 2022[17]. Expressed in ESA 2010 terms, the budget deficit was also estimated at 4.4% of GDP, down by 1.8 percentage points from the level assessed by the Ministry of Finance for 2022, of 6.2% of GDP. The consolidated general budget for 2023 was based on a macroeconomic scenario that estimated a real GDP growth of 2.8%, a GDP deflator of 8.2%, and an average annual inflation rate of 9.6%.

In the medium term, considering Romania's placement under the excessive deficit procedure (EDP)[18], the Fiscal Strategy projected a return to and maintenance of the budget deficit, in ESA 2010 terms, below the reference level of 3% of GDP starting from 2024[19].

In its opinion on the Budget Law for 2023[20], the FC noted that the budget draft and the 2023-2025 Fiscal Strategy were developed in an extremely complicated and complex international context, defined by the economic and security consequences of the war in Ukraine, the energy crisis caused by the significant rise in energy prices, persistent high inflation, tightening financial conditions in markets, a food crisis, the fragmentation of the global economic system, the regionalization of supply chains, and the increasingly severe effects of climate change. Among the main aspects mentioned by the FC are:

- According to the cash methodology, the planned reduction of the budget deficit to 4.4% in the 2023 budget was achieved through an increase in budget revenues by 0.9 percentage points of GDP, alongside a reduction in budget expenditures by 0.44 percentage points of GDP.
- The main factors influencing the projected dynamics of budget revenues in nominal terms for 2023 were: the macroeconomic framework, the adopted fiscal policy measures, the amount of funds considered to result from improved collection efficiency/reduction of tax evasion (towards which the FC expressed reservations about including *ex-ante* in the budget projection, in accordance with the principle of prudence), and the projects from the National Recovery and Resilience Plan. The FC deemed it likely that revenues would be lower compared to the targets set in the budget draft, by approximately 11.3 billion lei, representing around 0.73% of GDP.
- The planned reduction of budget expenditures, expressed as a share of GDP, was the result of a nominal decrease in subsidies, as well as moderate nominal growth rates for social assistance, goods and services, personnel, and interest expenditures, which were substantially lower than the projected nominal GDP growth. This reduction was partially offset by a significant increase in expenditures for projects financed by European funds, especially those related to NRRP, and

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[17] The execution for 2022 indicated a cash deficit of 5.72% of GDP, based on the GDP data published by Eurostat in April 2023.

[18] Triggered in April 2020, following the exceeding in 2019 of the reference level of 3% of GDP for the budget deficit expressed in European standards.

[19] The calendar is established by the EC within the framework of the EDP, taking into account the suspension of fiscal rules at EU level in the 2021-2023 period.

[20] http://www.fiscalcouncil.ro/FC%20opinion%20budget%202023%20FS%202023-2025.pdf

capital expenditures. The FC estimated that additional budget allocations would likely be necessary, amounting to approximately 5 billion lei for goods and services expenditures, at least 2 billion lei for social assistance expenditures, and at least 2 billion lei for interest expenditures, resulting in an under-budgeting of expenditures by at least 0.58% of GDP.

- Based on a prudent approach to budget revenues and expenditures, the FC assessed the 2023 budget framework as being compatible with a cash deficit of around 5.7% of GDP, significantly higher than the target of 4.4%.
- The FC welcomed the objective of raising investments to over 7% of GDP in 2023, considering the available European resources. However, the FC pointed out that the volume of investment expenditures not covered by non-reimbursable funding, especially the capital expenditure component and the loan component of the National Recovery and Resilience Plan, places additional pressure on the public budget.
- The medium-term fiscal consolidation was projected to be achieved predominantly through budgetary expenditure reductions. However, the FC raised questions about the realism of this approach, expressing concerns that, in the absence of credible policies also aimed at increasing fiscal revenues, the balance of risks was tilted toward higher deficits than those projected for the coming years.

2. The two budget revisions during 2023

In 2023, the Government did not resort to traditional budget revisions, but instead implemented a series of extreme measures to limit expenditures, using a *sui generis* instrument, the contingency reserve fund at the Government's disposal – measures which the FC equated with an actual budget revision[21]. Emergency Ordinance no. 90/2023, concerning the limitation of public expenditures in the last two months of 2023, reflected concerns about the evolution of the budget deficit, given the Government's commitments and targets related to the excessive deficit procedure.

Thus, in the first nine months of 2023, the budget deficit had reached 3.55% of GDP, and there was a possibility of it rising to around 6.5% of GDP in cash terms (according to the Fiscal Council's evaluations), in the absence of corrective actions. This was due to additional expenditures on wages, social assistance, interest payments etc., compared to those initially projected, and revenues falling short of budgetary forecasts. Since fiscal measures could not have a significant impact in the remaining months of 2023 (October-December), only the limitation of expenditures could have reduced the deficit and brought it below 6% of GDP in cash terms.

Regarding the set of fiscal measures enacted through Law no. 296/2023, the FC acknowledged that, despite the controversies, it represented a step towards establishing a fairer tax regime by eliminating exemptions and loopholes, as well as combating tax evasion. However, the projected budgetary impact of these measures was insufficient to reduce and maintain the budget deficit below the 3% of GDP threshold. In the context of a challenging budget execution and adverse internal and international

[21] http://www.fiscalcouncil.ro/Nota%20ordonanta%20cheltuieli%20EN%20-%20FINAL.pdf

conditions, the FC advocated for realism and prudence in budget planning, urging for measures that adhere to fiscal rules, consider transparency criteria, and follow best practices.

During September-October 2023, the Government adopted a series of normative acts targeting budgetary measures, namely: Government Emergency Ordinance (GEO) no. 73/14 September 2023 regarding certain budgetary measures; GEO no. 74/20 September 2023 for the amendment of paragraph (4) of Article 4 of Law no. 227/2015 regarding the Fiscal Code; GEO no. 78/28 September 2023 for the completion of Government Emergency Ordinance no. 73/2023 regarding certain budgetary measures, as well as measures to improve the absorption of European funds; and GEO no. 90/27 October 2023 for the approval of measures to reduce budgetary expenditures for 2023 in order to meet the budget deficit target assumed under the Convergence Program, as well as for the amendment and completion of certain normative acts.

- GEO no. 74/2023 derogated from the rule concerning the amendment of the Fiscal Code, which required a minimum period of 6 months between the time of publication in the Official Gazette of Romania and the moment the changes took effect. This was done under more broadly defined circumstances (such as the excessive budget deficit procedure) and targeted budget revenues, including the introduction of new taxes, fees, or mandatory contributions, the increase of existing ones, and the elimination or reduction of current tax benefits.
- GEO no. 73/2023 modified the operational framework of the contingency reserve fund, derogating from Law no. 500/2002 and from Article 12 (1) a) and c) and Articles 26 (4) and (5) of Law no. 69/2010 (regarding the ceiling on the consolidated general budget balance, the ceiling on personnel expenditures, and the ceiling on total expenditures of the consolidated general budget, respectively the limits on the total balance and personnel expenditures of the consolidated general budget). This transformed the reserve fund from an instrument dedicated to exceptional situations into a tool for normal budget adjustments, used to finance current and capital expenditures of the main credit authorizing officers[22].
- GEO no. 90/2023 generalized the mechanism introduced by GEO no. 73/2023 and supplemented by GEO no. 78/2023, making the budgetary reserve fund the instrument through which the Government could reduce expenditures and reallocate resources to other areas at its discretion. As a result, the normative act posed major legislative risks and had undesirable budgetary effects.

From a legislative perspective, GEO no. 90/2023 derogated from Article 12 (1) e) and Article 23 (1) of Law no. 69/2010, allowing the transfer of budget credits from investments to current expenditures and nullifying the rules regarding budget revisions, according to which "Any revision of the state budget, the social security budget, and special fund budgets, as well as the use of amounts retained in accordance with the provisions of Article 21 (5) of Law no. 500/2002, with subsequent amendments and completions, must take into account the conclusions of the semi-annual report on the economic and

[22] For the prioritized financing of personnel expenses, social assistance expenditures, the national public contribution for projects funded by non-reimbursable external funds, expenditures on medicines, and the health programs and actions of the main credit authorizing officers.

budgetary situation, as well as the opinion of the Fiscal Council regarding it." This emphasized the arbitrary use of public resources and discretionary allocation of these resources.

From a budgetary perspective, the provisions of GEO no. 90/2023 allowed for a reduction in the cash budget deficit, primarily by generating arrears (delaying payment of invoices, payment orders issued by National Authority for Property Restitution – NAPR, installments related to enforceable court rulings or administrative acts, etc.). However, this reduction would not be significant enough to bring the deficit close to the 2023 target (which the Fiscal Council had deemed unrealistic in its opinion on the 2023 budget draft). In ESA 2010 methodology (according to which targets under the excessive deficit procedure are set), the potential reduction of the deficit through the effects of the mentioned ordinance was considerably more limited. Furthermore, any such effect would be offset by a symmetrical impact, meaning an increase in the deficit in 2024.

Under these conditions, the FC considered a possible cash deficit of around 6% of GDP in 2023, with an even higher ESA deficit – both significantly exceeding the 4.4% of GDP target. The non-execution of certain military expenditures could have helped limit the cash deficit, but it would not have had any impact under the European ESA 2010 methodology.

The FC also emphasized that the use of the contingency reserve fund, effectively replacing formal budget revisions, could set a precedent involving major risks, ranging from a lack of transparency in budget execution to the discretionary use of resources and an increased reliance on derogations from fiscal rules. EU fiscal rules and practices promoted by the OECD call for this approach (using emergency ordinances to modify the budget without a proper revision) not to be repeated. Transparency is one of the essential requirements for the implementation of public policies, particularly fiscal-budgetary policy.

3. Compliance with fiscal rules in the budget programming process

Romania is subject of the excessive deficit procedure[23] that started prior to the triggering of the temporary derogation clause from the Stability and Growth Pact (SGP), whereby the budgetary rules were suspended in the 2020-2023 period[24] to give the member states the necessary leeway to implement appropriate measures to manage the difficult situations generated by the evolution of the pandemic, the increase in energy prices, the war in Ukraine, with important budgetary consequences.

On June 18, 2021, taking into account the special circumstances, the EU Council adopted a recommendation under the EDP stating that Romania should end the excessive deficit situation no later than 2024. The deadline allowed for a gradual effort and a balance between fiscal consolidation and economic recovery, thereby avoiding major economic shocks. According to this recommendation, in order to meet the deadline, Romania needed to follow the next trajectory for the gradual reduction of

[23] Following the exceeding in 2019 of the threshold of 3% of GDP, on the recommendation of the Commission from March 4, 2020, the Council decided on April 3, 2020 to apply EDP for Romania, with the recommendation to reduce the excessive deficit by 2024.

[24] In May 2022, the EC extended for another year the activation of the derogatory clause that allows the temporary exceeding of the limits set out in the SGP, due to the uncertain economic context created by the war in Ukraine.

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 Romania managed to meet the deficit levels set for 2021 and 2022 in line with the fiscal consolidation calendar, 2023 saw a major deviation from the 4.4% target, recording an ESA deficit of 6.6%. This highlights serious shortcomings in the 2023 budget framework, which the Fiscal Council had already warned about in its December 2022 opinion.

On June 19, 2024, the EU Council officially concluded[25] that the actions taken by Romania in response to the recommendations made on June 18, 2021, were insufficient to meet the established trajectory for reducing the budget deficit by 2024. The fiscal effort was significantly lower in 2023, as public expenditures saw a sharp increase, especially in social assistance, interest payments, goods and services, capital expenditures, and public sector wage increases following court rulings. The higher-than-expected GDP growth led to a significant increase in public revenues, but most of this increase was directed towards supporting the elevated public spending, rather than towards fiscal consolidation, as would have been appropriate and in line with the European Commission's recommendations. The European Commission's Spring 2024 forecast placed Romania's budget deficit for 2024 at nearly 7% of GDP (specifically, 6.9%), driven by a significant increase in current public expenditures.

Typically, the assessment of compliance with fiscal rules is conducted by analysing any changes to the ceilings defined by Law no. 360/2022 for the approval of certain indicators within the fiscal-budgetary framework for 2023, through derogations established during the budget revisions that should have been adopted throughout the year. In the absence of these revisions, which were avoided by turning the reserve fund into a budget adjustment tool, the ceilings defined by Law no. 360/2022 will be compared to the actual values in the budget execution.

It is important to note that Law no. 360/2022 set the cash deficit limit at 4.4% of GDP for 2023, corresponding to an ESA deficit of 4.4% of GDP, which was equal to the 2023 target specified in the European Commission's June 2021 recommendation under the excessive deficit procedure. By derogation from the provisions of Articles 6, 7, and Article 26(3) of the Fiscal Responsibility Law, Law no. 360/2022 did not provide a clear path toward the medium-term budgetary objective (MTO). However, it specified that structural balance adjustment would continue in 2023, with the structural deficit estimated at -3.79% of potential GDP, expected to decrease in 2024 (-2.71%) and to reach -3% in 2025[26].

In *Table 2*, the limits of the main indicators established by Law no. 360/2022 are presented. The figures in italics represent the recalculated values of the indicators as a percentage of GDP, based on updated GDP data (Eurostat, May 2024), which amounted to 1,605.6 billion lei, compared to the initially estimated 1,552.1 billion lei in the original budget.

The ceiling for the general consolidated budget (GCB) balance was exceeded in the budget execution by 21.610 billion lei, with the deficit for 2023 amounting to a nominal value of 89.9024 billion lei. Relative to the updated GDP level, the deficit represented 5.6% of GDP, compared to the limit of 4.25%. Similarly,

[25] https://www.eumonitor.eu/9353000/1/j4nvhdfdk3hydzq_j9vvik7m1c3gyxp/vme95hgjzdvu

[26] In the 2023-2026 Convergence Program, the estimates for the structural balance were as follows: -3.5% in 2023, -2.2% in 2024, -2.4% in 2025, and -2.7% in 2026.

the ceiling for personnel expenditures was exceeded by almost 4%, with expenditures totaling 132,695.5 billion lei, compared to the limit of 127,628.3 billion lei. Based on the updated GDP level, personnel expenditures accounted for 8.26% of GDP, exceeding the ceiling of 7.9%.

Table 2: Nominal ceilings for GCB balance, total and personnel expenditure			
	Law no. 360/2022		
	GCB balance	Total expenditure*	of which: Personnel expenditure
mil. lei	**-68,292.4**	**536,824.5**	**127,628.3**
% of GDP initial budget	**-4.40%**	**34.6%**	**8.2%**
% of GDP budget execution	*-4.25%*	*33.4%*	*7.9%*

** Excluding financial assistance from the EU and other donors*
Source: MF, Eurostat

Thus, even though no budget revisions were adopted in 2023, and consequently no increases in the initially set ceilings, the 2023 budget execution confirms, similar to previous years, the persistence of significant weaknesses in the construction of public budgets in Romania. It also highlights the weak binding nature of fiscal ceilings and rules, which can be easily circumvented, thereby limiting the role these should play in guiding the fiscal policy.

4. The budget execution

The results of the 2023 budget execution (including the swap scheme) indicate a deficit of 89.9 billion lei, according to the national methodology, which is 21.6 billion lei above the target set in the initial budget (68.3 billion lei). As a share of GDP, the cash deficit registered a higher level than planned (5.6% compared to 4.4%). According to the ESA methodology, the budget deficit was 6.6% of GDP, with the gap compared to the initial budget projection (4.4% of GDP) being even larger in this case.

The significant difference between the deficit according to the ESA methodology and the cash deficit was primarily driven by factors that increased the ESA deficit. These included: arrears of the consolidated general budget, likely due to the adoption of public expenditure limitation measures that mostly delayed payments (around +9 billion lei); court rulings regarding magistrates' salaries (around +8.1 billion lei); differences in the treatment of interest expenditures (around +2.1 billion lei); and unpaid NARP-issued titles (around +1.7 billion lei). These differences were partially offset, reducing the gap between the ESA and cash deficits, by revenues representing claims to be collected in 2024, amounting to around 7 billion lei, as well as by military equipment purchases worth approximately 1.3 billion lei. Unlike in 2022, the impact of the energy bill compensation scheme had a negligible effect on the gap between the cash and ESA deficits.

The 2023 execution (excluding the swap scheme[27]) reveals a significant shortfall in the revenue targets set in the initial budget, while the deviation in expenditures from the initial target is not as large, given the measures taken towards the end of the year to limit them. *Table 3* presents the evolution of the main budget aggregates throughout 2023 in cash standards.

Table 3: The evolution of the main budgetary aggregates during 2023 (billion lei)		
	Initial budget	**Budget execution**
Total revenues, of which:	**538.8**	**520.3**
Tax revenues	258.5	250.7
Social security contributions	161.6	157.8
EU funds	71.3	67.7
Total expenditures, of which:	**607.1**	**610.2**
Current expenditure, of which:	552.9	573.4
Projects from EU funds*	73.2	68.3
Capital expenditures	54.2	38.8
Budget deficit	**-68.3**	**-89.9**

Source: MF

Note: Amounts without swap compensation schemes

** Amounts without the loan component of NRRP*

Total budget revenues, net of the impact of swap compensation schemes, were 18.5 billion lei below the initial estimate. Structurally, all categories of revenues fell short of expectations, as follows: *tax revenues* (-7.8 billion lei), *social security contributions* (-3.8 billion lei), *non-fiscal revenues* (-3.3 billion lei), and in terms of *European funds* (including *amounts received from the EU for operational programs financed under the convergence objective*, as well as *amounts related to non-refundable financial assistance allocated for NRRP*), the shortfall compared to the budget projection was 3.6 billion lei.

Within the structure of *tax revenues*, significant exceedances were recorded compared to initial provisions in the following categories: *other taxes on goods and services* (+6.2 billion lei), *personal income tax* (+2.9 billion lei), and *other taxes on income, profits, and capital gains* (+1.6 billion lei). The largest shortfalls compared to the initial program were in *VAT* (-9.3 billion lei), *corporate tax* (-4 billion lei), *property taxes* (-2.7 billion lei), and *excise duties* (-1.3 billion lei).

The level of public expenditures exceeded the initially planned value by 3.1 billion lei. The main expenditure aggregates that recorded significant exceedances were: *social assistance* (+10 billion lei), *projects financed from non-reimbursable external post-accession funds 2014-2020* (+7 billion lei), *subsidies* (+6.7 billion lei), *personnel expenditures* (+5.1 billion lei), *projects financed from non-reimbursable external funds* (+3.5 billion lei), *goods and services* (+2.5 billion lei), and *other expenditures* (+1.6 billion lei). The largest shortfalls in budgeted amounts were recorded in *capital expenditures* (-15.4 billion lei, with funds redirected to *current expenditures*, which increased by 20.6 billion lei), followed by

[27] In the execution, this amounted to 1,136.1 million lei, exceeding the initially projected level of 850 million lei.

projects financed from non-reimbursable financial assistance under the NRRP (-11.9 billion lei), *projects financed from the loan component of the NRRP* (-2.2 billion lei), and *other transfers* (-1.9 billion lei).

Table 4 presents the evolution of budget revenues and expenditures from the perspective of the national (cash) methodology, expressed as a percentage of GDP. Compared to the previous year, in 2023, a reduction in the budget deficit as a percentage of GDP by 0.16 percentage points was recorded, explained by a decrease in the share of budget revenues in GDP by 0.36 percentage points, along with a reduction in the share of budget expenditures in GDP by 0.52 percentage points.

The GCB revenues with the most favorable evolution were the *amounts received from the EU for payments made* (+0.63 percentage points), while decreases occurred in *tax revenues* (-0.8 percentage points), *non-fiscal revenues* (-0.18 percentage points), and *social security contributions* (-0.11 percentage points).

At the level of *tax revenues*, increases compared to the previous year were recorded only for *personal income tax* (+0.11 percentage points), while decreases were noted for *other taxes on goods and services* (-0.30 percentage points), *VAT* (-0.21 percentage points), *excise duties* (-0.20 percentage points), and *corporate tax* (-0.09 percentage points).

Regarding GCB expenditures, compared to the previous year, the most significant reduction was recorded in *social assistance expenditures* (-0.54 percentage points), followed by *capital expenditures* (-0.47 percentage points), *goods and services* (-0.36 percentage points), *interest payments* (-0.17 percentage points), and *subsidies* (-0.16 percentage points), while the reduction in *personnel expenses* amounted to 0.13 percentage points of GDP.

On the other hand, increases compared to 2022 were recorded for expenditures on *projects financed from non-reimbursable post-accession external funds* (+1.25 percentage points).

Table 4: The evolution of public revenues and expenditures (national methodology, % of GDP)										
	2015	2016	2019	2020	2021	2022	Initial budget 2023	Execution budget 2023	Initial budget 2023 - Initial budget 2022	Execution 2023-2022
Total revenues	**32.8**	**29.4**	**30.3**	**30.4**	**31.9**	**32.8**	**33.6**	**32.4**	**2.22**	**-0.36**
Tax revenue (without SSC)	19.4	17.8	14.8	14.2	15.7	16.4	16.1	15.6	1.07	**-0.80**
Personal income tax	3.7	3.6	2.2	2.3	2.4	2.4	2.3	2.5	0.09	**0.11**
Corporate tax	1.9	2.0	1.7	1.5	1.7	1.9	2.1	1.8	0.52	**-0.09**
Property tax	0.8	0.8	0.6	0.6	0.6	0.5	0.6	0.5	0.08	**-0.04**
VAT	8.0	6.8	6.2	5.7	6.7	6.7	7.1	6.5	0.53	**-0.21**
Excise duties	3.7	3.5	3.0	2.9	2.9	2.5	2.4	2.3	-0.34	**-0.20**
SSC	8.1	8.0	10.5	10.5	10.7	9.9	10.1	9.8	0.11	**-0.11**
Non-fiscal revenues	2.7	2.3	2.6	2.3	2.2	2.8	2.9	2.7	0.79	**-0.18**
Donations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.00	**0.00**
Amounts received from the EU for payments made	2.4	1.0	2.4	3.3	3.2	3.3	3.7	4.0	0.14	**0.63**
Total expenditures	**34.2**	**31.6**	**34.9**	**40.0**	**38.7**	**38.5**	**37.8**	**38.0**	**0.98**	**-0.52**
Personnel expenditures	7.3	7.5	9.7	10.4	9.4	8.4	7.9	8.3	-0.29	**-0.13**
Goods and services	5.7	5.4	5.0	5.4	5.4	5.2	4.7	4.8	-0.10	**-0.36**
Interest	1.3	1.3	1.1	1.4	1.5	2.1	1.8	1.9	0.39	**-0.17**
Subsidies	0.9	0.9	0.7	0.8	0.7	1.3	0.7	1.1	-0.20	**-0.16**
Projects funded from non-refundable external post-accession funds	3.4	0.8	2.6	3.3	3.5	3.6	5.0	4.9	0.26	**1.25**
Social assistance	10.7	10.7	10.8	13.1	12.4	12.4	11.3	11.9	-0.17	**-0.54**
Capital expenditures	2.6	2.5	2.9	3.1	2.8	2.9	3.4	2.4	0.61	**-0.47**
Budget balance	**-1.45**	**-2.2**	**-4.59**	**-9.61**	**-6.73**	**-5.76**	**-4.25**	**-5.60**	**1.24**	**0.16**

Source: MF, FC's computation

Note: Amounts without swap compensation schemes

Table 5 presents the evolution of budgetary revenues and expenditures in ESA 2010 standards[28], expressed as a percentage of GDP.

Table 5: The evolution of public revenues and expenditures (ESA 2010, % of GDP)								
	2015	**2016**	**2019**	**2020**	**2021**	**2022**	**2023**	**Changes 2023/2022**
Total revenues	**35.5**	**32.5**	**32.0**	**32.5**	**32.9**	**33.7**	**33.6**	**-0.1**
Indirect taxes, of which	13.3	11.5	10.5	10.3	10.7	10.6	10.6	0.0
VAT	8.1	6.5	6.2	6.1	6.4	6.8	6.6	-0.2
Excises + custom duties	5.2	5.0	4.3	4.2	4.3	3.8	4.0	0.2
Direct taxes, of which:	6.6	6.5	4.8	4.7	5.1	6.1	5.2	-0.9
Personal income tax	3.7	3.7	2.3	2.4	2.4	2.5	...	...
Corporate tax	2.3	2.3	2.1	1.9	2.2	3.1	...	...
SSC	8.1	8.9	11.2	11.8	11.3	10.7	10.8	0.1
Other current revenues	2.0	1.6	1.8	1.8	1.5	1.7	1.8	0.1
Amounts from the EU	2.7	1.4	1.1	1.6	1.9	2.2	3.0	0.8
Total expenditure	**36.0**	**35.0**	**36.3**	**41.8**	**40.0**	**40.0**	**40.2**	**0.2**
Intermediate consumption	5.9	5.7	5.6	5.9	5.9	5.6	6.0	0.4
Compensation of employees	7.8	9.1	11.4	12.2	11.2	10.0	10.0	0.0
Interest	1.6	1.4	1.2	1.4	1.5	1.5	2.0	0.5
Social assistance	11.5	11.7	11.8	13.4	13.2	13.1	12.5	-0.6
Subsidies	0.4	0.3	0.3	0.9	0.5	1.7	1.0	-0.7
Other current expenditures	2.4	1.4	1.5	2.1	2.3	1.9	1.7	-0.2
Gross fixed capital formation	5.2	3.7	3.5	4.6	4.2	4.4	5.3	0.9
Budget balance	**-0.5**	**-2.5**	**-4.3**	**-9.3**	**-7.2**	**-6.3**	**-6.6**	**-0.3**

Source: Eurostat

The fiscal consolidation initiated in 2010 to correct the major imbalances in public finances was characterized by a rapid pace, with Romania managing to reduce the ESA budget deficit to 0.5% of GDP in 2015 within a relatively short period. Between 2016 and 2019, expansionary fiscal policy led to a reversal of this trend, with a significant increase in the budget deficit compared to 2015, driven by a massive drop in revenues. Consequently, 2019 marked the breach of the 3% of GDP threshold (with the recorded deficit being 4.3%), and Romania was placed under the excessive deficit procedure in April

[28] The data in this table are not fully comparable with those in *Table 4*, as the differences stem from the different scope covered by the two standards, ESA 2010 and the national standard.

2020. The fiscal measures taken in 2020 to mitigate the social and economic effects of the pandemic put additional pressure on the budget, with the GCB deficit reaching 9.3% of GDP. 2021 saw an economic recovery, driven by government support measures and an improvement in the health situation. Compared to the previous year, budget revenues increased by 0.4 pp of GDP, while total expenditures decreased by 1.8 pp of GDP, resulting in a deficit of 7.2% of GDP, 2.1 pp below the level reached in 2020. In 2022 and 2023, the significant growth in nominal GDP, 18.02% in 2022 and 14.6% in 2023, led to a strong increase in public revenues, 20.8% in 2022 and 14.2% in 2023. However, this increase was not used to reduce the budget deficit, but rather to finance additional expenditures[29].

In 2023, budget revenues accounted for 33.6% of GDP. The most significant increases compared to 2022 were recorded in *receipts from European funds* (+0.8 pp of GDP). The increases in *excise and customs duty revenues* (+0.2 pp of GDP) were offset by an equivalent decrease (-0.2 pp of GDP) in VAT revenues. Marginal increases were also noted for *social contributions and other current revenues* (+0.1 pp each), while *direct taxes* experienced a notable decline of -0.9 pp of GDP.

In 2023, budgetary expenditures accounted for 40.2% of GDP, an increase of 0.2 pp compared to the previous year. The most significant increases were observed in *expenditures on gross fixed capital formation* (+0.9 pp), *interest payments* (+0.5 pp), and *intermediate consumption* (+0.4 pp), while the share of *employee compensation* in GDP remained stagnant. On the other hand, decreases were recorded in *subsidies* (-0.7 pp), *social assistance expenditures* (-0.6 pp), and *other current expenditures* (-0.2 pp).

Romania's budgetary situation is particularly complicated. On one hand, the war in Ukraine (which requires increased defense funding), the challenges stemming from the energy transition and climate change, rising wages in numerous public sector areas, and the cost of pension reform are putting additional pressure on the budget. On the other hand, it is absolutely necessary for Romania to continue the process of fiscal consolidation, to stabilize public debt levels, reduce internal and external vulnerabilities, ensure the stability of the national currency, and safeguard macroeconomic balances.

Under these conditions, the fiscal consolidation process must also include measures to increase tax revenues, as they are at an unacceptably low level relative to Romania's needs and compared to EU benchmarks. Budgetary correction cannot be achieved solely by reducing expenditures. The implementation of a multi-annual fiscal consolidation plan and the efficient use of European funds available to Romania are essential foundations for a gradual adjustment. This approach aims to minimize the associated economic and social costs while fostering sustainable economic growth.

[29] https://www.eumonitor.eu/9353000/1/j4nvhdfdk3hydzq_j9vvik7m1c3gyxp/vme95hgjzdvu

III.3. The structural budget balance in Romania

The signing and ratification of the Treaty on Stability, Coordination, and Governance in the Economic and Monetary Union (TSCG) by Romania in 2012 established a rule-based fiscal framework aimed at a structural deficit target of no more than 1% of potential GDP[30]. The provisions of the TSCG and Directive 85/2011 were incorporated into national legislation through the amendment of Law 69/2010 (Fiscal Responsibility Law) in December 2013. As a result, medium-term budget planning became constrained by the new structural budget deficit rule[31] set out in the TSCG, starting with the preparation of the 2015 budget. Theoretically, with the attainment of the medium-term objective (MTO) in 2015, the fiscal consolidation process initiated in Romania in 2010 could have been considered complete. However, this constraint ceased to function afterward, as from 2016, there was a deliberate and significant deviation from the rule limiting the structural deficit to a maximum of 1%. Between 2017 and 2019, Romania was subject twice to the significant deviation procedure from the MTO – the preventive arm of the Stability and Growth Pact – and in early March 2020, Romania was placed under the excessive deficit procedure – the corrective arm of the SGP.

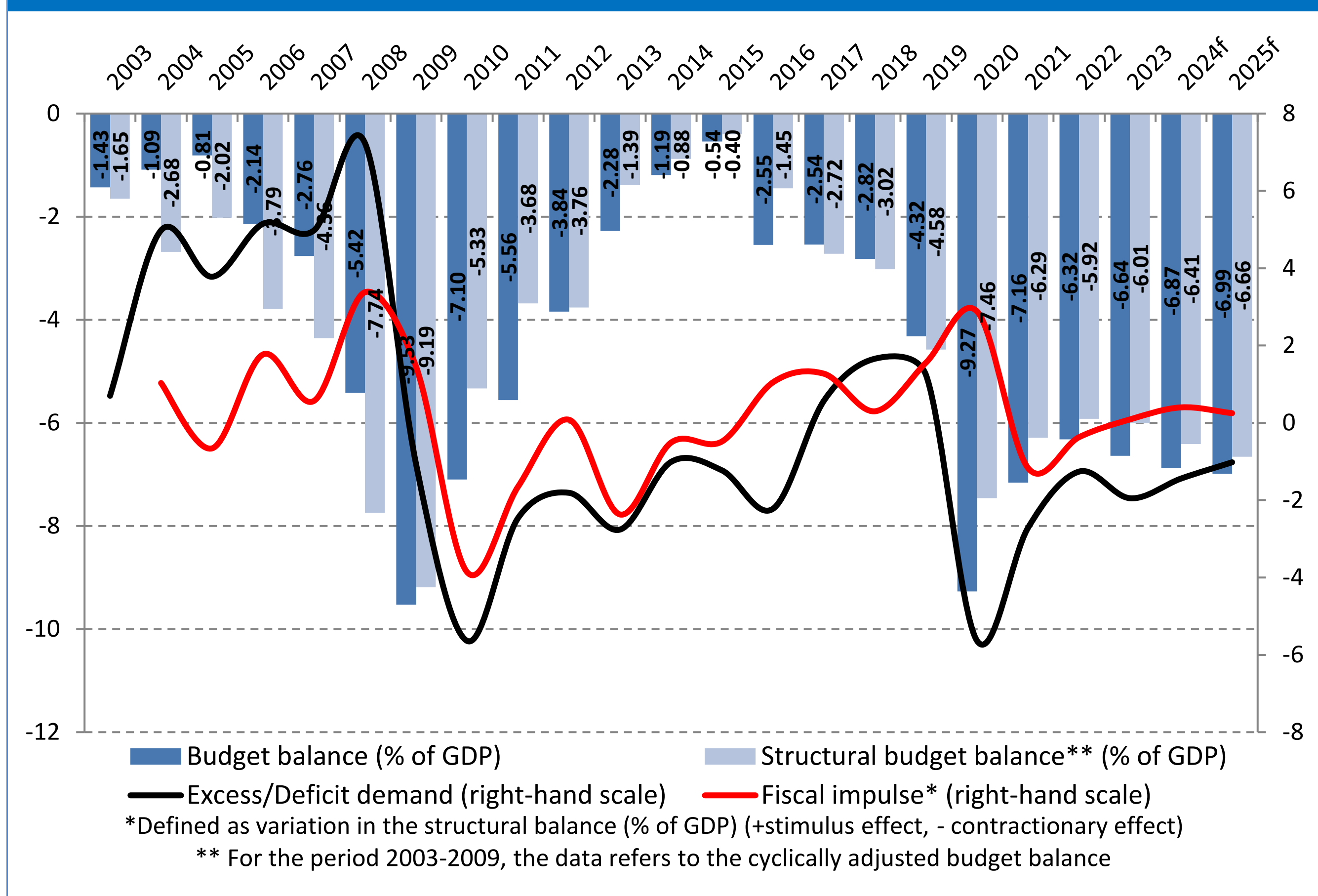
When defining the target in terms of the structural deficit, it implies an effective deficit goal adjusted for the economy's position in the economic cycle. When the output gap turns positive, achieving the structural deficit target of 1% of GDP requires lower actual deficit levels (as the cyclical budget balance component[32] is positive). Although the structural balance better reflects the fiscal stance, it has drawbacks, primarily due to uncertainties in its estimation. The structural balance depends on the output gap, which is calculated relative to potential GDP – an unobservable figure often subject to significant revisions based on updated data and methodologies. For instance, Romania's output gap estimate for 2021 was revised from -2.86% (2021), -1.09% (2022), and -1.17% (2023) (AMECO, June 2023) to -2.71% (2021), -1.26% (2022), and -1.95% (2023) (AMECO, June 2024).

[30] The TSCG requires the contracting parties to ensure convergence towards each country's specific medium-term objective (MTO) in accordance with the Stability and Growth Pact (SGP), with a structural deficit limit of 0.5% of GDP, or 1% of GDP for member states with public debt significantly below 60% of GDP (as is the case for Romania). Achieving the MTO should provide a safety margin to ensure compliance with the 3% of GDP limit for the ESA budget deficit, as well as sufficient fiscal space for some discretionary measures.

[31] The structural deficit is calculated by subtracting the cyclical component of the budget deficit and one-off and temporary measures from actual budget balance. For more details, see http://www.fiscalcouncil.ro/annualreport2012.pdf.

[32] The cyclical component of the budget balance is calculated as output gap * ε, where ε represents the semi-elasticity of the budget deficit to changes in the level of economic activity.

Figure 5: Structural deficit, fiscal impulse and the excess demand



Source: AMECO, FC's calculations

The evolution of the structural deficit, fiscal impulse, and demand excess (as shown in *Figure 5*) demonstrates that, between 2003 and 2023, Romania predominantly followed a pro-cyclical fiscal policy[33]. The discretionary policy of intense but unnecessary and counterproductive economic stimulus during pre-crisis expansion periods (2006-2008 and 2017-2019) and of tightening during periods when the economy operated below potential (2010-2015 and 2021-2022) contributed to amplifying economic cycle fluctuations due to its pro-cyclical nature, negating the effect of automatic stabilizers.

During the period from 2009 to 2015, Romania's structural budget deficit decreased from 9.2% of potential GDP in 2009 to 0.4% in 2015, with an average adjustment pace of 1.5 percentage points per year. Given the high starting level relative to financing constraints, radical measures were swiftly adopted in 2010 and 2011, achieving fiscal consolidation with an average adjustment of nearly 3 percentage points annually, primarily on the expenditure side. However, this process was reversed starting in 2016 due to the new Fiscal Code, which introduced significant fiscal relaxation alongside substantial increases in permanent spending (wages and pensions[34]). Maintaining an expansionary fiscal policy amid a positive output gap since 2017 and deliberately bypassing the rules of the TSCG and the

[33] Except for the years 2005, 2009, 2012, 2016, 2020, and 2023.

[34] Starting with 2017, a series of ad-hoc increases to the pension point were legislated (+65% between 2017-2020).

Fiscal Responsibility Law regarding the structural deficit target led to a rapid deterioration of public finances. The 2019 budget execution ended with an ESA deficit of 4.3% of GDP, significantly above the 3% threshold. As a result, Romania was placed under the excessive deficit procedure in March 2020, a status maintained even with the activation of the general escape clause under the Stability and Growth Pact.

The onset of the COVID-19 pandemic occurred while Romania ended 2019 with a structural deficit of approximately 4.6% of potential GDP, the highest in the EU, which greatly limited the room for maneuver in combating the effects generated by the pandemic. In 2020, a structural deficit of 7.5%[35] of potential GDP was recorded. Given the adverse cyclical developments[36] caused by the pandemic, fiscal-budgetary policy in 2020 was countercyclical, having a strongly stimulative character (a fiscal impulse of 2.9 pp), in the context of measures to support the economy, the population, and the healthcare sector, alongside increased expenditures (pension point and child allowance increases) and tax reductions decided prior to the pandemic's onset (the elimination of the supra-excise duty and the bank asset tax).

In 2021, the budget deficit according to the ESA 2010 methodology was reduced to 7.2% of GDP, against the backdrop of macroeconomic recovery and the better-than-expected recovery of budgetary obligations for 2020, which had been deferred by economic agents. These favorable developments could have allowed for a more significant reduction of the budget deficit compared to the actual level recorded. However, the additional revenues were fully allocated to increases in expenditure aggregates, with additional increases in budgetary expenditures also noted. Therefore, although the budget deficit decreased by 2.1 pp in 2021 compared to the previous year, the pace of structural deficit adjustment was only 1.2 pp, from 7.5% in 2020 to 6.3% in 2021.

In 2022, the process of fiscal consolidation continued, with the ESA deficit reaching 6.3% of GDP. However, compared to 2021, the magnitude of the budget deficit reduction was smaller, at only 0.9 pp, and the pace of structural deficit adjustment was just 0.4 percentage points, from 6.3% to 5.9% of potential GDP. Similar to 2021, the contractionary fiscal impulse overlapped with a demand deficit. The slowing of fiscal consolidation was mainly due to the complex context of 2022, marked by the energy crisis, continued supply chain tensions, the war in Ukraine, and high, persistent inflation. In this regard, 2022 saw a substantial upward revision of budget revenues compared to the initial budget, driven by higher-than-expected inflation and additional collections from the surcharge on electricity and natural gas producers. However, this revenue surplus was outweighed by increased budget expenditures, particularly in social assistance, interest payments, other transfers, and goods and services.

Unlike in 2021 and 2022, 2023 marked a reversal in the trend of fiscal consolidation. The ESA budget deficit increased by 0.3 pp compared to the previous year (from 6.3% in 2022 to 6.6% in 2023), while the structural deficit rose by 0.1 pp (6% in 2023, compared to 5.9% in 2022), reflecting a slight stimulative

[35] According to the AMECO database, it's important to note that the structural deficit level is identical in the European Commission's evaluation to that of the cyclically adjusted deficit.

[36] According to the European Commission (EC), Romania shifted from a demand surplus of 1.2% of potential GDP in 2019 to a demand deficit of 5.6% in 2020.

fiscal impulse. The widening of the budget deficit was driven by both the overestimation of budget revenues (mainly due to the *ex-ante* consideration of additional sums expected to be obtained from the desired improvement in collection efficiency) and the insufficient allocation of resources for certain expenditure categories (especially goods and services, interest payments, and social assistance). Additionally, the erosion of purchasing power, caused by high inflation, set the stage for labour disputes, which led to decisions to increase public sector wages, with negative implications for the aggregate personnel expenditure.

The budget framework for 2024 targets a budget deficit of 4.9% of GDP, according to ESA 2010 methodology, with a projected path to return below the 3% of GDP threshold starting in 2027[37]. This trajectory is deemed compatible, according to the MF, with a reduction in the structural deficit by 3.1 pp by 2027. For 2024, in the MF's view, the consolidation process will be supported on both the revenue and expenditure sides by the measures included in Law No. 296/2023 on fiscal-budgetary measures to ensure Romania's long-term financial sustainability. On the revenue side, the most important measures include: (i) introducing a minimum turnover tax; (ii) imposing an additional tax on credit institutions; (iii) introducing an additional tax for operators in the oil and natural gas industry; (iv) increasing taxes on the income of microenterprises; (v) eliminating reduced VAT rates on a range of services and products; (vi) updating excise duties for tobacco and alcohol products and introducing an excise tax on sugary non-alcoholic beverages; (vii) taxing high-value real estate and movable property; (viii) reducing tax exemptions in the construction, agriculture, food industry, and IT sectors; (ix) limiting health contribution deductions for self-employed activities and applying health contribution to meal and vacation vouchers. On the expenditure side, the main measures include: (i) eliminating vacant positions in public institutions and reducing leadership positions; (ii) merging some public institutions; (iii) reducing the provision of meal allowances and vacation vouchers; (iv) other spending cuts in state-owned companies and enterprises. As for medium-term fiscal consolidation, it is projected to be achieved exclusively through budget expenditure cuts. However, the Fiscal Council, in its analysis of the 2024 budget draft, emphasized that the projected target is unrealistic. It was likely, barring drastic cuts to capital expenditures, that the deficit would be around 6.4% of GDP. After reviewing the six-month budget execution and other data, the FC estimates that, in the absence of fiscal-budgetary consolidation measures, the deficit will probably exceed 7% of GDP this year, with the risk of approaching 8% of GDP.

