Fiscal Council of Romania

Fiscal Council's Opinion on the First Budget Revision for 2024

Summary

- The execution of the public budget has highlighted flaws in its construction for this year, including an initially projected budget deficit of 5% of GDP. The Fiscal Council pointed out the lack of realism in the budget deficit in its evaluation of the 2024 budget draft.
- Romania has one of the highest budget deficits in the EU, and the fact that seven other countries have also come under the excessive deficit procedure should not provide comfort to our authorities. Romania suffers from the "twin deficits" syndrome, with large external imbalances (trade balance and current account) that are significantly financed through external borrowing. Romania has the largest current account deficit as a percentage of GDP among the Central and Eastern European countries and is not in the Eurozone, which implies a currency risk.
- It is a risky statement to claim that deficits are explained by investments and that they are sustainable; the effects of investments depend on their composition, on the extent to which they develop the production of exportable goods and those that can replace imports (the so-called *tradables*). Additionally, a large portion of European resources is reflected in the public budget on both the expenditure and revenue sides. The Draghi report emphasizes the need for quality, future-oriented investments in the EU.
- A 7-year structural budget plan makes sense, given the size of the deficit and the impact of structural reforms. The correction cannot be achieved overwhelmingly through expenditures cuts; a significant increase in budgetary (fiscal) revenues is needed, including through changes in the tax system, a drastically reduction in the VAT collection gap, the expansion of the tax base, and combating tax evasion and tax optimization practices.
- The Fiscal Council has frequently mentioned that Romania has among the lowest fiscal revenues (including contributions) in the EU – around 26-27% of GDP. This level is completely inadequate given the increasing pressures on the budget resulting from the effects of climate change (see also this year's floods), the need to invest more in education and healthcare, defense, physical infrastructure, and to create fiscal space.

- Financial markets can “freeze” again for various reasons, and countries caught off guard (with large deficits) pay a high price. Romania has already gone through a bitter episode as a result of the 2008-2009 financial crisis.
- Romania has important strengths: it has achieved considerable real convergence (GDP per capita at purchasing power parity has reached 78% of the EU average), it has a multi-sector economy, it is an EU member state, and it benefits from massive transfers of European funds. However, economic hardships cannot be avoided if we do not correct the large budget deficits, which could propel public debt well above 60% of GDP. Economic rationale and the new fiscal governance framework in the EU demand the correction of the budget deficit.
- Recent macroeconomic data shows a slowdown in the economy. The macroeconomic scenario underlying the budget revision could be burdened by the risk of overestimating the dynamics of real growth. A rapid increase in investments can be noted in the new official forecast, despite a diminished role of these investments in GDP growth. The significant increase in consumption, driven by wage and pension developments, has simultaneously led to a widening of the external imbalance.
- Economic growth in Romania is not robust because it relies on significant internal and external imbalances.
- The budget execution for the first 7 months of 2024 recorded a cash deficit of approximately 71 billion lei, equivalent to 4.02% of GDP, which is 1.6 percentage points higher than the deficit recorded in the first 7 months of 2023 and represents about 81% of the deficit projected for the entire year 2024. After 8 months, the budget deficit stands at 4.53% of GDP.
- The budget revision foresees a significant nominal increase in both budget revenues and expenditures. The estimated level of the deficit of the general consolidated budget is 6.94%, about 1.94 percentage points higher than the target in the original budget draft.
- On the revenue side, the budget revision maintains the projection of 10.5 billion lei from digitalization, which translates into an overestimation of budget revenues by 0.6% of GDP. Additionally, there is a degree of uncertainty regarding the impact of the tax amnesty, estimated at 7.9 billion lei, equivalent to about 0.45% of GDP.
- The analysis of budget expenditure categories indicates a possible underestimation of expenditures for goods and services (by about 0.2% of GDP) and for subsidies (by about 0.3% of GDP). Additionally, there are risks concerning the social assistance aggregate, given the uncertainties related to the impact of pension recalculations in the public system.
- Based on the new data, the Fiscal Council estimates that the cash budget deficit will be around 8% of GDP in 2024, consistent with the analysis in its annual report.
- Given the government’s negotiations with the European Commission regarding Romania’s structural budget plan, within the context of the new economic governance framework in the European Union, it is possible that some expenditures may be further reduced,

potentially resulting in a deficit slightly below 8% of GDP. On the other hand, underestimating the risks generated by rapidly increasing expenditures could lead to a deficit significantly above 8% of GDP.

- The government should strictly control expenditures for the remainder of the year. As in previous years, postponing certain payments does not resolve the structural problems of the public budget.
- According to the budget revision, total investment expenditures, from both internal and external sources, are estimated at 6.8% of GDP. Structurally, investments financed from internal resources account for 40.9% (compared to 31.2% in the initial budget proposal), while investments financed from European funds account for 59.1%.
- The absorption of European funds in the first 8 months of 2024 was limited to reimbursements totaling approximately 2.5 billion euros from the 2014-2020 Multiannual Financial Framework (benefiting from the N+3 rule). For the 2021-2027 Multiannual Financial Framework, the absorption rate of structural and cohesion funds was zero as of August 2024. Regarding the Recovery and Resilience Facility (NRRP), the third payment request submitted in December 2023, amounting to approximately 2 billion euros, is still under evaluation by the European Commission. This highlights institutional weaknesses in attracting and absorbing European funds.
- Romania risks developing a dependence on European funds that could prove dangerous. This is particularly concerning because the Recovery and Resilience Facility (NRRP) has a limited lifespan (until August 2026), and structural and cohesion funds will enter a different allocation logic. Additionally, Romania’s GDP per capita is expected to reach a level that will no longer entitle it to receive net funds on the same scale as in the last decade (as a percentage of GDP).

Fiscal Council’s Opinion on the First Budget Revision for 2024

On September 19, 2024, the Ministry of Finance (MF) sent to the Fiscal Council (FC), by address no. 467144/19.09.2024, the Report on the economic and budgetary situation for the first six months of 2024, the draft revision to the 2024 general consolidated budget, the explanatory note and the draft of the Government Emergency Ordinance on the revision of the 2024 state budget, as well as the explanatory note and the draft of the Government Emergency Ordinance for the revision of the 2024 social security budget, requesting, based on Article 53, para. (2) of the Fiscal Responsibility Law (no. 69/2010, republished, hereinafter referred to as FRL), the opinion of the Fiscal Council.

According to Article 53, para. (4) of the FRL, the Government and Parliament have the obligation to analyze the opinions and recommendations of the Fiscal Council when they draft the Fiscal Strategy, the annual budget laws, as well as other measures determined by the implementation of this law and, respectively, when they approve them.

1. General considerations

The budget revision announced by the Government is necessitated by the course of budget execution; it is, at the same time, a natural exercise of transparency in budgetary policy.

The execution of the public budget has illustrated flaws in its construction for this year, including a budget deficit initially projected at 5% of GDP. Without a revision with the official increase of the deficit to 6.94% of GDP, there is a risk that the state will fail to meet some basic current obligations. The Fiscal Council has pointed out in its evaluation of the 2024 budget draft the lack of realism regarding the budget deficit.

The international environment is very complicated, with wars affecting large regions of the globe and increasingly acute geopolitical tensions. The fragmentation of the global economy continues, and military security considerations are reflected in budget constructions and restructuring in resource allocation.

A decrease in the monetary policy rate does not automatically mean a relaxation of monetary conditions, as inflation has significantly decreased in Europe; there is a slowdown in the major European economies, which affects Romania’s exports.

Romania has one of the highest budget deficits in the EU, and the fact that 7 other countries have also fallen under the excessive deficit procedure should not be a comfort for our authorities. Romania suffers from the “twin deficits” syndrome, with significant external imbalances (in trade balance and current account), relying heavily on external borrowing for financing. Romania has

the largest current account deficit as a percentage of GDP among the countries in Central and Eastern Europe and is not in the Eurozone, which implies currency risk.

It is a risky statement to claim that deficits are explained by investments and that they are sustainable; the effects of investments depend on their composition, on the extent to which they develop the production of exportable goods and those that can replace imports (the so-called *tradables*). Additionally, a large portion of European resources is reflected in the public budget on both the expenditure and revenue sides. The Draghi report emphasizes the need for quality, future-oriented investments in the EU.