In its analyses, the FC has repeatedly highlighted the particularly difficult fiscal situation Romania is facing, characterized by insufficient budget revenues relative to expenditures, as well as a high level of structural deficit and external deficits. Fiscal consolidation is urgently needed, but the FC has pointed out that this consolidation cannot be achieved solely through expenditure reductions, as critical sectors (such as public health and education) are chronically underfunded, the military conflict in Ukraine requires increased defense and security spending, high inflation has significantly eroded purchasing power, with significant effects on low-income individuals, and the impact of climate change and the energy transition necessitate strengthening the state's intervention capacity in times of crisis. Therefore,

[37] According to the Ministry of Finance's Report on the Macroeconomic Situation for 2024 and Its Projection for 2025-2027 period, by the Ministry of Finance.

fiscal consolidation through increased tax revenues is a matter of economic security and national solidarity, enabling the public budget to meet the very high current and future needs.

III.4. Budget revenues

GCB's revenues, net of the impact of outstanding obligations compensation schemes of the swap-type (amounting to 1.1 billion lei), increased in 2023 by 13.3% (+61.2 billion lei) compared to the previous year, supported by the positive dynamics of nominal GDP (due to a deflator of 12.2%) and labour market indicators (a 1.1% increase in the average number of employees and a 13.8% increase in the average gross salary), by fiscal policy measures adopted (with an estimated impact by the Ministry of Finance of 6.9 billion lei), and by the increased absorption of European funds allocated to Romania through the MFF and the NRRP. Thus, budget revenues reached a level of 520.3 billion lei (representing about 32.4% of GDP), which marks a decrease of 0.4 percentage points compared to the 32.8% of GDP recorded in 2022.

Fiscal revenues recorded decreases in their share of GDP across most component aggregates (corporate income tax -0.1 pp; VAT -0.2 pp; excise duties -0.2 pp; other taxes on goods and services -0.3 pp), with the exception of income tax (+0.1 pp). Reductions in the share of GDP were also recorded for social security contributions (-0.1 pp) and non-fiscal revenues (-0.2 pp). These negative effects were partially offset by the increase in amounts received from the EU (nearly +0.8 pp), reflecting an increase of 9.3 billion lei in amounts related to the 2014-2020 MFF, 7.7 billion lei in amounts related to the 2021-2027 MFF, and 1.7 billion lei in non-reimbursable financial assistance allocated through the NRRP.

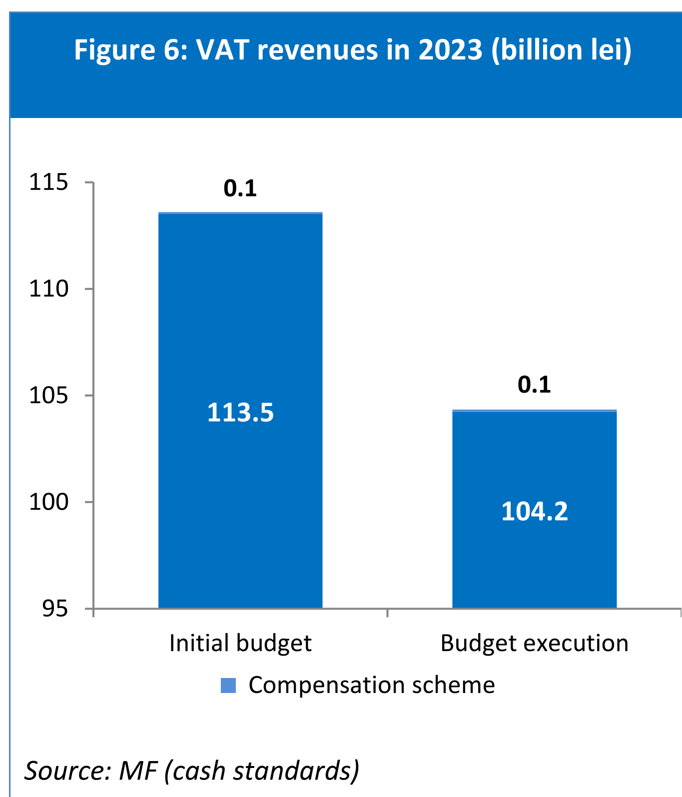
Compared to the initial budget projection, the actual revenues of GCB collected in 2023, net of the impact of swap-type compensation schemes, registered a substantial shortfall of 18.5 billion lei (representing nearly -1.2 pp of GDP). The failure to meet the projected level was seen across all main revenue categories, as follows: fiscal revenues (-7.8 billion lei, -0.5 pp of GDP), social security contributions (-3.8 billion lei, -0.2 pp of GDP, despite the gross wage fund in the economy exceeding the estimates made at the time of the initial budget drafting), non-fiscal revenues (-3.3 billion lei, -0.2 pp of GDP), and amounts received from the EU (-3.6 billion lei, -0.2 pp of GDP). It should be noted that the revenues projected in the initial budget also included an amount of 8.7 billion lei expected from an anticipated increase in collection efficiency/reduction in tax evasion, reflected in social security contributions and certain fiscal revenues.

In the case of fiscal revenues, the shortfall compared to the initial projection is mainly due to VAT collections (-0.6 pp), corporate tax (-0.3 pp), property taxes (-0.2 pp, considering that the measure to increase property taxes, included in the initial budget projection, was later postponed), and excise duties (-0.1 pp). This dynamic was partially offset by higher collections from other taxes on goods and services (+0.4 pp) and income tax (+0.2 pp). Regarding the amounts received from the EU, the most significant shortfall against the 2023 budget target was recorded in the non-reimbursable financial assistance allocated through the NRRP (-0.6 pp).

III.4.1. VAT and excise duties

VAT revenues, in cash standards, net of the impact of swap-type compensation schemes, reached 104.2 billion lei in 2023, falling short by 9.3 billion lei compared to the level forecasted in the initial budget. The adjacent chart shows the evolution of collections and the compensation schemes as programmed in the initial budget compared to the values actually recorded in the budget execution.

Figure 6: VAT revenues in 2023 (billion lei)



Source: MF (cash standards)

It should be noted that the level programmed in the initial budget for VAT collections included the effect of several fiscal policy measures, such as the increase of the VAT rate from 9% to 19% for non-alcoholic beverages with added sugar, the increase of the VAT rate from 5% to 9% for restaurant and catering services and hotel accommodation activities, and the modification of the threshold from 700,000 lei to 600,000 lei for the application of the reduced 5% VAT rate for housing deliveries), whose impact was estimated by the Ministry of Finance at approximately 2 billion lei, as well as an additional 5.2 billion lei based on an anticipated increase in collection efficiency. Additionally, the relevant macroeconomic base (represented by final consumption of the population, excluding the components of self-consumption and farmers' markets) grew by 12.7% in 2023, similar to the dynamics estimated by the National Commission for Strategy and Prognosis (NCSP) at the time the budget was drafted. In this context, the fact that VAT collections significantly underperformed compared to the level planned in the initial budget reflects a flawed programming of this aggregate and confirms the Fiscal Council's warnings about the need for cautious revenue projections that do not include upfront additional amounts expected to be obtained from improved collection.

The Fiscal Council has repeatedly warned that it is not prudent to include additional revenues sourced from improved collection efficiency in the budget's construction upfront (*ex ante*). Moreover, an analysis of budget executions in recent years shows that the targets for increasing collection efficiency, as assumed in initial budgets or during budget revisions, have never been met. Therefore, additional revenues from improved collection should only be included in the budget construction *ex post*, but only once their amount can be evaluated with a high degree of confidence and there are sufficient signs of a trend towards reducing tax evasion. This would imply that these revenues have a permanent character.

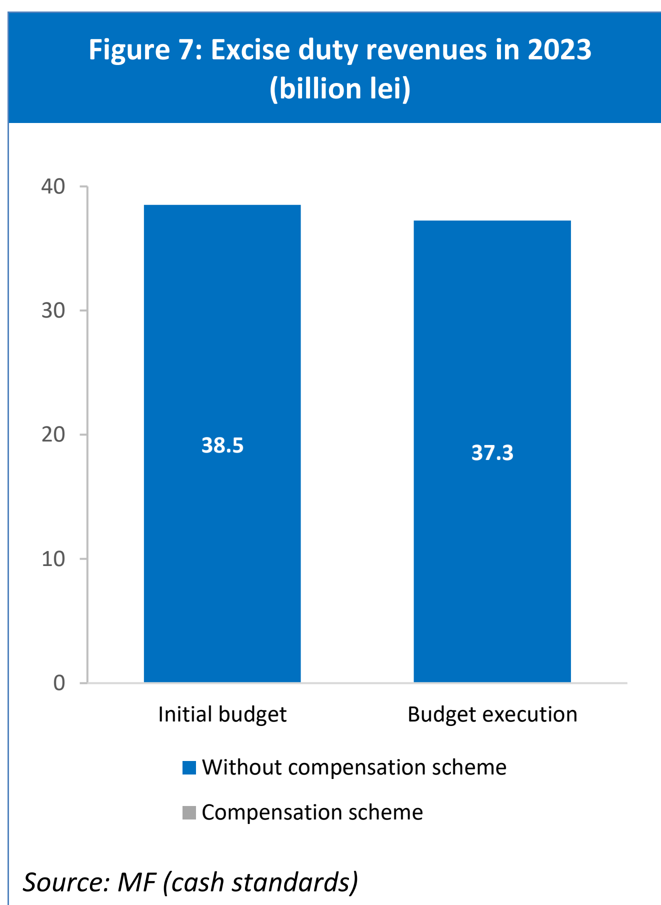
Compared to the previous year, the level of collections for this budgetary aggregate, net of the impact of swap-type schemes, increased by 11% (+10.3 billion lei). To investigate the performance of VAT collections, an *ex post* projection was made to compare with the actual results. Starting from the 2022 budget execution of VAT revenues, a 12.7% increase in final consumption expenditure of the population

(excluding the self-consumption and farmers' market components) was applied, and the effect of fiscal policy measures implemented in 2023 (previously mentioned), estimated by the Ministry of Finance at approximately 2 billion lei, was taken into account. Under the impact of these factors, the *ex post* projection of VAT collections for 2023 stands at nearly 108 billion lei, while the actual execution recorded a level of 104.2 billion lei. The results indicate an unfavorable difference of 3-4 billion lei, which could suggest a deterioration in VAT revenue collection during 2023.

The revenues collected from **excise duties** totaled 37.3 billion lei in 2023, which is 1.2 billion lei lower than the estimates considered when drafting the budget. The initial program forecast excise revenues of 38.5 billion lei, based on a projected increase in final consumption of the population in real terms of approximately 2.7%.

Compared to the previous year, the level of revenues collected from excise duties increased by 1.9 billion lei (+5.5%) in the context of a 2.6% increase in final consumption of the population in real terms, as well as the increase in the excise duty on cigarettes from April 1, 2023 (from 594.97 lei/1,000 cigarettes to 625.97 lei/1,000 cigarettes). Additionally, there was a reduction, from January 1, 2023, in the excise duty on diesel to 1,931.61 lei/ton from 2,052.89 lei/ton in 2022, and on unleaded gasoline to 2,305.64 lei/ton from 2,458.1 lei/ton in 2022[38].

Figure 7: Excise duty revenues in 2023 (billion lei)



Source: MF (cash standards)

Given that excise duties are presented in aggregate form in the budget construction, which does not allow for studying the impact of changes in a single category, an analysis of the structure of excise revenue is of interest. Thus, with a share of 48% of total collections (down from 50.1% recorded in the previous year), excise duties on energy products continue to represent the most significant component of excise revenue, followed closely by excise duties on tobacco products, with a share of 47.4% of total collections (up from 45.3% recorded in the previous year). Excise revenues from alcohol, distilled beverages, and alcoholic drinks remained at around 4.5% of total collections, while the rest of the categories continued to account for less than 1%.

Analysing the changes compared to 2022 for each product category, it is observed that excise revenues from energy products increased by only 1.1% (+0.2 billion lei), a pace lower than the dynamics of the relevant macroeconomic base (+2.6%), also influenced by the reduction in excise duties on diesel and unleaded gasoline. Excise revenues from tobacco products increased by 10.4% (+1.7 billion lei), slightly

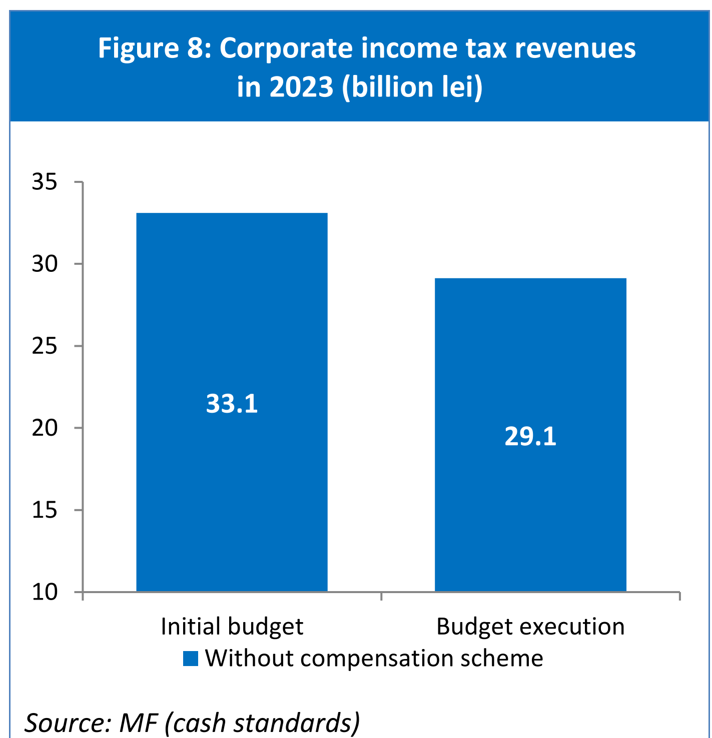
[38] According to the Ministry of Finance's Report on the final budget execution for the year 2023.

exceeding the Ministry of Finance's estimates at the time of drafting the initial budget regarding the impact of the excise increase on these products (estimated at 1.1 billion lei). Lastly, excise revenues from alcohol, distilled beverages, and alcoholic drinks increased by 6.1% (+0.1 billion lei), a pace below the dynamics of the relevant macroeconomic base, combined with the update for the increase in consumer prices, as reported by the National Institute of Statistics (+11.8% for the period October 2021 - September 2022). In conclusion, analysing the structural evolution of excise revenues throughout 2023, there is no conclusive evidence of an improvement in the efficiency of collection for this aggregate, even though the initial budget revenue projection had considered an increase in excise revenues of approximately 1 billion lei, based on improved collection efficiency/reduced tax evasion.

III.4.2. Direct taxes

Cash-standard **corporate income tax** revenues amounted to 29.1 billion lei, representing an increase of 2.5 billion lei (+9.4%) compared to 2022, but also a shortfall of 4 billion lei from the budget target. The initial program projected corporate income tax revenues of 33.1 billion lei, based on an anticipated increase in the relevant macroeconomic base (nominal GDP) of 11.2%. Additionally, the projected level for this aggregate included the effect of changes in the taxation of micro-enterprises (reducing the revenue threshold from 1,000,000 euros to 500,000 euros and instituting the requirement for micro-enterprises to have at least one employee), estimated by the Ministry of Finance at around 1 billion lei.

Figure 8: Corporate income tax revenues in 2023 (billion lei)



Source: MF (cash standards)

The 9.4% increase in corporate income tax revenues compared to the previous year was significantly below the actual dynamics of nominal GDP, which was 14.6%. Thus, starting from the 2022 budget execution for corporate income tax revenues, a 14.6% increase in nominal GDP was applied, taking into account the effect of fiscal policy measures implemented in 2023, estimated by the Ministry of Finance at around 1 billion lei, as well as the redirection of 0.8 billion lei from corporate income tax for sponsorships and/or philanthropic acts or for granting private scholarships[39]. Under the impact of these factors, the *ex post* projection for corporate income tax revenues in 2023 stands at around 30.7 billion lei (with the actual execution recording a level of 29.1 billion lei), which could suggest a worsening of collection efficiency.

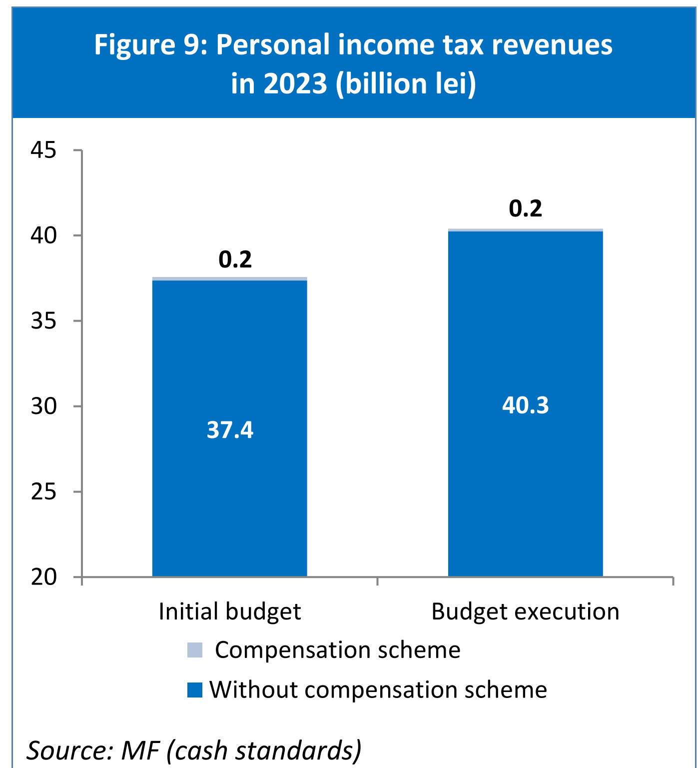
An analysis of the revenue structure for this budgetary aggregate shows that the largest impact came from the evolution of corporate income tax paid by non-financial sector economic agents (this being the

[39] According to the Ministry of Finance's Report on the final budget execution for the year 2023.

main component of corporate income tax revenues, accounting for 92.4% of total collections), which increased by around 3 billion lei (+12.2%) compared to the previous year. On the other hand, revenues from corporate income tax paid by commercial banks increased by around 0.3 billion lei (+13.5%). Given that both categories of revenue had a lower growth rate than the relevant macroeconomic base (nominal GDP), the conclusion mentioned above is confirmed, indicating a possible deterioration in the collection efficiency of corporate income tax revenues in 2023.

Cash-standard revenues from **income tax**, net of the impact of swap-type compensation schemes, amounted to 40.3 billion lei, exceeding the budgeted level at the beginning of 2023 by 2.9 billion lei. The initial program projected revenues of 37.4 billion lei, based on an estimated increase of 1.5% in the average number of employees and a 10.9% increase in the average gross wage. Additionally, the initial revenue projection included the impact of fiscal policy measures (such as the revision of the personal deductions system for taxpayers earning salary income, changes in the taxation of gambling, adjustments to the tax rates for the transfer of ownership of buildings and land, and the elimination of the non-taxable threshold of 450,000 lei, the increase in the dividend tax rate from 5% to 8%, and the reduction of the threshold up to which tax incentives are granted in the construction, agricultural, and food industries) with an estimated impact of approximately 0.5 billion lei, according to the Ministry of Finance.

Figure 9: Personal income tax revenues in 2023 (billion lei)



Source: MF (cash standards)

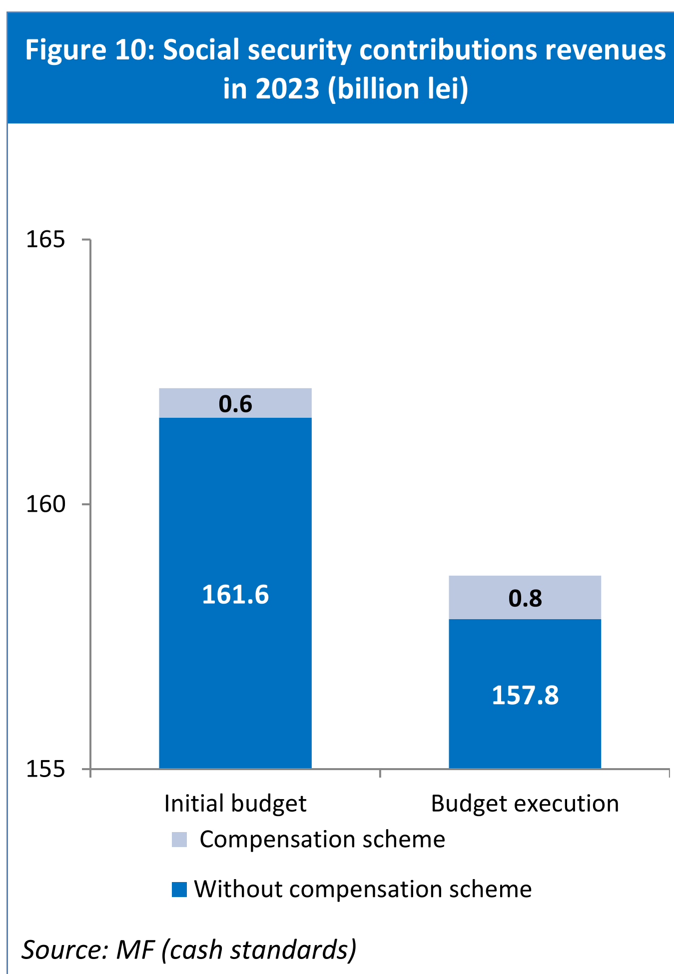
Compared to the previous year, revenues from income tax increased by 19.9% (+6.7 billion lei), with the growth of this category exceeding the actual increase in the wage bill in the economy, which was around 15.1%. To investigate this development in more detail, an analysis of the structure of income tax revenues by their main components was conducted. Thus, the income tax (which accounts for 63% of this budgetary aggregate) grew at a slower pace than the wage bill in the economy, recording an increase of only 11.2% (+2.5 billion lei) compared to the previous year. As a result, the overall growth in income tax revenue is due to the faster growth of other components of this budgetary aggregate. For instance, revenues from the dividend income tax (which makes up 15% of total revenue) increased by almost 32% (+1.5 billion lei) due to exceptional dividend distributions in December 2022 (with the tax collected in January 2023, a month that accounted for 32.2% of the revenue in this category) to take advantage of the 5% tax rate before it was raised to 8% starting January 1, 2023. Revenues from the pension income tax (8.8% of total revenues) also grew by 41.8% (+1 billion lei), revenues from the tax on income declared through the single declaration (7.4% of total revenues) increased by 11.5% (+0.3 billion lei), revenues from gambling income tax (1.8% of total revenues) rose by almost 110% (+0.4 billion lei), and revenues from the tax on income from real estate transfers (1.6% of total revenues) increased by 93.6% (+0.3 billion lei), with the latter two

categories reflecting the impact of fiscal policy measures adopted. In conclusion, analysing the main components of income, it is observed that the revenue growth is primarily the result of the increase in dividend income tax and other tax components, with no signs of improved collection efficiency being identified.

III.4.3. Social security contributions

Cash-standard revenues from **social security contributions (SSC)**, net of the impact of compensation schemes, amounted to 157.8 billion lei by the end of 2023, approximately 3.8 billion lei below the initial budget estimates. This shortfall occurred despite the gross wage bill in the economy increasing by 15.1%, exceeding the initial projection of 12.6%. The programmed level of this budgetary aggregate included the favorable impact of the modification of the taxable base for pension and health contributions for employees with part-time contracts, estimated by the Ministry of Finance at 2 billion lei, as well as a target of 2.5 billion lei for improving collection efficiency. On the other hand, it should be noted that the planned value of enforcement titles for 2023 was around 8.1 billion lei, while actual payments amounted to only 1.7 billion lei, which led to a significant decrease in pension contributions revenues compared to the planned level, by approximately 2.2 billion lei.

Figure 10: Social security contributions revenues in 2023 (billion lei)



Source: MF (cash standards)

Compared to the previous year, pension contributions revenues, net of the impact of compensation schemes, increased by 18.6 billion lei (+13.3%), a growth rate lower than the increase in the wage bill in the economy (+15.1%), which suggests that the goal of improving collection efficiency was not achieved. According to the Ministry of Finance, the slower growth rate of pension contributions is due, among other things, to the expansion of tax incentives granted to the agricultural and food industries, the exclusion from the social security contributions calculation base of the 200 lei/month amount, representing salary and salary-assimilated income, as well as the cessation of CASS (health insurance contributions) payments for pension incomes over 4,000 lei (a measure declared unconstitutional by the Constitutional Court of Romania at the end of 2022), and the reimbursement of amounts withheld as health contributions from pension incomes starting on March 1, 2023[40].

[40] According to the Ministry of Finance's Report on the final budget execution for the year 2023.

To more accurately reflect the dynamics of pension contributions over the 2020-2023 period, the table below presents the adjusted series for this budgetary aggregate[41], as well as its gross series, obtained by eliminating the swap-type compensation schemes and adding transfers to Pillar II.

Table 6: Social security contributions (million lei)					
		Budget execution 2020	Budget execution 2021	Budget execution 2022	Budget execution 2023
Adjusted series	**1**	**112,250.7**	**127,493.4**	**139,920.2**	**158,655.4**
Swap	2	552.4	396.6	664.8	823.3
Pillar II	3	8,912.2	9,768.6	10,986.6	12,818.4
Gross series*	**4=1-2+3**	**120,610.5**	**136,865.4**	**150,241.9**	**170,650.4**
* out of which enforceable titles		537.9	461.5	577.5	568.7

Source: Romanian Association for Privately Managed Pensions, MF, Fiscal Council's calculations

Thus, if the gross series is considered, it can be observed that in 2023 revenues from pension contributions amounted to approximately 171 billion lei, exceeding the 2022 collections by 13.58% (+20.4 billion lei). This growth rate is higher than the increase in pension contributions recorded in the budget execution (+13.4%) because the gross series also includes transfers to Pillar II, which grew at a faster pace (+16.7%). Excluding the impact of enforcement titles from the gross series, pension contributions increased by 13.64% (+20.4 billion lei) in 2023 compared to the previous year, against a backdrop of marginally lower payments related to this category.

III.5. Budget expenditures

Budgetary expenditures, net of the impact of swap compensation schemes (in the amount of 1.1 billion lei), increased by 13% compared to the previous year (+70.3 billion lei), reaching the end of 2023 to 610.2 billion lei. In the conditions of the significant increase in nominal GDP (+14.6%, against the background of a deflator of 12.2%), the share of budget expenditures in GDP decreased by about 0.5 pp, respectively from 38.5% to 38.0 % of GDP. In terms of increasing the share of budget expenditures in GDP, the categories of *projects with financing from external non-reimbursable funds after accession 2014-2020* (+0.6 pp), *projects with financing from external non-reimbursable funds* (+0.6 pp), *projects with financing from the amounts related to the loan component of the NRRP* (+0.2 pp), respectively, *projects financed from the amounts representing the non-refundable financial assistance related to the NRRP* (+0.1 pp). However, the evolution of these aggregates was counterbalanced by the dynamics of *social assistance expenditures* (-0.5 pp), *capital expenditures* (-0.5 pp), *expenditures on goods and services* (-0.4 pp), *interest expenditures* (- 0.2 pp), *subsidies* (-0.2 pp), *personnel expenditures* (-0.1 pp)

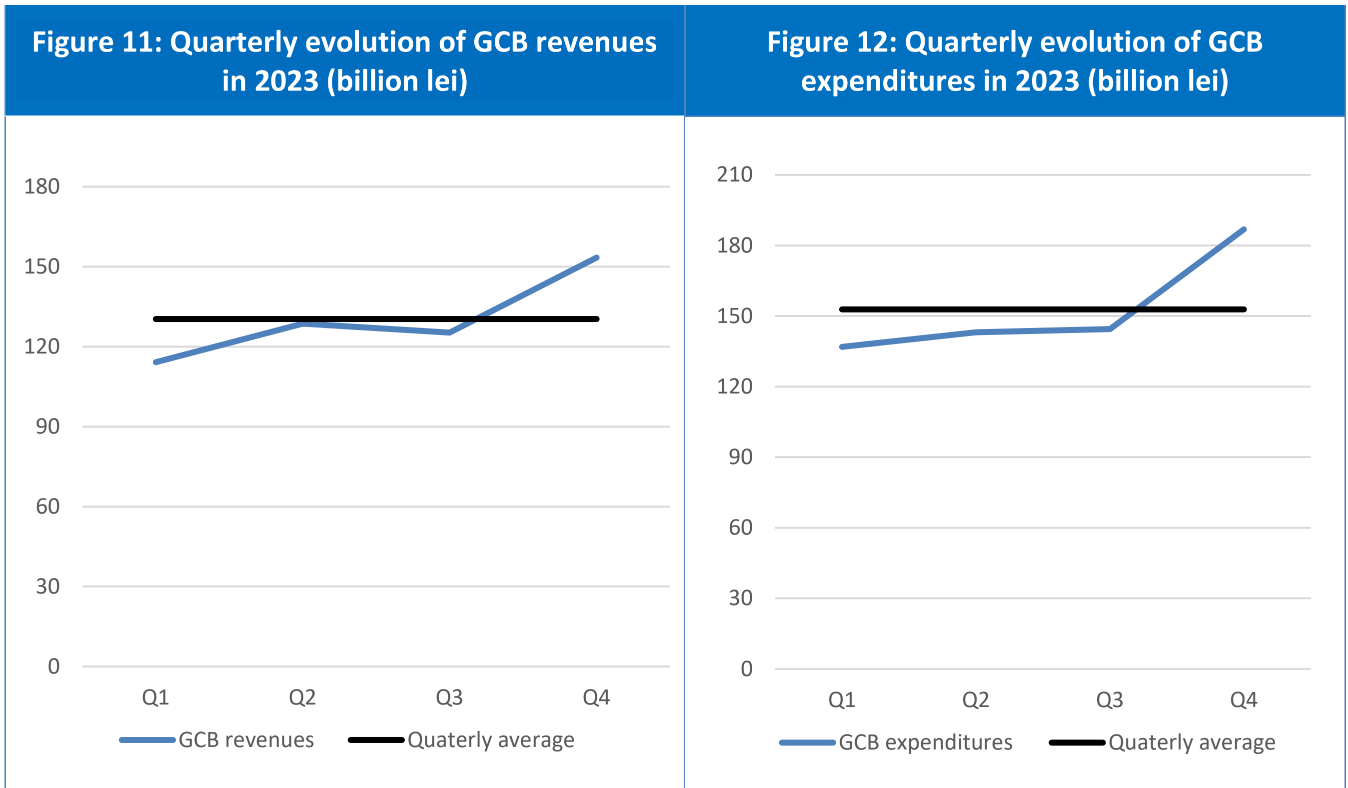
[41] Taken from the budget execution of each year.

and *other transfers* (-0.1 pp). As for the other expenditure aggregates, they registered marginal changes in the weight in GDP compared to the execution of 2022.

In relation to the allocations established by the draft budget for 2023, budget expenditures were at a higher level, being higher by 3.1 billion lei (+0.5%), respectively by 0.2 pp of GDP, exceeding the initially budgeted amounts being recorded at the level of the majority of expenditure aggregates: *social assistance* (+0.6 pp), *subsidies* (+0.4 pp), *projects financed from non-reimbursable external funds post-accession 2014-2020* (+0.4 pp), *personnel expenditures* (+0.3 pp), *projects financed by non-refundable external funds* (+0.2 pp), *goods and services* (+0.2 pp), *interest* (+0.1 pp) and *others expenditure* (+0.1 pp). On the other hand, the main expenditure categories that registered a failure to meet the levels provided for in the initial budget are represented by *capital expenditure* (-1 pp), their under-execution being used in the past to keep the budget deficit under control, and by *projects with funding from the amounts representing non-refundable financial assistance related to NRRP* (-0.7 pp), a situation similar to 2022, which attests to the maintenance of some delays in the start of projects financed by NRRP.

Similar to the previous years, in 2023 the analysis of the quarterly execution of GCB[42] expenditures shows a concentration of them in the last quarter, the share of the fourth quarter in the total year being, however, in a slight decrease compared to 2022 (30.6%, compared to 31%). Thus, total expenditures in the fourth quarter of 2023 amounted to 186.9 billion lei (compared to 167.9 billion lei in the fourth quarter of 2022, representing an increase of about 11.3%), being superior by 29.3 % of the level of the previous quarter (compared to a 26.3% increase in spending in the fourth quarter compared to the third quarter of 2022).

[42] Including the swap compensation scheme.



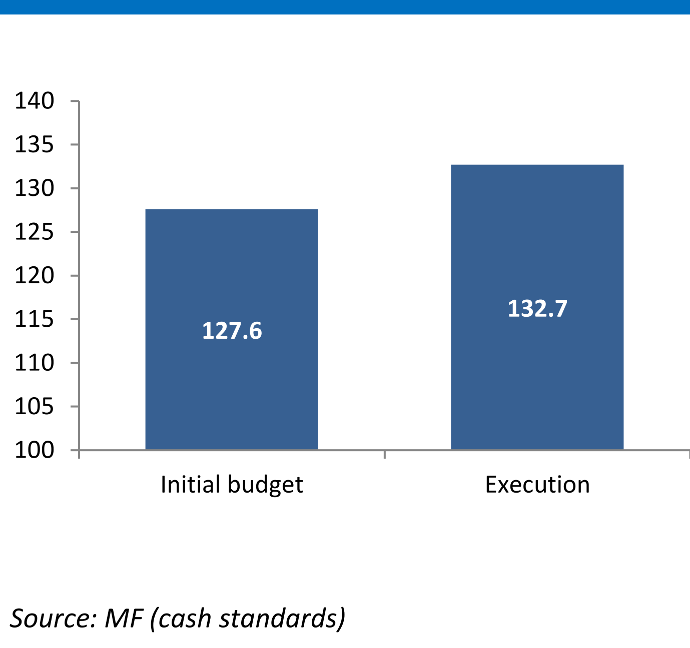
Source: MF (cash standards)

Analysing the evolution of the expenditure structure in the fourth quarter of 2023 compared to the previous quarter, *the projects with financing from non-reimbursable external funds post-accession 2014-2020* (+165.6%, with a contribution of 46.6% of the total increase in the fourth/third quarter), *projects with financing from external non-reimbursable funds* (+948%, with a contribution of 16% of the total increase IV/III quarter), *capital expenditures* (+55.3%, with a contribution of 12.8% of the total increase quarter IV/III) and *expenditure on goods and services* (+29.5%, with a contribution of 12.5% of the total increase quarter IV/III) stand out. The other categories of budget expenditures had a combined contribution of only 12.1% to the increase in total expenditures in the fourth quarter compared to the previous quarter. The concentration of expenditures in the last quarter of the year highlights the shortcomings of the budget programming process, especially for public investment expenditures (capital expenditure and European funds), even if the principle of prudence could partially justify the postponement of some expenditures until the moment when the projection of budget receipts has a lower degree of uncertainty. Regarding the quarterly evolution of budget revenues, they were also mostly achieved in the last quarter of the year, in a slightly higher proportion compared to the previous year (with a total weight of 29.4%, compared to 28% in 2022, respectively an increase compared to the previous quarter by around 22.5%, compared to 12% in 2022). In this context, the Fiscal Council reiterates the recommendation from previous years regarding the reduction of the quarterly volatility of budget execution.

III.5.1. Personnel and social assistance expenditures

The execution of **personnel expenditures** recorded an increase of 5.1 billion lei compared to the level considered when preparing the draft budget for 2023. Initially estimated at a level of 127.6 billion lei, the final value of these expenditures was of 132.7 billion lei, respectively 8.3% of GDP. Moreover, the evolution of personnel expenditures for this year 2023 recorded an exceeding of the ceilings defined by Law no. 360/2022 for the approval of some indicators specified in the fiscal-budgetary framework for 2023, where a ceiling of 8.2% of GDP was provided for this category of expenditures. As for the nominal GDP level, it was 53.5 billion lei (+3.5%) higher than the one estimated at the time of establishing the initial budget.

Figure 13: Personnel expenditures in 2023 (billion lei)



Source: MF (cash standards)

Table 7: Enforceable titles issued/paid on the account of the court decisions regarding the payment of salary differences for certain categories of public employees, million lei

		2015	2016	2017	2018	2019	2020	2021	2022	2023	Total
Enforceable titles issued, including Law no. 85/2016	Central administration (State budget)	82.3	1599.4	67.4	996.9	1461.6	2812.3	1163.3	2340.5	8063.5	18587.1
	Local administration	1064.1	2094.3	20.3	0.0	0.0	10.3	74.0	117.1	76.4	3456.5
	Social security budget	12.2	7.6	1.2	0.0	0.9	0.0	0.0	3.0	7.1	31.9
	Total	**1158.5**	**3701.2**	**88.9**	**996.9**	**1462.5**	**2822.6**	**1237.3**	**2460.6**	**8147.0**	**22075.5**
Enforceable titles paid, including Law no. 85/2016	Central administration (State budget)	1234.6	363.1	476.2	80.8	999.7	1551.5	1314.6	1652.9	1628.0	9301.5
	Local administration	2806.1	544.6	705.0	79.2	947.7	17.5	31.4	33.8	32.6	5197.9
	Social security budget	0.0	0.6	0.6	0.6	4.2	2.4	2.3	0.5	0.8	12.0
	Total	**4040.7**	**908.4**	**1181.8**	**160.6**	**1951.6**	**1571.5**	**1348.3**	**1687.2**	**1661.4**	**14511.3**

Source: MF

Compared to 2022, personnel expenditures increased by approximately 15 billion lei, respectively by 12.76%. In 2023, there is a marginal decrease in the amounts paid on account of court rulings regarding

the payment of salary differences for some categories of budget workers, from 1,687.2 million lei in the previous year, to 1,661.4 million lei. On the other hand, an increase of 231.1% in 2023 (8,147 million lei) compared to 2022 (2,460.6 million lei) is observed at the level of newly issued enforceable titles, so the amount recorded in 2023 will continue to affect the cash execution of subsequent years.

The average gross salary (*Figure 14*) in the public system reached, in 2023, 8,155 lei/month, 11.76% higher than in 2022, surpassing by 13.75% the one in the private sector, which it stood at 7,169 lei/month (increasing by 15.33% compared to the previous year). Considering quarterly averages, the average gross monthly salary in the public sector for the fourth quarter of 2023 recorded a level of 8,588 lei, 16.4% more than in the same period of 2022, while the salary in the private system was 7,678 lei, also increasing by 16.4% compared to the fourth quarter of 2022.

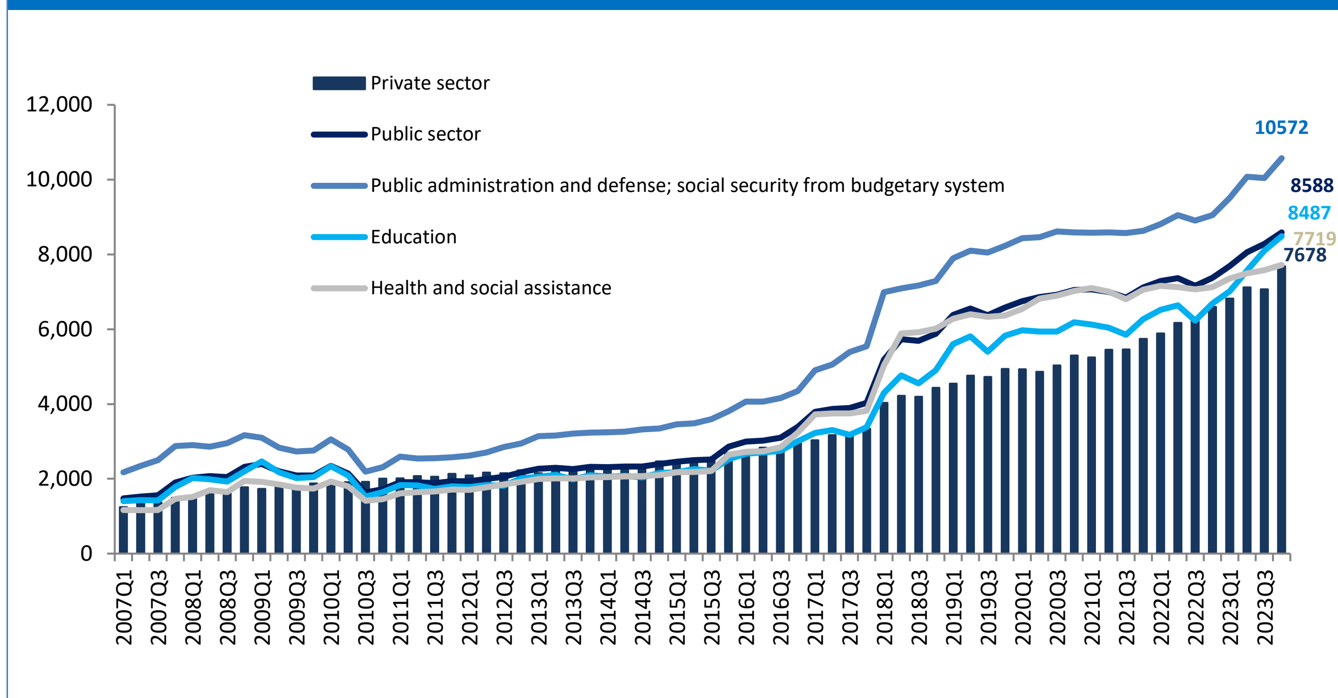
Taking into account the fields of activity of the public sector, the three most important in terms of weight had the following evolution of the average gross salary in the fourth quarter of 2023 compared to the fourth quarter of 2022: in public administration and defense the dynamic recorded was 16,8%, in education the increase was 26.9%[43], and in health, 8.4%.

After the increase of 165,600 people, recorded in the 2005-2008 period, the total number of employees in the government sector decreased by 105,663 people between December 2008 and December 2023, to a level of 1.29 million (*Figure 15*). Practically, most of the staff reduction took place in the 2009-2011 period, when the number of employees in the budgetary sector decreased by about 180 thousand, while in the 2012-2014 period the decrease was about 9,540 positions. The adjustment recorded in the 2009-2023 period occurred especially at the level of local executive authorities (-30,421 filled positions), the Ministry of Internal Affairs (-23,147 filled positions), other institutions fully financed from own revenues (-12,463 filled positions), the Ministry of Justice[44] (-10.826 filled positions), the Ministry of Finance (-8,837 filled positions) and the Ministry of National Defense (-7,008 filled positions). On the other hand, during the same period, increases were recorded at the level of the health system, including the Ministry of Health (+29,065 filled positions), the High Court of Cassation and Justice (+13,912 filled positions), the General Secretariat of the Government (+2,493 filled positions), state higher education units (+2,147 filled positions) and the Ministry of Investments and European Projects (+2,131 filled positions).