Deficits (internal and external) are a vulnerability that must be addressed through macroeconomic correction. A seven-year structural budget plan makes sense, given the size of the deficit and the impact of structural reforms. The correction cannot primarily be achieved through expenditures cuts; there is a need for a significant increase in budgetary (fiscal) revenues, including changes in the tax regime, a drastic reduction in the VAT collection gap, an expansion of the tax base, and combating tax evasion and tax optimization.

The Fiscal Council has frequently mentioned that Romania has one of the lowest tax revenues (including contributions) in the EU – around 26-27% of GDP. This is a completely inadequate level considering the increasing pressures on the budget stemming from the effects of climate change (see also the floods this year), the need to invest more in education and health, defense, physical infrastructure, and to create fiscal space.

Financial markets can "freeze" again for various reasons, and countries that find themselves in a difficult position (large deficits) are paying a high price. Romania has gone through another bitter episode as a result of the effects of the 2008-2009 financial crisis.

Romania has significant advantages: it has achieved considerable real convergence (GDP per capita at purchasing power parity has reached 78% of the EU average), it has a multi-sectoral economy, it is a member state of the EU, and it benefits from massive transfers of European funds. However, economic hardships cannot be avoided if we do not correct large budget deficits, which could catapult public debt well above 60% of GDP. The economic rationale and the new framework for fiscal governance in the EU call for the correction of the budget deficit.

2. The macroeconomic framework underlying the first budget revision in 2024

In analyzing the first budget revision of this year, the Fiscal Council starts, similar to previously expressed opinions, from both the general economic coordinates for Romania that are relevant from a fiscal perspective – mainly encompassed by the macroeconomic projections of the National

Commission for Strategy and Prognosis (NCSP) from September 18, 2024[1] –, and from the international context.

The assessment of the plausibility of the evolution of the gross domestic product (GDP) starts from the latest data published by the National Institute of Statistics. Thus, the provisional data 1[2] regarding GDP for the second quarter of 2024 indicates a significant deceleration in economic growth, with the real GDP variation being 0.1% quarter-on-quarter and 0.8% year-on-year, both values lower than the averages of the recent period. In the first semester, the year-on-year economic growth is 0.7%. From the perspective of the method of formation/production of GDP, the growth of 0.8% is reflected in: contributions of 0.3 pp from the sectors (i) agriculture and (ii) cultural, entertainment, and recreational activities, (iii) construction contributes with 0.2 pp, while (iv) net tax on products account for 0.4 pp, all of which are offset by negative contributions of 0.1 pp from the sectors (v) industry, (vi) information and communications, a negative influence of 0.2 pp from the real estate transactions sector, and a null contribution from the sectors (vii) professional, scientific, and technical activities, as well as (viii) public administration and defense. On the usage side of GDP/expenditure method, in Q2 2024, the growth of 0.8% is reflected in: (i) actual final consumption – contributing 5 pp, (ii) gross fixed capital formation with 1.4 pp, both offset by the negative contribution of (iii) inventory variation with 1.2 pp, and (iv) net exports which reduce overall real economic growth by 4.4 pp, due to a rapid increase in imports relative to exports (exports are decreasing at a nominal rate, thus having a negative contribution to economic growth of 1.4 pp, while imports are rising by 5.8%, resulting in a negative contribution to economic growth of 3 pp). The indicators reported by the National Institute of Statistics with greater frequency confirm the trends within the GDP data and anticipate a potentially more unfavorable development, at least in the industrial and construction sectors, and possibly also in agriculture – due to the drought. All of this could indicate a trend of slowing economic activity in the last two quarters of the year, which could bring real economic growth for the entire year of 2024 to a value in the range of 1-2%. In light of these trends, the reduction of the economic growth forecast by the National Commission for Prognosis, which underpins the fiscal projections included in the revision, to a value of 2.8% in the Summer 2024 forecast, compared to 3.4% in the Spring 2024 forecast (-0.6pp), is welcome. However, a cautious forecast of economic growth for this year – desirable, given the current difficult fiscal circumstances, in order not to distort the fiscal projection – has, as its center of gravity for probable trajectories, a lower value. Consequently, the forecast for real GDP seems slightly overestimated.

The current forecast of the NCSP regarding the GDP deflator is 7.2% – within the Summer projection – revised upwards (+0.7 pp) from 6.5% in the previous Spring projection. This review, starting from the high values of the GDP deflator in the first two quarters of the year – 9.7% in Q1

[1] Summer forecast 2024, Projection of key macroeconomic indicators 2024-2028, September 18, 2024, https://cnp.ro/wp-content/uploads/2024/09/Prognoza-2024-2028-varianta-de-vara-2024.pdf

[2] Published on September 6, 2024.

2024 and 8.5% in Q2 2024 – appears to be in the opposite direction of the historical trend we can observe for this indicator, as well as contrary to the evolution of inflation (which dropped to 5.1% in August 2024, and is expected to decrease even further towards the end of 2024) calculated through the consumer price index (CPI), as well as through the industrial producer price index (IPPI, which increased by only 2.6% in July 2024). Under these conditions, there seems to be a slight overestimation at the level of the GDP deflator as well.

Given the recent increased volatility of economic indicators, amid the turning points of certain indicators, slight overestimations of these indicators are relatively plausible. However, the fact that these are composed at the nominal GDP level makes the likelihood of a nominal GDP increase of 10.2% in 2024 relatively lower, with smaller values of this nominal increase being more plausible. Consequently, the FC believes that at the level of nominal GDP evolution, the projection is overestimated, likely leading to an underestimation of the fiscal sector situation and the deficit (both through a denominator effect and through faster developments in the fiscal macroeconomic bases, which are particularly at the core of the revenue projection).

To these considerations, the analysis of the composition of economic growth is also added. Thus, the growth of real final consumption (expected to increase by 4.5% for 2024, revised from 4% previously – in the NCSP Spring forecast) and gross fixed capital formation (+5.8% in the current projection, a downward revision from +6.1% in the Spring forecast) falls within a range of plausible values, the latter determined based on recent economic trends and the evolution of high-frequency indicators. However, the "*tax rich*" composition[3] of the projected economic evolution, combined with a faster growth of nominal GDP, is likely to lead to both more significant budget revenues from taxes and a lower value of the indicators reported to GDP, due to a denominator effect. Considering all these effects, the FC believes that the projected developments are plausible, even if they fall within a higher probability distribution range for the analyzed indicators.

Regarding the labor market, the NCSP anticipates in the current projection a 0.9% increase in the number of employees in 2024 (a downward revision from +1.5% in the Spring 2024 forecast) and an increase in the average gross salary of 14.6% (an upward revision from 10.8% previously). Regarding the unemployment rate, the indicator that considers registered unemployed individuals (relevant in terms of unemployment benefit expenditures) is projected at a value of 3.1% (up from 2.8% previously, a slight upward revision). Corroborating this information with recent developments in the labor market – highlighted by higher frequency indicators, such as the average gross salary[4], for example –, as well as with the measures already implemented, the FC believes that the values of the indicators appear plausible, outlining a probable evolution

[3] One way to illustrate the tax rich composition could be to compare (i) a consumption-based growth (or internal absorption) with (ii) an export-based growth. The first leads to the collection of more taxes for each percentage of economic growth, while the second situation results in lower revenues (for example, exports are not subject to VAT).
[4] This has increased, according to the press release from the National Institute of Statistics on September 12, 2024, to 8580 lei, a rise of 17.3% compared to the same month in 2023.

regarding the salary envelope in the economy, which underpins the projection of income tax and social security contributions – two of the most important sources of revenue for the general consolidated budget.

However, the macroeconomic forecast also highlights some risk elements, determined by the slight overestimation of nominal GDP, the tax-rich composition of the economic growth structure, as well as the rapid increase in investments in the forecast, despite their slightly diminished role in GDP growth in favor of consumption in recent times. The rapid increase in consumption, influenced by developments in private sector wages and measures that have raised public salaries and pensions, has simultaneously led to a widening of the external imbalance – evident in a 34% increase in the current account deficit of the balance of payments in the first seven months of 2024, compared to the same period in 2023.