[43] This increase is mainly the result of the granting of substantial salary increases during 2023.

[44] As a result of the transfer, starting from January 1, 2023, of the employees of the courts from the Ministry of Justice to the High Court of Cassation and Justice.

Figure 14: Average gross earnings in the private and public sectors between 2007-2023 (lei/month)



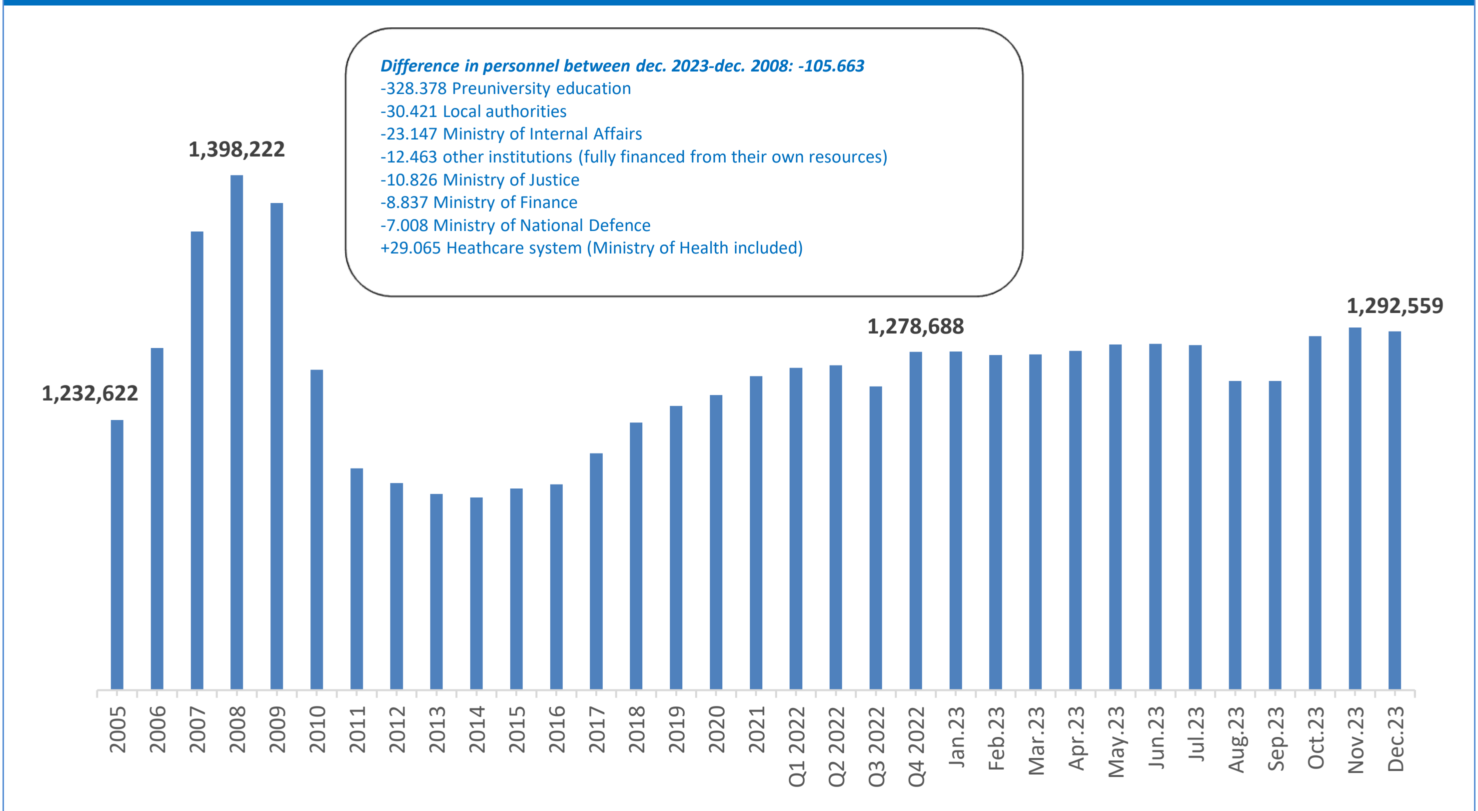
Source: NIS, FC's computation

At the same time, it should be mentioned that in 2023 the growth rate of the number of employees in the public sector was lower than that recorded in the previous year, namely 1.08% (+13,871 people) compared to 1.3% (+16,370 people). Staff increases were registered especially at the level of the Ministry of Education (+7,292 filled positions), local executive authorities (+3,974 filled positions) and state higher education units (+2,073 filled positions). On the other hand, the most important staff reductions were registered at the level of the Ministry of Internal Affairs (-1,860 filled positions) and the Ministry of National Defense (-752 filled positions).

The adjustment between 2009 and 2012 was mainly the result of enforcing the rule of "1 new employee per 7 departures" given that most of the exits from the system were made through voluntary departures or retirement. The abandonment of this rule starting in 2013 was intended to reduce adverse selection and allow the operation of some changes in the structure of the employed personnel.

Thus, the reduction operated in the 2009-2012 period was based only to a small extent on qualitative criteria, such as reducing staff where a surplus of employees was identified simultaneously with new hires in deficit areas, taking into account rigorously defined cost standards and establishing an optimal level of operation. The FC considers such an approach appropriate and recommends that new hires be made in areas with insufficient personnel, even by transferring positions from areas with a surplus of staff to those with a deficit, taking into account at the same time the strict inclusion in the previously approved salary envelope.

Figure 15: The evolution of public sector employment between 2005-2023



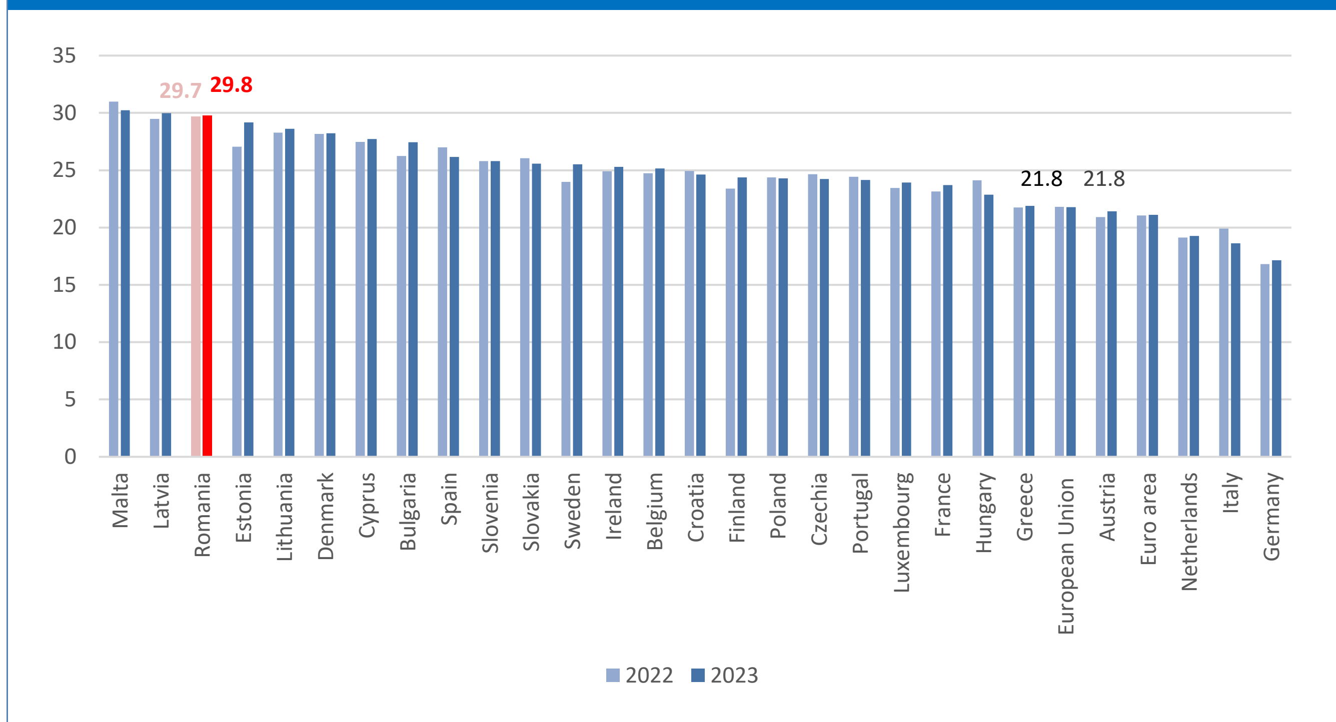
Source: MF

With regard to the ratio between budget sector personnel expenditures and total revenue received (*Figure 16*), according to ESA 2010 standards, in 2023 there is a marginal increase in this indicator compared to the previous year, Romania being ahead of Malta (30,2%) and Latvia (30%) in the ranking of EU states. If until 2009 Romania was placed in the first half of the ranking, in terms of the ratio of personnel expenditures to total budget revenues (8th position in 2008 and 10th in 2009), in 2011, as a result of fiscal consolidation measures initiated in the middle of 2010, Romania dropped to the 19th position out of 27.

In 2013, Romania reached the 17th position, due to salary recoveries and increases for certain categories of public employees, but in 2015 it ranked 20th out of 27, given a slight increase in budget revenues while personnel expenditures remained constant as a percentage of GDP. Starting from 2016, the situation changed and Romania climbed steeply to 10th place, reaching second place in 2017, and from 2018 occupying the first position until 2021.

In 2022, against the background of a decrease in the share of salary expenditures in total budget revenues, Romania dropped to the second position in the ranking, and in 2023 it was in the third position, being also overtaken by Latvia. The top positions in this ranking are mainly determined by Romania’s low tax revenues compared to the other member states, the denominator effect being more significant.

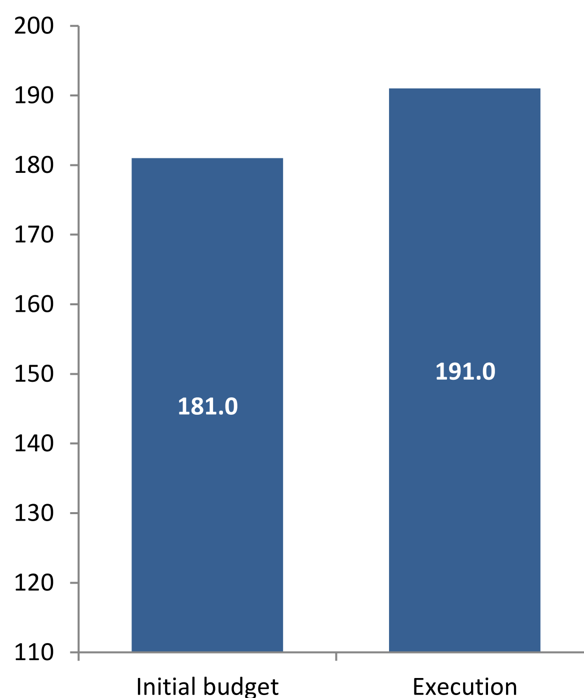
Figure 16: Personnel expenditures as a share of total budget revenues in EU27 countries



Source: Eurostat

In 2023, **social assistance** expenditures exceeded the level provided for in the draft budget (of 181 billion lei) by 5.5%, reaching a value of about 191 billion lei, representing 11.9% of GDP. Compared to the execution of the previous year, this category of expenditures increased by 16.7 billion lei (+9.6%).

Figure 17: Social assistance expenditure in 2023 (billion lei)



Source: MF (cash standards)

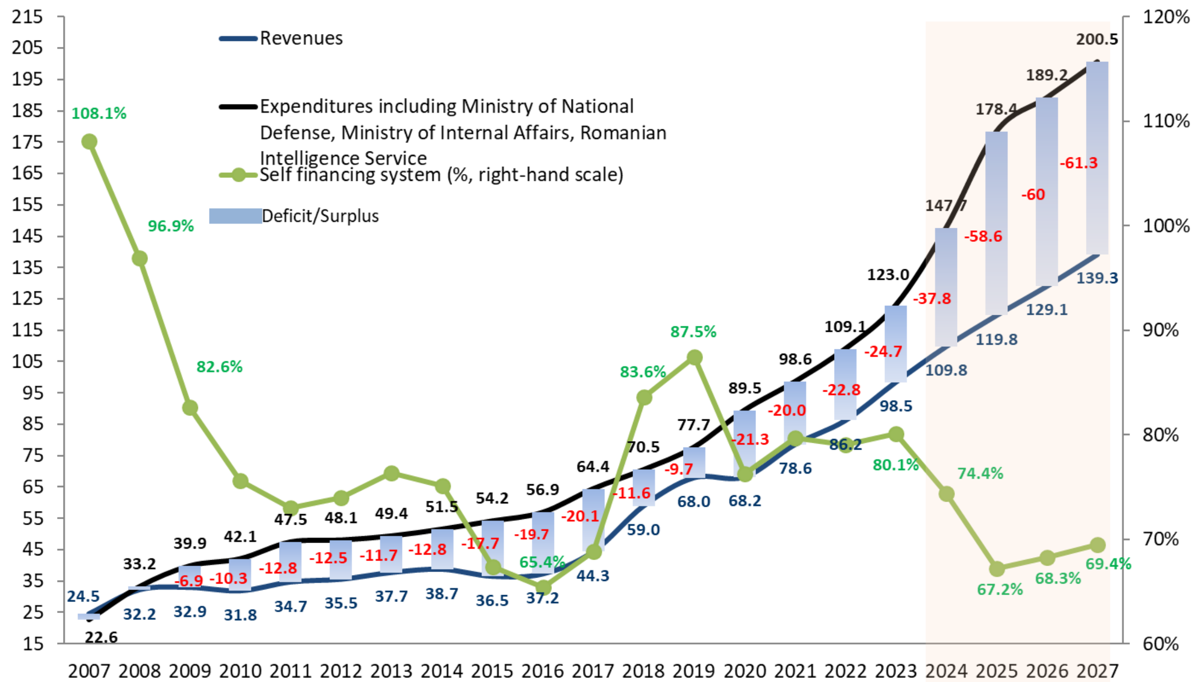
Starting from 2009, the deficit of the social security budget, including special/service pensions, has deepened significantly, reaching 20.7 billion lei in 2022 (*Figure 18*). In 2018, it was significantly reduced, dropping to 11.6 billion lei, mainly as a result of the adoption of fiscal measures regarding the resettlement of the taxation structure of income from salaries, pensions, independent activities and copyrights by transferring contributions from the employer to the employee.

Thus, although the total contribution rates apparently decreased from 39.25% to 37.25%, the transfer of contributions from the employer to employee determined a significant increase in the

gross salary, practically leading to an increase in the level of taxation through social security contributions by about 13.9%. In addition to the increase in labour taxation through SSC, the decrease of the deficit in 2018 is also explained by the reduction in the contribution rate to Pillar II of pensions (from 5.1% in 2017 to 3.75% in 2018). In 2019, the deficit of the social security budget continued to decrease, reaching the value of 9.7 billion lei, as a result of the increase in the number of employees in the economy. However, in 2020, the deficit of the social security budget deepened significantly both due to the increase in pensions and to the unfavourable evolution of revenues, as a result of the recession generated by the pandemic, then remaining at relatively close levels in 2021 and 2022.

The estimates of the Ministry of Finance for the coming years foreshadow an accelerated growth trend of the social security budget deficit, up to 61.3 billion lei in 2027, in the absence of measures to compensate for the unfavorable impact of the implementation of the new pension law. In its opinion regarding the draft budget for 2024, the Fiscal Council considers that the adoption of a law that ensures the equity, predictability and sustainability of the public pension system is beneficial, but its budgetary impact is considerable in the coming years and there is an important risk to significantly deviate the trajectory of achieving the budget correction towards a deficit of 3% of GDP. At the same time, social expenditures (salaries, pensions and other social benefits), which in the European context, as a percentage of GDP, do not seem excessive, compared to domestic tax revenues, can be overwhelming.

Figure 18: The evolution of revenues and expenditures from the social security budget (billion lei)



Source: MF (cash standards)

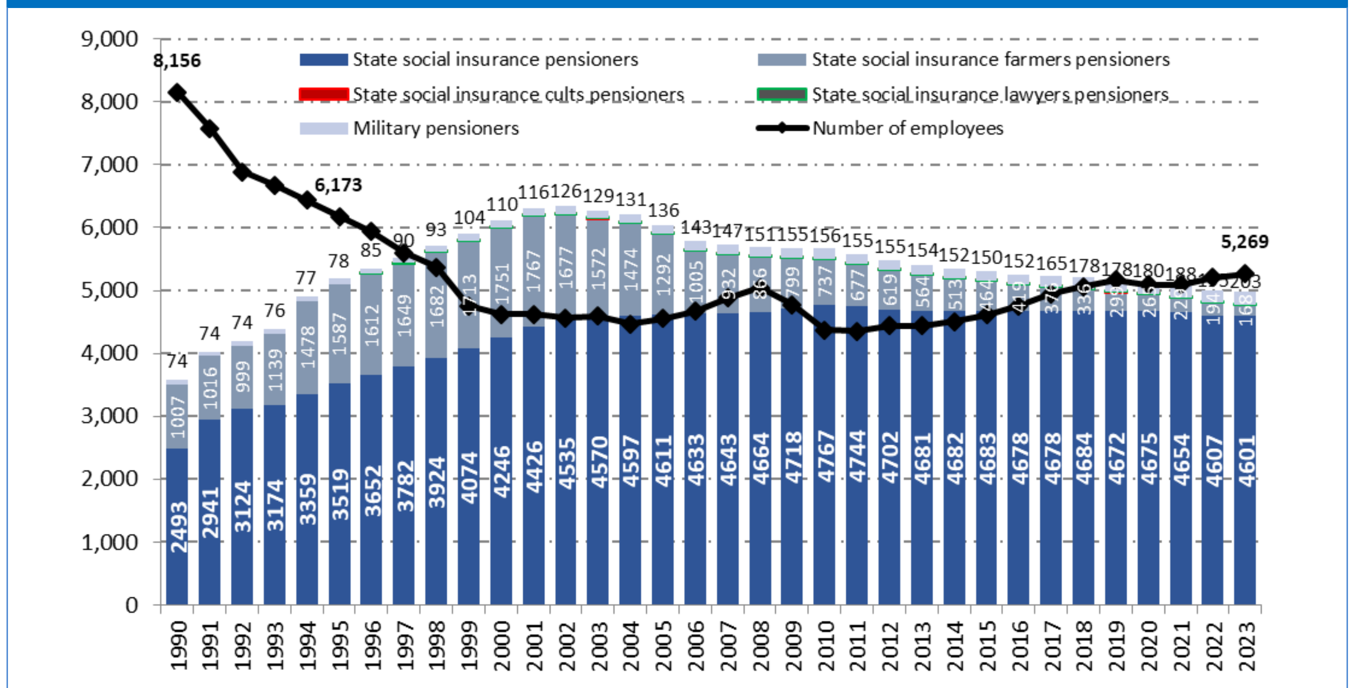
Note: In addition to the expenditures of the social security budget, military pensions were also included for the 2016-2022 period. According to Law no. 223/2015, since January 1, 2016 the necessary funds for paying military pensions and other social security rights due to military pensioners are provided from the state budget, through the budgets of the following institutions: Ministry of National Defence, Ministry of Internal Affairs and Romanian Intelligence Service.

From the perspective of expressing the deficit as a percentage of GDP, there is a decrease from 2.29% in 2011 to 1.92% in 2014, followed by an increase in 2015 to 2.48%, then a decrease significant in 2018, when it reached 1.20% of GDP, and 2019, when it reached 0.92%. The downward trend of the deficit as a share of GDP was reversed in 2020, its level reaching 1.99%, in the context of the economic contraction determined by the COVID-19 pandemic, but also of the significant increase in the aggregate of social security expenditures (by 15.15%), while the collected revenues remained relatively constant compared to 2019. In 2021, the value of the deficit as a share of GDP entered a slightly downward trend, reaching 1.69%, which was also maintained in 2022 (1.63%) and 2023 (1.53%), this last value representing the minimum recorded from 2020 to date. The MF projections indicate a significant deepening of the deficit in the coming years; as a result of the impact of the new pension law, it is expected to reach a historical maximum of 3.05% of GDP in 2025, while at the end of the forecast horizon (year 2027) the deficit will stand at around 2.75% of GDP.

The social security budget started recording deficits due to an excessive increase in its expenditures between 2007 and 2009 (+75.8%) and in the context of a favourable dynamics of SSC revenues in the

period preceding the financial crisis, as a result of the economic boom, when it was anticipated that this trend would be kept in the following years. However, a significant part of the increase in SSC revenues turned out to be cyclical, with subsequent developments disproving the optimistic forecasts that underpinned the substantial increase in the pension point. The self-financing of the system decreased steeply from 111.8% in 2006 to 73.02% in 2011, reaching its historical minimum in 2016 (65.4%) and remaining close to it in 2017 (68.84%). In 2018, the self-financing capacity registered a slight recovery, reaching 83.6%, and the growth continued in 2019, to 87.5%. In 2020, there was a significant reduction in the degree of self-financing of the system, its value being 76.24%, followed by a slight increase to 79.68% in 2021 and a slight decrease to 79.08% in 2022. In 2023, the degree of self-financing of the system was 80.1%, but the MF estimates for the following years indicate a drastic reduction of this indicator, in the context of the new pension law, to a level of 69.4% in 2027.

Figure 19: The evolution of the number of pensioners vs the number of employees (thousand persons)



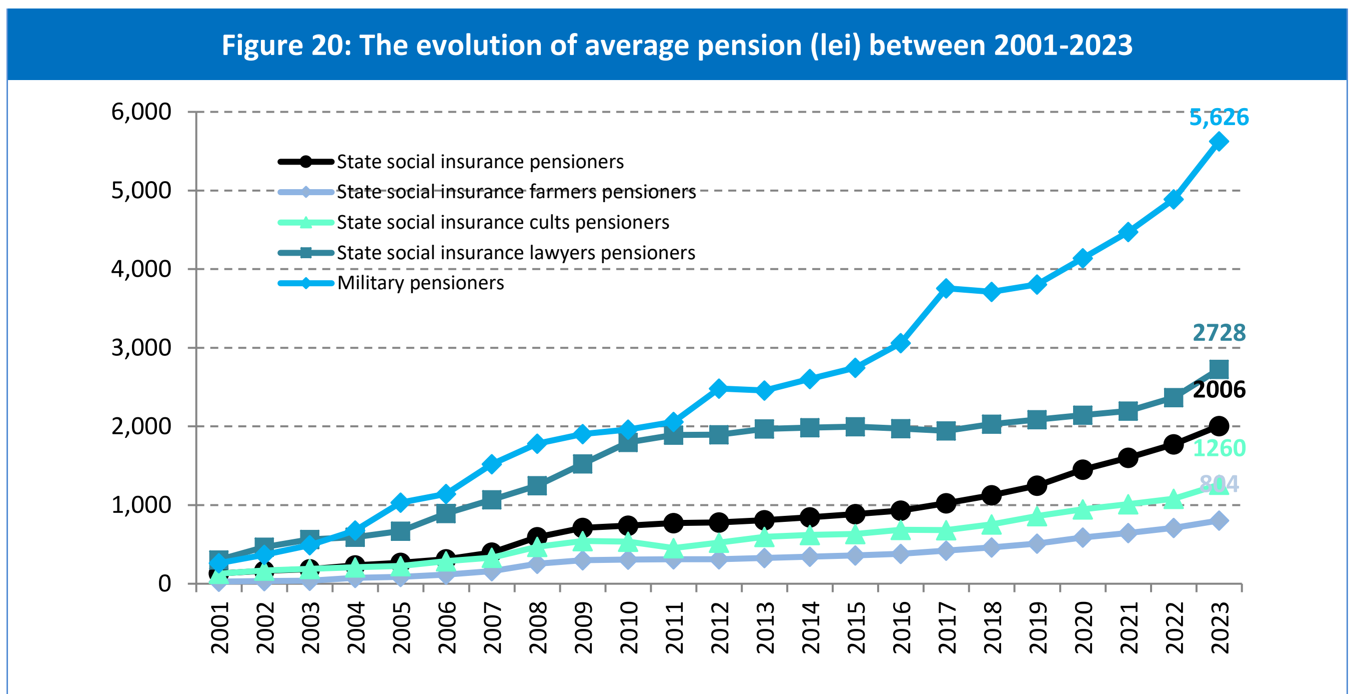
Source: NIS, except for the number of employees in 2022 and 2023, for which the source is NCSP, Spring Forecast 2024

The decision to increase permanent expenditures, such as those related to pensions, should take into account the trend of SSC revenues, as well as the forecasts regarding the employees-to-pensioners ratio, especially since, given the accentuation of the demographic aging phenomenon, on January 1, 2018, the elderly population aged 65 and over outnumbered the young population aged 0-14 (3,596 thousand versus 3,042 thousand people), according to NIS data. The ratio between the number of taxpayers and the number of beneficiaries (*Figure 19*) has decreased very strongly in the last 30 years, from 2.28

employees to one pensioner in 1990, to only 1.06 in 2023. Moreover, the EC[45] estimates that this ratio will reduce to 0.84 employees to one pensioner by the year 2050. Thus, it is obvious the need to find an indexation rule that ensures the long-term sustainability of the social security budget, and from this point of view the entry into force of the new pension law is salutary.

According to NIS reports, in 2023, the average monthly pension (*Figure 20*) was 2,113 lei, up 13.9% compared to the previous year, due to the increase of the pension point by 12.5%, from 1,586 lei in January 2022, to 1,785 lei in January 2023. Pensions paid from the social insurance budget were at an average level of 2,006 lei, and those corresponding to agricultural pensioners were 804 lei on average. At the same time, the pensions granted to the military reached an average monthly level of 5,626 lei, an increase of 739 lei (15.1%) compared to 2022. The average monthly pension corresponding to beneficiaries from the defense, public order and national security system registered a growth of approximately 187% in the period 2010-2023. In the same period, the average monthly pension of pension beneficiaries from the state social insurance budget increased by about 172%.

Figure 20: The evolution of average pension (lei) between 2001-2023



Source: NIS

In 2023, Romania was one position lower in the ranking of EU member states according to the share of SSC expenditures in total revenues (*Figure 21*), namely position 18, in 2022 occupying position 17. This evolution occurred against the background of the decrease with 1.7 pp of the share of SSC expenditures in total budget revenues compared to the previous year, a decrease determined by the slower growth rate of this category of expenditures compared to the growth rate of budget revenues.

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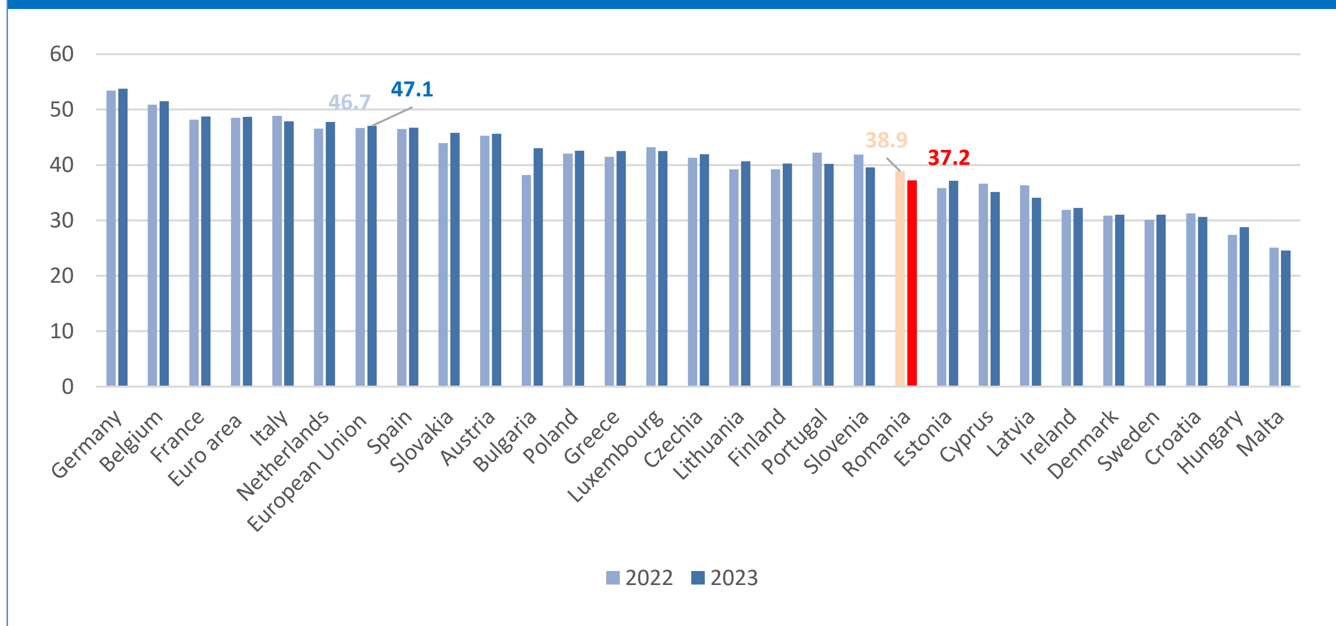
[45] According to *The 2024 Ageing Report: Economic and Budgetary Projections for the EU Member States (2022-2070)*, https://economy-finance.ec.europa.eu/document/download/971dd209-41c2-425d-94f8-e3c3c3459af9_en?filename=ip279_en.pdf

Figure 21: Social assistance expenditures as a share of total budget revenues in EU27 countries

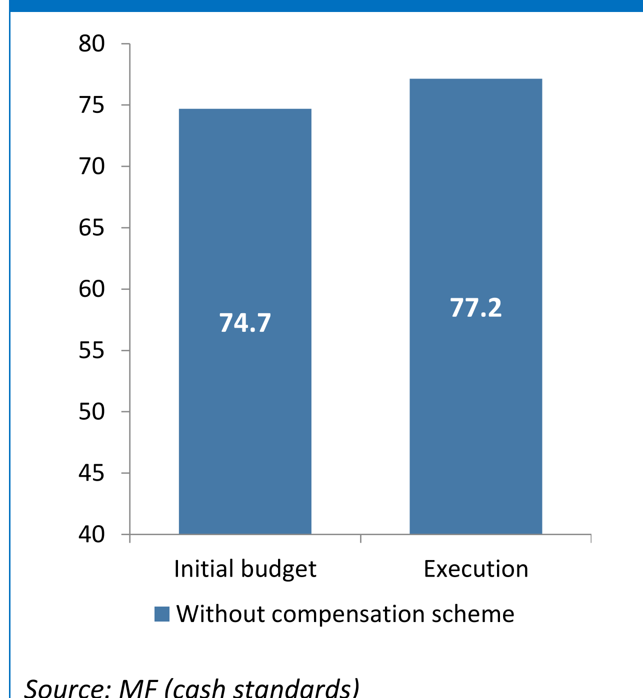


Source: Eurostat

III.5.2. Goods and services expenditures

The execution of expenditure on **goods and services** recorded a higher level compared to that envisaged in the draft budget (+2.5 billion lei), against the background of still high, although decreasing, inflation from 2023. Initially projected at 74.7 billion lei, the final execution of this aggregate reached a level of 77.2 billion lei, confirming the assessment of the FC, which had signaled an underestimation of expenditure on goods and services in its opinion on the draft budget for 2023[46]. From the note accompanying the execution of the general consolidated budget for 2023[47], for this budgetary aggregate, there was an increase of 3.3% in local budgets and by 17.1% in the budget of the Social Health Insurance Fund, compared to the previous year, for the settlement of medicines.

Figure 22: Goods and services expenditures in 2023 (billion lei)



Source: MF (cash standards)

[46] By comparison with the execution of 2022 (72.4 billion lei), the initial budget for 2023 had projected an increase of only 2.3 billion lei for the expenditure on goods and services.

[47] https://mfinante.gov.ro/static/10/Mfp/buletin/executii/nota_bgc31122023.pdf

Compared to the execution of the previous year, expenditure on goods and services increased by 4.7 billion lei (+6.5%), but, against the background of the faster growth of nominal GDP, their share in GDP decreased by almost 0.4 pp, reaching the level of 4.8% of GDP.

The expenditures on goods and services have proven to be difficult to control, a situation that is similar to previous years. Thus, during the periods 2011-2013 and 2017-2021, the execution of expenditures on goods and services (net of swap compensation schemes) exceeded the initially budgeted level or even the revised upward limits set during budget revisions. In contrast, the 2014-2016 period was characterized by a different situation, where the final execution recorded a lower level of expenditures compared to the last budget iteration.

The FC highlights a chronic lack of transparency in projecting this expenditure aggregate, particularly regarding the assumptions that underlie its trajectory. The reasons behind significant revisions made throughout the year are not explained in the documents accompanying budget iterations. These explanations are all the more necessary as changes are often substantial and have the potential to impact the achievement of the budget deficit target or the compliance with fiscal rules. The FC advocates for a budget planning process that encompasses all expenditures within this category in the draft budget, along with an appropriate breakdown of fund allocations, as well as comprehensive explanations during budget revisions regarding potential increases in this expenditure category. Improved transparency could serve as a good starting point in optimizing expenditures on goods and services, but this should be accompanied by a comprehensive reform of the public procurement system.

III.5.3. Public investment expenditures

Investment expenditures include, according to the budget classification, *capital expenditures* (non-financial assets), *projects financed from post-accession non-reimbursable external funds*, *expenditures related to reimbursable financing programs*, *capital transfers* and *other transfers of an investment nature* and, starting with 2022, the *projects financed from the amounts representing non-refundable financial assistance related to the NRRP*, respectively the *projects financed from the amounts related to the loan component of the NRRP*. Within this chapter, the structural analysis of this budgetary aggregate complies with the above definition.

In the initial budget construction of the year 2023, the investment expenditures, in cash standards, were estimated at 112.1 billion lei, 23.7 billion lei above the level programmed for the year 2022. The financing structure was designed in favour of the external financing sources (projects with financing from external non-refundable post-accession funds and projects with financing from the amounts representing non-refundable financial assistance and related loan NRRP accumulating about 54% of the total, 3.6 pp less than in the initial budget of 2022), the internal sources, the remaining 46% of the total (compared to the share of 42.5% of the initial budget of 2022). This structure was also determined by the fact that 2023 is the last year in which amounts could be attracted through the 2014-2020 MFF, as well as by the fact that, starting from this year, the payment requests related to the NRRP began to represent more substantial amounts. The Fiscal Council supports, similar to its previous reports, the financing of the

highest possible proportion of public investments from European funds, considering the high budget deficit and the general economic context characterized by uncertainty.

In execution, the increase compared to the previous year was 28.1 billion lei (at a level of 100.7 billion lei), representing an increase of almost 39% in nominal terms[48]. All components of investment expenditures contributed to this increase, respectively: *projects with financing from external non-refundable post-accession funds* (+22.7 billion lei), *projects with financing from amounts representing non-refundable financial assistance and loans related to NRRP* (+5.1 billion. lei), while sources from the domestic economy were higher by about 389 million lei compared to 2022. Thus, in 2023 the ratio between internal and external sources[49] of financing the state's investment expenditures remained supra-unitary, increasing from 108% in 2022 to 186% in 2023.

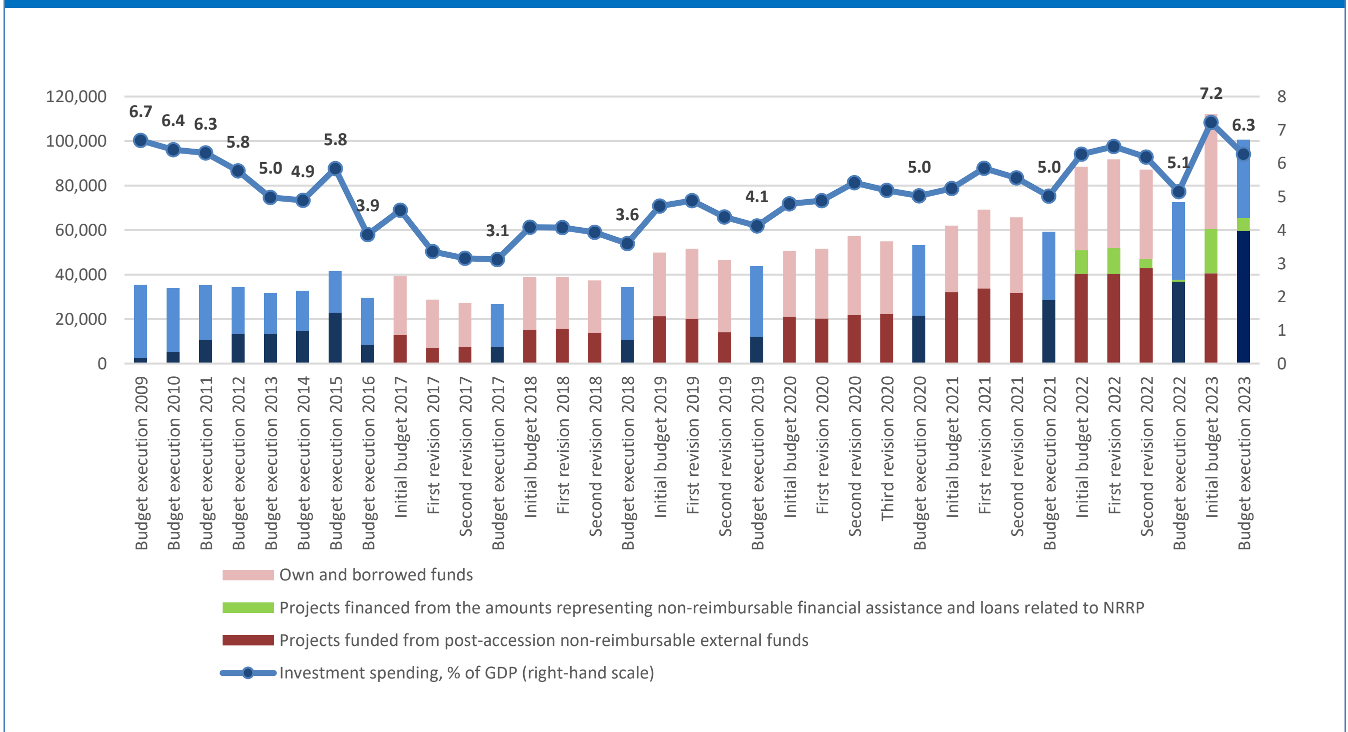
The share of investment expenditure in GDP, according to the cash methodology, reached 6.3% in 2023, 1.2 pp above the level recorded in the previous year (5.1%), representing an increase of approximately 2.6 pp compared to the average years 2016-2019 and exceeding by 0.5 pp the average of the years 2009-2015 (5.8% of GDP). Thus, 2023 recorded the continuation of the investment revival of recent years, the share of public investments in GDP significantly exceeding the average of the last 10 years, of 4.7% of GDP. Also, from the perspective of the share of investments in total budget revenues, a level of 19.1% was recorded in 2023, which represents the maximum of the last 10 years.

The evolution of this budgetary aggregate from the perspective of the comparison between the actual achievements and the values planned in the initial budget, or established on the occasion of the budget rectifications, is illustrated in *Figure 23* for the 2017-2023 period, with the execution results for the years 2009-2016 also being presented. In recent years, a high volatility of forecasts during the year regarding public investment expenditures has been observed, the execution results being usually lower than the estimates from the initial budgets (with the exception of 2020) and, without exception, the estimates made on the occasion of budget corrections.

[48] More than GDP growth in nominal terms, which was approx. 15%.

[49] Starting from 2022, this category also includes the aggregate of *projects with financing from the amounts representing non-refundable financial assistance and related to NRRP loan*.

Figure 23: Investment expenditures between 2009-2023



Source: MF (cash standards)

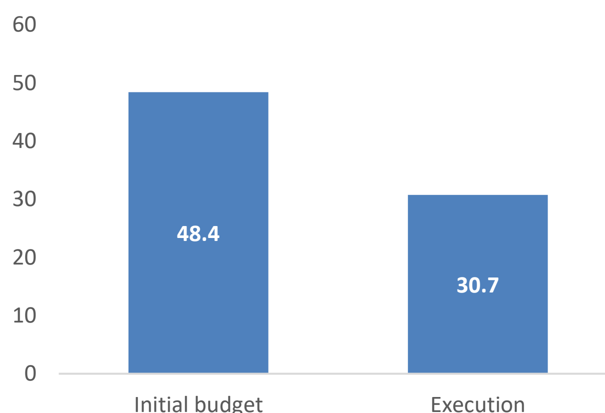
The evolution in 2023 does not deviate from this trend, with a gap between the execution and the level programmed in the initial budget of 11.4 billion lei, of which the largest non-realization, of 16.4 billion lei, was in the amounts from own and borrowed funds, followed by projects financed from amounts representing non-reimbursable financial assistance and loans related to NRRP (-14.1 billion lei), while at the level of amounts related to projects financed from non-reimbursable external funds post-accession, the execution exceeded the level budgeted with 19.1 billion lei. The Fiscal Council appreciates the intention to finance an important part of public investment expenditures from external funds (considering the very low level of tax revenues in Romania), but major non-achievement of investment targets (by almost 1 pp of GDP in 2023) shows deficiencies in the budgeting process. These can make the process of budget consolidation difficult in the conditions of the reduced fiscal space available to our country.

Also, the quarterly distribution of the share of investment spending in total execution shows high volatility, fluctuating from 13.1% in the first quarter, to 19.5% in the second quarter, to 21.2% in the third quarter, and to 46 .3% in the last quarter. Practically, in the last 3 months of the year, investment expenditures were 2.6 times higher than the average of the previous three quarters. Given that the same pattern was systematically manifested in previous years, this practice calls into question the efficiency of the budget programming process from the perspective of the way investment projects are managed and the establishment of criteria for their realization in accordance with their importance and utility.
Next, the evolution of the main components of investment expenditures during 2023 is presented (summed up, they represent about 96% of the total) by comparing the actual achievements with the levels programmed in the initial budget.