The dynamics of external imbalances outline a significant role of consumption in a slowing economic growth and emphasize the relatively high cost of this growth in terms of economic imbalances – particularly external (the current account deficit of the balance of payments), but also internal (inflation). From this angle of analysis, investments play an important role in generating economic growth, but their historical contribution should not be fetishized or absolutized. Investments represent a healthy foundation for economic growth[5] – as economic theory also demonstrates –, but recent developments in economies, both at the European and regional levels, reveal some vulnerabilities: (i) the source of financing for investments matters; if it is done by increasing the deficit and, implicitly, a need for financing for a budget that has already reached its upper limit, an additional impulse may cause problems in the flow of financing and/or excessive costs, with the final effect potentially being the opposite of what was intended; (ii) the destination/multiplier of these investments is very important; well-selected, efficient projects that multiply the added value generated in the economy are an essential condition for the sustainability of a high investment rate – recent history provides examples of public investments with lower multipliers/efficiency, as well as successful examples – large parts of public investments in CEE countries being the result of European funds (about half in Romania); (iii) thus, the absorption of multiannual European funds and those from the National Recovery and Resilience Plan (NRRP) is a *sine-qua-non* condition for accelerated economic development, necessary for real convergence; (iv) the correlation of the investment rate with the savings rate – reflected by the external deficit of the current account of the balance of payments – is another important indicator of the sustainability and efficiency of investments. The extrapolation of the current account deficit trend from the first 7 months leads to a current account deficit in the balance of payments for the entire year of 2024 exceeding 7% and, with a significant probability, close to 8% of GDP. Another finding that emerges from the balance of payments figures for the first seven months is that the coverage of the current account deficit with autonomous sources is lower, at only 28.4%, compared to 55.2% at the same time (cumulative for seven months) in 2023. Autonomous funding

[5] At least until reaching an "optimal" level of capital endowment of the workforce.

sources are generally considered to be equal to the balance of the capital account as well as, from the financial account, only "*equity participations*" (which, in turn, include only equity participations from foreign direct investment, excluding profit reinvestment, but without debt instruments). Ultimately, it is essential that a large part of the investments develop the production of *tradables*. A high rate of public investment (and capital expenditures), which results in a large budget deficit, offset by a significant private domestic savings rate, leading to small deficits or even a surplus in the current account of the balance of payments – as is the case for most CEE countries, with the exception of our country – combined with relevant real GDP growth rates, signals the sustainability of this macroeconomic situation. A developed financial sector, capable of making the financial accelerator operational, is particularly important for investments and significantly boosting economic growth. However, such development depends on fiscal and trade discipline regarding the capitalization of firms in the economy; deficiencies in this regard can undermine both the efficiency of tax revenue collection and the creditworthiness of firms – leading to a blockage, due to demand, of financing in that economy.

3. Updated coordinates of budget revenues and expenditures

The analysis of the revision project starts from the initial budget construction, which had a deficit target of 5.00% of GDP, according to cash methodology. In its opinion on the budget draft, based on the macroeconomic framework projected at that time and a cautious approach to revenues and expenditures, the FC assessed the cash budget deficit at around 6.4%. Based on the available information, the FC identified an overestimation of budget revenues by approximately 19 billion lei and a need for additional allocations at the level of expenditures on goods and services and social assistance amounting to about 4.5 billion lei. The FC emphasized that it is not prudent to include hypothetical revenues in the budget construction that are based on the increase in collection efficiency/reduction of tax evasion/digitalization of NAFA (National Agency for Fiscal Administration). Additionally, considering the discretionary salary increases in the public system granted in 2023, the uncertainties regarding the impact of pension recalculations, as well as the electoral context in 2024, the FC has indicated that there are additional risks concerning personnel expenditures, interest expenditures, and social assistance expenditures.

The first part of 2024 saw the adoption of measures that had a negative impact on budget execution, confirming risks highlighted by the FC. Specifically, the Government adopted a series of emergency ordinances, through which it increased salaries in several public sectors, relaxed some of the measures related to public spending included in Law no. 296/2023 regarding certain fiscal-budgetary measures to ensure Romania's long-term financial sustainability, and raised the amount of the gross minimum monthly salary for which income tax and mandatory social contributions are not owed from 200 to 300 lei. Additionally, the budget arrears of about 9 billion lei, created by the postponement of some payments at the end of 2023, have significantly amplified budget expenditures. Some measures can find justifications in such complicated times and social pressures, but there must be limits to the expansion of the budget deficit.

In this context, the budget execution for the first 7 months of 2024 recorded a cash deficit of approximately 71 billion lei, equivalent to 4.02% of GDP, which is 1.6 pp higher than the deficit recorded in the first 7 months of 2023 and represents about 81% of the deficit planned for the entire year of 2024. The deficit for the first 8 months is 4.53% of GDP, which shows how difficult it is for the Government to keep expenditures under control.

In the first 7 months, budget revenues have performed better than expected: +15% compared to the same period in 2023, while the projection outlined in the 2024 budget, compared to the previous year's execution, was 12.4%. This dynamic was supported by the increase in the GDP deflator, which exceeded the estimate on which the budget was based (in the first half of 2024, the GDP deflator was 9%, compared to 5.9%, the value on which the budget was constructed), allowing for a counterbalance to the slower pace of economic growth (the first half recorded an economic growth of 0.7%). In addition, in the first seven months, the average gross monthly salary was 16.4% higher than that recorded in the previous period, exceeding the growth estimate of 9.1% from the budget draft. We must also consider the additional revenue from the turnover tax on companies with a turnover exceeding 50 million euros (approximately 2 billion lei in the first semester), the turnover tax collected from credit institutions (around 320 million lei in the first semester), the specific turnover tax from economic agents in the oil and natural gas sectors (about 148 million lei in the first semester), and the introduction of the excise tax on the sale of sugary non-alcoholic beverages (approximately 253 million lei in the first semester).

The dynamics of budget revenues was more than offset by the scale of budget expenditures. The growth rate of budget expenditures was +23.2%, while the increase projected in the budget for 2024, compared to the execution of the previous year, was only 10%. Additionally, the magnitude of the pension recalculation effect, the seasonality of budget execution, characterized by the concentration of certain categories of expenditures in the last months of the year, as well as the adoption of measures with a negative impact on budget revenues – for example, the increase of the non-taxable amount applied to pension incomes from 2,000 to 3,000 lei – will negatively influence budget execution in the latter part of the year. To mitigate these effects, the Government has adopted an emergency ordinance that includes tax amnesty measures, with a positive budgetary impact estimated at 7.9 billion lei, as well as measures to restrict public spending, with an impact of approximately 2.05 billion lei. It should be emphasized that the amnesty does not impact the structural deficit, but only the cash deficit – depending on the revenues collected.

In this context, the budget revision project provides for a substantial nominal increase in both budget revenues (+29.6 billion lei, representing about 5.06% of the initially projected budget revenues) and budget expenditures (+65.8 billion lei, representing about 9.8% of the initially projected budget expenditures). Consequently, the deficit of the consolidated general budget is approximately 36.2 billion lei higher in the revision project, rising from 86.6 billion lei to 122.8 billion lei. Expressed as a percentage of GDP, the estimated level of the general government deficit is 6.94%, which is about 1.94 pp higher than the target in the budget draft.

Essentially, the review of budget revenues has the following main sources:

- an upward adjustment of certain macroeconomic assumptions, beyond the values on which the budget draft was based, particularly regarding the GDP deflator and the rate of growth of the average gross monthly wage;
- the inclusion in revenue aggregates of additional collections from the tax amnesty of about 7.9 billion lei, equivalent to approximately 0.45% of GDP;
- a slightly better-than-expected dynamic in the revenues collected as a result of measures included in Law no. 296/2023 regarding the long-term financial sustainability of Romania, especially those concerning: (i) the minimum tax on turnover for companies with an annual turnover exceeding 50 million euros, amounts included in the corporate income tax aggregate, (ii) the revision of tax benefits regarding income tax and insurance contributions for the construction, food, agricultural, and IT sectors, amounts included in the personal income tax aggregate and in the social security contributions aggregate, and (iii) the turnover tax imposed on credit institutions and economic agents in the oil and natural gas sectors, amounts included in the aggregate of other taxes on goods and services.