In 2023, *capital expenditure* for public investment [50] were projected in the initial budget at a level of 48.4 billion lei, excluding the impact of swap compensation schemes. Compared to the execution of 2022, this category of expenditures was increased by 15.3 billion lei.

The final execution recorded a failure by 17.7 billion lei (-36.5%) of the level programmed in the initial budget of 2023.

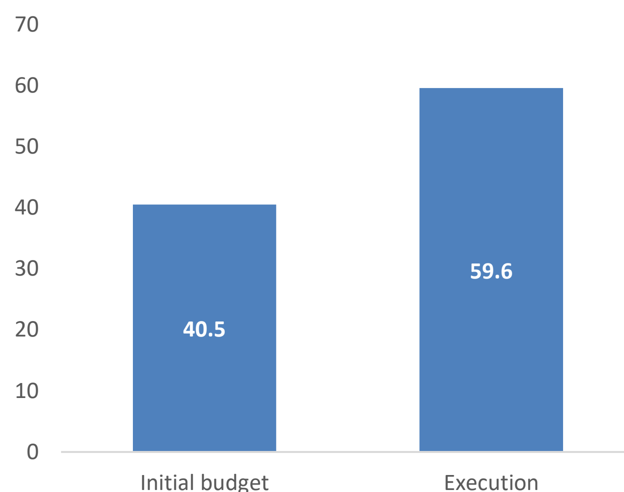
Figure 24: Capital expenditures in 2023 (billion lei)



Source: MF (cash standards)

The *projects with financing from post-accession non-refundable external funds* (NREF) intended for public investments were estimated in the initial budget of 2023 at 40.5 billion lei, with 4.2 billion lei above the level recorded in the execution of 2022. The final execution of the year 2023 recorded an excess of 19.1 billion lei from the initially programmed level, the degree of realization of the program being about 147%, in a significant increase compared to the previous year, when it was 91.5%. At the same time, compared to the execution in 2022 of the projects with financing from external non-refundable post-accession funds intended for public investments, in 2023 there was an increase of 23.3 billion lei.

Figure 25: Projects financed from post-accession NREF in 2023 (billion lei)



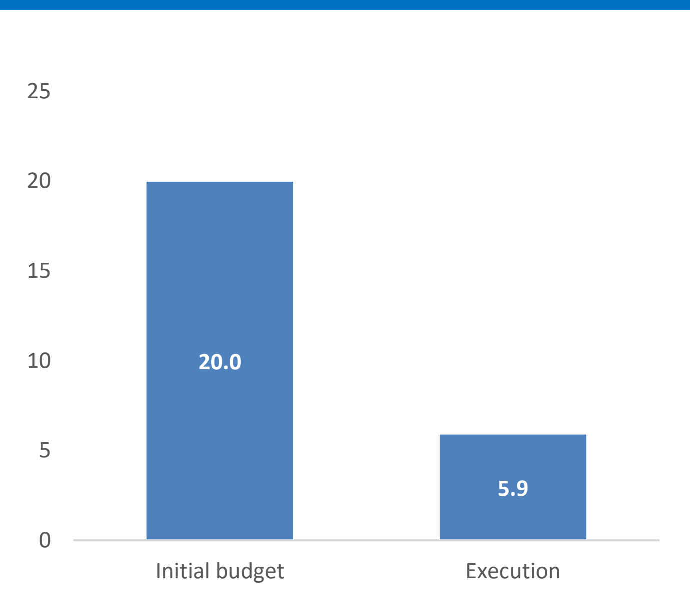
Source: MF (cash standards)

[50] These represent the main component of capital expenditure in GCB (which also includes capital transfers and inventories).

The projects with financing from the amounts representing non-refundable financial assistance and loan related to NRRP were estimated in the initial budget of 2022 at a level of about 20 billion lei. According to the GCB execution data, the amounts actually spent were only 5.9 billion lei, representing approximately 29.5% of the initially budgeted amount.

The Fiscal Council draws attention to the fact that an additional impact on the deficit can be exerted by the amounts related to the loan component of the NRRP, to the extent that it is not possible to accommodate them by restricting other categories of expenditures and/or by increasing budget revenues.

Figure 26: The evolution of expenditures with projects financed from the amounts representing non-reimbursable financial assistance and loans related to the NRRP in 2023 (billion lei)



Source: MF (cash standards)

An analysis of the efficiency of investment spending over the last 10 years reveals an unsatisfactory result for our country compared to other EU member states. Given that Romania had, in the last decade, one of the highest shares of investment expenditure in GDP compared to the EU average, the infrastructure is insufficient both in terms of quantity and quality, a sign of a low efficiency of public investment expenditures. Thus, in the 2014-2023 period, the share of investment expenditures in GDP, according to the European methodology (*Figure 27*), placed Romania in the first half of the ranking (11th place in the EU), with an average share of 4% of GDP, with approximately 0.8 pp above the EU average. Compared to the first ranked, Hungary, the gap is 1.5 pp, and compared to the second ranked, Estonia, by 1.3 pp. Regarding the ranking achieved at the level of 2023, Romania is in third position, with a share of 5.3% of GDP, behind Estonia (gap of 1 pp) and Croatia (gap of 0.1 pp).

The analyses developed in recent years by the EC and various international financial institutions[51] shows that, systematically, the quality of infrastructure in Romania is among the lowest at European level, especially in critical sectors, such as road, rail and energy infrastructure, due to the modest performances recorded by most state-owned enterprises – the main infrastructure providers in these areas – and the lack of progress in restructuring loss-making businesses. According to the latest FC[52] analysis regarding the SOEs performance, the rate of new investments (% of total assets) in these companies had a fluctuating evolution over time (6% in 2022, 7.2% in 2021, 5.3% in 2020, 5.8% in 2019

[51] E.g., *The Global Competitiveness Report 2019* (World Economic Forum, 2019), *Romania Diagnostic* (Milatovic and Szczurek, 2020) etc.

[52] http://www.fiscalcouncil.ro/SOE%202022%20EN.pdf

compared to 1, 3% in 2018 or 4.7% in 2015) being far below the average from the pre-crisis period (around 12%).

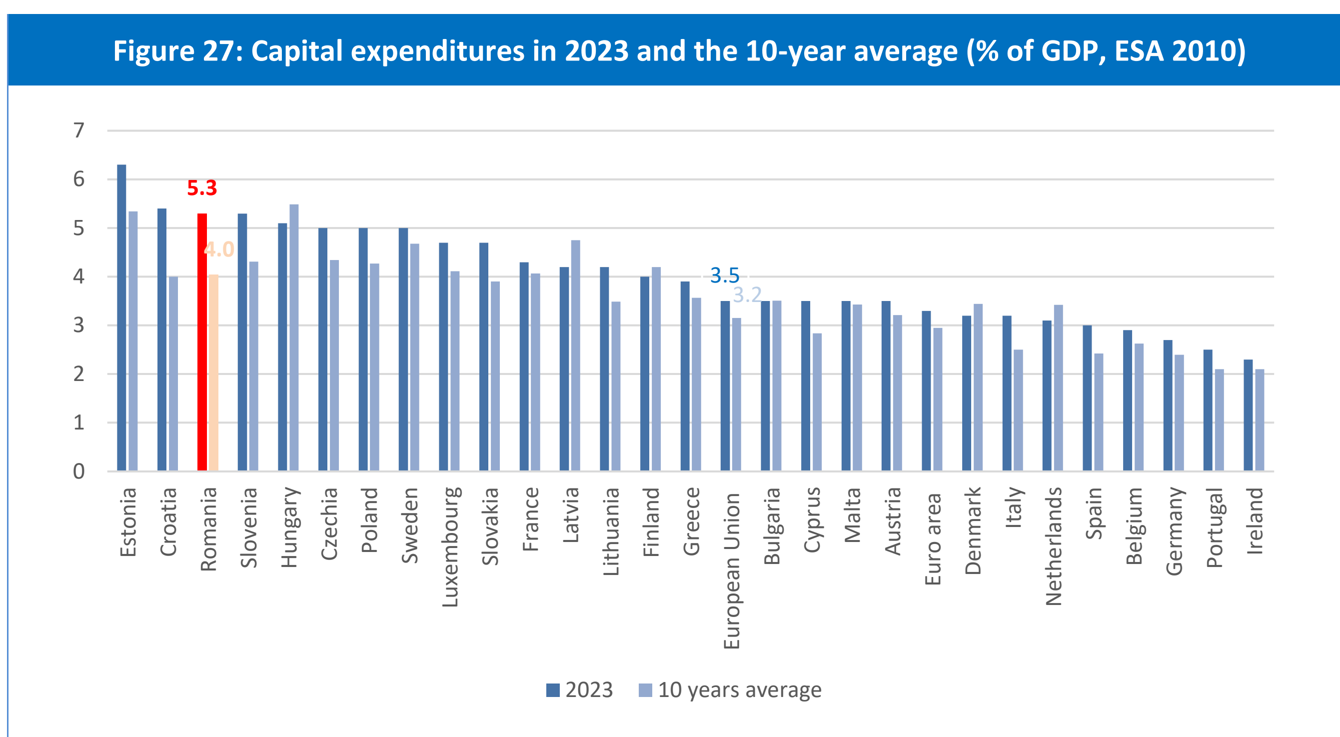


Figure 27: Capital expenditures in 2023 and the 10-year average (% of GDP, ESA 2010)

Source: Eurostat

Note. Investment expenditures according to the ESA 2010 methodology represent expenditures intended for the formation of gross fixed capital. This indicator is used at EU level and can be a comparative reference for investment expenditures in the member states. The differences between the level of investment expenditures according to the cash methodology, respectively, according to the European methodology generally come from the different way of recording arrears, defense expenditures, as well as some categories of non-reimbursable external funds.

In the *EC Country Report*[53] it is stated that the productivity of Romania's economy is approaching the EU average, but significant regional disparities still persist, the high level of investments in recent years, especially those from European funds, being the engine for recovering the gaps compared to the EU average. At the same time, a series of problems affecting the level of competitiveness of our country are identified, such as the volatile tax system, which represents a barrier to private investments, and the limited competition in the public procurement process, which leads to an inefficient allocation of resources in economics. From the point of view of administrative capacity, it is recommended to strengthen it, especially at the local and regional level, by implementing the Cohesion Policy and NRRP reforms. Other obstacles to investments, indicated by the EC report, are: i) the significant deficiencies of the transport infrastructure (even if recently there has been an acceleration of civil construction works), ii) a shortage on the labour market, both for the skilled workforce, as well as for the unskilled, iii) the low level of digitization, as well as iv) the generally low IT skills of the population.

[53] https://economy-finance.ec.europa.eu/document/download/dcac26a0-120e-4233-88b6-8c7b0d919257_en?filename=SWD_2024_623_1_EN_Romania.pdf

Also, the *Report prepared by the OECD in 2024*[54] mentioned polarization and regional disparities as Romania's priority problems. The study shows that our country also faces a problem of internal mobility between regions, and a solution to it could reduce the massive departures to the diaspora, leading to the reduction of unemployment in the less developed regions. Moreover, the report emphasizes that investments from European funds represented an important support for domestic economic activity in 2024, given the still high interest rates and the pressures related to the election year.

Considering this aspect, the Fiscal Council pleads for the acceleration of efforts regarding the implementation of real reform measures in the field of public investments in order to make the most of the opportunity to access European funds allocated through the 2021-2027 Multiannual Financial Framework and through the NRRP for the implementation of reforms that address Romania's acute investment priorities.

The Fiscal Council appreciates that a good prioritization of investments, their orientation towards research, development and innovation activities in strategic areas, in the physical infrastructure and especially in the digital one, can contribute to the reduction of regional disparities and to the improvement of productivity and long-term growth of the Romanian economy.

In this sense, a better absorption of European funds from the 2021-2027 Multiannual Financial Framework and access to the resources available through the NRRP are prerequisites for the upward investment trend of the last two years to be significantly accentuated in the medium term, allowing a rapid economic growth in parallel with the adjustment of the budget deficit according to Romania's commitment within the EDP.

III.5.4. The contingency reserve fund and the intervention fund at Government's disposal

In accordance with art. 30 of the Public Finance Law no. 500/2002, with subsequent amendments and additions, **the contingency reserve fund** at the Government's disposal and **the intervention fund** at the Government's disposal are included in the state budget.

The contingency reserve fund at the Government's disposal is allocated to main authorizing officers of the state budget and local budgets, based on Government decisions, for financing urgent or unforeseen expenditures arising during the budget exercise. The allocation of amounts from the contingency reserve fund at the Government disposal, for local budgets, is done by increasing the amounts subtracted from some state budget revenues or the transfers from the state budget to local budgets for investments partially financed by external loans, as the case may be.

The utility of a contingency reserve fund lies in the flexibility given to the Government regarding the annual budget execution, particularly for covering urgent or unforeseen expenditures. The reserve fund can be established as a separate fund from the budget (off-budget) or as an integrated component

[54] OECD. 2024. Economic Surveys: Romania 2024, https://read.oecd-ilibrary.org/economics/oecd-economic-surveys-romania-2024_106b32c4-en#page37

within the budget, and it is found in the vast majority of OECD countries[55]. The opportunity of including a contingency reserve fund into the general budget is confirmed by the literature on budget programming, which also highlights the necessity of finding a balance regarding the dimension of such a fund. Therefore, a level of the contingency reserve fund that is too low might be insufficient to cover unforeseen expenditures, while an oversized fund might grant too much power for the authorities to spend excessively, without the Parliament's approval.

The legal framework provided by Law no. 500/2002, however, only specifies generically the type of allocations allowed from the reserve fund (respectively for "unforeseen or urgent" situations), without explicitly establishing the categories of *expenditures* that can be committed from the reserve fund or the amount of allocated sums, which gives room for discretionary and non-transparent allocations. In this sense, the Fiscal Council notes the lack of transparency of the destination of allocations from this fund, the absence of clear criteria for establishing the *expenditures* that can be financed from the budget reserve fund and the lack of control by the Parliament. Thus, considering the evolution in recent years of the amounts spent from this fund that are not intended for urgent or unforeseen situations, the Fiscal Council firmly advocates for the amendment of the legislation that establishes the way of using the reserve fund, in the sense of establishing clear criteria and procedures of its use, exclusively for unpredictable or urgent situations, which cannot be foreseen in the process of establishing budget allocations.

The intervention fund at the Government's disposal is allocated to main authorizing officers of the state budget and local budgets, based on Government decisions, for the financing of urgent expenditures in order to remove the effects of natural calamities and support the impacted persons. Unlike the possible destinations of allocations from the contingency reserve fund, which leave room for interpretation, in the case of the intervention fund, they are clearly specified by the law, the opportunity of the existence of such fund being justified. Over the course of the year, this fund can be supplemented from the reserve fund, depending on the needs regarding the provision of the amounts necessary to eliminate the effects of natural calamities.

The present section of the report analyses the use of the two funds during 2023, based on the Government decisions published in the Official Gazette of Romania, by which sums are allocated to authorizing officers and destinations.

In an increasingly complicated international environment, marked by economic, political and geopolitical tensions, Romania's most acute problem in 2023 was represented by the budget deficit[56]. In an attempt to keep public spending under control, the Government approved a series of measures[57] which transformed **the budget reserve fund** at the disposal of the Government into a discretionary

[55] OECD. 2020. Government at a Glance: Latin America and the Caribbean 2020, https://www.oecd-ilibrary.org/governance/government-at-a-glance-latin-america-and-the-caribbean-2020_13130fbb-en

[56] http://www.fiscalcouncil.ro/EN%20-%20Opinie_CF_buget_2024.pdf

[57] As GEO no. 90/2023, which sought to limit spending on goods and services and those on investments, from the last two months of the year, to the January-September 2023 average level.

instrument through which the authorities had the possibility to adjust the general consolidated budget without having to resort to budget corrections. It was thus possible to redistribute the unspent resources of the main credit authorizing officers to other areas.

GEO no. 73 regarding some budgetary measures, from September 14, 2023, prepared the changes regarding the operation of the reserve fund, stipulating that, based on Government decisions, amounts can be allocated from it to finance the current and capital expenditures of the main authorizing officers, priority being the expenditures of staff, social assistance expenditures, national public contribution related to projects financed from external non-reimbursable funds, medicine expenditures, health programs and actions of the main credit authorizers. Thus, the reserve fund became the instrument by which the adoption of budget corrections during 2023 was evaded.

In the construction of the state budget for 2023[58], approximately 685.7 million lei were provided as reserve funds. At the same time, only one derogation was established from the provisions of art. 30 para. (2) from Law no. 500/2002, namely for the financing of the National Local Development Program, including stage II, and the “Anghel Saligny” National Investment Program, with the Ministry of Development, Public Works and Administration as beneficiary.

However, during the year, even before the adoption of GEO no. 73/2023, the use of some amounts from the reserve fund was beyond the framework established in the Public Finance Law no. 500/2002, respectively for expenditures that cannot be categorized as urgent or unforeseen and that should have been taken into account when establishing the state budget and local budgets, such as:

- funding for the “Development of school transport in general education institutions in the Republic of Moldova” project;
- financing for local development projects (water supply, sewerage, aqueduct systems etc.) “European Village – public works and infrastructure”;
- the organization of the Business Forum of the Three Seas Initiative, national activities and meetings and for the coordination of other collaborations regarding the Three Seas Initiative, in the context of the organization of the Summit of the Three Seas Initiative in Bucharest, between September 6-7, 2023;
- ensuring the necessary funding from the state budget for payment/reimbursement requests to the beneficiaries of the Large Infrastructure Operational Program;
- balancing local budgets, for the payment of current and capital expenditures.

In 2023, a record amount was allocated from the reserve fund, almost 47 times more than what was foreseen in the draft state budget for 2023, namely 32.08 billion lei, representing 5.2% of total expenditures of the general consolidated budget, respectively 2.03% of GDP. From the beginning of the year until September 14, 2023, when the legislative framework regarding the operation of the reserve fund was changed, 0.45 billion lei were allocated from the reserve fund, the difference, about 31.64 billion lei, being allocated based on the new legislative framework for the operation of the reserve fund.

[58] https://mfinante.gov.ro/static/10/Mfp/buget2023/legeabugetuluidestat2023.pdf

For comparison, in the 2007-2022 period, the reserve fund allocations varied between a minimum of 0.53 billion lei, in 2015, and 7.96 billion lei, in 2020. Therefore, allocations for 2023 are over 4 times higher than the previous maximum, recorded in the first year of the pandemic, and almost 9 times higher than the previous year (3.61 billion lei allocations in 2022).

If in 2022 allocations to administrative-territorial units prevailed (52.24% of total allocations from the reserve fund), in 2023 most of them were directed to the central administration (91.27%, namely 29.28 billion lei), the administrative-territorial units receiving 8.73% of the total allocations, namely 2.8 billion lei (higher, however, by 48.45% compared to 2022).

Thus, 2023 records a substantial increase in the share of the amounts used from the budget reserve fund in the total budget expenditures, compared to the previous year, by 4.5 pp (from 0.7% in 2022 to 5.2% in 2023). Referring to the average of the 2014-2023 period (10 years), of 1.3%, we observe a significant worsening, after in 2022 the share of allocations from the reserve fund in total budget expenditures had been relatively close to the minimum of the interval (0.2% in 2015).

The evolution of the amounts allocated from the budget reserve fund at the disposal of the Government and their weight in the total budget expenditures is shown in *Figure 28*.

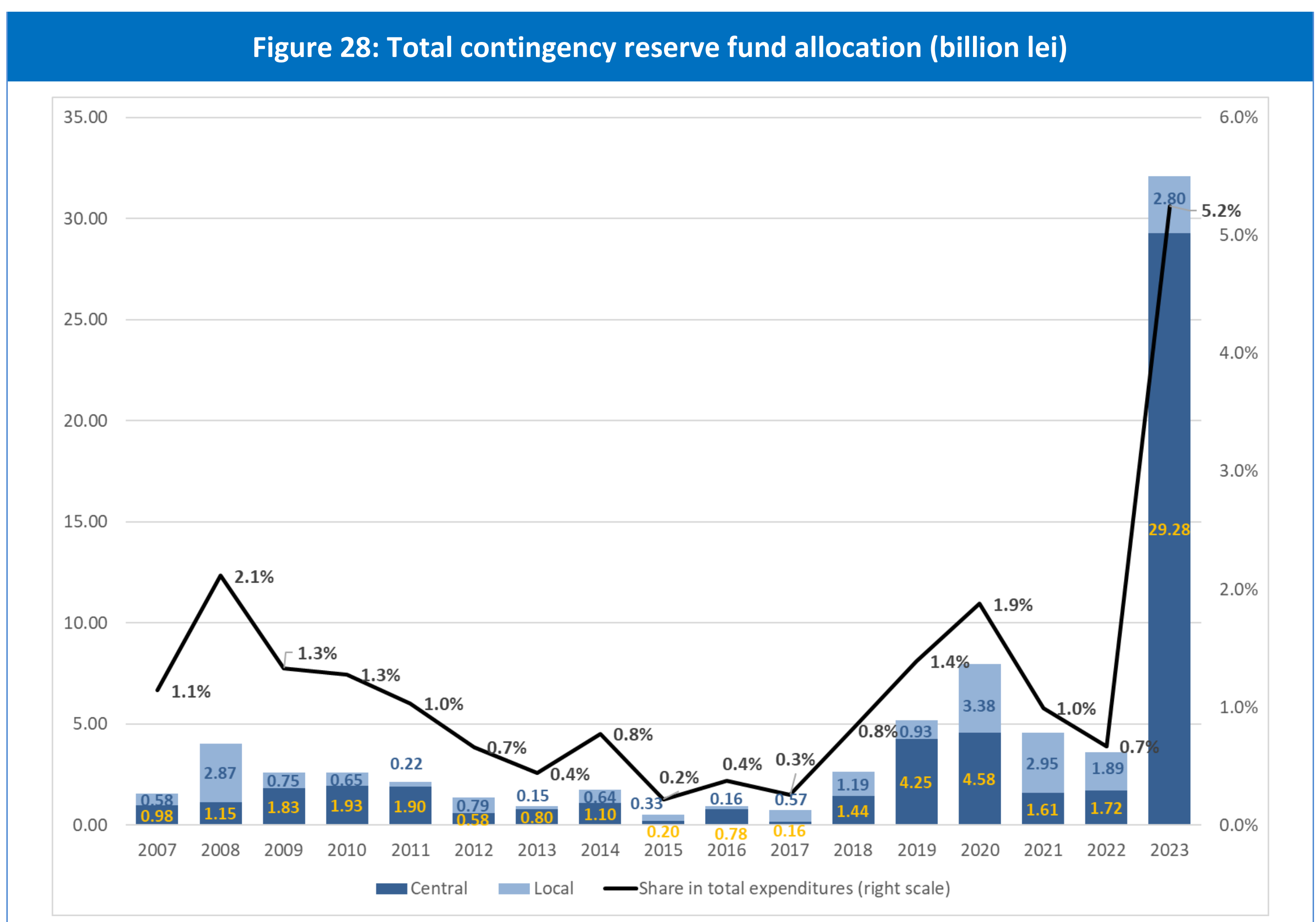


Figure 28: Total contingency reserve fund allocation (billion lei)

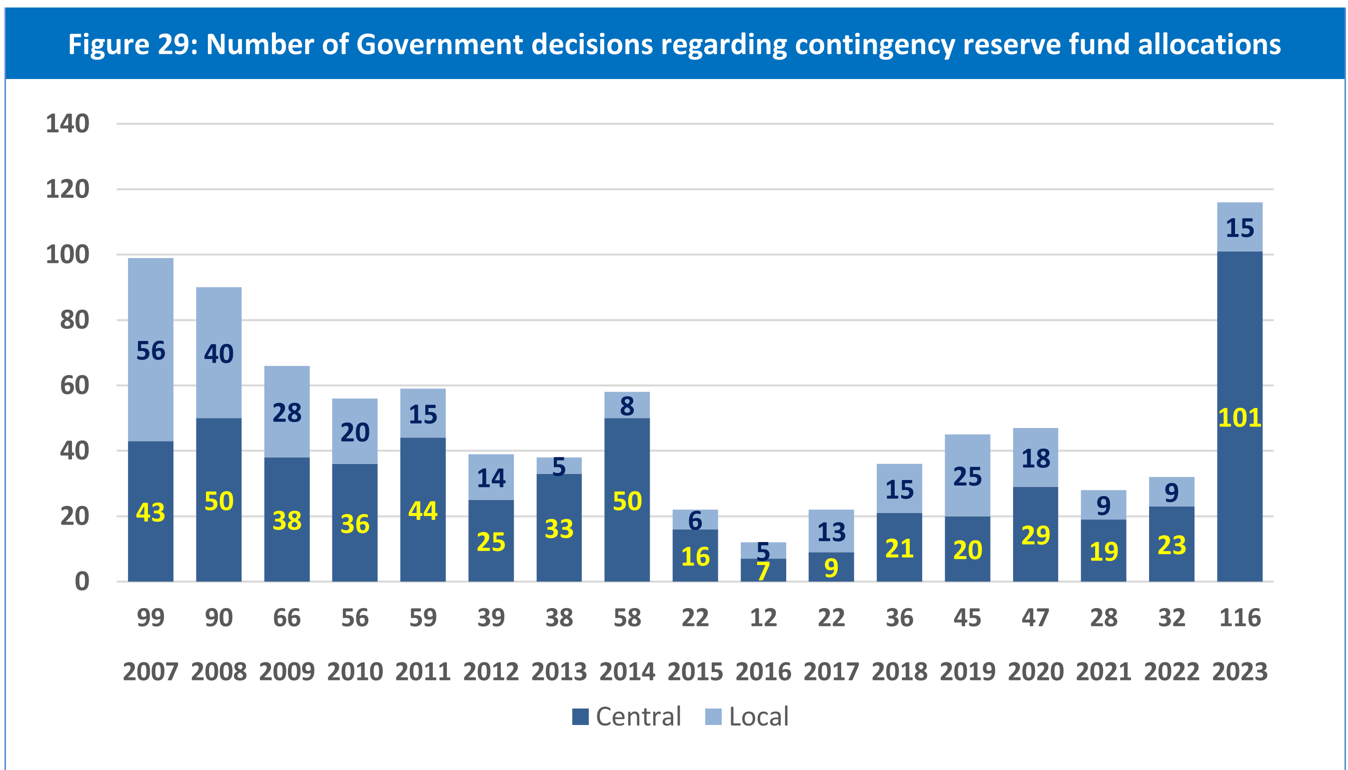
Source: Fiscal Council's calculations based on Government decisions regarding the contingency reserve fund allocations

Also, in terms of the number of Government decisions for the allocation of amounts from the reserve fund, 2023 was a record: 116 decisions, of which most (104) were given after the amendment of the legislative framework regarding the operation of the reserve fund (September 14, 2024). The figure is higher than the sum of Government decisions for this purpose from the last 3 years prior to the year of analysis (see *Figure 29*).

At the same time, there is a change in the tendency shown in previous years to employ almost half of the total expenditures from the budget reserve fund towards the end of the year. In December 2023, 26 of the 116 decisions were approved, allocating sums in the amount of 3.96 billion lei, which represents only 12.35% of the allocations for the entire year. However, this situation cannot be categorized as an improvement, given the change in the legislative framework and the unprecedented derogations regarding the operation of the reserve fund.

21 of the 26 Government decisions adopted in December were for allocations to the central administration, in the amount of 3.48 billion lei, the main beneficiaries being the Ministry of Development, Public Works and Administration (1.15 billion lei, for financing the Program National Development Fund, the “Anghel Saligny” National Investment Program and the National Public or Social Interest Construction Program) and the High Court of Cassation and Justice (0.82 billion lei, for the payment of the salary rights of the staff of the related courts in part in October and in full in November 2023 and for the payment of salary rights established by enforceable titles in favour of the staff of the High Court of Cassation and Justice and of the other courts, for which the staggered payment terms are fulfilled in 2023, as well as of the accessories related to these rights).

Figure 29: Number of Government decisions regarding contingency reserve fund allocations



Source: Fiscal Council’s calculations based on Government decisions regarding the contingency reserve fund allocations

In 2023, the main beneficiaries of the contingency reserve fund (*Figure 30*) were the Health Fund and the Ministry of Education, especially as a result of the wage increases granted, won through protests by teachers and medical staff[59]. The administrative-territorial units, which occupied the first position in the previous year, were in 5th place in 2023 from the perspective of the volume of allocations. Thus, the main recipients of the reserve fund allocations were:

- *The Health Fund*, 18.05% of the total allocations (5.79 billion lei), whose budget was supplemented 5 times during the year to cover the expenditures necessary for the health units with beds and to finance the expenditures with materials and provision of services of a medical nature, as well as for the financing of the wage increases benefiting the personnel employed in the public health units;
- *The Ministry of Education*, 16.22% of the total allocations (5.2 billion lei), whose budget was supplemented 3 times during the year, for the financing of the "Development of school transport in general education institutions in the Republic of Moldova" project, staff expenditures and student scholarship expenditures;
- *Ministry of Internal Affairs*, 11.84% of the total allocations (3.8 billion lei), whose budget was supplemented 8 times during the year, for the settlement of food and accommodation expenditures of foreign citizens or stateless persons in special situations, from the area of the armed conflict in Ukraine, for the training of specialized personnel from Ukraine on the provision of qualified first aid, for the payment of social rights, for the financing of the expenditures generated by the provision of humanitarian assistance, as well as for the financing of the expenditures related to the provision of temporary protection;
- *Ministry of Labor and Social Solidarity*, 8.97% of the total allocations (2.88 billion lei), whose budget was supplemented 4 times during the year, to finance the expenditures incurred from the unemployment insurance budget, to ensure the payment of aid for home heating and the supplement for energy related to the consumption of solid and/or petroleum fuels and for social benefits in cash, to ensure the payment of social security rights from the public pension system which is borne from the state social security budget;
- *Administrative-territorial units*, 8.73% of the total allocations (2.8 billion lei), for which 15 decisions were given by the Government, for the payment of current and capital expenditures and for the balancing of local budgets for 2023;
- *The Ministry of Development, Public Works and Administration*, 7.58% of the total allocations (2.43 billion lei), whose budget was supplemented 6 times during the year, for granting a non-refundable financial assistance to the Republic of Moldova for the financing of the project "The European Village – public works and infrastructure", for the financing of the National Program for Local Development, the National Investment Program "Anghel Saligny", the National Program for constructions of public or social interest, as well as some personnel expenditures;
- *The Ministry of Investments and European Projects*, 6.7% of the total allocations (2.15 billion lei), whose budget was supplemented 7 times during the year, to ensure the necessary funding from

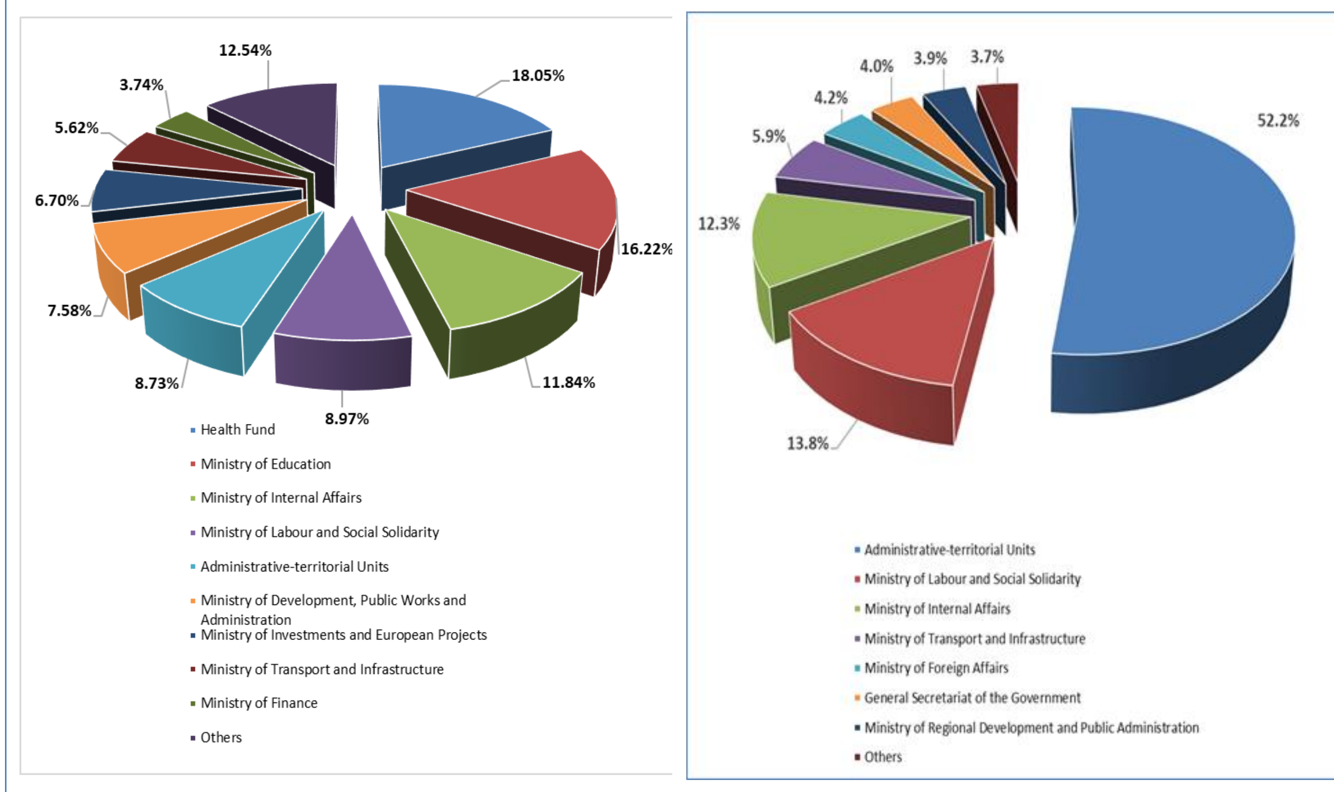
[59] OECD. 2024. Economic Surveys: Romania 2024, https://read.oecd-ilibrary.org/economics/oecd-economic-surveys-romania-2024_106b32c4-en#page37

the state budget for payment requests/reimbursement, for the implementation of the temporary measure “Support for Romania” by granting the October tranche of material support in the form of social vouchers on electronic support, for the implementation of the support measure for the didactic activity issued on electronic support;

- *The Ministry of Transport and Infrastructure*, 5.62% of the total allocations (1.8 billion lei), whose budget was supplemented 8 times during the year, for the improvement of road transport capacities in the area of the border crossing point between Bumbăta localities (Romania) - Leova (Republic of Moldova), against the background of the situations generated by the military conflict, as well as the measures recommended by the European Commission regarding the elimination of blockages at border crossing points, to ensure the necessary funds for the Project on the connection of the metro network with Henri Coandă Otopeni International Airport - Bucharest, for the support of passenger rail transport, for ensuring the necessary funding from the state budget for the projects in the field of transport carried out by the beneficiaries of the Large Infrastructure Operational Program and of the projects financed under the Mechanism for the Interconnection of Europe, for the payment obligations to GCB;
- *Ministry of Finance*, 3.74% of the total allocations (1.2 billion lei), whose budget was supplemented once during the year, for the payment of interest on the public debt.

Figure 30: The beneficiaries of the contingency reserve fund (% of total allocations)

2023 **2022**



Source: Fiscal Council's calculations based on Government decisions regarding the contingency reserve fund allocations

Considering the purposes for which significant sums of the reserve fund have been allocated, it must be emphasized that, despite the recommendations made by the Court of Accounts to combat the recurring use of a significant share of the reserve fund to finance some largely determined expenditures by underestimating the need for budget credits at the time of drafting the budget, and which are not intended for urgent or unforeseen situations, this practice was intensively used in 2023, when the reserve fund *de facto* replaced budget revision.

Considering the best international practices, as well as the conclusions formulated by the Court of Accounts in its annual reports[60], The Fiscal Council reiterates the recommendation from previous reports regarding the explicit identification of expenditures that can be committed from the reserve fund, together with much greater transparency, including through periodic reporting to Parliament of the manner and level of use of the budget reserve fund. In addition, considering the special situation recorded in 2023, the Fiscal Council emphasized in the Position Note regarding the Restriction of Public Expenditures[61] that the replacement of budget revisions with the use of reserve fund creates a

[60] https://www.curteadeconturi.ro/

[61] http://www.fiscalcouncil.ro/Nota%20ordonanta%20cheltuieli%20EN%20-%20FINAL.pdf

precedent involving major risks, from the lack of transparency in budget execution, to the discretionary use and increased recourse to exemptions from fiscal rules.

In 2023, allocations from **the intervention fund** experienced a significant increase compared to the previous year (to 72.7 million lei, from 11.2 million lei), and their destinations fell within the provisions of the Public Finance Law no. 500/2002, the funds being used for: some administrative-territorial units in Gorj county, affected by the earthquakes of February 13-14, 2023, for the municipality of Târgu Jiu, for various consolidations and rehabilitations, as well as for the emergency implementation of investment works to prevent the effects of calamities produced by the loss of the existing defense infrastructure as a result of the erosion phenomena recorded and accentuated during 2023 in the area of Bozânta Mică, Maramureș county (beneficiary – Ministry of the Environment, Waters and Forests). It should be noted that all 3 Government decisions aimed at using the intervention fund assumed its supplementation from the budget reserve fund.

III.5.5. Arrears of the general consolidated budget

At the end of 2023, *GCB arrears*[62] were 280 mil. lei, a slight decrease, with 2.6 mil. lei (-0.9%), compared to December 2022. Analysing their structure, it is found that the great majority of arrears were registered at the level of local budgets (91.9% of the total). Regarding the number of days late, 38.4% of arrears are between 90 and 120 days, 37.9% between 90 and 360 days, and the remaining 23.7%, over 360 days.

The *GCB' arrears (90-360 days) to the private sector companies* amounted to 274.5 million lei, compared to 276.7 million lei at the end of the previous year (-2.2 million lei, or -0.8%). These arrears are predominantly located at the level of local budgets.

The following table shows the quarterly evolution of the stock of *total outstanding payments of the GCB* overall and for each budget category (state budget, local budgets and social security budget), compared to the previous year.

[62] According to the Public Finance Law no. 500/2002 with subsequent amendments and additions, *overdue payments older than 90 days*, calculated from their due date, are considered *arrears*.

Table 8: Quarterly evolution of GCB outstanding payments (0-360 days) in 2023 (million lei)					
	Q4 2022	**Q1 2023**	**Q2 2023**	**Q3 2023**	**Q4 2023**
State budget	**18.0**	**16.2**	**18.4**	**22.3**	**22.7**
Over 90 days	3.8	3.6	2.4	4.3	6.0
Over 120 days	4.4	4.2	6.8	7.4	7.4
Over 360 days	9.8	8.3	9.3	10.5	9.2
Local budgets	**264.6**	**283.6**	**321.4**	**261.6**	**257.3**
Over 90 days	62.7	68.5	53.7	72.8	101.5
Over 120 days	163.4	167.1	195.2	137.2	98.6
Over 360 days	38.5	48.0	72.5	51.6	57.2
Social security budget	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Between 90 and 360 days	0.0	0.0	0.0	0.0	0.0
Total arreas (90-360 days)	**282.6**	**299.8**	**339.9**	**283.9**	**280.0**
Over 90 days	66.4	72.1	56.1	77.2	107.6
Over 120 days	167.8	171.4	202.0	144.6	106.0
Over 360 days	48.3	56.3	81.8	62.1	66.4

Source: MF

Overall, there is a significant reduction of *GCB arrears* (90-360 days) to the private sector in the last 11 years (from 3.8 billion lei in 2012, to below 0.3 billion lei in 2023), which is mainly explained by the implementation of EU Directive no. 7/2011 on combating the delay in making payments in commercial transactions (transposed into national legislation by Law no. 72/2013), as well as the positive effect of other legislative measures aimed at reducing the stock of arrears: GEO no. 29/2011 for the regulation of payment installments, GEO no. 3/2013 which restricted the possibility of local authorities to contract new loans strictly for the settlement of arrears and GEO no. 12/2013 which introduced a mechanism for extinguishing mutual payment obligations.

III.6. Public debt

Public debt, measured according to the European ESA 2010 methodology, increased by 118.1 billion lei (+17.7%) in 2023 compared to the previous year, and its share in GDP rose by 1.3 pp, from 47.5% to 48.8%. According to the national methodology[63], public debt increased by approximately 130.9 billion lei (+15.9%). Given the slower growth of nominal GDP, its share in GDP increased by 0.7 pp, from 58.8% in 2022 to 59.5% in 2023. The slightly upward trajectory of public debt was driven by the continuation of a high budget deficit.

[63] Public debt, according to the national methodology, additionally includes, compared to the European methodology, government-guaranteed debt, which is repaid from the beneficiaries' own sources of guarantee, as well as loans from the general account of the State Treasury.

Regarding the structure of public debt[64], the share of central government debt increased slightly in 2023 (97.8% of the total, compared to 97.5% in the previous year), to the detriment of local public debt (2.2% of the total, compared to 2.5% in the previous year). Government bonds maintained their position as the main instrument of government public debt, accounting for 34.3% of the total (compared to 33.6% in 2022), followed by Eurobonds with 31.8% (compared to 31.3% in 2022), state loans (15.5%, compared to 16.9% in 2022), retail bonds (3.7%, compared to 3.4% in 2022), and treasury bills (0.8%, compared to 0.6% in 2022), while loans from the general account of the State Treasury slightly decreased (12.6%, compared to 13.1% in 2022). In terms of currency structure, there was a slight increase in the share of loans in national currency, from 55.1% in 2022 to 56.3% in 2023, as well as an increase in the share of loans contracted in US dollars, from 7.0% in 2022 to 7.3% in 2023. On the other hand, the share of debt in euros decreased from 37.6% in 2022 to 36.3% in 2023.

In 2023, the gross financing need, consisting of the budget deficit, refinancing, capital repayments, and pre-financing for the following year, was 12.8% of GDP (approximately 205 billion lei), up from 10.6% of GDP in 2022 (around 150 billion lei)[65]. This increase was driven by a roughly 39% rise in refinancing and capital repayments (95.8 billion lei in 2023, compared to 69.2 billion lei in 2022), the creation of a buffer of about 19.2 billion lei for pre-financing 2024 needs, and an 11% increase in financing the consolidated general budget deficit (89.9 billion lei in 2023, compared to 81 billion lei in 2022). It is also worth noting that in 2023, due to exceeding the budget deficit target, the financing need was revised three times, from the initially planned 160 billion lei to 205 billion lei.

Interest expenses, on a cash basis, increased by almost 1.5 billion lei (+5.2%) in 2023 compared to the previous year. This dynamic occurred partly due to the accelerated growth of the public debt stock in recent years (+31.7% in 2020, +18% in 2021, +18% in 2022, and +15.9% in 2023[66]) and partly due to the persistence of high interest rates. The share of interest expenses in GDP decreased from 2.1% to 1.9%, in the context of a 14.6% increase in nominal GDP. The actual execution of this expenditure chapter was nearly 1.5 billion lei above the projection in the initial budget.

The average interest paid on public debt[67], according to the national methodology, followed a downward trend, decreasing from 4.2% in 2022 to 3.7% in 2023, after an increase of 1.1 pp in 2022. This downward trend was driven by the end of the cycle of rising reference interest rates and the slight decline in bond yields, especially in the second half of the year, as disinflationary pressures solidified.

From the perspective of the ESA 2010 methodology, interest expenses experienced a more substantial increase compared to the previous year (+11.4 billion lei, representing +55.2%), compared to the national methodology. The difference in the variation of interest expenses between the two methodologies can

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[64] According to the national methodology, this information is available on the Ministry of Finance website.

[65] According to the Public Debt Reports, available on the Ministry of Finance website.

[66] According to the national methodology.

[67] Calculated as the ratio between the interest expenses for the current year and the public debt balance at the end of the previous year.

be explained by the different treatment of discounts[68] and issuance premiums[69]. Under the national methodology, these are fully recorded in the value of interest expenses, whereas under the ESA methodology, they are gradually amortized over the entire life of the loan.

The cost of attracting new loans in national currency (see *Figure 31*) experienced a series of positive developments during the 2014-2016 period, driven by the inclusion, starting in July 2014, of Romanian government bonds in the GBI-EM Global Diversified index series, the extension of the average maturity of public debt, monetary policy easing measures adopted by the National Bank of Romania, the achievement of a BBB- rating by Standard & Poor's in May 2014[70], and excess liquidity in financial markets. However, starting in 2017, this trend reversed, with the cost of attracting new loans in national currency rising, a trajectory that significantly accelerated during 2018 due to the sharp increase in inflation. The year 2019 marked a slight reduction (between 0.1 and 0.4 pp) in the cost of attracting new loans in national currency for most considered maturities, a trend that continued in 2020, with average reductions of 0.5 pp. In 2020, the reduction in interest rates was significantly influenced by the monetary policies implemented by central banks, particularly reflected in the substantial lowering of reference interest rates, liquidity injections into the banking system, and asset purchases. In 2021, a further decrease in the cost of attracting resources in national currency was recorded for most maturities, averaging 0.5 pp, with the largest reductions (1 pp) observed for 6- and 12-month maturities, while the cost increased by about 0.5 pp for 5- and 10-year maturities. In the last quarter of 2021, amid rising inflation, the central bank made two consecutive increases in the reference interest rate, by 25 basis points each, which also led to an increase in sovereign yields. In 2022, the downward trend in yields seen in recent years was strongly reversed. The cost of attracting new loans in national currency increased on average by about 5 pp for securities with maturities of 12 months, 2 years, 3 years, and 4 years, and by about 3.5 pp for 5- and 10-year maturities. This evolution was driven by the accelerated rise in inflation and its persistence, leading to successive increases in the reference interest rate, from 1.75% at the beginning of 2022 to 6.75% by the end of the same year.

In 2023, for most maturities, the cost of attracting resources in national currency slightly decreased. The most significant declines were for bonds with maturities between 2 and 4 years, with yields decreasing by 1.0 to 1.2 pp, while for 5- and 10-year maturities, the yield reduction was around 0.5 pp. These developments were driven by the disinflationary trend, which led to the conclusion of the interest rate tightening cycle. Thus, in 2023, the National Bank of Romania (NBR) decided on only one rate hike of 0.25 pp during the January meeting. Subsequently, the reference interest rate remained unchanged.

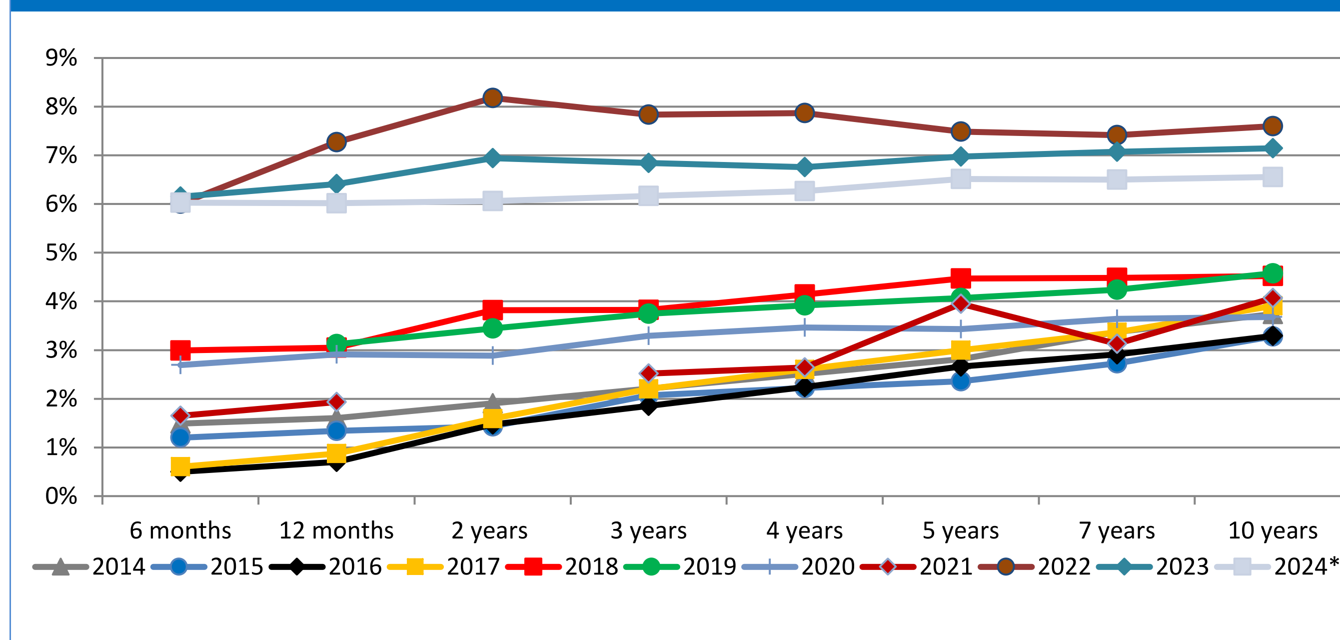
[68] The discount represents the difference between the issue price of a government bond and its nominal value, if the price is lower than the nominal value. Discounts on the nominal value of government bonds are granted when older bond issues are reopened, which have yields lower than the current market yield at the time of reopening, in order to align the bond's yield with the market rate.

[69] The premium is the difference between the issue price of a government bond and its nominal value, if the price is higher than the nominal value.

[70] Some investors face restrictions on investing in debt securities issued by countries that are not classified as investment-grade.

Additionally, in March 2023, the central bank intervened in the secondary market, purchasing government bonds worth approximately 1.3 billion lei[71].

Figure 31: The yield curve for government bonds, issued in domestic currency between 2014 - 30 June 2024



Source: NBR (June 30, 2024)*

The contraction of debt on external markets experienced a downward trend in 2023, reaching a level of approximately 39.2 billion lei (equivalent in the national currency), a decrease of 26.7% compared to the previous year. The reduction in foreign currency issuances can be explained by the narrowing interest rate differential between the national currency and the euro/dollar. In January 2023, three dollar-denominated issuances were launched, with maturities of 5, 10, and 30 years, with a cumulative value of around 4.52 billion dollars, representing a marginal increase (+0.06 billion dollars) compared to dollar issuances in 2022. At the same time, financing costs for dollar issuances rose significantly. Thus, the yields on the 5- and 10-year issuances increased by about 3.6 pp and 3.5 pp, respectively, compared to similar maturity issuances launched in January 2022. This difference can be attributed to the fact that between January 2022 and January 2023, in the context of rising inflation, the Federal Reserve raised the reference rate by about 4.25 pp. In euros, two issuances were launched in September 2023, with maturities of 5 and 10 years and a cumulative value of 3.75 billion euros, down by approximately 3 billion euros compared to the previous year. The yields associated with these two issuances were 5.5% and 6.375%, respectively. From a financing cost perspective, the maturities of the euro-denominated issuances in 2023 are not comparable to those launched in September 2022, which had maturities of 4 years (yield of 5%) and 7 years (yield of 6.625%), respectively.

[71] According to the NBR's Monthly Bulletin for January 2024.

The value of government securities in the national currency issued on the domestic market amounted to approximately 116.9 billion lei in 2023, an increase of about 81.9% compared to 2022[72]. Additionally, the domestic market saw four euro-denominated issuances, which attracted financing, equivalent in the national currency, of around 5.3 billion lei. Regarding the maturity structure of government securities in the national currency issued on the domestic market in 2023, there was an increase in both short-term issuances, with maturities of up to 1 year, and long-term bond issuances with maturities exceeding 10 years. Treasury bills with maturities of up to 1 year accounted for 15.4% of new borrowing in 2023, up by about 8.6 pp from the previous year. It is notable that the share of longer-term financing has increased significantly compared to the 2009-2012 period (the share of treasury bills with maturities of up to 1 year was 65% in 2009). Bonds with maturities between 1 and 5 years represented 23.7% of new borrowing in 2023 (a decrease from 26.8% in 2022), those with maturities between 5 and 10 years accounted for 40.7% (down from 52.7% in 2022), and those with maturities over 10 years had a share of 20.2% (an increase of 6.5 pp compared to 2022). As a result, the average residual maturity of newly issued national currency government securities on the domestic market decreased to 6.6 years in 2023, from 7 years in 2022. The slight reduction in maturity can be explained by the fiscal tensions that marked the 2023 budget execution, with the exceeding of the initial budget deficit target leading to three revisions of the financing needs throughout the year.

The bid-to-cover ratio for government securities issued in the national currency marginally declined (from 1.55 in 2022 to 1.50 in 2023), reflecting sustained demand for government bonds. The decrease was more pronounced for short-term maturities, with the ratio for treasury bills dropping from 1.58 in 2022 to 1.39 in 2023, and for bonds with maturities over 12 years, where the ratio fell from 1.73 in 2022 to 1.62 in 2023.

The evolution of public debt, expressed as a percentage of GDP, can be analyzed based on the following equation[73], derived from the budgetary identity:

$$\frac{d_t}{y_t} = (1 + \lambda_t) \times \frac{d_{t-1}}{y_{t-1}} + \frac{pb_t}{y_t} + sfa_t$$

where d_t represents the stock of public debt at time t, y_t denotes the nominal GDP at time t, pb_t represents the primary deficit for period t, sfa_t – refers to stock-flow adjustments in period t, and

$$1 + \lambda_t = \frac{1 + i_t}{(1 + \pi_t) \times (1 + \gamma_t)}$$

[72] The accelerated growth in domestic financing was primarily driven by the significant increase in financing needs, from 150 billion lei in 2022 to 205 billion lei in 2023, as well as by the decrease in the value of bond issuances on external markets by approximately 26.7% compared to 2022.

[73] Cafiso, G. (2012), "A Guide to Public Debt Equations", available online: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1975710. A relatively similar model is also presented by Escolano, J. (2010), "A Practical Guide to Public Debt Dynamics, Fiscal Sustainability, and Cyclical Adjustment of Budgetary Aggregates", IMF Technical Report, available online: https://www.imf.org/external/pubs/ft/tnm/2010/tnm1002.pdf.

where γ_t– the real GDP growth rate in period t , i_t – the nominal interest rate at time t, and π_t – inflation in period t, measured by the GDP deflator.

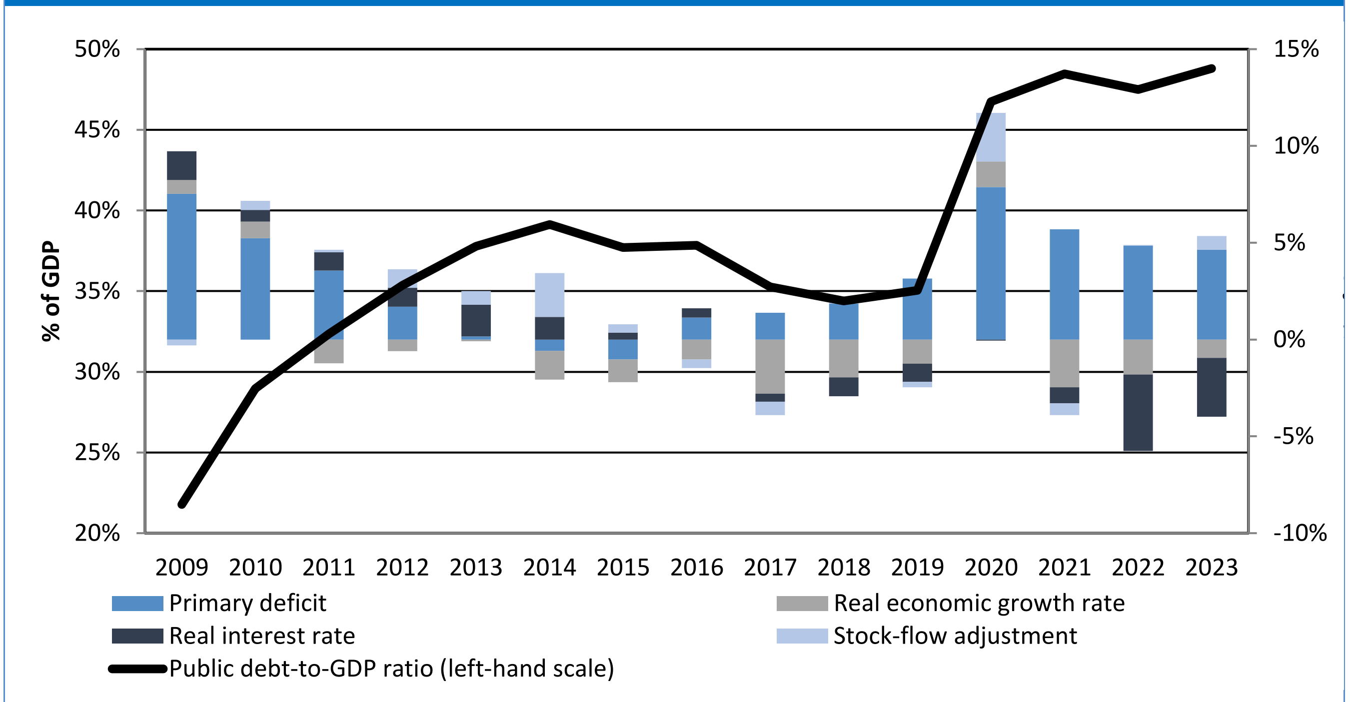
In essence, the relationship shows that the public debt-to-GDP ratio at time t depends on the ratio from the previous period, multiplied by the difference between the real interest rate and the real economic growth rate, to which the primary deficit of the general government budget, expressed as a percentage of GDP, is added. When the economic growth rate exceeds the real interest rate on public debt, the public debt-to-GDP ratio will tend to decrease. Conversely, if the economic growth rate is lower than the real interest rate, the public debt ratio will tend to increase, with the actual dynamic depending on the sign and value of the primary budget balance. Thus, the coefficient λ_t can be interpreted as the real interest rate adjusted for economic growth.

The year 2023 saw a moderate increase (+1.3 pp) in the share of public debt in GDP (*Figure 32*). Using the previously presented dynamic equation, it is noted that the high primary deficit is the main factor driving the increase in the public debt-to-GDP ratio (+4.6 pp), along with the stock-flow adjustment effect (+0.7 pp)[74]. Other factors partially offset the effect of the primary deficit and stock-flow adjustment: real economic growth (with an effect of -0.9 pp, down compared to the previous year due to the slowing dynamics of real GDP) and the real interest rate (with an effect of -3 pp, also down compared to the previous year, amid declining inflation and the GDP deflator). It should be noted that Romania recorded the largest primary deficit among EU member states in both 2022 and 2023 (*Figure 33*). Moreover, Romania reduced its primary deficit by only 0.2 pp in 2023 (from 4.8% of GDP in 2022 to 4.6% of GDP), representing the second smallest adjustment among EU member states with primary deficits.

In conclusion, in 2023, the economic growth of 2.1% coincided with a negative real interest rate (-7.3%), resulting in a negative value for the coefficient λ_t and, consequently, a favorable impact on the dynamics of public debt expressed as a percentage of GDP. The positive gap between the economic growth rate and the real interest rate largely countered the effects of the budget deficit, allowing for better control of public debt. However, the experience of 2020, when this gap suddenly reversed, leading to a significant increase in the debt level, calls for caution in budget management and in maintaining public debt levels.

[74] Regarding the stock-flow adjustment, it made a small contribution to the increase in the public debt-to-GDP ratio, which is the result of several significant factors acting in opposite directions. Thus, the increase in liquid reserves available in the State Treasury, advance payments for military purchases, the depreciation of the national currency, receivables mainly related to taxes and social contributions, the amounts paid and loans taken by the Government to finance EU-funded projects, but not yet reimbursed, were the main factors leading to the increase in public debt. Their effect was partially offset by superdividends paid by state-owned companies, differences in the recording of interest for government securities issued with premiums or discounts, as well as other outstanding amounts, mainly related to goods and services acquired but not yet paid for, court decisions with retroactive effect, EU funds received from the EU but not yet paid to primary beneficiaries, and outstanding tax refunds.

Figure 32: Contributions to changes in the public debt-to-GDP ratio for the 2009-2023 period

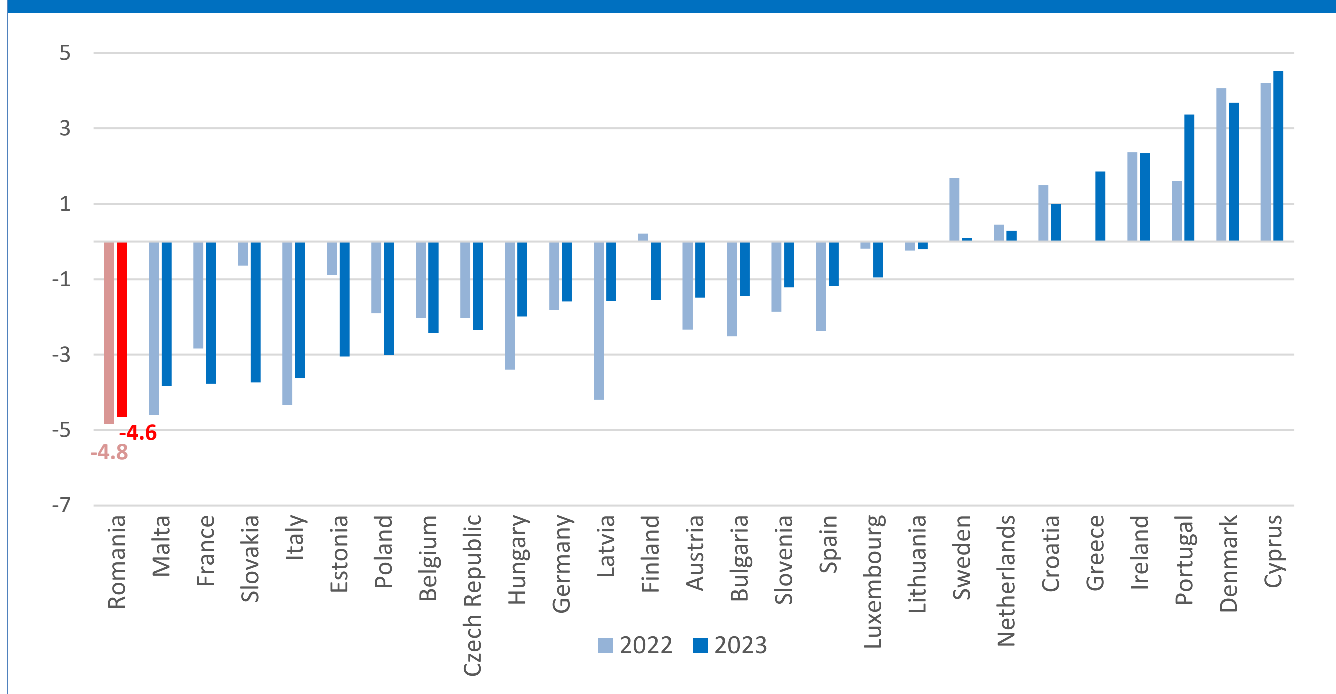


Source: Eurostat, FC's calculations

Analyzing the level of public debt at the end of 2023 (48.8% of GDP), it should be noted that it remains above the alert threshold of 45% of GDP established by the Fiscal Responsibility Law. This necessitates the Ministry of Finance to present a report justifying the increase in public debt and proposals to maintain it at a sustainable level. Justification is not an issue, considering that, amid the COVID-19 pandemic, the share of public debt in GDP increased by 11.6 pp in 2020 compared to 2019, and by 1.8 pp in 2021 compared to 2020. However, the alert signal is relevant given the large structural deficit. Currently, according to a report on the evolution of public debt published on the MF website[75], to keep the public debt ratio in GDP at a sustainable level, the Government aims to stimulate economic growth potential by increasing the share of investment spending in GDP, supported by accessing European funds from the MFF, as well as by implementing the reforms and investments outlined in the NRRP.

[75] https://mfinante.gov.ro/static/10/Mfp/buletin/executii/Informprivindevdatpubluna022024.pdf

Figure 33: Primary balance in EU member states, in 2021 and 2023 (% of GDP, ESA 2010)



Source: Eurostat

The analysis of the evolution of public debt in Romania has shown that the effects of economic growth, combined with the real interest rate, have anchored the share of public debt in GDP, largely nullifying or even completely offsetting the effect of the primary deficit during the period from 2021 to 2023. However, future prospects are unfavorable given the tempering of economic growth and a possible increase in the real interest rate, considering the disinflation trend that began in 2023 and the sustained high levels of reference interest rates for extended periods. Additionally, adverse events in recent years have demonstrated that the impact of severe shocks occurring simultaneously can lead to a rapid increase in public debt due to the sudden reversal of the differential between economic growth and the real interest rate. Moreover, uncertainties regarding fiscal consolidation continue to exert significant pressure on the primary budget balance. Already, in the first part of 2024, official data published by Eurostat[76] and the Ministry of Finance[77] indicate that the second alert threshold established by the FRL, set at 50% of GDP, has been exceeded. According to FRL, when the share of public debt in GDP falls within the range of 50%-55%, the government is required to present and implement a program to reduce the share of public debt in GDP, approved through a legislative act. The structural budget plan that the government must present to the European Commission in September 2024, which is primarily determined by the very high budget deficit, will inherently include measures to limit public debt.

An additional constraint is linked to the high level of public debt compared to the depth of the domestic financial sector and the limited capacity to absorb additional public debt at the current level of financial intermediation. Thus, at the end of 2023, Romania's public debt to total banking assets ratio was

[76] https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-22072024-ap

[77] https://mfinante.gov.ro/static/10/Mfp/buletin/executii/EvdatguvconformUERo042024.pdf

approximately 98% (up from around 95% the previous year), while exposure to the governmental sector relative to the assets of local banks[78] (the primary holders of public debt in the domestic market) was about 22.6% (slightly up from 22.4% in 2022), with these indicators ranking among the highest in the EU. This situation has the potential to lead to increased dependence on non-resident investors, which is associated with growing vulnerability to interest rate and exchange rate shocks, changes in risk appetite in global financial markets, and potential sovereign rating changes.

[78] The banking system's exposure to the governmental sector is calculated as the ratio of banks' claims on the governmental sector (comprising securities and loans) to total banking assets, based on information available in the European Central Bank's database.

IV. The absorption of EU funds

The EU's Multiannual Financial Framework for the period 2021-2027 (€1,074 billion) and the Next Generation EU instrument (€750 billion)[79], totaling €1,824 billion, represent the largest financial package in the Union's history. This framework aims to support the recovery of member states' economies following the shock of the COVID-19 pandemic, as well as to achieve the EU's long-term priority objectives, focusing on the green and digital transitions.

European funds represent an essential financial resource for Romania's economic and social development. Therefore, it is vital for Romania to seize this historic opportunity, benefiting from nearly €80 billion in allocations from the EU (€31 billion from the Cohesion Policy and around €20 billion from the Common Agricultural Policy for the 2021-2027 MFF), in addition to €13.5 billion in grants and €15 billion in loans through the Recovery and Resilience Facility (RRF), the most significant financial mechanism within the Next Generation EU framework.

A high absorption rate of the European funds allocated through the 2021-2027 MFF and the National Recovery and Resilience Plan would enhance the investment factor's contribution to both potential and real GDP growth and help maintain internal and external financial balances. In terms of the real economy, it would support the implementation of structural reforms, directly and indirectly promoting fiscal consolidation at a time when Romania faces significant challenges due to external factors and volatility in the international economic, financial, and geopolitical landscape. European financial resources can play a key role in mitigating the contractionary effects of the necessary correction of the structural budget deficit, a point reiterated by the Commission in numerous analyses.

Absorption of structural and cohesion funds from the 2014-2020 MFF

In the 2014-2020 Multiannual Financial Framework, Romania was allocated approximately €24.1 billion in structural and cohesion funds, structured across six operational programs (OP): Regional OP, Large Infrastructure OP, Competitiveness OP, Human Capital OP, Administrative Capacity OP, and Technical Assistance OP. It is worth noting that initially, seven operational programs were defined (the above-mentioned ones and the SME Initiative OP). However, in October 2018, the integration of the program for SMEs into the Regional OP was approved, which also benefited from a reallocation of over €150 million.

Analysing the available data as of June 2024 (see *Table 9*), there is an improvement in the absorption rate of European funds compared to the results reported by the Commission in May 2023[80]. Specifically, compared to that situation, the absorption rate (including pre-financing) increased by 16.9 percentage points, from 79% to 95.9% of the total structural and cohesion funds allocated for the 2014-2020 programming period, benefiting from the N+3 rule.

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[79] Documents approved by the European Parliament in December 2020 and February 2021.

[80] See the *Annual Report of the Fiscal Council 2022*, July 2023, http://www.fiscalcouncil.ro/RA%20CF%202022%20EN.pdf.

Table 9: Structural funds absorption by operational program for the 2014-2020 MFF as of June 2024 (million euro)						
	Total allocations 2014-2020 (cumulative)	Total payments 2014-2024 (cumulative) June 2024			Absorption rate June 2024	Absorption rate excluding pre-financing June 2024
		Total, out of which:	Pre-financing	EU refunds		
Regional	6,860.0	6,458.0	397.6	6,060.4	94.1%	88.3%
Large Infrastructure	9,338.6	9,195.8	789.1	8,406.7	98.5%	90.0%
Competitiveness	2,379.8	2,055.1	330.6	1,724.5	86.4%	72.5%
Human Capital	4,596.1	4,482.0	358.5	4,123.5	97.5%	89.7%
Administrative Capacity	563.6	563.6	39.7	523.9	100.0%	93.0%
Technical Assistance	332.8	327.9	12.0	315.8	98.5%	94.9%
Total	**24,070.8**	**23,082.3**	**1,927.6**	**21,154.7**	**95.9%**	**87.9%**

Source: EC, FC's computation

At the level of operational programs, absorption rates have increased on average by 18.3 percentage points compared to the values recorded in May 2023. The most significant increases in absorption rates occurred in the Administrative Capacity OP (from 72.8% to 100%) and the Regional OP (from 70.7% to 94.1%). Meanwhile, the absorption rate for the Human Capital OP increased relatively less during the period from May 2023 to June 2024 (from 85.3% to 97.5%), due to an already high absorption rate recorded in the previous year. For the other three operational programs, absorption rates grew below the average, as follows: the Large Infrastructure OP (from 84.3% to 98.5%), the Competitiveness OP (from 71% to 86.4%), and the Technical Assistance OP (from 81.2% to 98.5%).

Table 10 presents an analysis of the situation in Romania compared to other EU member states in Central and Eastern Europe, based on data available as of June 2024. The vast majority of these states (including Romania) received higher allocations of structural and cohesion funds for the period 2014-2020 compared to the previous financial exercise, with exceptions including the Czech Republic (€22.7 billion compared to €26.5 billion), Slovenia (€3.3 billion compared to €4.1 billion), and Hungary (€22.5 billion compared to €24.9 billion). It is noteworthy that Latvia, following additional allocations in 2021 for the 2014-2020 financial exercise[81], exceeded the allocations of the previous multiannual exercise (€4.6 billion compared to €4.5 billion).

On the other hand, when comparing the allocations received per capita[82], Romania ranks second to last, with approximately €1,207 per inhabitant, surpassing only Bulgaria (€1,094 per inhabitant). Conversely,

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[81] The amounts allocated for the 2014-2020 financial exercise were revised due to additional allocations through React EU.

[82] The population as of January 1, 2014, according to data provided by Eurostat.

8 out of the 11 analyzed states have allocations exceeding €2,000 per capita, with the highest values recorded in Estonia (€2,814 per inhabitant) and Slovakia (€2,638 per inhabitant).

Table 10: Absorption of structural funds for the 2014-2020 MFF – comparison with other EU member states as of June 2024

	Total allocations 2014-2020 billion euro	Total payments June 2024 billion euro	Absorption rate June 2024 %	Total allocations 2014-2020 /inhabitant Euro	Total payments/ inhabitant June 2024 euro
Bulgaria	7.9	7.3	91.7	1,093.7	1,002.9
Czechia	22.7	22.4	98.9	2,157.1	2,134.2
Croatia	9.1	8.7	95.4	2,146.3	2,048.0
Estonia	3.7	3.6	97.7	2,813.6	2,749.0
Latvia	4.6	4.3	93.7	2,318.6	2,172.7
Lithuania	7.0	6.9	98.4	2,389.5	2,351.0
Poland	78.8	78.1	99.1	2,072.6	2,053.0
Romania	**24.1**	**23.1**	**95.9**	**1,206.7**	**1,157.2**
Slovakia	14.3	13.8	96.9	2,638.2	2,555.4
Slovenia	3.3	3.3	98.7	1,619.0	1,597.2
Hungary	22.5	22.2	98.4	2,280.9	2,243.6

Source: EC, Eurostat, Fiscal Council's calculation

Note: The absorption rate is calculated on the basis of interim payments and pre-financing.

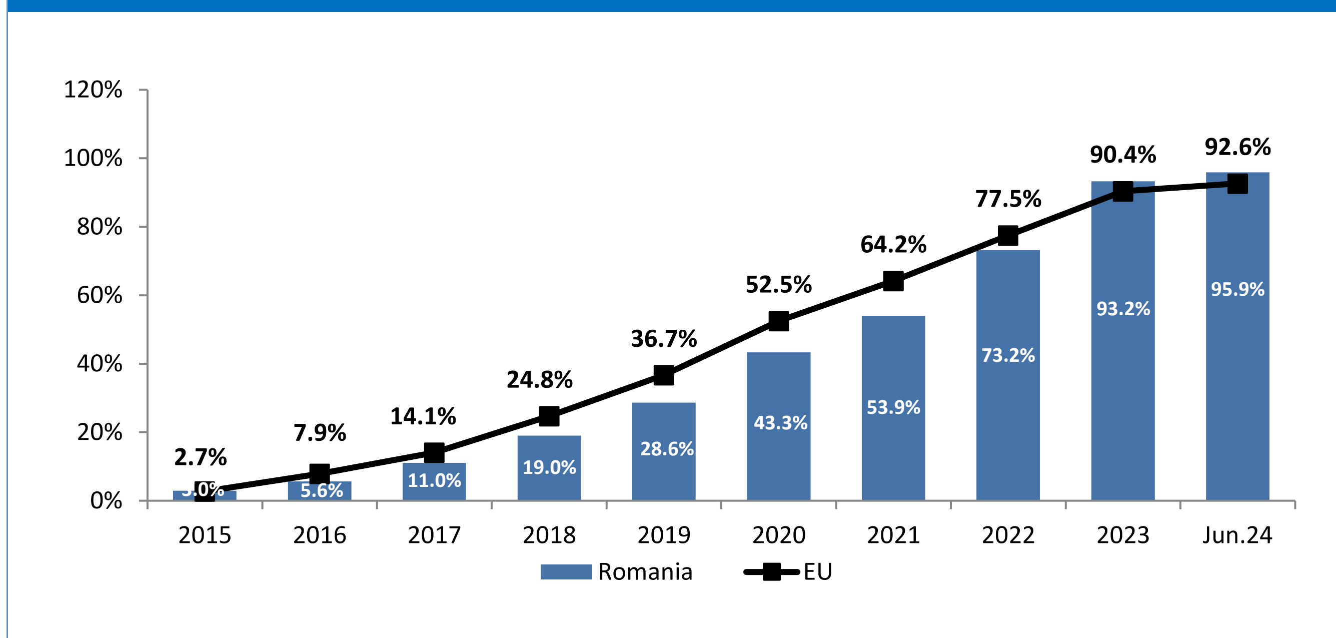
From the perspective of the absorption rates of structural and cohesion funds recorded as of June 2024, Romania dropped one position from the previous year, ranking 8th with an absorption rate of 95.9%, surpassing Croatia (95.4%), Latvia (93.7%), and Bulgaria (91.7%). The average for the entire sample is 97.8%. Among the states included in the analysis, the highest absorption rates are recorded by Poland (99.1%), the Czech Republic (98.9%), Slovenia (98.7%), and both Lithuania and Hungary (98.4% each). It is noteworthy that during the period from May 2023 to June 2024, Romania experienced a significant increase in the absorption rate of 16.9 percentage points, exceeding the average increase among the analyzed states (13.2 percentage points) and ranking third in terms of the relative size of the increase, surpassed only by Croatia (29.8 percentage points) and Slovakia (22.1 percentage points).

The reduction of the gap compared to EU states over the past few years can be observed from the analysis of the evolution of absorption rates of structural and cohesion funds in Romania, compared to the EU average[83] (see *Figure 34*). Thus, the 2014-2020 multiannual financial exercise started with difficulties both in Romania and at the EU level, due to the delayed finalization of the legislative, institutional, and functional framework. Consequently, the initial years of the period recorded low absorption rates, with Romania hovering near the average recorded at the European level. Starting in

[83] Exclusively the United Kingdom, starting from 2021.

2016, an unfavorable gap emerged compared to the EU average, which continued to widen until 2021, when it reached approximately 10.3 percentage points. This trend changed in 2022, when the gap to the EU average significantly reduced. Furthermore, since 2023, the absorption rate of structural and cohesion funds related to the 2014-2020 multiannual financial exercise in Romania has surpassed the EU average, exceeding it by 3.3 percentage points as of June 2024.

Figure 34: Evolution of EU funds absorption rate: Romania versus EU average, 2015 - June 2024 (2014-2020 MFF)



Source: EC, FC's computation

It is vital for Romania to leverage the experience from this financial exercise as well as the previous one to attract European funds related to the MFF 2021-2027 in a timely and balanced manner, with a total sum of over €55 billion. The allocations from the Structural and Cohesion Funds (SCF) amount to €31 billion (including €1.4 billion in advances). A particularly concerning issue for the authorities in Romania is that, by the midpoint of the financial exercise, at the end of June 2024, according to data from the Ministry of Finance, the absorption rate of these funds (excluding advances) was 0.00%[84]!

The National Recovery and Resilience Plan (NRRP)

To counteract the extremely severe economic and social impact of the shock caused by the COVID-19 pandemic, the European Union launched the Next Generation EU plan, including the Recovery and Resilience Facility (RRF) approved at the European level on February 12, 2021. This facility made available to member states grants of up to €312.5 billion and loans of up to €360 billion to support reforms and investments[85].

[84] https://mfinante.gov.ro/static/10/Mfp/buget/sitebuget/BFN30iunie2024.pdf

[85] It should be noted that, unlike the Cohesion Policy related to the MFF 2021-2027, projects funded through the RRF cannot be extended beyond the end of the period and cannot be phased, thus requiring their completion by August 2026.

In this context, following the adjustment made in June 2022[86], Romania was allocated €12.1 billion in grants and €14.9 billion in loans, with an additional €1.4 billion from the REPowerEU[87] plan, bringing the total amount allocated to our country through the RRF to €28.5 billion.

Accessing the RRF facility by Romania is done through the **National Recovery and Resilience Plan** (NRRP), a strategic document that underpins the priorities for reform and investment areas at the national level, approved by the EU Council in October 2021. The key principles in developing the NRRP were based on the priorities set for member states within the European Semester (Country-Specific Recommendations). According to EU rules, at least 37% of the total amounts related to the NRRP were allocated to measures aimed at achieving climate objectives, and at least 20% for achieving digitalization objectives.

With some delays in operationalizing the necessary organizational structures for initiating the implementation of the NRRP, at the end of May 2022, the Ministry of Investment and European Projects (MIEP) submitted the first payment request to the European Commission, amounting to nearly €3 billion, of which approximately €2 billion were grants and €0.9 billion were loans. This request aimed to fulfill the 21 milestones/targets for the fourth quarter of 2021, primarily related to reforms and investments in the areas of energy efficiency, digital transformation, justice and anti-corruption, support for the private sector, and the audit and control system related to the RRF[88]. Following additional clarifications requested, in September 2022, the European Commission published a positive preliminary assessment

[86] According to Article 11(1) of the regulation establishing the RRF, the allocation of grants to each EU member state was calculated based on the variation in real GDP in 2020 and the aggregated variation in real GDP during the period 2020-2021, based on the Commission's forecasts from the autumn of 2020. According to Article 11(2) of the regulation, the allocations for each EU member state were recalculated (at the end of June 2022) based on the Commission's spring 2022 estimates, taking into account the actual results of real GDP variation in 2020 and 2021. In this context, the initially allocated amount for Romania through non-repayable grants from the RRF was €14.2 billion, calculated based on the European Commission's estimate of a 5.2% contraction in real GDP in 2020 and a recovery of 3.3% in 2021 (European Commission, *European Economic Forecast Autumn 2020*, November 2020), representing a scenario in which the GDP decline caused by the pandemic would not have been recovered in the following year. Actual results for Romania showed better performance than anticipated, with a real GDP decline of 3.7% in 2020 being lower than the Commission's estimates, and an economic growth of 5.9% recorded in 2021 ensuring the recovery of the decline (European Commission, *European Economic Forecast Spring 2022*, May 2022). This led to a reduction in the total amount allocated to Romania from grants from €14.2 billion to €12.1 billion (European Commission, *RRF: Update of the maximum financial contribution*, Commission note to the Council and European Parliament, June 30, 2022).

[87] In May 2022, following Russia's invasion of Ukraine, the European Commission launched the REPowerEU plan, valued at €210 billion, to cover the financial resource needs for additional investments, complementing measures funded by the RRF, aimed at reducing dependency on gas, coal, and oil imports from the Russian Federation. Consequently, all EU member states revised their National Recovery and Resilience Plans (NRRPs) by including a new chapter on the reforms and investments related to REPowerEU and submitted them to the Commission for validation, which also included other proposed modifications/funding. In Romania's case, the revision of the NRRP involved difficult negotiations with the Commission regarding a reduction in grants by €2.1 billion, adjustments in investment and infrastructure project prices due to rising material and labor costs (estimated at around €2.2 billion), as well as changes to milestones and targets based on objective circumstances. The revised plan contains 518 milestones and targets.

[88] https://mfe.gov.ro/pnrr-a-fost-transmisa-comisiei-europene-prima-cerere-de-plata-in-valoare-de-3-miliarde-euro/

of the payment request[89], and after obtaining approval from the Economic and Financial Committee, in October 2022, it authorized the payment of the first tranche of financial support—exclusively related to pre-financing – amounting to €2.6 billion (€1.8 billion from the grants component and €0.8 billion from the loans component)[90].

In mid-December 2022, with a delay of about three months, the Ministry of Investment and European Projects (MIEP) submitted the second payment request to the European Commission, amounting to €3.2 billion (€2.7 billion excluding pre-financing)[91], aimed at fulfilling 51 milestones and targets for the first and second quarters of 2022. These were related to reforms and investments in the areas of the electricity market, energy efficiency of buildings, digitalization, decarbonization, good governance, interoperability of databases to reduce bureaucracy, governmental cloud services, and sustainable mobility. Although the evaluation period for payment requests by the European Commission is generally around two months, the Commission only published its preliminary assessment of Romania's second payment request at the end of June 2023[92]. The validation process for some milestones was hindered by the time taken to respond to clarifications requested by the Commission's experts, as well as requests for additional evidence. Following consultations and discussions with the Commission's technical services, the Romanian authorities made some corrections and adjustments, including the urgent adoption of regulatory acts related to these milestones. Noting that milestones 129 and 133 (in the energy sector, regarding the construction of new electrolysis capacities and high-efficiency natural gas cogeneration) were not satisfactorily fulfilled, the Commission's evaluation was only partially positive, activating the suspension of payments for these two milestones (estimated at around €53 million), with a six-month period granted to fulfill them. Consequently, the Commission transmitted its preliminary assessment to the Economic and Financial Committee, which usually issues an opinion within four weeks. After receiving this opinion, through the comitology committee, the Commission adopts the final decision regarding the payment tranche to Romania (excluding payments related to the two unmet milestones). Considering the duration of these procedures at the Commission level for EU member states[93], the average time between the publication of the preliminary assessment and the final decision regarding authorization and payment is about two months. As a result, for Romania, the transfer of the amount of €2.7 billion corresponding to payment request number 2 occurred only in September 2023.