By categories of budget revenues, positive revisions of the projected levels in the initial budget occur, with a few exceptions, in most of them, as follows:

- Tax revenues: +26.0 billion lei, with the main changes found at the level of the following components:
    - *Corporate income tax:* +1.1 billion lei. The review of this aggregate takes into account an increase in the projection for nominal GDP by 35 billion lei, equivalent to 2.0% compared to the estimate in the budget draft, the revenue evolution slightly exceeding expectations compared to the estimated program, as well as the inclusion of 720 million lei, which is part of the positive impact of the tax amnesty. The budget execution for the first seven months indicates a 22% increase in profit tax revenues compared to the same period last year (the budget draft set a growth target of 21.3%), while the new target in the revision project foresees a 25.2% increase compared to the budget execution of 2023. Under the conditions where the influence of additional revenues from amnesty is removed, the growth target in the revision project is 22.6%, close to the execution dynamics over the past seven months.
    - *Personal income tax:* +4.1 billion lei. The review aims to modify the forecast that served as the basis for the initial budget regarding relevant macroeconomic aggregates (the average number of employees from +1.6% to +0.9% and the average gross salary from +9.1% to +14.6%, which corresponds to an increase in the wage mass in the economy of about 5 pp above initial expectations), as well as the inclusion of 450 million lei, which is part of the positive impact of the tax

amnesty. The budget execution for the first seven months indicates an increase in revenue from income and salary tax of about 22% (the budget draft set a growth target of 14%), while the new target in the revision project is 24.2%. If we eliminate the influence of additional revenues from the amnesty, the target in the revision project is 23%, which is 1 pp above the execution for the first seven months. It is worth mentioning here that this increase is largely driven by the rise in salaries.

- *Other taxes on income, profits, and capital gains*: -1.3 billion lei. The downward revision of the aggregate is determined by the performance of revenues from the micro-enterprise income tax (the 7-month execution reveals that the micro-enterprise income tax, which represents about 57% of this aggregate, has decreased by about 2% compared to the same period last year). Overall, the 7-month budget execution indicates a 14% increase in revenues from other taxes on income, profits, and capital gains compared to the same period last year (the budget draft had projected a growth target of 31.8%), while the new target in the revision project is 8.7%, driven by a reduction of the revenue target from the micro-enterprise income tax by approximately 2.3 billion lei.
- *Property taxes*: +0.08 billion lei.
- *VAT*: +2.1 billion lei. The revision mainly takes into account the inclusion of approximately 1.96 billion lei, a component of the expected positive impact of the tax amnesty. The 7-month budget execution indicates a 14.8% increase in VAT revenues compared to the same period last year (the budget draft had set a growth target of 14.5%). The new growth target in the revision project is 16.4%, and when excluding the presumed revenues from the amnesty, the growth target is 14.6%, a value close to the 7-month execution.
- *Excise duties*: +2.5 billion lei. The increase is driven by higher-than-expected revenues compared to initial estimates, due to consumption growth outpacing the dynamics planned in the budget draft, the introduction of an excise tax on sugary non-alcoholic beverages starting in 2024, and the inclusion of approximately 230 million lei, a component of the positive impact of the tax amnesty. The 7-month execution shows a 13.9% increase in excise revenues, which includes the increase in fuel excise duties from July 1st (the budget draft had set a growth target of 9.4%). The new projection in the revision project is 16.1%, and excluding the impact of revenues from the amnesty, the growth target is 15.5%.
- *Other taxes on goods and services*: +4.2 billion lei. The positive revision takes into account the better-than-expected dynamics of the revenue aggregate. Thus, the 7-month execution indicates a decrease of only 4.9% in revenues, whereas the budget draft had forecasted a reduction of 53.1%. The new target in the revision project indicates a decrease of 28.4%. Although this may seem pessimistic, according to additional data, it is confirmed by the 8-month execution.