The third payment request, amounting to €3.1 billion (€2.7 billion excluding pre-financing), related to the fulfillment of 74 milestones and targets with deadlines in the third and fourth quarters of 2022, was submitted only in December 2023, with a delay of 9 months from the initial schedule. This delay leads to gaps in the process of submitting subsequent payment requests, in their evaluations by the Commission, in the approval of requests by the Economic and Financial Committee, and in the authorization and execution of related payments. In the second decade of July 2024, more than 6

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[89] https://commission.europa.eu/system/files/2022-09/c_2022_6711_1_annexe_en.pdf

[90] https://economy-finance.ec.europa.eu/news/commission-disburses-first-payment-eu26-billion-romania-under-recovery-and-resilience-facility-2022-10-27_en

[91] https://ec.europa.eu/commission/presscorner/detail/en/mex_22_7792

[92] https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3496

[93] https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard/timeline.html

months after submission, payment request number 3 was still under evaluation by the European Commission, with 4 milestones in the process of clarification.

Thus, due to the failure to adhere to the schedule outlined in the NRRP, in addition to Romania being deprived of significant foreign currency inflows in 2023 – a situation that is set to repeat in 2024 – that could have substantially contributed to partially covering the need for external financing and improving fiscal-budgetary parameters, a major risk of losing funds is emerging. Officials from the European Commission delegation visiting Bucharest from March 18-21, 2024, during the annual monitoring mission of the NRRP, noted delays in many reforms and investment programs, warning that the timeframe of only 29 months, until August 2026, to implement 400 milestones and targets is very short, and any failures to meet these will result in losses or even the return of funds[94].

In the context of the European Semester – the Spring Package 2024, published in June of this year –, such risks are also highlighted in the country report on Romania, specifying that the NRRP is facing significant delays and substantial challenges, necessitating decisive actions to ensure the implementation of all measures in the NRRP by August 2026[95]. The two Country Specific Recommendations (CSRs) made to Romania by the European Commission in June 2024 refer to the development of a fiscal-structural plan in a manner that limits the growth of net expenditures to reduce the budget deficit below the 3% threshold in the coming years, and to accelerate the implementation of the NRRP by strengthening administrative capacity and increasing governance effectiveness, ensuring the completion of all reform and investment programs by August 2026[96].

The disruption of the entire financial flow calendar related to the NRRP[97] exposes Romania to additional risks of payment suspensions, with direct and collateral effects on the absorption rate of allocated funds, both in terms of grants and loans, as well as on reform and investment programs. This, in turn, impacts the macroeconomic and fiscal stability of Romania, the financing costs of internal and external imbalances, against the backdrop of constraints imposed by the new EU economic and fiscal governance framework[98].

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[94] https://romania.representation.ec.europa.eu/news/conferinta-anuala-privind-implementarea-pnrr-2024-03-14_ro

[95] European Commission, *2024 Country Report - Romania*, Commission Staff Working Document, SWD(2024) 623 final, Brussels, 19.6.2024.

[96] European Commission. *Recommendation for a Council recommendation on the economic, social, employment, structural and budgetary policies of Romania*, COM(2024) 623 final, Brussels, 19.6.2024.

[97] The increasing risks regarding delays related to the NRRP were also noted in a press briefing by the European Parliament in mid-March 2024 (European Parliament. Romania's National Recovery and Resilience Plan: Latest state of play, European Parliament Briefing, March 18, 2024).

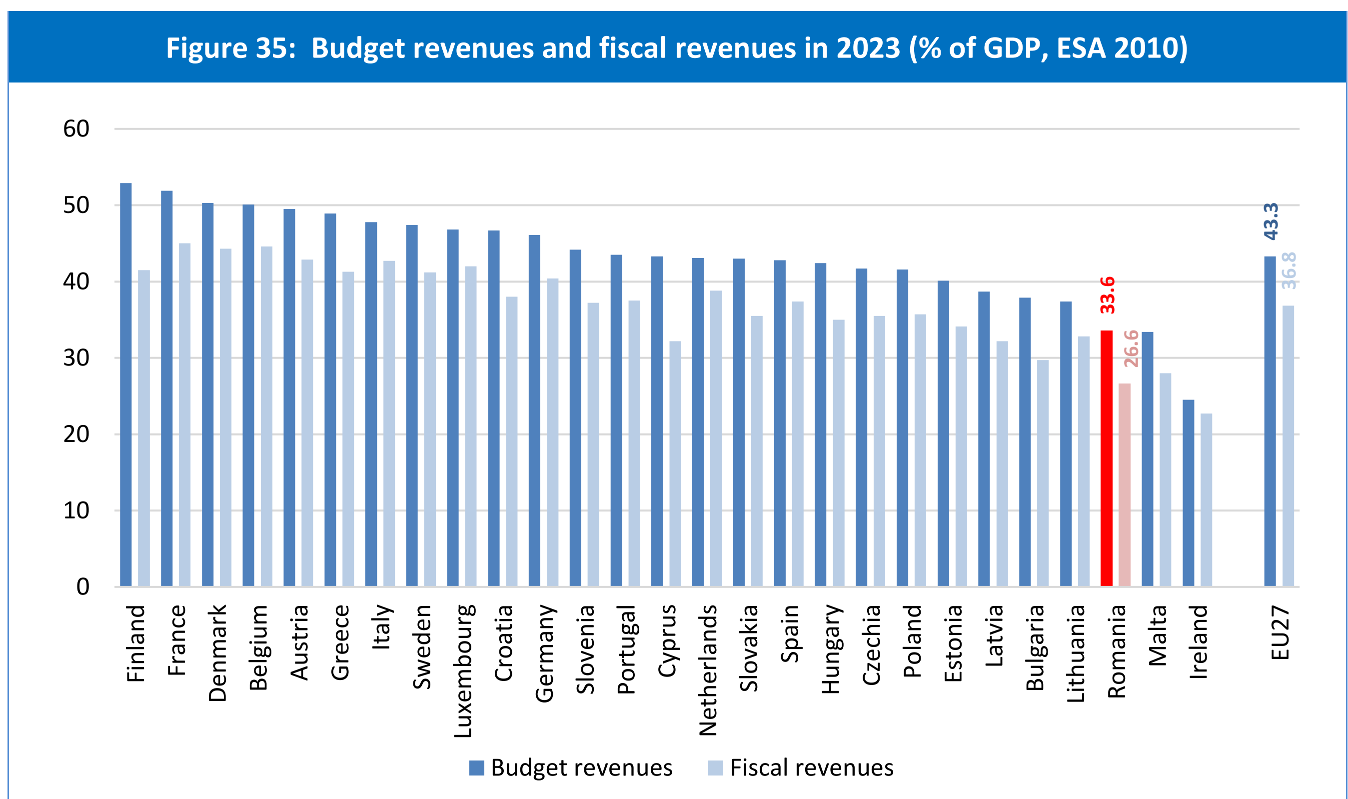
[98] The Council of the European Union, *Council Directive (EU) 2024/1265 of 29 April 2024 amending Directive 2011/85/EU on requirements for budgetary frameworks of the Member States*, Official Journal of the European Union L series, 30.4.2024.

V. Tax collection and the structure of budget expenditures – international comparisons

V.1. Tax collection in Romania – international comparisons

In 2023, Romania recorded a budget revenue share of 33.6% of GDP, according to the ESA 2010 methodology, significantly below the European average of 43.3% (a gap of 9.7 pp), one of the lowest compared to EU member states, followed by Malta and Ireland. The level of fiscal revenues (taxes and social contributions) decreased from 27.2% of GDP in 2022 to 26.6% of GDP in 2023, a situation that places Romania second to last, with a gap of 10.2 pp compared to the EU average (36.8% of GDP). Analysing the evolution of these indicators compared to the previous year, the gap between Romania and the EU27 average has significantly decreased, both in terms of budget revenues (from 13 pp in 2022 to 9.7 pp in 2023) and in terms of fiscal/tax revenues (from 13.7 pp to 10.2 pp), a situation primarily due to the reduction of average revenue weights at the EU27 level.

Figure 35: Budget revenues and fiscal revenues in 2023 (% of GDP, ESA 2010)



Source: Eurostat
Note: Fiscal revenues also include social security contributions.

The share of tax revenues in GDP recorded by Romania in 2023 is significantly below that of other countries with similar economies, such as Slovenia (37.2%), Poland (35.7%), the Czech Republic (35.5%), and Hungary (35.0%). Moreover, in Romania, the share of tax revenues in GDP is decreasing, while in the previously mentioned countries, the trend is increasing compared to the previous year. Compared to Bulgaria, the share of budget revenues in GDP is 4.3 pp lower, while the share of tax revenues is 3.1

pp lower. This unfavorable development is both the result of an inefficient tax administration and successive tax relaxations since 2012, particularly in the area of capital income taxation, household income taxation, as well as the VAT rate.

From the perspective of the structure of tax revenues, the share of indirect tax collections in fiscal revenues in Romania remains in 2023 at a level higher than the European average (39.8% compared to 32.3%), but below the levels recorded by Croatia (51.5%), Hungary (50.1%), or Bulgaria (49.8%).

The share of social security contributions in fiscal revenues reached a level of 40.6%, above the EU average (of 34.7%). Based on this indicator, Romania ranks 5th in the EU27 (up from 6th place in 2022), following the Czech Republic (44.9%), Slovenia (43.4%), Slovakia (43.4%), and Germany (42.7%).

Regarding direct taxes, Romania has one of the lowest shares in tax revenues in the EU[99], specifically 19.6%, compared to 21.7% in 2022, now being 13.5 pp below the EU27 average, compared to 11.3 pp in 2022.

The structure of budget revenues in Romania is predominantly oriented towards indirect taxes and social security contributions – together, these account for 80.4% of tax revenues, ranking first in the EU, with 13.4 pp above the EU average. In contrast, at the European level, there is a trend towards balancing the weights of direct taxes, indirect taxes, and social security contributions in the formation of fiscal revenues (specifically, an EU average of 33%, 32.3%, and 34.7%).

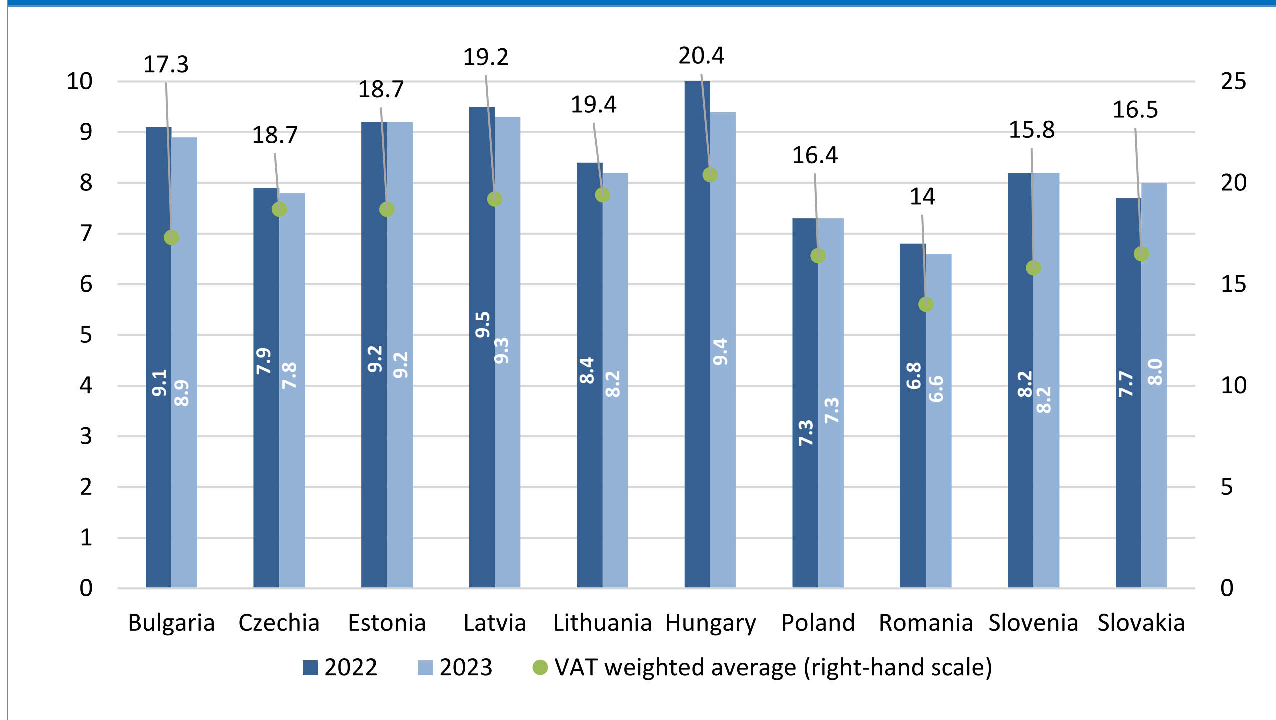
According to a study from 2022[100], the low level of tax revenues in Romania compared to similar economies in the EU can be attributed to the following factors: (i) low collection rate; (ii) exemptions and deductions that reduce the tax base and preferential regimes in certain sectors of activity/categories of taxpayers; (iii) tax rates in some cases lower than those in the EU.

The following is a brief analysis from the perspective of collecting VAT revenues and social security contributions in Romania compared to Eastern European countries. Compared to similar economies in Central and Eastern Europe, it can be appreciated that Romania has an unsatisfactory level of VAT revenue collection (*Figure 36*) – indeed, given the low value of the weighted average VAT rate. Thus, similar to previous years, in terms of VAT revenues reported to GDP and the level of the average weighted VAT rate, Romania ranked last among the ECE countries in 2023.

[99] This result was contributed to by the reduction of the income tax from 16% to 10% in 2018.

[100] *Budget consolidation and the increase of tax revenues – a vital necessity for the economic stability and security of Romania* (http://www.fiscalcouncil.ro/Analiza_sistem_fiscal%20EN%2031%20mai.pdf).

Figure 36: VAT revenues in 2023 compared to the previous year (% of GDP)



Source: EC, Eurostat

With an average weighted VAT rate of 14.0% (compared to a legal rate of 19%), Romania collected about 6.6% of GDP from VAT, falling short by 1.6 pp of Slovenia, which collected 8.2% of GDP at an average weighted VAT rate of 15.8% – Slovenia was chosen for comparison because, among the ECE countries, it is the closest to us in terms of the average weighted VAT rate.

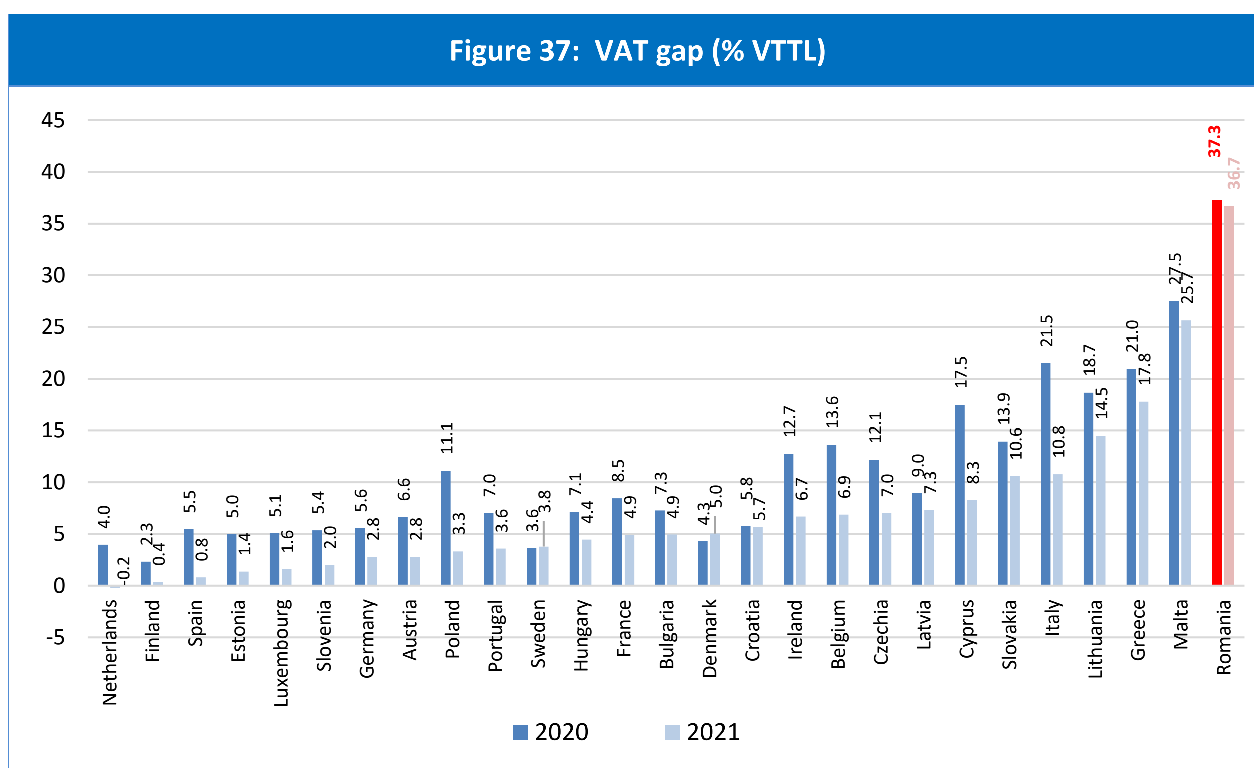
It is noteworthy to mention Bulgaria's performance, with an economic structure relatively similar to that of our country and a weighted average VAT rate of 17.3%, which collected 8.9% of GDP, being surpassed by Hungary with 9.4% of GDP, at a much higher weighted average VAT rate (20.4%), by Latvia with 9.3%, at a weighted average of 19.2%, and by Estonia with 9.2%, at a weighted average of 18.7%, but exceeding countries that benefit from a higher weighted average VAT rate, such as Lithuania and the Czech Republic.

The reduced VAT revenues, reported in relation to the ECE states, are also the result of a significant VAT [101] gap, an indicator that measures the effectiveness of compliance assurance measures and adherence to VAT legislation. It is calculated as the difference between the theoretically estimated VAT revenues expected to be collected (VTTL, amounts owed by economic agents under conditions of full compliance) and those actually collected by the tax administration. According to the latest assessments

[101] The calculation of the VAT collection deficit is based on a common methodology for all EU member states. It is determined in relation to the amounts remaining in the budget after the reimbursements and tax amnesties have been made, including the accessories. Include: non-compliance with payment, tax fraud, tax evasion, tax optimization, recording errors. Do not include the influence of fiscal policy (the deficit resulting from the application of reduced rates and the exemption regime).

(October 2023) from the European Commission’s annual study[102] on this indicator, Romania’s estimated VAT revenue shortfall for the year 2021 was 9 billion euros, representing a share of 36.7% of the theoretically estimated revenues to be collected, the highest value in the EU (*Figure 37*). Compared to the previous year, the deficit in Romania has decreased by 0.5 pp, a situation that is reflected in most countries and, implicitly, at the EU average level, which has reduced by 3.7 pp (to 7.4%, down from 11.1%). Estonia recorded a revenue shortfall relative to GDP of only 1.4% (down from 5% in 2020), Bulgaria at 4.9% (down from 7.3% in 2020), Hungary at 4.4% (down from 7.1% in 2020), Poland at 3.3% (down from 11.1% in 2020), the Czech Republic at 7% (down from 12.1% in 2020), and Slovakia at 10.6% (down from 13.9% in 2020).

Figure 37: VAT gap (% VTTL)



Source: EC, VAT Gap in the EU Report 2023

The excessive deficit recorded in VAT collection in Romania (almost 5 times higher than the EU average) is primarily determined by the poor digitization of NAFA. Modern solutions specific to digital transformation, which have been applied for many years in most EU countries, have been implemented in Romania only partially and with significant delays (such as connecting cash registers to the National Center for Financial Information – NCFI servers or e-Invoice in 2021).

From the perspective of revenues collected from social security contributions (SSC) paid by employees and employers (expressed as a percentage of GDP), compared to the same set of countries, Romania

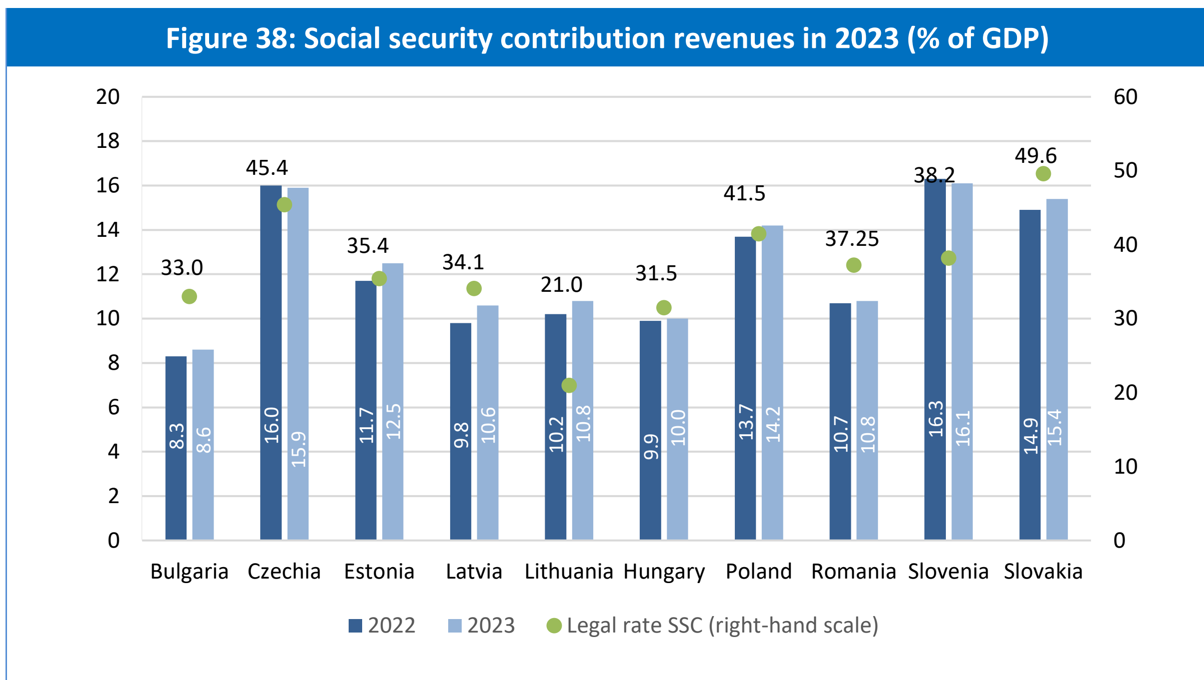
[102] European Commission, Directorate-General for Taxation and Customs Union, Poniatowski, G., Bonch-Osmolovskiy, M., Śmietanka, A. et al., *VAT gap in the EU – 2023 report*, Publications Office of the European Union, 2023, https://op.europa.eu/en/publication-detail/-/publication/84ba1bdf-7230-11ee-9220-01aa75ed71a1

ranks in the middle of the classification, with a relatively low level of collection in relation to the legal rate of social contributions (*Figure 38*).

In 2023, the revenues from social security contributions showed a slight upward trend compared to the previous year (0.1 pp of GDP), reaching a level of 10.8% of GDP, with a legal rate equivalent to 44.7%[103] (a level corresponding to the legal rate of 37.25% adjusted for the increase in the tax base to allow for comparison with other countries).

Given that this equivalent tax rate is the third highest among the analyzed states (after Slovakia and the Czech Republic), the collected revenues are only higher than those of Bulgaria (8.6% of GDP, with a legal rate of 33%), Hungary (10.0% of GDP, in the context of a legal rate of 31.5%), and Latvia (10.6% of GDP, with a legal rate of 34.1%).

Figure 38: Social security contribution revenues in 2023 (% of GDP)



Source: *EC, Eurostat*

On the other hand, Lithuania (with revenues of 10.8% of GDP) and Estonia (12.5% of GDP) have matched or exceeded Romania, despite having lower legal rates of social security contributions. Compared to Poland, which collected about 14.2% of GDP from social security contributions, the equivalent legal rate in Romania is higher by 3.2 pp, and in relation to Slovenia, the leader in this ranking with revenues of 16.1% of GDP, the equivalent legal rate in Romania is 6.5 pp higher.

Romania's positioning among the last countries in the EU27 in terms of budgetary and fiscal revenues expressed as a percentage of GDP in recent years is both the result of an expansionary fiscal policy and major errors in the construction of the tax regime, as well as an insufficiently modernized tax administration apparatus, with slow and partial reforms. If at the central level there has been some

[103] Calculated level to correct the legal rate with the increase in gross salaries following the transfer of social contributions from the employer's responsibility to that of the employee starting in 2018.

success in simplifying and streamlining the administrative apparatus for collecting taxes and fees, at the local level efforts still need to be made in this direction.

The reform of NAFA through digitalization, outlined in the NRRP, starts from the recognition that, in order to address the budget deficit, there is a need for a rapid improvement in the efficiency of public revenue collection activities and an enhancement of the relationship with taxpayers. The reform plan is built on two directions – increasing voluntary compliance through the development of digital services (prioritizing digital interaction via the VPS (Virtual Private Space) and using pre-filled forms where possible; creating a mechanism for assessing taxpayer satisfaction in relation to NAFA and ongoing consultation with them) and improving the processes of tax and fee administration, including through the implementation of integrated risk management (reducing the level of non-compliance, among other things, by interconnecting the IT systems of the Ministry of Finance/NAFA with those of the European Commission and with those of the tax administrations of member states).

From the perspective of the Digital Economy and Society Index (DESI, see *Box 1*), according to the report prepared by the EC in 2023[104], Romania has made some progress (see *Box 2*), but it remains among the last countries in the EU.

Analyzing the structure of the *digital skills* axis, Romania ranks below the EU average in most indicators, with the exception of the indicator for graduates in the ICT field, where Romania records a value of 6.9% (the EU average being 4.2%). An appropriate level compared to the EU average (84% versus 88.6%) is recorded regarding the internet usage indicator. On the other hand, significant gaps are recorded in basic digital skills (28% versus 54%), digital skills above the elementary level (9% versus 26%), as well as in the proportion of ICT specialists among total hires (2.8% versus 4.6%). Thus, sustained efforts are necessary in the areas of basic digital skills and ICT specialists – essential fields for the digital transformation of Romania.

Regarding the *digital infrastructure* axis, Romania is making significant progress in connectivity, with 96% of households already having access to the internet, well above the EU average of 73%. In terms of broadband services of at least 100 Mbps, Romania stands at 81.3% compared to 55.1% in the EU, and for internet usage of at least 1 Gbps, the figures are 23% versus 14%. Nevertheless, 5G coverage is at 27%, well below the EU average of 81%. A series of measures have been implemented in previous years and are expected to lead to progress in this area, particularly the new 5G network security law, the implementation of various recommendations established in the EU's connectivity tools etc.

[104] https://digital-strategy.ec.europa.eu/en/library/2023-report-state-digital-decade. The data is for the year 2022.

Box 1: Digital Economy and Society Index (DESI)[105]

The DESI report monitors the global digital performance in the EU, tracking the progress made by member states towards a digital economy and society. Starting from 2021, the composite DESI index has had 4 major axes (instead of 5 axes during the 2014-2020 period), in line with two policy initiatives that have a significant impact on digital transformation: The Recovery and Resilience Mechanism and the Digital Decade Compass. Since 2023[106], DESI provides a multidimensional and detailed overview of the annual progress made towards the goals of the Digital Decade 2030, structured around 4 main axes (relatively similar to previous ones), 9 subdomains (compared to 11 in the previous year), and 32 indicators (partially revised from the previous version), which we will briefly present below:

1. Digital skills (*subdomain – internet usage skills*: internet usage, at least basic digital competencies, digital competencies above the elementary level, at least basic skills in digital content creation, enterprises offering training in the ICT field; *subdomain – advanced development skills*: ICT specialists, graduates in the ICT field);

2. Digital infrastructure (*subdomain – fixed broadband*: usage of fixed broadband services of at least 100 Mbps, usage of services of at least 1 Gbps, coverage of very high capacity fixed networks (VHCN), coverage of fiber optic networks up to the building (Fibre to the Premises – FTTP); *subdomain – mobile broadband*: usage of mobile broadband, 5G coverage, 5G spectrum);

3. The integration of digital technology in business (*subdomain – digital intensity*: SMEs that have at least a basic level of digital intensity; *subdomain – digital technologies for business*: electronic information exchange, social communication platforms, big data, cloud technology, artificial intelligence, electronic invoices; *subdomain – e-commerce*: SMEs that make online sales, the turnover of e-commerce, cross-border online sales);

4. Digitalization of public services (*subdomain – e-Government*: e-government users, digital public services for citizens, digital public services for businesses, pre-filled forms, transparency in service provision, design, and personal data, user assistance, mobile accessibility; *subdomain – e-health:* access to electronic medical records).

The DESI report for 2023 (published in July 2024) includes an analysis of digital policies at the level of each member state, providing details on structural elements and progress in the digitalization of the economy and society, identifying performances and aspects that require improvement efforts. Compared to the reports from previous years, the DESI 2023 report no longer provides centralized data on the 4 main axes.

[105] A detailed report based on the Methodological Note regarding DESI 2023, prepared by the European Commission on September 27, 2023.

[106] The implementing decision (EU) 2023/1353 of the Commission dated June 30, 2023, establishing key performance indicators to measure progress towards the digital objectives set out in Article 4, paragraph (1) of Decision (EU) 2022/2481 of the European Parliament and of the Council.

Box 2: The structural situation of the DESI index, Romania versus EU 27, in 2023

Subdomains	RO	EU27	u.m.	Axis
Internet usage	84,0	88,6	% of the population between the ages of 16 and 74	1. Digital skills
At least basic digital skills	27,8	53,9		
Digital skills above the elementary level	8,7	26,5		
At least basic skills in digital content creation	41,4	66,1		
Companies offering training in ICT	8,8	22,4	% of enterprises	
ICT specialists	2,8	4,6	% of total employment	
Graduates in the field of ICT	6,9	4,2	% of graduates	
Use of fixed broadband services of at least 100 Mbps	81,3	55,1	% of households	2. Digital infrastructure
Use of services of at least 1 Gbps	23,3	13,8		
Coverage of very high capacity fixed networks (VHCN)	95,6	73,4		
Coverage of fiber optic networks up to the building (Fibre to the Premises – FTTP)	95,6	56,5		
Use of mobile broadband	82,4	86,5	% of the population aged 16 to 74	
5G coverage	26,8	81,2	% of populated areas	
5G spectrum	38,3	68,2	% of the total harmonized 5G spectrum	
SMEs with at least a basic level of digital intensity	52,5	69,1	% of SMEs	3. The integration of digital technology in business
Electronic information exchange	16,8	38	% of businesses	
Social communication platforms	11,7	29,3		
Large volumes of data	5,1	14,2		
Cloud technology	11,3	34		
Artificial intelligence	1,4	7,9		
Electronic invoices	16,9	32,2		
SMEs that sell online	10,2	19,1	% of SMEs	
The turnover of e-commerce	7,6	11,3		
Cross-border online sales	4,1	8,7		
E-Governance Users	23,6	74,2	% of internet users	4. Digitalization of public services
Digital Public Services for Citizens	47,6	77,0	Score (from 0 to 100)	
Digital Public Services for Businesses	44,6	83,7		
Pre-filled Forms	40,7	68,2		
Transparency in Service Provision and Personal Data	43,8	64,7		
User Support	68,3	83,6		
Mobile Accessibility	77,2	93,3		
Access to Electronic Medical Records	57,1	71,7		

The integration of digital technology into businesses remains a major challenge for Romania, with all indicators falling below the EU average, showing notable differences in the adoption of cloud technology (11% versus 34%), electronic information exchange (17% versus 38%), the use of social communication platforms (12% versus 29%), and the use of electronic invoicing (17% versus 32%). It is anticipated that several measures currently being implemented will lead to progress in this area, including a support scheme within the NRRP, aimed at the development and adoption of digital technologies by SMEs, as well as a measure funded by the European Regional Development Fund (ERDF), which focuses on the development of innovation clusters and, thus, an ICT sector based on innovation.

Regarding the axis of *digitalization of public services*, all indicators related to Romania are below the EU average. Significant discrepancies are noted in the use of e-government services among internet users (24% versus 74%), the availability of digital public services for citizens (score 48, compared to the EU average of 77), and for businesses (score 45, compared to the EU average of 84), as well as in the use of pre-filled forms (score 41, compared to the EU average of 68).

The report on Romania's progress towards the objectives of the Digital Decade [107] highlights two strengths in this regard: first, concerning the digitalization of SMEs, where there is a significant increase in electronic invoicing; and second, in the digitalization of public services, which, although still low, has the prospect of significant improvement in the coming years in terms of transparency, simplification, and quality. The same report also highlights two weaknesses that require improvement, namely in the area of digital skills, with over 72% of the population lacking basic digital competencies, and regarding 5G coverage, which is improving but still lags far behind the EU average (27% compared to 81%).

In conclusion, the government administration, including the fiscal one, is at an early stage of digitalization, with unfavorable results in terms of public services and, implicitly, budget revenues, placing us among the last in the EU. In this context, as the FC has repeatedly emphasized, intense efforts are needed to increase investments in fiscal infrastructure and, above all, in digital technology. Access to the resources made available to Romania through the Recovery and Resilience Mechanism (5.97 billion euros for digital transformation) represents the opportunity to achieve these goals in the coming years, allowing for the exploitation of new innovative economic models to address future challenges arising from the need for budgetary correction assumed through the excessive deficit procedure, improving financial soundness, and ensuring the sustainability of public finances. Furthermore, efforts can be significantly intensified by involving stakeholders (for example, the private sector) in the development and delivery of policies for digital skills, to strengthen efforts for upskilling and reskilling, as well as to attract and retain ICT specialists.

[107] https://digital-strategy.ec.europa.eu/en/node/12837/printable/pdf

V.2. Public expenditures – structure and sustainability

The structure of budget expenditures in Romania is characterized by the dominance of expenditures on salaries and social assistance (pensions, social assistance etc.). Although their relative importance significantly reduced between 2011 and 2015, as a result of the fiscal consolidation process, with 2015 representing the minimum of the analysed period, the 2016-2020 period saw a strong reversal of this evolution (*Figure 39*). Thus, at the end of 2020, the share of expenditures on salaries and social assistance in budget revenues was approximately 24 pp higher than in 2015, reaching a level of 78.5%, which represents the peak of the analyzed period. In contrast, starting from the year 2021, there has been a noticeable trend of decreasing the share of expenditures on salaries and social assistance in total budget revenues, with a decrease of 4.5 pp in 2021, 5.2 pp in 2022, and 1.6 pp in 2023, reaching a value of 67.3%.

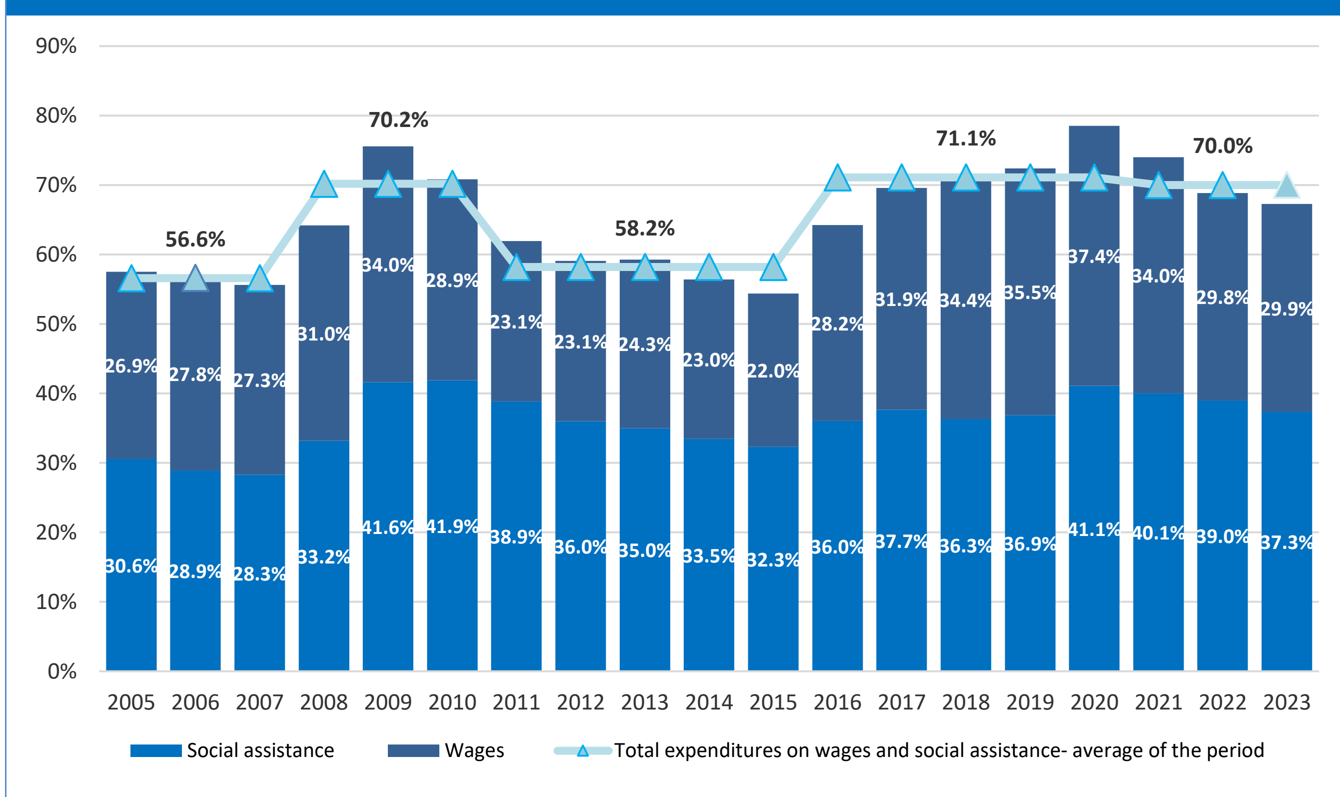
Thus, although the trend of reducing the share of these categories of expenditures in total budget revenues continued in 2023, a significant deceleration is observed compared to previous years. The marginal decline in 2023 can be explained by the narrowing differential between the nominal growth of budget revenues and the nominal growth of expenditures on salaries and social assistance. In this context, in 2023, the nominal growth of budget revenues was 14.2%, while the growth rate of nominal expenditures on salaries and social assistance was 11.6%, compared to a revenue increase of 20.8% and a budget expenditure increase of 12.3% in 2022.

It is noteworthy that the share of salary expenditures in total budget revenues has remained relatively constant compared to the previous year, at nearly 30%. This situation can be explained by the fact that, in nominal terms, the increase in salary expenditures (14.6%) was relatively similar to the increase in budget revenues (14.2%). The share of social assistance expenditures in total budget revenues continued to decline in 2023, decreasing by 1.7 pp compared to the previous year, amid a faster growth rate of budget revenues (14.2%) compared to the growth of social assistance expenditures (9.3%).

In this context, it is noteworthy that both the share of salary expenditures in total budget revenues for the year 2023 (29.9%) and the share of social assistance expenditures (37.3%) are below the averages of the period 2008-2010 (31.3% and 38.9%, respectively), but above the averages recorded during the fiscal consolidation period between 2011 and 2015 (23.1% and 35.1%, respectively). Between 2016 and 2020, the expansionary fiscal policy led to an increase in the average shares of the two categories of expenditures in total budget revenues compared to the period of fiscal consolidation (by 10.4 pp for salary expenditures and by 2.5 pp for social assistance expenditures), a development that negated the effects of the adjustments made between 2011 and 2015. Starting from 2018, the change in the taxation regime for salary earnings by transferring contributions from the employer to the employee has led to a significant increase in gross salary, which has equated to an increase in contributions to the social security system. These measures, along with the reduction of the quota transferred to Pillar II, have contributed to improving the self-financing capacity of the system in the last two years. On the other hand, the share of this category of expenditures in total revenues remains very high compared to other EU member states. Therefore, from the perspective of ensuring the medium and long-term sustainability

of public finances, it is important that any potential increases in salary expenditures in the public sector in the coming years are made only in correlation with the evolution of economic activity and, in particular, with productivity gains. The pandemic crisis has amplified the overall increase in expenditures and, implicitly, the shares of spending on salaries and social assistance in total budget revenues, reaching peak values for the analyzed period (37.4% and 41.1%, respectively) in the year 2020. The situation was determined by the fact that the growth rate of total budget revenues was 2% compared to 2019, while the growth rate of expenditures on salaries and social assistance was 10.6% compared to 2019. Fortunately, this trend was reversed during the period from 2021 to 2023, when spending on salaries and social assistance increased at a rate lower than the growth of budget revenues.

Figure 39: The evolution of social assistance and personnel expenditures as a share of total budget revenues (ESA 2010, %)



Source: Eurostat

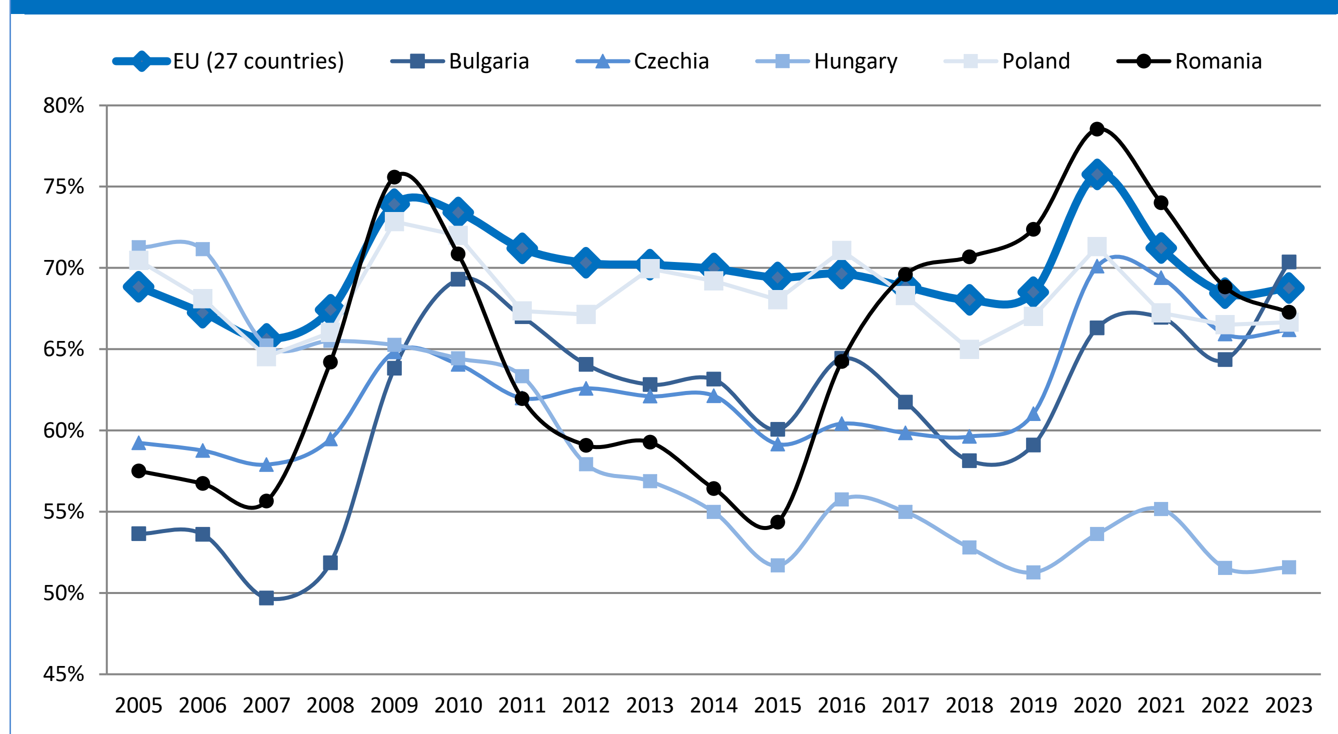
Note: The total expenditures on social assistance and salaries represent average weights for the following periods: 2005-2007; 2008-2010; 2011-2015; 2016-2020; and 2021-2023.

After a relatively stable evolution in relation to budget revenues before 2007, in Romania, spending on salaries and pensions increased at a rapid pace during the period of 2008-2009[108], reaching 75.6% in 2009. Following the implementation of the fiscal consolidation program, their share significantly decreased during the period 2013-2015 to a level lower than that of countries in CEE, with the exception of Hungary. However, starting in 2016, Romania reversed this trend, and against the backdrop of rising salaries in the public sector and pensions, the period from 2018 to 2020 saw, once again, the highest

[108] The respective average weight of these in total budget revenues is nearly 70%.

values in the region for spending on salaries and social assistance relative to budget revenues (70.7% in 2018, 72.4% in 2019, and 78.5% in 2020), also surpassing the EU27 average (*Figure 40*). Starting from 2021, this upward trend was reversed, and spending on salaries and social assistance entered a downward trajectory, so that by the end of 2023, Romania (67.3%) was positioned below Bulgaria (70.4%), as well as below the average share recorded in the EU27 (68.8%), and at a level close to Poland (66.7%). In the case of our country, the evolution of the indicators is negatively influenced by the fact that total budget revenues, expressed as a percentage of GDP, are the lowest compared to the CEE countries. In 2023, the share of budget revenues in GDP in Romania was 33.6%, in Bulgaria it was 37.9%, in the Czech Republic it was 41.7%, in Hungary it was 42.4%, and in Poland it was 41.6%, while the EU27 average is 45.9%.

Figure 40: The share of personnel and social assistance expenditures (including pensions) in total budget revenues in EU27 and CEE between 2005-2023 (ESA 2010, %)



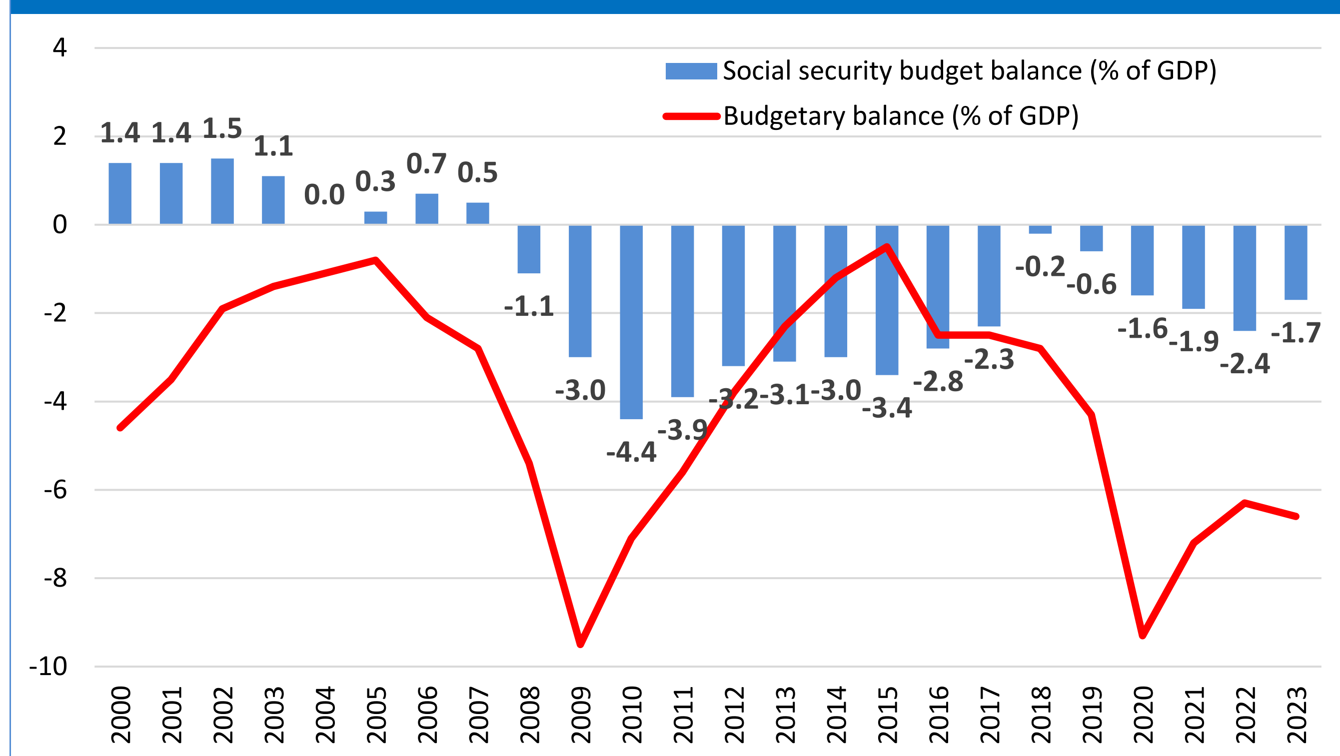
Source: Eurostat

Regarding the evolution of social security budgets (pensions, unemployment, and health, see *Figure 41*), it is observed that, while in the period from 2000 to 2007 they were characterized by a relatively balanced or even surplus balance, after 2008 they shifted to a deficit and came to represent an important component of the total deficit, specifically between 62% and 92% in the period from 2010 to 2017[109]. In 2019, the deficit of social security systems accounted for 14% of the total budget deficit, after it had significantly decreased in 2018 as a result of fiscal measures aimed at restructuring taxation, which were reflected in the increase of taxation through security contributions (reaching 7% of the total budget deficit). In 2020, it increased by 1 pp compared to 2018, representing 17% of the total budget deficit.

[109] During the period from 2013 to 2016, even surpassing the level of the budget deficit.

The trend of increasing deficits in social security systems continued to manifest in the following years, reaching a value of 2.4% of GDP by the end of 2022, which represents a share of 38% of the total budget deficit (an increase of 12 pp compared to the previous year). In 2023, the balance of social security budgets improved by 0.7 pp compared to 2022, against the backdrop of a 0.6 pp reduction in the share of expenditures in GDP, while the share of revenues increased by 0.1 pp. Regarding the contribution of the social security systems' deficit to the overall budget deficit, it was 26%, down by 12 pp compared to the previous year.

Figure 41: Social security budget balance (pensions, unemployment and health) and total budget balance (ESA 2010, % of GDP)



Source: Eurostat

In 2023, the share of investment expenditures, according to European methodology, was 5.3% of GDP[110], higher than the previous year by 0.9 pp. Compared to 2015[111], public investment expenditures as a percentage of GDP in 2023 are higher by 0.1 pp. From the perspective of allocations for this purpose as

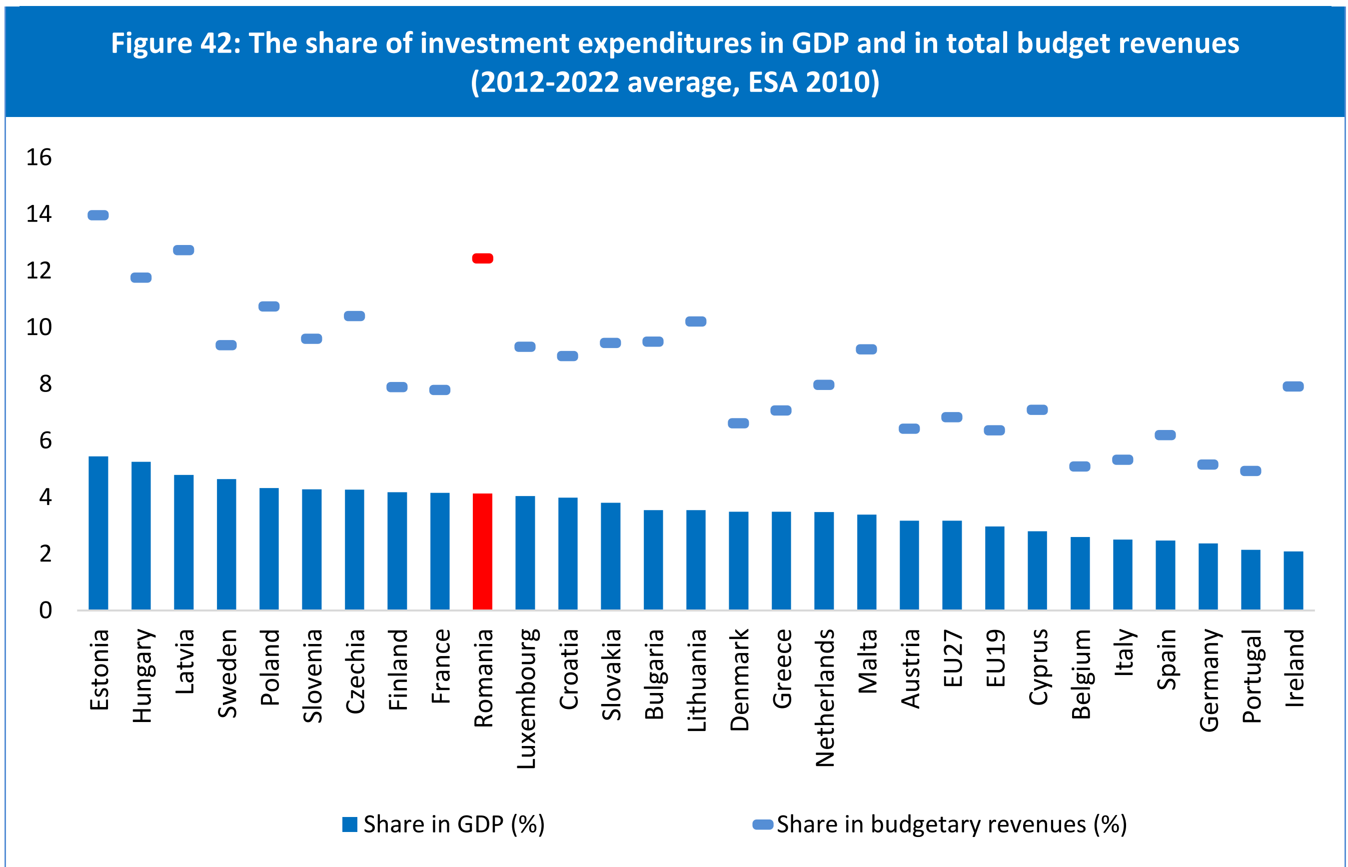
[110] Investment expenditures according to the ESA 2010 methodology represent expenditures aimed at the gross formation of fixed capital. This indicator is used at the EU level and can serve as a comparative reference for investment expenditures in member states. The differences between the level of investment expenditures according to the cash methodology and according to the European methodology generally arise from the different ways of recording arrears, defense-related expenditures, as well as certain categories of non-reimbursable external funds.

[111] The year 2015 marked the first year since 2008 in which public investment expenditures increased as a percentage of GDP compared to the previous year, given that this year was the deadline for attracting European funds related to the financial exercise 2007-2013.

a percentage of GDP, Romania ranked 3rd in the EU27 in 2023 (compared to 6th place in 2022), and 10th position if we consider the average investment spending from 2012 to 2023 (*Figure 42*).

The share of expenditures on investments in total budget revenues in 2023 (at 15.8%) was 2.8 pp higher than the previous year and 1.2 pp higher than in 2015. In the EU27, from the perspective of the share of investments in budget revenues, Romania maintained its second place, similar to the previous year, ranking third when considering the average investment expenditures from 2012 to 2023. At the same time, it should be noted that European funds have played an important role in the evolution of investment spending, with 2023 being the deadline for attracting European funds related to the 2014-2020 Multiannual Financial Framework.

Figure 42: The share of investment expenditures in GDP and in total budget revenues (2012-2022 average, ESA 2010)



Source: Eurostat

VI. 2024 – Macroeconomic and fiscal perspectives

VI.1. Macroeconomic framework

Romania's economy grew by 2.1% in real terms in 2023, driven by the continued recovery of the two major components of domestic demand – consumption and, especially, investment. Gross fixed capital formation significantly contributed to economic growth (by 3.6 percentage points), and final consumption also made a substantial contribution (2.8 percentage points)[112], partially offset by the negative contribution of stock variation. Among the factors that contributed to these developments, we can mention (i) a loose fiscal policy – evident in the size of the deficit both in 2023 and in the early months of 2024 – and (ii) a relatively relaxed monetary policy – although the monetary policy interest rate is at a relatively high level, it remains in real-negative territory. Furthermore, (iii) external demand reduced its negative contribution to Romania's economic growth – it is worth noting that Romania, along with other Central and Eastern European (CEE) countries, has one of the most open economies in terms of external trade. Other determinants of favorable developments in the gross added value of the economy include: (iv) the absorption of European funds, both those related to the multiannual program and those associated with the National Recovery and Resilience Plan (NRRP) – despite the slow pace of absorption, the volume already absorbed is significant for an economy of Romania's size, (v) the improvement of credit conditions – reflected both in increased lending volumes and in lower interest rates on loans, as well as (vi) relatively easy access to external funds by the government sector, despite Romania being an emerging economy marked by certain imbalances and vulnerabilities, and also (vii) the private sector, in terms of a volume of foreign direct investments relatively similar to previous years, and (viii) measures aimed at supporting the increase in real incomes of the population. All of these occurred despite (ix) a fragile external demand, in a context marked by high inflation, high interest rates, reduced new orders, and some recurring issues with value chains – as many maritime shipments between China and Europe were and still are forced to choose alternative routes that avoid the conflict area in the southern Red Sea. Another favorable factor for economic growth is (x) the rapid pace of population income growth – in the context of a tight labor market marked by a structural mismatch between labor demand and supply in various specialties, as well as a robust increase in pensions.

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[112] The 2.1% growth in 2023 compared to 2022, based on data published by the National Institute of Statistics (NIS/INS) on April 9, 2024, shows, on the **demand** side, a significant positive contribution from **gross fixed capital formation** (+3.6 percentage points), **final consumption** (+2.8 percentage points), with **net exports** having a neutral contribution, and **stock variation** having a negative contribution that partially offset consumption and investment (-4.3 percentage points). On the **supply** side, the annual economic growth of 2.1% is attributable to the **construction** sector (0.8 percentage points), the **services** sector – which had a cumulative contribution of 0.6 percentage points – particularly professional, scientific, and technical activities, cultural and recreational activities, and real estate transactions; **agriculture** (0.4 percentage points), the **IT** sector (0.4 percentage points), **trade** (0.1 percentage points), and **net taxes on products** (0.3 percentage points), partially offset by the negative contribution from **industry** (-0.5 percentage points).

The most recent detailed forecast by the International Monetary Fund (IMF)[113] estimates that the global economy's gross domestic product will grow by 3.2% in real terms during 2024, a pace consistent with the previous year (2023), and only showing a slight acceleration (+0.1 percentage points) compared to the previous forecast[114]. The projected economic growth rate is "historically low, due to both short-term factors – such as high borrowing costs and less expansionary fiscal policies – and long-term factors – such as the effects of the COVID pandemic, the impact of the Russian invasion of Ukraine, weak labor productivity growth, and increasing fragmentation of the global economy".

At the same time, the pace of convergence towards higher living standards has slowed for low- and middle-income economies, which implicitly means greater persistence in economic disparities between countries. Weaker medium-term global economic growth, measured in *per capita* terms (reflected, among other things, by the constant downward revision of growth projections from one IMF publication to the next), is mainly due to persistent structural barriers to the international mobility of capital and labor towards more productive firms. These unfavorable developments are primarily located in the Chinese economy and other large emerging economies, where relatively slow growth and weak prospects in this regard, given their increasing share of the global economy, are also weighing on the economic growth of their key trading partners.

Advanced economies are expected to grow by 1.7% in real terms in 2024 (and 1.8% in 2025), largely due to the performance of the US economy, which is projected to grow by 2.7% in 2024 and 1.9% in 2025. This reflects a very rapid pace of economic recovery, allowing the US to surpass its pre-COVID growth trend. In Europe, the Eurozone's economic growth is projected to increase from 0.4% in 2023 to 0.8% in 2024 (and then accelerate to 1.5% in 2025), while the UK economy is also expected to accelerate from 0.1% in 2023 to 0.5% in 2024 (and up to 1.5% in 2025).

Emerging and developing countries are projected to grow by 4.2% in 2024 (and at the same rate in 2025), with the economies of India and China (along with other countries in Asia) providing a significant part of this momentum. India is expected to grow by 6.8% in 2024 and 6.5% in 2025, while China's growth rates are forecasted at 4.6% in 2024 and 4.1% in 2025. Central and Eastern European (CEE) countries are projected to grow by 3.1% in 2024, showing a slight deceleration compared to the previous year, when they recorded a growth rate 0.1 percentage points higher. In 2025, economic growth in the CEE region is expected to continue decelerating to 2.8%, amid weaker growth in both the Eurozone and Russia (which, besides showing relatively low growth, also has a downward trend over the projection horizon).

All these global developments justify the IMF's overall assessment of reduced, but stable growth. The forecast from this international institution also highlights balanced risks regarding economic growth at this time. Downward pressures include: (i) potential new price increases as a result of geopolitical tensions, which could exacerbate high core inflation in economies with tight labor markets, potentially

[113] World Economic Outlook – April 2024, https://www.imf.org/en/Publications/WEO/Issues/2024/04/16/world-economic-outlook-april-2024

[114] World Economic Outlook update – January 2024, https://www.imf.org/en/Publications/WEO/Issues/2024/01/30/world-economic-outlook-update-january-2024

leading to higher interest rate expectations and a decline in asset prices. Divergent inflation trends across various economies could lead to sudden and large exchange rate movements, which would (ii) strain financial system stability. Another downward risk for economic growth is (iii) the prospect of higher interest rates, which could more strongly impact disposable income, especially in the context of heightened financial stress. Additionally, a risk acting in the same direction is the possibility that (iv) without a comprehensive response to China's real estate sector crisis, growth in this second-largest player in the global economy could suffer, potentially causing spillover effects for its major trading partners. Moreover, (v) the high pressure of increased debt levels could hinder growth as repayments reduce available resources and dampen expectations. Global economic fragmentation could intensify, which would (vi) raise additional barriers to the mobility of goods and services, capital, and labor, effectively shrinking aggregate supply.

In contrast to these negative risks, the IMF report outlines several potential positive factors. These include the possibility of (i) more relaxed fiscal policies, (ii) a faster reduction in inflation – which would positively impact purchasing power and lead to quicker declines in interest rates, and (iii) unexpected gains in labor force participation in some economies, all of which could contribute to faster economic growth. Additionally, there is the potential that (iv) the introduction of artificial intelligence in some economies and (v) stronger structural reforms could drive significant productivity gains, resulting in a more rapid advance of the global economy. These figures and explanations are largely confirmed by the IMF's summary projection update from July 16, 2024[115].

The most recent forecast from the European Commission (EC) – published in May 2024[116] as the Spring Economic Forecast – estimates real GDP growth of 1% for the EU27[117] and 0.8% for the Eurozone in 2024, accelerating from a growth rate of 0.4% for both in 2023. In 2025, the growth rate is projected to further accelerate to 1.6% for the EU27 and 1.4% for the Eurozone. Compared to the EC's Winter 2024 provisional forecast, published in February 2024, the latest forecast shows marginally higher growth for the EU in 2024, but steady growth for the Eurozone. The previous forecast projected growth rates of 0.9% for the EU27 and 0.8% for the Eurozone, meaning the current forecast for the EU27 is 0.1 percentage points higher.

The economic scenario and assumptions underlying the forecast take into account several key factors: (i) the European economy began to grow at the start of 2024, after a prolonged period of stagnation, and the forecast assumes this trend will continue, (ii) economic growth in Southern Europe is faster than in other countries, which contributes to advancing economic convergence within the EU, (iii) inflation continues to decline, as already seen in recent data, (iv) this decline in inflation will lead to more relaxed monetary policies, though not immediately, as time is needed to confirm the sustainability of the downward inflation trend – this will also be reflected in lower interest rates throughout the projection

[115] World Economic Outlook update – 16 July 2024, https://www.imf.org/en/Publications/WEO/Issues/ 2024/07/16/world-economic-outlook-update-july-2024

[116] European Economic Forecast, Spring 2024 (15 May), https://economy-finance.ec.europa.eu/document/download/c63e0da2-c6d6-4d13-8dcb-646b0d1927a4_en?filename=ip286_en.pdf

[117] Without UK.

horizon, (v) a gradual recovery in lending volumes, especially to businesses, is expected, driven both by the easing monetary policy and the overall macroeconomic recovery, (vi) the recovery and resilience facility (NRRP) will continue to support economic activity in most countries, particularly through non-residential investments, (vii) consumer spending is expected to recover in the coming years, as the inflation shock that eroded purchasing power dissipates, (viii) the labor market will remain relatively tight in the future, though the tension will ease over time, (ix) external demand is expected to remain favorable for the EU27, boosting the European manufacturing sector and contributing to future improvements in the EU27's balance of payments, (x) fiscal policy will gradually consolidate as support measures in the energy sector are withdrawn, subsidies for investments are reduced, and economic activity gradually recovers.

The changes in the European Commission's Spring 2024 projection compared to the Winter forecast are relatively modest for the main variables, and this similarity is reflected in the key risks highlighted by the projection reports. The following risks, which could have a downward impact on growth, are seen as becoming more significant: (i) risks originating outside the EU27 have become more prominent, particularly due to two regional wars and escalating geopolitical tensions – these could potentially impact global trade and the prices of raw materials, especially energy, (ii) the persistence of inflation in the US could lead the Federal Reserve (FED) to adopt a more cautious monetary policy, (iii) within the EU27, central banks are expected to be cautious about lowering interest rates until the durability of disinflationary trends is confirmed, which could weigh on economic growth, (iv) the pressing need to reduce public debt and/or deficits could prompt some European countries to adopt tighter fiscal policies, which could have a similarly unfavorable effect on growth, (v) a decline in the marginal propensity to save could lead to an additional increase in consumption, thereby boosting economic growth, along with a faster recovery in residential construction investments, (vi) climate change-related risks, reflected in the degradation of natural capital, could have a more significant impact on economic growth prospects, especially since Europe is the continent experiencing the fastest increase in average temperatures.

The spring forecast of the European Commission for 2024 estimates faster growth rates for countries such as Malta (4.6%), Romania and Croatia (each with 3.3%), Poland and Cyprus (each with 2.8%). The slowest GDP dynamics are expected to be recorded in countries like Estonia (a contraction of 0.5%), Finland (economic stagnation in 2024), Germany (0.1%), Sweden (0.2%) and Austria (0.3%). The projection indicates that the dispersion of GDP per capita in euros across European countries may slightly increase, given different starting points, despite the strong convergence of economic growth rates. This is still expected to widen the gap between countries and regions over the projection horizon for this indicator. The pace of economic growth in 2025 is anticipated to increase or remain high in most European countries (with an aggregate dynamic of 1.6%, higher by 0.6 percentage points compared to the previous year), especially in Malta (growth decreases by 0.3 percentage points to 4.3%), Ireland (to 3.6%, an increase of 2.4 percentage points), Hungary (to 3.5%, an increase of 1.1 percentage points compared to 2024), Poland (to 3.4%, an increase of 0.6 percentage points) and Romania (to 3.1%, a decrease from 3.3% in 2024). The countries with the slowest economic growth projected for 2025 are Germany (1.0%, an acceleration of 0.9 percentage points from the previous year), Italy (1.1%, accelerating by only 0.2 percentage points compared to 2024), France (with 1.3%, an acceleration of 0.6

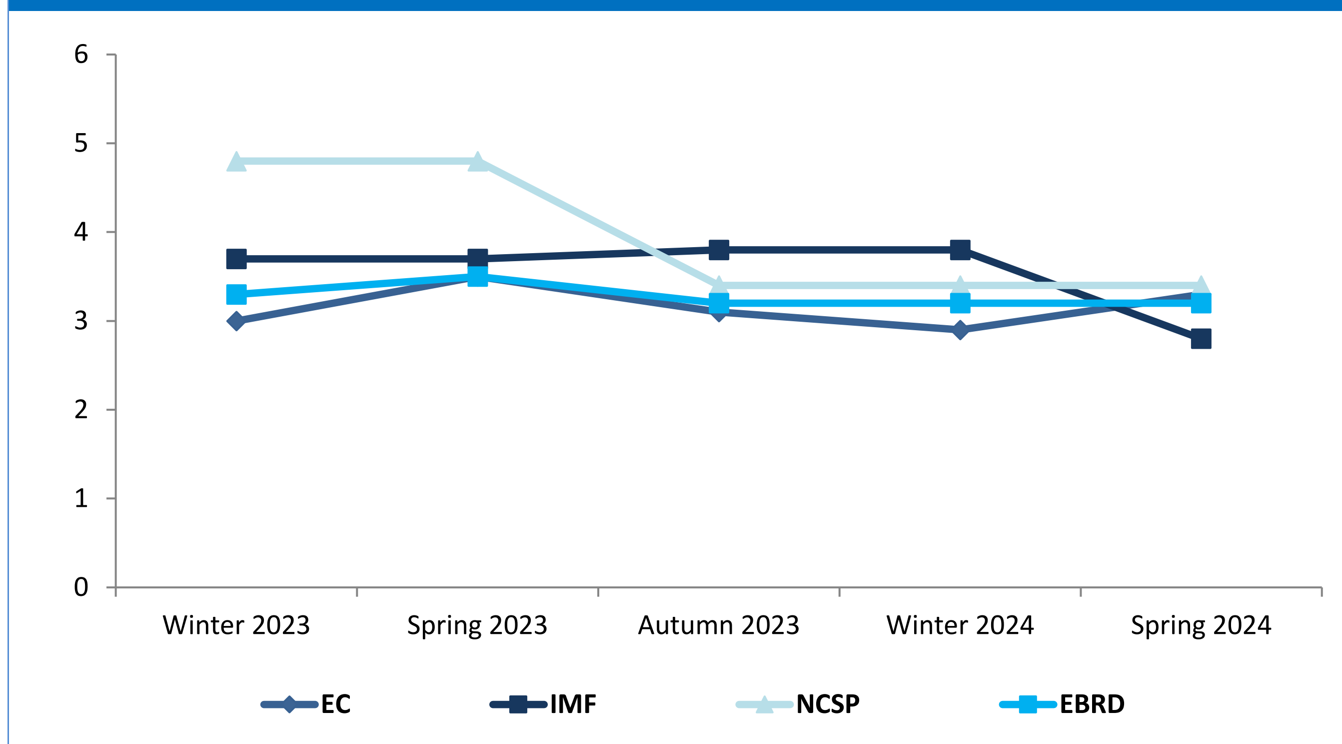
percentage points), Finland (growth of 1.4%, 1.4 percentage points higher than in 2024) and Belgium (also with 1.4%, but with a marginal annual acceleration of only 0.1 percentage points). These growth projections are influenced both by the assumptions taken into account and by the relatively high risks in this round of forecasts.

In the current year, the European Commission's forecast for inflation, expressed through the Harmonized Index of Consumer Prices (HICP), indicates that, at an aggregate level, inflation in the EU27 will be 2.7% and 2.5% in the Eurozone. This represents a significant decrease compared to the previous year, both for the EU27 (down from 6.4% in 2023, a reduction of 3.7 percentage points) and for the Eurozone (where it was 5.4%, a reduction of 2.9 percentage points). This marks a return of inflation to levels consistent with the targets set by the central banks of the EU27 and the European Central Bank for the Eurozone. It is noteworthy that, in the current forecast, emerging countries within the Eurozone and particularly those outside it have higher HICP levels compared to other states. Differences arise both from a stronger impact of adverse shocks, largely supply-side, on prices within each country and from different policies and economic structures (including exchange rate regimes and the degree of pass-through of exchange rate variations). These factors differentiate countries in terms of resilience and internal balance, represented also by price dynamics. In terms of HICP inflation, the largest difference among EU27 countries in the 2024 forecast is between the anticipated inflation for Romania (5.9%), Poland (4.3%), Hungary (4.1%), Belgium (4.0%), and Austria (3.6%) on one hand, and the projected inflation for Finland (1.4%), Italy and Latvia (1.6%), and Lithuania and Ireland (1.9%) on the other.

The European Commission's latest spring forecast anticipates a real GDP growth of 3.3% for Romania in 2024, which is higher than the IM's forecast of 2.8% (from their detailed April 2024 forecast). However, for 2025, both the trend and the ranking regarding growth speed reverse, with the EC predicting a deceleration to 3.1%, below the IMF's projection of 3.6%, which, in contrast, expects an acceleration in economic growth towards the end of the forecast period. The key drivers of the upward GDP trajectory over the next two years are expected to be private consumption, due to the increase in real disposable income, and robust investment. EU funds are projected to strongly support public investments, especially in infrastructure. As in previous forecasts, net exports are expected to have a negative contribution to economic growth, with the external imbalance (represented by the trade deficit and the current account deficit) anticipated to remain around 6.5-7% of GDP over the forecast period, on a marginally declining trajectory. This external imbalance evolution is primarily explained by weak external demand from Romania's main EU trading partners. Inflation, following an increase in January 2024 due to changes in indirect taxes, is expected to continue its downward trend in both 2024 and 2025, though at a slightly higher level than previous projections. Significant pension and salary increases over the next two years will result in a high and persistent core inflation, consistently above the total inflation rate. Thus, the average HICP inflation is projected to decrease from 9.7% in 2023 to 5.9% in 2024 and 4% in 2025, with risks leaning towards a slower reduction. As internal inflationary imbalances are corrected, monetary and financial conditions will ease, supporting consumption growth despite a deceleration in the growth rate of real disposable income. The risks to economic growth mentioned in the EC forecast include the possibility of a higher deficit in 2024 due to an expansionary fiscal stance amid the electoral calendar, which could boost economic growth, as well as the potential improvement in tax collection

rates. The reform of the micro-enterprise sector (as planned in the National Recovery and Resilience Plan) is not included in the forecast, similar to the broader fiscal system reform, both of which are not sufficiently defined to be considered. This could result in a slower economic evolution due to a less favorable fiscal impulse and changes in economic operators' (households and firms) expectations.

Figure 43: Economic growth forecasts for Romania in 2024



Source: EC, IMF, NCSP, EBRD

For the current year, the initial forecasts from the European Commission, IMF and EBRD projected an economic growth for Romania above its potential, which would exacerbate domestic demand excess. The downward revision of these forecasts, to a level close to or slightly above potential, occurs due to less favorable historical developments, driven both by changes in external demand (which are influenced by certain strains in global supply chains and weak performance of major European economies) and by the impact of more restrictive monetary policy (with real rates increasing as the disinflation process progresses).

The realization of these forecasts worsening in 2024 can be observed in the GDP data for the first quarter of 2024, provisional variant (2), published by NIS on July 8 this year. The new data confirm a modest year-on-year economic growth of 0.5% (six times slower than in the previous quarter – Q4 2023, with a year-on-year dynamic of 3%), and GDP growth in the current quarter (Q1 2024) compared to the previous one (Q4 2023) was only 0.7% – marking a slight economic recovery after the 0.5% contraction in Q4 2023. The new GDP data for Q1 2024 (year-on-year growth of 0.5%) reflect a positive contribution (on the GDP formation side) from the following sectors: information and communication (+0.2 pp), performing arts and similar activities (+0.2 pp), trade (+0.1%), along with net taxes on products (+0.5 pp). Agriculture, forestry, and fishing have a neutral impact, alongside the real estate, financial

intermediation, insurance, and public administration sectors. These are offset by negative contributions from industry (-0.2 pp), professional activities and similar sectors (-0.2 pp), and the construction sector (-0.1 pp). On the GDP usage side, final consumption effectively contributes positively to the 0.5% economic growth (+1.7 pp), along with gross fixed capital formation (+1.4 pp), partially offset by net exports with a negative influence (-2.5 pp); inventory changes do not affect the GDP growth rate (having a neutral impact, for the first time recently, after the negative influences from previous data were primarily distributed onto final consumption).

Under the conditions of significant twin deficits in recent years (for example, Romania had a current account deficit of 7.0% and a fiscal deficit of 6.6% in European methodology in 2023; the public savings-investment imbalance representing 94% of the overall savings-investment imbalance), Romania's economy remains particularly vulnerable to changes in the attitudes of financiers, as reflected in the financial markets. This attitude, in turn, largely depends on the performance of the public sector and its alignment with a consolidation trajectory, which would also help reduce the large external deficit.

From the perspective of the necessary fiscal adjustment in the coming years, the following can be noted: (i) nominal GDP is likely to continue growing relatively quickly, which will aid the fiscal consolidation process both through the denominator effect and through a "tax-rich" composition of economic growth; regarding debt dynamics, a high rate of nominal GDP growth compared to the average effective interest rate paid will help flatten the trajectory of public debt as a share of GDP, (ii) closing the *output gap* will reveal, in the medium term, the very large structural deficit, complicating the consolidation process, (iii) the six-month cumulative execution (for 2024) reveals a relatively large deficit, in national methodology, of 3.6% of GDP (which represents 72% of the official cash deficit target for the whole year of 5%), raising again the issue of the Fiscal Council's (FC) opinion at the time of budget approval for 2024 (and the 2024-2026 fiscal-budgetary strategy), regarding a deficit larger than projected. Based on the first six months of budget execution and other data, the FC considers that the deficit in 2024 is likely to exceed 7% of GDP, with the risk of approaching 8% of GDP (larger than the FC's earlier estimate of 6.4% versus the official target of 5%). The new estimate takes into account that a series of reforms – such as the pension law – will bring additional costs in the last part of the year (starting in September), and the seasonality of budget execution will concentrate a large portion of investment spending in the final months of the year. (iv) The adjustment trajectory – which is being negotiated with the European Commission as part of the new European fiscal regulations – has not yet been made public, but it will need to specify a relatively rapid pace of fiscal consolidation, given the high current deficit and the fact that the target is below 3% due to the "*common structural resilience margin*"[118], defined by the new legislation as 1.5% of GDP in relation to the reference value of 3%. It should also be noted that the adjustment is defined both as a maximum growth rate for *net primary spending*[119] and as a minimum

[118] Part of the safeguard mechanism concerning deficit resilience.

[119] *Net (primary) expenditures* are defined as public expenditures excluding interest payments, discretionary revenue measures, expenditures related to EU programs fully covered by EU funds, national expenditures for co-financing programs financed by the EU, as well as cyclical components of unemployment benefit expenditures.

average variation of the *primary structural balance*[120]. Another point to observe is that (v) a generous macroeconomic scenario in the medium-term plan (2025-2028) helps by raising the spending growth caps (net primary), but has only a limited impact on the trajectory of primary structural deficit adjustment; (vi) the EU Council recommends, through a letter dated July 9, 2024[121], that Romania submits its medium-term budget-structural plan on time, (vi.a) which should include a fiscal adjustment for 2024, and (vi.b) recommends accelerating the absorption of cohesion and NRRP funds – implicitly with adherence to the conditionalities and reforms Romania has committed to; (vii) all of this outlines a complex situation regarding fiscal adjustment, which, aside from its significant magnitude, may also require relatively rapid implementation under possibly less favorable conditions, both financially and in terms of economic and public sector dynamics.

Regarding the forecasts for the external deficit (current account balance) and the budget deficit, the latest European Commission forecast anticipates divergent trajectories for these two. The current account deficit is expected to increase (from 6.7% of GDP in 2023) to a deficit of 7.0% of GDP in 2024, before decreasing to 6.6% in 2025. In contrast, the public sector deficit is anticipated to grow (from a deficit of 6.6% of GDP in 2023) to 6.9% in 2024 and 7.0% in 2025. It can be observed that while the external deficit is expected to slightly adjust in 2025, the budget deficit is projected to continue widening throughout the forecast period. However, the levels of both remain close (between 6.6% and 7.0% of GDP), and their tandem movement at this relatively high level justifies the economic theory term “twin deficits”.

According to the Inflation Report published by the National Bank of Romania (NBR) in August 2024, the annual CPI inflation rate[122] is expected to reach 4% by the end of 2024, following a downward trajectory from 15.5% at the end of February 2023. By the end of 2025, the projected value in the report is 3.4%. “According to the baseline scenario, the general downward trend in the annual CPI inflation rate will continue throughout almost the entire forecast period, but the pace of disinflation is anticipated to slow significantly in the latter half of this period. Structurally, core inflation is projected to gradually decrease and then slow down more over the medium term, while exogenous components will register a more volatile cumulative contribution in the first part of the forecast period, reflecting a series of base effects. [...] In the short term, disinflation will be temporarily interrupted in July 2024, mainly due to anticipated increases in fuel prices as a result of higher excise duties, and in natural gas prices following distribution tariff hikes. After resuming its decline in August, the annual CPI inflation rate is projected to fall [...] by the end of 2024. Subsequently, it will fluctuate significantly in the first part of the next year due to substantial base effects. Thus, the *headline* indicator will benefit from favorable influences at the beginning of the year, as the indirect tax increases from January 2024 drop out of the calculation base, temporarily reaching a minimum value of 2.9% in March 2025. In the second quarter of 2025, opposite

[120] *Primary structural balance* refers to the cyclically adjusted public budget balance, from which exceptional measures and other temporary measures, as well as interest expenses, are deducted – in accordance with EU Regulation 2024/1263 from April 29, 2024.

[121] Council Recommendation on the economic, social, employment, structural and budgetary policies of Romania, 11715/24.

[122] Calculated according to the national methodology. It differs from the HICP inflation rate, which is calculated according to the European methodology.

effects will emerge, associated with corrections in natural gas prices and LFO prices from the second quarter of the current year, pushing inflation back above the target range, to 3.7% in June 2025. Later, with the stabilization of transient influences related to base effects from the previous year, the annual inflation rate will return to the upper half of the target band (2.5% plus/minus 1 percentage point)".

The projection for adjusted CORE2 inflation for 2024 reflects the developments previously described in the report, reaching a level of 4.6% by the end of the year. The moderation of core inflation to 3.5% by the end of 2025, a level that, while decreasing, remains relatively high, reflects "especially the gradual slowdown in the annual dynamics of non-food goods and services prices, from the still high values recorded in June (8.6% and 8.0%, respectively). Recent data indicated a decrease in the monthly rates of these subcomponents, an evolution correlated with that of the industrial production prices for non-food goods, excluding energy. Additionally, the annual dynamics of unit labor costs are projected to decrease, while still remaining at robust levels. At the same time, the food subcomponent will continue to receive favorable influences from global agricultural product prices, transmitted along the production chain and onto local prices in the food industry. Thus, the annual dynamics of the food subcomponent of core inflation, which registered 2.1% in June, are expected to remain at significantly lower values than the rest of the core index subcomponents". The NBR report also mentions that "from a structural perspective, an important contribution to the reduction of core inflation over the forecast period is due to the ongoing correction of inflation expectations, which is, in fact, the component with the most significant contribution to the evolution of core inflation. Additionally, the dynamics of imported goods prices, expected to decrease in the first part of the current year and stabilize afterward, will also play a role, correlating with the anticipated dynamics of the annual HICP inflation excluding energy in the Eurozone. The slowdown in disinflation, more visible in the second half of the forecast period, is driven by the continued positive output gap[123], as well as inflation expectations, while decreasing, remaining at levels above those associated with the inflation target until the end of the forecast horizon".

The most recent statistical data published by NIS, for the first quarter of 2024, indicate a quarter-on-quarter increase (seasonally adjusted) of 0.7%, marking a recovery from the contraction in the fourth quarter of the previous year (of 0.5%). This rebound is attributed to above-average performance in the IT sector and trade, as well as net taxes on products, in terms of GDP formation. In terms of GDP usage, consumption and investment explain the more favorable evolution in the first quarter of 2024. However, net exports contribute negatively to economic growth. This is confirmed by the high level of the current account deficit (9.2 billion euros cumulative for the first five months of 2024); moreover, this deficit has resumed a rapid growth trend (an increase of 33.4% in euros in the first five months of the current year compared to the same period last year), although it was on an adjusting trajectory at the end of 2023 and in some early months of 2024. This dynamic results from: (i) an increase in the goods trade deficit (13.1%), (ii) a reduction in the services trade surplus (11.5%), (iii) a larger primary revenue deficit[124] (27.7%), all partially offset by (iv) a significantly larger secondary revenue surplus (127.8%). The

[123] The connection between the output gap and inflation is modeled through a Phillips curve.
[124] Equivalent to production factor revenue.

evolution of real wages in the economy (+7.2% year-on-year in May 2024[125]) and real pensions in the first quarter of the year (+15.1% year-on-year[126]), as well as positive developments in trade[127] and services[128] also confirm the structure of the aforementioned economic growth.

In addition, in the opinion issued regarding the draft budget for 2024 and the fiscal-budgetary strategy for 2024-2026, the FC considered that the projected values for real growth are slightly overestimated ("regarding the projected levels for real economic growth across the projection horizon, the cumulative effect can be considered to be sensitive to the upper margin of a likely evolution range [...] For these reasons, the FC believes that the real GDP forecast for the 2024-2026 period is marked by slight optimism, being dependent on a high degree of absorption of European funds – multiannual and from the NRRP – and on the absence of a significant global recession – especially in the US and EU27 economies – as well as on the non-materialization of other previously mentioned risks") and these accumulate year by year ("it is also worth noting that these slightly higher increases reinforce each other, accumulating, by the end of the projection, systematic positive deviations, leading to a higher GDP level – contributing to higher budget revenues but also to a denominator effect on the shares of fiscal indicators in GDP – deficit, debt etc."), but are offset by an underestimation of the GDP deflator over the projection horizon ("the projected growth rate of the GDP deflator, at 10.2% in 2023, revised upward from 9.7% in the previous macroeconomic projection by NCSP, is cautious, and could be, in plausible scenarios, even slightly higher" and "this characteristic of the GDP deflator forecast is also found at the 2024 level, with the anticipated level of +5.9% for its variation appearing to be very cautious. For the years at the end of the projection horizon – 2025 and 2026 – the NCSP also sees deflator values of +4.1% and +3.3%, which are likely in the minimal area of a plausible projection range (as evidenced by comparisons with recent projections from internal and international institutions").

And once again, all the elements described above "lead to the opposite conclusion, as previously formulated regarding real GDP; in this case, possible systematic negative errors accumulate to ultimately result, *ceteris paribus*, in a lower nominal GDP level. However, given 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 across the entire interval these possible systematic deviations offset each other, leading to the conclusion of a nominal GDP projection – with a high degree of plausibility according to the FC – given all the currently available economic information".

Recent information indicates that for 2024, the government's economic growth forecast of 3.4%, as outlined in the initial budget proposal and maintained in both the NCSP winter forecast (published on February 12) and the spring forecast (published on April 30), might be marked by moderate optimism and could face downward revisions in light of new GDP data and high uncertainty regarding both domestic and external economic developments. The GDP deflator forecast for 2024, initially set at 5.9% in the NCSP fall forecast (November 9, 2023) related to the 2024 budget proposal, was later revised

[125] NIS Press Release no. 183 / 12 July 2024.
[126] NIS Press Release no. 152 / 14 June 2024.
[127] NIS Press Release no. 175 / 5 July 2024.
[128] NIS Press Release no. 191 / 19 July 2024.

down to 5.8% (in the winter 2024 forecast) and then increased to 6.5% in the spring forecast. The risks to this indicator's evolution at present can be considered balanced. This implies that the nominal GDP evolution for the current year carries the same risks as those affecting real GDP, reflecting a slight optimism in the NCSP projections.

For the coming years, regarding the NCSP's combined forecast of real economic growth and deflator dynamics (i.e., nominal GDP), the observations made in the FC opinion – prompted by the 2024 budget draft and the fiscal-budgetary strategy for 2024-2026 – are considered to remain valid. This translates into the assessment of a slight overestimation of real growth, nearly fully offset by the underestimation of the GDP deflator, resulting in a plausible trajectory for nominal GDP in the years following the current one. As in previous FC documents, it is believed that the NCSP forecasts could benefit from increased transparency regarding the determinants of future economic growth (including clarification of the assumptions regarding the absorption of NRPR and multiannual framework funds) and, implicitly, the detailed correlations between domestic savings and the external balance, connected to the evolution of financing conditions.

VI.2. Fiscal framework

The budget execution for 2023 recorded a cash budget deficit of 5.6% of GDP and a deficit of 6.6% of GDP according to the ESA 2010 methodology. The initial budget had set a target deficit of 4.4% of GDP under both methodologies. Thus, 2023 saw a substantial deviation from the budgetary consolidation trajectory established under the excessive deficit procedure, due to a significant shortfall in revenue targets set in the initial budget, while expenditure exceeded the budgeted ceilings to a lesser extent, thanks to measures taken towards the end of the year to curb them.

Similar to previous years, Romania remained in a very difficult fiscal situation in 2023, characterized by insufficient budget revenues (approximately 33.6% of GDP, compared to an average of about 43.3% of GDP in the EU) and tax revenues (26.6% of GDP, versus an average of 36.8% in the EU), alongside a high level of structural deficit (6% of potential GDP) and external deficit (current account deficit of 7% of GDP).

In this context, the 2024 budget project targeted a cash deficit of 5% of GDP, representing a decrease of 0.6 pp from the level recorded in the previous year. The deficit target, according to the ESA 2010 methodology, was set at 4.9% of GDP, implying a reduction of 1.7 pp compared to the level recorded in 2023. The planned reduction in the deficit was anticipated to be achieved primarily through an increase in the share of budget revenues in GDP, driven by the projected macroeconomic framework, fiscal policy measures adopted at the end of 2023, hypothetical revenues from improved collection efficiency/digitalization of NAFA (estimated by the Ministry of Finance at 19 billion lei), and projections for European fund absorption. On the other hand, the share of budget expenditures in GDP was planned to decrease marginally, with increases in expenditures for projects funded by European funds, personnel costs, social assistance, and other expenses being counterbalanced by reductions in subsidies, other transfers, and spending on goods and services. In its opinion on the 2024 budget project and the 2024-2026 Fiscal Strategy, the Fiscal Council noted the following key aspects:

- The preparation of fiscal-budgetary programming documents took place in an international context marked by economic, political, and geopolitical uncertainties, as well as military conflicts. Domestically, Romania's most severe issue, beyond external deficits and institutional weaknesses, is the budget deficit.

- The correction of the deficit should primarily focus on revenues, given that fiscal revenues are extremely low, education and healthcare are underfunded, and tax evasion and avoidance are nearly institutionalized. Additionally, Romania needs to spend more efficiently, necessitating public spending reviews.

- Although the fiscal measures adopted by the Government in 2023 were estimated to have an impact of around 1% of GDP, additional measures are required to reduce the budget deficit to 3% of GDP within a few years.

- The new pension law is necessary to address glaring inequities and to account for the aging population. However, it represents a permanent increase in expenditures with severe short- and medium-term impacts.

- In this context, the FC emphasized the need for continued fiscal reform and a vigorous fight against tax evasion and avoidance. Failure to achieve a credible adjustment, supported by transparent measures that address the existing shortcomings of the current fiscal framework (regressivity/high tax evasion, partly due to flawed legislation and inefficient institutional architecture), could lead to disordered economic developments.

- Following the analysis of the 2024 budget draft, based on a cautious approach, the FC estimated a probable revenue shortfall of about 19 billion lei, approximately 1.1% of GDP, compared to budgeted targets. On the expenditure side, the FC identified a need for additional budget allocations of around 4.5 billion lei for goods and services and social assistance, representing about 0.26% of GDP.

- Considering the evaluation of revenue and expenditure projections, the FC assessed that the budget prepared for 2024 was compatible with a cash deficit of around 6.4% of GDP, indicating major risks regarding the consolidation process. This assessment was based on information available to the FC in December 2023, uncertainties regarding the final form of measures adopted by the authorities, and the assumption that there would be no forced expenditure reductions.

- According to the projected medium-term fiscal-budgetary framework, budgetary consolidation for the 2025-2027 period will be achieved exclusively through expenditure cuts, while the share of budgetary revenues in GDP indicates a downward trend during the analysed period. The FC assessed that, in the absence of sufficiently concrete and credible policies to support medium-term fiscal-budgetary consolidation on the revenue side and improve revenue collection, the risk balance is clearly tilted towards higher deficits than those projected by the fiscal-budgetary framework for the 2025-2027 period.

- Furthermore, FC highlighted that macroeconomic adjustment and fiscal consolidation require a significant increase in fiscal revenues. Through fiscal reforms and labour market adjustments, as well as improved revenue collection, Romania could achieve fiscal revenues well above 30% of GDP by 2027-2028, a level necessary given current and future challenges.
- A credible fiscal consolidation can reassure markets and keep the economy attractive to investors. Combined with reforms and major investments, it would increase potential GDP and support economic growth significantly above the EU average, also leading to a substantial reduction in the current account deficit.

The first half of 2024 witnessed a series of measures with negative effects on budget execution. As anticipated by the FC in its opinion on the budget draft, several discretionary wages increases were granted following the adoption of the budget. In March, base wages for healthcare personnel, staff within the Ministry of Health, and social assistance personnel were increased by 20%, resulting in a budgetary impact of approximately 1.5 billion lei. In the same month, wages were raised by up to 30% for personnel in defense, public order, and national security institutions, with additional benefits (such as doubling of delegation/detachment allowances, monetary compensation for annual leave etc.), leading to an estimated budgetary impact of about 1.2 billion lei for 2024. In May, measures were adopted to increase base wages by 10% for various public sectors, with an estimated budgetary impact of around 1.1 billion lei. The negative budgetary effect was expected to be offset through institutional reorganizations, increased employment levels, and reductions in expenditures on goods and services.

Additionally, in March, the Government adopted Emergency Ordinance No. 31/2024 concerning the regulation of certain fiscal-budgetary measures and the modification and completion of some normative acts. This ordinance relaxed some of the public expenditure measures included in Law No. 296/2023, which addressed fiscal-budgetary measures for ensuring Romania's long-term financial sustainability, resulting in a negative budgetary impact of approximately 0.4 billion lei.

Another factor exacerbating the pressures on the 2024 budget execution was the budget arrears of about 9 billion lei, created by deferring some payments at the end of 2023, most likely as a consequence of the public expenditure limitation measures adopted in October of the previous year. These arrears are reflected in the difference between the ESA deficit and the cash deficit for 2023, as well as in the accelerated dynamics of expenditures on goods and services in the current budget execution.

In this context, at the beginning of May, the Government adopted Emergency Ordinance No. 46/2024 regarding certain budgetary measures and the modification and completion of some normative acts. This ordinance, through a series of exceptions to the existing legislative framework, provided that in 2024: (i) from the contingency reserve fund, amounts can be allocated, based on Government decisions, for the financing of current and capital expenditures of the main authorizing officers; (ii) the main budgetary authorities of the state budget must allocate, to the contingency reserve fund, within one working day of the Ministry of Finance request, 10% of the commitment appropriations and budgetary appropriations held; (iii) amounts provided in the budgets of the main authorizing officers under Title 56 "Projects with financing from non-refundable external funds post-accession", Title 58 "Projects with

financing from non-refundable external funds related to the 2014-2020 financial framework", Title 60 "Projects with financing from the amounts representing non-refundable financial assistance related to the NRRP", and Title 61 "Projects with financing from the amounts related to the loan component of the NRRP" can be transferred to the reserve fund provided in the state budget for 2024, in compliance with the provisions of Article 54, paragraph (1) of Law No. 500/2002, with subsequent amendments and completions. Through these measures, as in 2023, a framework was created, allowing the contingency reserve fund to be used to balance local and central budgets without the need for annual budget revision acts. In these conditions, the warning from the FC[129] regarding the use of the contingency reserve fund as a replacement for budget revisions remains relevant. This practice involves significant risks, from lack of transparency in budget execution to discretionary use and increased resorting to exceptions from fiscal rules.

The budget execution for the first six months of 2024 recorded a high cash deficit of 3.6% of GDP (approximately 1.3 pp higher than the same period in the previous year), due to a sharp increase in budgetary expenditures. While budgetary revenues exceeded expectations (+13.5% compared to the same period in 2023, with a growth of 12.4% projected in the 2024 project budget), the pace of growth in budgetary expenditures was much faster (+21.2%, while the growth projected in the 2024 budget compared to the previous year's execution was of only 10%). Additionally, it should be noted that in the second half of the year, the dynamics of personnel expenditures will be higher since some wage increases for the public sector were planned to be implemented in two phases (in the first half and the second half of the year). An acceleration in social assistance expenditures is also expected from September 2024, following the implementation of the new pension law. Furthermore, with the increase in the minimum wage, the authorities decided to raise the amount exempt from income tax and not included in the monthly base for mandatory social contributions, from 200 to 300 lei. This measure is expected to have a negative budgetary impact of approximately 0.3 billion lei on budgetary revenues in the second half of the year.

The unfavorable dynamics of the budget execution in the first half of 2024 are is reflected in the increase of the public debt-to-GDP ratio. As such, data published by Eurostat[130] show a public debt ratio of 51.6% of GDP at the end of March 2024, while data from the Ministry of Finance[131], available for April 2024, indicate a public debt ratio of 52.1% of GDP, both exceeding the 50% threshold established by the FRL. In this situation, where the public debt ratio falls within the 50%-55% range, according to Article 13, paragraph (2) of the FRL, the Government should present and implement a program to reduce the public debt-to-GDP ratio, which must be approved by a legislative act. It is expected that the fiscal-structural plan, which will be submitted by the Government, in September 2024, and which primarily addresses the urgent need for fiscal consolidation, will inherently include measures to limit public debt.

The EC, in its Spring 2024 forecast, has upwardly revised the budget deficit projection for Romania for the current year to 6.9% of GDP, up from 5.3% in the Autumn 2023 forecast. On the expenditure side,

[129] See the *Position note regarding the restriction of public expenditures,* published by the FC on October 31, 2023.
[130] https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-22072024-ap
[131] https://mfinante.gov.ro/static/10/Mfp/buletin/executii/EvdatguvconformUERo042024.pdf

the Commission has highlighted an accelerated increase in expenditures on personnel and the impact of the new pension law, along with the continued high level of public investments. Regarding revenues, in the light of the fiscal measures adopted at the end of 2023 and an anticipated improvement in tax collection, the Commission expects a revenue growth rate higher than the nominal GDP growth. It is important to note that, as of the completion of this report, the authorities have not published any document updating the budget deficit target.

In this context, the budget execution for the first six months of 2024 seems to confirm the FC assessment from its opinion on the budget proposal, which estimated the cash deficit for the current year at around 6.4% of GDP, significantly above the assumed target of 5% of GDP. Furthermore, in the absence of fiscal consolidation measures, the deficit is likely to exceed 7% of GDP, with a risk of approaching 8% of GDP. This deficit trend is attributed to the new pension law and the wage increases granted in the public sector, which will generate additional costs in the second half of 2024, coupled with the seasonal concentration of certain expenditure categories in the last months of the year. It seems unlikely that, in the context of a highly turbulent political year, decisive corrective measures for the budgetary deviation will be adopted. Thus, despite Romania being under an excessive deficit procedure, it is very likely that 2024 will be the second consecutive year of deviation from the deficit adjustment trajectory established by European institutions.

As a result, fiscal-budgetary consolidation is both urgent and unavoidable. Following the adoption of the new EU economic governance framework in April 2024 (outlined in *Box 3*), and given Romania's budget deficit exceeding 3% of GDP, the European Commission will provide the national authorities with a reference trajectory for the net expenditure path. Based on this, Romania will need to propose a fiscal-structural plan that includes the necessary reforms and investments, emphasizing the impact on revenues and budgetary expenditures, to ensure that the budget deficit falls below 3%. Therefore, in the upcoming period, Romania will need to implement viable measures to reduce the structural deficit, aiming both to increase the share of fiscal revenues in GDP and to improve the efficiency of budgetary expenditures.

Box 3: The new economic governance framework of the European Union

The coordination of the economic policies of the EU member states, i.e. price stability, the soundness of public finances, the strength of monetary conditions, and the sustainability of the balance of payments, represents a cornerstone of the European Union's functioning. While the coordination of monetary policy for Eurozone member states falls under the responsibility of the European Central Bank, the implementation of fiscal policy is carried out by each member state, in compliance with a set of rules established both at the EU and national level.

The Stability and Growth Pact (SGP), along with its subsequent revisions, encompasses the set of rules that have guided the coordination of the fiscal policies of EU member states since 1997. In February 2020, the European Commission presented an assessment of the effectiveness of the SGP's provisions[132]

[132] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020SC0210

and launched a public debate on its future[133]. On March 20, 2020, the Commission decided to suspend the SGP's provisions[134] to allow member states' fiscal policies to adequately respond to the challenges posed by the COVID-19 pandemic.

In November 2022, the European Commission launched a public debate on the new EU economic governance framework[135], and in April 2023, it published the proposed version of this framework[136]. Following negotiations between the European Commission, the European Parliament, and the Council of the EU, on April 29, 2024, the Council of the EU adopted the final version of the new economic governance framework. This framework is based on three key documents[137]: (1) Regulation (EU) 2024/1263 on the effective coordination of economic policies and multilateral budgetary surveillance, repealing Regulation (EC) No 1466/97; (2) Regulation (EU) 2024/1264 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure; and (3) Directive (EU) 2024/1265 amending Directive 2011/85/EU on requirements for the budgetary frameworks of the member states.

The new governance framework retains as key benchmarks the two rules proposed in the Maastricht Treaty: a budget deficit of less than 3% of GDP and public debt under 60% of GDP. To simplify the proposed rules and increase transparency, the new framework introduces a single operational indicator – the net expenditure trajectory[138] – aimed at ensuring that the two benchmarks are maintained within sustainable and balanced limits. Additionally, based on the net expenditure trajectory, each member state will commit to a medium-term fiscal-structural plan that will include reforms and investments and promote sound fiscal policy.

Specifically, for member states whose public debt exceeds 60% of GDP or whose public deficit surpasses 3% of GDP, the European Commission provides a reference trajectory for net expenditures over a four-year adjustment period. There is also the possibility for member states to commit to an additional set of reforms and investments that meet certain criteria, allowing the adjustment period to be extended to seven years.

Compliance with the net expenditure trajectory should ensure that, by the end of the adjustment period, under a no-policy-change scenario, the public debt-to-GDP ratio is on a plausibly declining path or

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[133] https://economy-finance.ec.europa.eu/document/download/a636323a-917f-4840-9663-2e6c3c415195_en?filename=com_2020_55_en.pdf

[134] The provisions of the SGP remained suspended until April 2024, when a new set of rules was adopted.

[135] https://economy-finance.ec.europa.eu/document/download/43105168-be28-463e-81e7-8242c59f0cd2_en?filename=com_2022_583_1_en.pdf

[136] https://economy-finance.ec.europa.eu/publications/new-economic-governance-rules-fit-future_en

[137] The three documents can also be consulted on the Fiscal Council's website (http://www.fiscalcouncil.ro/cadru.htm). EU regulations are directly applicable in the member states, while EU directives are transposed into national legislation.

[138] According to Regulation (EU) 2024/1263, net expenditures are defined as government expenditure net of interest expenditure, discretionary revenue measures, expenditure on programmes of the Union fully matched by revenue from Union funds, national expenditure on co-financing of programmes funded by the Union, cyclical elements of unemployment benefit expenditure, and one-offs and other temporary measures.

remains below 60% of GDP in the medium term. Similarly, the budget deficit should fall below 3% of GDP during the adjustment period and remain under this level in the medium term. To ensure debt sustainability, the reference trajectory requires that the public debt-to-GDP ratio decreases by an average of at least 1 pp annually if the ratio exceeds 90%, and by at least 0.5 pp if the debt-to-GDP ratio falls between 60% and 90%. To safeguard deficit resilience, the reference trajectory mandates that budgetary adjustment continues until a deficit level is reached that provides a common structural resilience margin of 1.5% of GDP relative to the 3% deficit benchmark. To meet this target, the minimum adjustment should be 0.4 and 0.25 pp of GDP for the four-year and seven-year adjustment periods, respectively.

Alongside the reference trajectory, the EC provides member states with public debt projections, its macroeconomic forecasts and assumptions, as well as calculation models and relevant information necessary to ensure the replicability of the results. Member states can engage in a technical exchange of information with the EC regarding the latest statistical data, as well as economic and budgetary outlooks.

Using the net expenditure trajectory and targeted reforms and investments as primary references, each member state will submit its national fiscal-structural plan to the Commission and the Council. This plan must include: the trajectory of net expenditures; the macroeconomic assumptions underlying it and the planned structural fiscal measures to comply with the limits and requirements on public debt and budget deficits; how the member state will ensure the implementation of reforms and investments[139]; actions taken to respond to country-specific recommendations; reforms and investments undertaken to extend the adjustment period to seven years; the impact of reforms and investments already implemented by the member state, with particular attention to their effect on revenues and budgetary expenditures; and other information regarding key macroeconomic and budgetary assumptions, the impact of reforms and investments, public investment needs etc. Member states may base their fiscal-structural plan on a net expenditure trajectory higher than that provided by the EC. However, in such cases, the plan must include economic, data-driven arguments justifying the difference. Member states can also request an opinion from independent fiscal institutions on the macroeconomic forecasts underlying the net expenditure trajectory, which can be included in the fiscal-structural plan submitted to the EC. The national fiscal-structural plan is evaluated by the Commission and approved by the Council.

Given that Romania exceeds the reference value for the budget deficit, by September 20, 2024, based on the net expenditure trajectory, provided by the European Commission, the Government must develop a fiscal-structural plan that includes fiscal commitments, targeted reforms, and investments. The fiscal-structural plan must ensure, by the end of the adjustment period, a reduction in the budget deficit as a percentage of GDP below the reference value, a gradual decrease in the public debt-to-GDP ratio, and sustainable economic growth.

[139] The reforms and investments included by each country in the fiscal-structural plan must aim to achieve objectives that ensure: (i) a balanced green and digital transition; (ii) social and economic resilience; (iii) energy security; (iv) strengthening defence capacities.

Each year, member states present the EC an annual report on the progress made in implementing the fiscal-structural plans. Member states may request independent fiscal institutions to conduct an assessment of the compliance of the data on the budgetary framework presented in the annual report with the net expenditure trajectory established by the Council. The European Commission monitors the progress of each member state, particularly the adherence to the net expenditure trajectory and the reforms and investments underlying the extension of the adjustment period. To this end, the Commission will create a control account that will highlight cumulative deviations from the trajectory: expenditures exceeding the trajectory will be recorded as debits, while expenditures falling below the trajectory will be recorded as credits.

The new governance framework allows, in certain situations, the activation of derogatory clauses. Thus, member states can deviate from the net expenditure trajectory in the event of a severe economic recession in the Eurozone or the EU (general derogation clause) or if there are exceptional circumstances beyond the control of the member state that have a significant impact on public finances (national derogation clause). The Council sets a limit period of one year, which can be extended multiple times, during which member states can deviate from the net expenditure trajectory. During this period, deviations will not be recorded in the control account.

The control account becomes an important reference point in triggering the excessive deficit procedure. Thus, the EC will prepare a report, based on Article 126(3) of the TFEU, if the ratio of public debt to GDP exceeds the reference value, the budgetary position is not close to balance or in surplus, and deviations in the control account exceed 0.3 pp of GDP annually or 0.6 pp of GDP cumulatively. The new governance framework proposes that, for a proper assessment of the public debt-to-GDP ratio, factors such as population aging, potential economic growth, inflation developments, or public defense investments should also be considered. Additionally, in line with the derogatory clauses, the public deficit is considered exceptional if it results from a severe economic recession in the Eurozone or the EU or from exceptional circumstances beyond the member state's control that have a major impact on public finances.

After the report prepared by the EC, the Council decides on the existence of an excessive deficit and makes recommendations to the member state, setting a deadline of up to six months for the adoption of effective measures and a timeline for correcting the excessive deficit. Member states must submit a report to the Council detailing the measures adopted and the revenue and expenditure targets that align with the Council's recommendations. The governance framework allows member states to request independent fiscal institutions to assess, in a separate report, the measures taken and those planned to meet the revenue and expenditure targets. If, based on the member state's report, the Council determines that no measures to reduce the deficit have been taken, it will issue a warning requiring the implementation of a corrective net expenditure trajectory and indicate measures to support achieving this trajectory. The excessive deficit procedure is suspended if the member state complies with the Council's recommendations/warnings. Otherwise, the Council may impose sanctions under Article 126(11) of the TFEU.

As previously mentioned, the new economic governance framework grants independent fiscal

institutions an advisory role in reviewing the forecasts and macroeconomic assumptions underpinning the net expenditure trajectory, analysing the compliance of budgetary data with this trajectory, and in the excessive deficit procedure. Additionally, Directive (EU) 2024/1265 clarifies the functions and requirements associated with independent fiscal institutions, based on the premise that they represent a key pillar of budgetary frameworks. A more detailed analysis of the role of independent fiscal institutions in the new EU economic governance architecture can be found in the publications available on the FC website[140].

In accordance with Article 8a, paragraph 1, of the mentioned directive, member states must ensure the establishment of independent fiscal institutions, comprised of members appointed and designated based on their experience and expertise in public finances, macroeconomics, and budgetary management. To ensure their independence, according to Article 8a, paragraph 4, independent fiscal institutions shall not accept instructions from the budgetary authorities of the member states or from any other public or private bodies, will have adequate and stable resources to perform their tasks effectively, will have timely and appropriate access to necessary information, and will be subject to regular external evaluations.

The functions of independent fiscal institutions, as outlined in Article 8a, paragraph 5, include:

(i) producing, assessing or endorsing annual and multiannual macroeconomic forecasts;
(ii) monitoring compliance with country-specific numerical fiscal rules;
(iii) undertaking the advisory tasks established by the new economic governance framework;
(iv) assessing the consistency, coherence and effectiveness of the national budgetary framework;
(v) participating in hearings and discussions in the national Parliament, if invited.

To fulfill the tasks specified in points (i) to (iv), independent fiscal institutions will conduct and publish evaluations. Member states are required to comply with these evaluations or publicly explain why they do not adhere to them.

The provisions of the directive are to be transposed into national legislation by December 31, 2025. By this date, the EC will also present a report on the capacity and tasks of independent fiscal institutions in the EU.

[140] Dăianu, D. 2023. A New EU Economic Governance and Fiscal Framework: what role for the national independent fiscal institutions (IFIs)?, *SUERF Policy Brief*, 532, February, https://www.consiliulfiscal.ro/IFIs%20role.pdf; Dăianu, D. 2024. National independent fiscal institutions need to be stronger to perform effectively. *Intereconomics*, 59(2), 112-118, https://www.consiliulfiscal.ro/2024%20-%2001%20-%2018%20ian%20-%20National%20Independent%20Fiscal%20Institutions%20(IFIs)%20need%20to%20be%20stronger.pdf

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Appendix – Glossary of terms

Adjustment program – a detailed economic program, usually supported by IMF resources, that is based on an analysis of the economic problems of the member country and specifies the policies implemented or that will be implemented by the country in the monetary, fiscal, balance of payments and structural areas to set the basis for economic stabilization and sustainable economic growth.

Aggregate demand – total expenditures of internal and external users for acquiring final goods and services produced in an economy. It is computed as the sum between internal demand and exports of goods and services.

Aggregate supply – represents all goods and services offered on the domestic market by all domestic and foreign operators. In other words, the aggregate supply is the total domestic production of economic goods plus foreign countries offer (imports).

Annual spending ceiling – the maximum amount, set by law, that can be allocated to a certain category of government spending in one year.

Arrears of the general consolidated budget – money loans or debt that have become overdue for more than 90 days following the breach of a contract between economic entities and the state as a result of contractual terms' violations.

Automatic disengagement – part of the budgetary commitment that is automatically disengaged by the European Commission if it remains unused or if no request for payment is received by the end of the third year after the budgetary commitment. The difference between the two values (the one allocated and the one forwarded to the Commission for reimbursement) is lost through the automatic disengagement procedure.

Automatic stabilizers – tools for self-regulating the economy with the aim of reducing economic fluctuations; for example: taxation in proportional percentage rates, social benefits for unemployment.

Balance of payments – accounting record describing the transactions concluded between a country and its external partners in a specified period of time.

Balance of the general consolidated budget – indicator computed as the difference between total public revenues and total public expenditures.

Base point – unit of measure for the interest rate, equivalent to 0.01%.

Budget revision – operation through which the budget is amended during a budgetary year.

Budgetary policy – financial policy of the state regarding budget expenditures; public resource allocation policy.

Buffer – a reserve established by the Ministry of Finance in the Treasury in order to cover in advance the financing needs and which serves to protect against the event of adverse conditions in financial markets.

Capital account – flows of capital transfers and acquisitions /sales of non-financial and intangible assets.

Cash methodology – involves recording revenues when they are actually received and recording expenditures at the time of payment.

Classification by function – the classification of expenditures based on their destination, in order to assess public funds allocations.

Clawback tax – charge imposed on the pharmaceutical industry that requires all manufacturers of medicinal products to help the funding of the public health system with part of the profits made from sales of subsidized drugs in excess of their allocated quota from the national health fund.

Cohesion Fund – financial instrument supporting investments in transport infrastructure and environment.

Conditionalities – economic policies that members intend to follow as a condition for the use of IMF resources. These are often expressed as performance criteria (for example, monetary and budgetary targets) or benchmarks, and are intended to ensure that the use of IMF credit is temporary and consistent with the adjustment program designed to correct a member's external payments imbalance.

Consolidation – the operation of eliminating transfers between two component budgets of the general consolidated budget, in order to avoid their double accounting.

Contagion – the transmission of shocks to several economic sectors, internally and abroad.

Contingency reserve fund – amount of money available to the Government, which is allocated to main authorizing officers from central and local budgets, based on the Government's decisions to finance urgent or unforeseen expenditures incurred during the year.

Contribution – compulsory imputation of a share from the revenues of employees or firms, with or without the possibility of obtaining a public service in exchange.

Countercyclical fiscal policy – fiscal policy behaviour which has the role of stabilizing the economic cycle and helps to reduce cyclical fluctuations and inflationary pressures from excess demand.

Country risk premium – additional return required by an investor to compensate for the increased risk posed by a certain investment in a country. This is reflected in CDS quotations which measure the cost of insuring against default risk.

Current account deficit – occurs when total imports of goods, services and transfers to a country exceed exports of goods, services and transfers from that country; in this case, that country becomes a net debtor to the rest of the world.

Cyclical adjustment of budget revenues – elimination of the budget revenues' component dependent on the demand excess/deficit (economic expansion/contraction), eliminating trend deviations; the level of cyclically adjusted budget revenues is the level that would have been collected if the GDP reached its potential growth.

Cyclical component of budget balance – modification of the budget balance due to cyclical developments in the economy.

Cyclically adjusted budget balance – the balance of the general consolidated budget, net of the cyclical component. It is a measure of the fundamental trend in the budget balance.

Direct public debt – total public debt, except for guaranteed public debt.

Disinflation – the process of reducing inflation.

Economic classification – the classification of expenditures based on their economic nature and effect.

ESA 2010 methodology (*European System of National and Regional Accounts*) – accounting reporting framework used internationally for a systematic and detailed description of an economy (region, country or group of countries), or its components and relationships with other economies. The main difference between ESA 2010 methodology and the cash methodology is that revenues and expenditures are recorded in "accrual" system (based on commitments, not actual payments as in the cash system). ESA 2010 methodology replaced ESA 95 methodology, being adopted in 2013.

Euro Plus Pact – it is also known as the Competitiveness Pact and its objective is the stability of euro area, Member States committing themselves to take measures to encourage competitiveness, employment and consolidation of public finances.

European Agricultural Guarantee Fund – European funds for the implementation of support measures for farmers.

European Regional Development Fund – Structural Fund which supports the less developed regions by financing investments in the productive sector, infrastructure, education, health, local development and small and medium enterprises.

European semester – additional tool for the preventive surveillance of economic and fiscal policies of the Member States; it is an annual cycle of economic and budgetary policy coordination, which takes place in the first six months of the year, in order to identify any inconsistencies and emerging imbalances of economic and fiscal policies that would violate the rules set out in the Stability and Growth Pact.

European Social Fund – Structural Fund for Social Policy of the European Union, which supports employment measures for labour and human resource development.

Eurosystem – the central banking system of the euro area. It comprises the European Central Bank and the national central banks of EU Member States from the euro area.

Excessive Deficit Procedure – the corrective arm of the Stability and Growth Pact that imposes penalties in cases of no prompt correction of excessively high deficits (having breached or being in risk of breaching the deficit threshold of 3% of GDP at market prices) or excessively high debt (having violated the debt rule by having a government debt level above 60% of GDP, which is not diminishing at a satisfactory pace. This means that the gap between a country's debt level and the 60% reference needs to be reduced by 1/20th annually on average over three years).

Exchange Rate Mechanism II – the exchange rate arrangement established on January 1, 1999 that provides a framework for exchange rate policy cooperation between the Eurosystem and EU Member States that are not in the euro area. Although membership in ERM II is voluntary, Member States with derogation are expected to join. This involves establishing both a central rate for their respective currency's exchange rate against the euro and a band for its fluctuation around that central rate. The standard fluctuation band is ±15%, but a narrower band may be agreed on request.

Excise duty – special consumption tax applied to domestic and imported products, borne by consumers and included in the sale price of certain specific commodities.

Expansionary fiscal policy – fiscal policy behaviour that has an accelerating effect on aggregate demand growth and may lead to an amplification of inflationary pressures.

Expansionary monetary policy – monetary policy that stimulates aggregate demand and a possible amplification of inflationary pressures.

Fee – amount paid as remuneration for services provided by an economic agent or a public institution.

Final consumption – component of the aggregate demand which includes private consumption and government expenditures for public goods and services.

Financial account – flows of transactions associated with ownership change regarding the assets or liabilities of a country. It includes foreign direct investments, portfolio investments, financial derivatives, other capital investments and reserve assets.

Fiscal Compact – part of the Treaty on Stability, Coordination and Governance signed on March 2, 2012 by all EU member states, except for the United Kingdom and Czechia. The treaty is aimed at strengthening fiscal discipline by introducing an automatic correction mechanism and stricter surveillance. The fiscal compact establishes a requirement for national budgets to be in balance or in surplus. This criterion is met if the annual structural government deficit does not exceed 0.5% of GDP at market prices. If public debt is significantly below 60% of GDP and risks posed to long-term public finance sustainability are low, the structural deficit may reach a maximum level of 1% of GDP.

Fiscal consolidation – policy aimed at reducing budget deficits and the accumulation of public debt.

Fiscal impulse – the impact of discretionary fiscal policy on aggregate demand. It is computed as the change of structural balance relative to the previous period; a positive value corresponds to an expansionary fiscal policy and a negative value to a restrictive fiscal policy.

Fiscal policy – policy that aims to influence the economy using the tax system.

Fiscal rule – a long-term constraint on fiscal policy through numerical limits on budgetary aggregates. Fiscal rules are intended to avoid pressure from incentives and excessive spending, especially in the upward phase of the economic cycle so as to ensure accountability in the management of public finances and public debt sustainability.

Fiscal space – 1. the difference between current public debt and a threshold of public debt that does not involve increasing costs for financing the deficit and which takes into account the historical evolution of fiscal adjustment; 2. financial resources available for additional expenditures required to implement development projects.

Fiscal strategy – public policy document designed to set out fiscal objectives and priorities, revenue and expenditure targets of the general consolidated budget and its components and the evolution of the budget balance for a three-year period.

Fiscal sustainability – a set of policies is said to be sustainable if the state is able to meet its debt payments without any major additional correction in the budget balance.

Fiscal/Tax revenues – budget revenues collected through taxation. Fiscal revenues include: personal income taxes, corporate income taxes, capital gain taxes, property taxes and fees, goods and services taxes and fees, taxes on foreign trade and international transactions, other taxes and fees, social security contributions.

GDP deflator – an indicator that reflects the change in prices of the goods and services composing the GDP; it is computed as a ratio between GDP in current prices and GDP in prices of the base year.

GDP deviation – an indicator that measures the difference between the actual GDP of an economy and its potential GDP. It is also known as output-gap.

General consolidated budget – the set of budgets (provided in art. 1 para. (2) of Law 500/2002 on Public Finances, to which local budgets are added), aggregated and consolidated to form a whole.

Guaranteed public debt – loans guaranteed by the Ministry of Finance and local government authorities.

Harmonized Index of Consumer Prices – consumer price index whose methodology has been harmonized between EU countries; the inflation objective of the European Central Bank and the euro area inflation rate are expressed based on this index.

Implicit tax rate – the ratio between the actual collected revenue for a specific type of tax and the corresponding macroeconomic tax base.

Inflation – reflects the widespread and persistent increase in prices and it is typically measured by the consumer price index.

Inflation target – is set by central banks that have adopted the inflation targeting strategy. The target can be set as a fixed level of inflation and/or as a range. The National Bank of Romania sets the target as a midpoint within a target band of +/- 1 pp.

Informal economy – legal economic activity, but hidden from public authorities in order to avoid paying taxes, social security contributions or to avoid compliance with legal standards on labour and with other administrative procedures.

Medium Term Objective – is the medium-term objective for the budgetary position and differs for each EU Member State. For states that have adopted the euro or are in the Exchange Rate Mechanism II, it is -1% of GDP or a budget surplus. Reassessment of medium-term objectives is done every four years or when a major structural reform is adopted.

Monetary policy interest rate – the interest rate used for the main operations of the NBR. At present, these are one-week repo operations, established by fixed interest rate auctions.

Nominal convergence criteria (Maastricht) – the four criteria set out in Article 140 (1) of the TFEU that must be fulfilled by each EU Member State before it can adopt the euro, namely: 1) the inflation rate must not exceed by more than 1.5 pp the average of the three best performing EU countries in this respect; 2) the long-term nominal interest rate must not exceed by more than 2 pp the average interest rate in the first three member states with the best performance in terms of price stability; 3) the public budget deficit must be less than 3% of GDP, the public debt to GDP ratio must be less than 60%; 4) exchange rate fluctuations must not exceed +/- 15% in the last two years preceding the examination.

Nominal variables – variables expressed in current prices.

Non-fiscal/Non-tax revenues – other budget revenues that do not include taxation, such as royalties, payments from SOEs’ profit, fines, charges.

One-off component of the budget balance – component of revenues or expenditures that has a temporary nature.

Pillar 1 of the pension system – the name given to the state pension system; it has a compulsory character and is based on the redistribution of money collected during a financial year, the “pay as you go” system (present employees pay for the currently retired population).

Pillar 2 of the pension system – name given to the private pension system; it has a compulsory character for employees below the age of 35 years at the time of its introduction (2007) and aims to provide a private pension that supplements the public pension. Contributions to private pension funds are nominal and immediately after they are paid into the employee’s account, they become his property.

Potential GDP – real GDP that can be produced by the economy without generating inflationary pressures. Potential GDP is determined by long-term fundamental factors such as organization of the economy and the productive capacity determined by technology and demographic factors that affect labour etc.

Primary balance of the general consolidated budget – the difference between total budget revenues and expenditures, excluding the interest payments with regard to public debt.

Primary structural budget deficit – structural budget deficit net of the "non-discretionary" component of the budgetary policy - interest expenses related to public debt; it is used in the analysis of the sustainability of fiscal policy.

Pro-cyclical fiscal policy – fiscal policy behaviour that does not fulfil a stabilizing role of the economic cycle but rather contributes to amplifying cyclical fluctuations and inflationary pressures from excess demand.

Proxy – a variable that estimates/approximates and replaces another variable, an unobservable one.

Quasi-fiscal deficit – takes into account public sector expenditures not recorded into the budget; particularly, it refers to the losses of state-owned enterprises which translate in the default of their financial obligations to the public budgets and public utilities.

Real convergence – reaching a high degree of similarity and cohesion of economic structures of the candidate countries; although the Maastricht Treaty does not mention real convergence criteria, these can be summarized by a series of economic indicators like GDP per capita, the openness of an economy, the share of trade with Member States in foreign trade, the structure of the economy.

Real GDP – represents the value of final goods and services produced in an economy in a given period, adjusted for price increases. Real GDP dynamics is used to measure the economic growth of a country.

Real variables – variables expressed in constant prices (the prices of a base year).

Reference interest rate – starting with September 1, 2011, the NBR's reference interest rate is the monetary policy interest rate, established by decision of the NBR's Board of Directors.

Relevant macroeconomic basis – macroeconomic aggregate on which proceeds from a certain category of budget revenues depend.

Restrictive monetary policy – monetary policy behaviour that constrains the aggregate demand in order to reduce inflation.

Royalty – payment to the holder of a patent, copyright or resource for the right to use their property.

S0 – an "early detection indicator" which is designed to highlight shorter term risks of fiscal stress (within a 1-year horizon) through the "signals approach".

S1 – indicator of the sustainability gap that shows the required increase in taxes or decrease in expenditures (as a percentage of GDP) subject to a debt level of 60% of GDP at the end of the period.

S2 – indicator of the sustainability gap that indicates the required fiscal effort (as a percentage of GDP) subject to the inter-temporal budget constraint on an infinite time horizon.

Seasonality – periodic pattern in the evolution of an economic variable that systematically appears at certain times of the year.

Stability and Growth Pact – consists of two EU Council Regulations, on "the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies" and on "speeding up and clarifying the implementation of the excessive deficit procedure", and of a European Council Resolution adopted at the Amsterdam Summit on June 17, 1997. More specifically, budgetary positions close to balance or in surplus are required as the medium-term objective for Member States since this would allow them to deal with normal cyclical fluctuations while keeping their government deficit below the reference value of 3% of GDP. In accordance with the Stability and Growth Pact, countries participating in EMU will submit annual stability programs, while non-participating countries will provide annual convergence programs.

Stand-by Arrangement – an arrangement for an IMF member through which the country is assured that it will be able to make purchases (drawings) from the General Resources Account up to a specified amount and during a specified period of time, usually one to two years, provided that the member respects the terms set out in the supporting arrangement (see **Conditionalities**).

Stock-flow adjustment of public debt – process that ensures consistency between changes in the debt stock and net lending flows. It takes into account accumulation of financial assets, changes of foreign currency debt and statistical adjustments.

Structural budget balance – is determined by subtracting the temporary elements (one-offs) from the cyclically adjusted budget balance.

Structural budget deficit – the budget deficit that would be recorded if GDP was at its potential level; it is the size of the deficit recorded in the absence of business cycle influences.

Swap – chain compensation scheme for outstanding obligations to the general consolidated budget; operation that implements the extinction of outstanding budgetary obligations, with equivalent impact on revenues and expenditures.

Tax – compulsory and non-refundable levy, without immediate and direct compensation, charged by a public authority with the purpose of financing public goods and services.

Taxation efficiency index – index through which it is measured the effectiveness of tax collection. It is computed as the ratio between the implicit tax rate and the statutory tax rate.

Trade balance – section of the balance of payments that records the difference between exports and imports of goods and services made in a certain period of time.

Voluntary compliance – principle under which taxpayers will comply with the tax laws and, more importantly, will accurately report income and the deductions they benefit from, without direct compulsion by the authorities empowered to do so.