    - *Taxes on the use of goods, on authorizing the use of goods and on carrying activities*: +0.3 billion lei. The 7-month execution indicates a 13.5% increase in this aggregate, in line with the initial budget draft of 13.4%. The new growth target in the revision project is 17.8%.
    - *Other tax revenue*: +0.04 billion lei.
- *Social security contributions*: +11.99 billion lei. The significant increase is based on the favorable development of relevant macroeconomic bases (the positive dynamics of the gross average salary, similar to the case of personal income tax), as well as the inclusion in the growth projection of the expected impact of the tax amnesty. The 7-month budget execution indicates a 20.7% increase in revenues from contributions compared to the same period last year (the budget draft included a growth target of approximately 13.4%). The new growth target in the revision is around 22.9%. If the expected impact of the amnesty is excluded, the growth rate of the aggregate is close to the 7-month execution.
- *Non-tax revenues*: +0.87 billion lei. The revision reflects the better-than-expected performance of the budget execution for this aggregate: +18.4% over seven months, compared to a target of only 7.2% in the initial budget draft.
- *Additional revenues collected from digitalization*: the amount forecasted in the 2024 budget draft, approximately 10.5 billion lei, remains unchanged. Although the 7-month execution does not indicate any amount collected under this budget line, the revision project continues to maintain a collection target of 10.5 billion lei.
- *Capital revenues*: -0.07 billion lei.
- *Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020*: +2.2 billion lei.
- *Amounts related to the non-reimbursable financial assistance allocated to NRRP (National Recovery and Resilience Plan)*: -11.3 billion lei. The downward revision only partially reflects the reduced absorption in the first part of the year. The 7-month execution shows an absorption of only 3.05 billion lei, equivalent to just 12.1% of the amount in the budget draft. Despite the negative revision of the aggregate, the target remains optimistic, with the 7-month execution representing 22.1% of the new rectified target, implying a significant acceleration in the last months of the year.

As highlighted in previous analyses, the Fiscal Council does not take into account, in its evaluation, revenues sourced from the Ministry of Finance's planned increase in collection efficiency or the digitalization of NAFA. In fact, this assumption is validated by the 7-month budget execution, where no value is recorded under this category.

The revision project maintains the revenue projection of 10.5 billion lei from digitalization, which equates to an overestimation of budget revenues by 0.6% of GDP. Additionally, the Fiscal Council highlights a degree of uncertainty regarding the impact of the tax amnesty, estimated at 7.9 billion

lei, equivalent to about 0.45% of GDP, which amplifies the dynamics of the 7-month budget execution beyond that of the macroeconomic bases relevant to the revenue aggregates.

On the expenditure side, there is a significant increase compared to the parameters approved in the budget draft, mainly driven by the supplementation of personnel expenditures, expenditures on goods and services, social assistance, and capital expenditures. The upward revision occurs in almost all major expenditure categories, as follows:

- *Personnel expenditures*: +18 billion lei. The upward revision of this aggregate is driven by salary increases in several public sectors in the first part of the year. Some of these increases are scheduled to be granted in the last quarter of this year as well. The Fiscal Council highlighted in its opinion on the budget that the discretionary salary increases in 2023 pose heightened risks of additional pressure from other public sectors in 2024. The 7-month execution indicates a 23.9% increase in personnel expenditures compared to the same period last year, whereas the target projected in the initial budget was only 10.2%. In the revision project, the new growth target is 23.7%, in line with the execution dynamics. However, the last part of the year will involve a second round of raises for some public sectors, which creates a risk of exceeding the ceiling set in the revision.
- *Goods and services*: +10.6 billion lei. The increase in this indicator only partially takes into account the dynamics of budget execution, likely relying on the public spending restriction measures included in Emergency Ordinance 107/2024 for regulating fiscal-budgetary measures regarding the management of budgetary claims and the budget deficit for Romania's general consolidated budget in 2024, whose impact is estimated by the Government at around 2.05 billion lei. The 7-month execution shows an increase of around 25.7% in the goods and services aggregate, significantly above the 5.7% target projected in the initial budget. The upward revision of the aggregate in the revision project sets a target of around 19.5%, which is 6 percentage points below the execution dynamics. Goods and services related to the National Health Insurance Fund (NHIF) budget represent about 60% of the total aggregate of goods and services, with their 7-month dynamics showing a 28% increase compared to the same period last year, due to an annual increase of around 24% in the Consumer Price Index (CPI) for medicines. Consequently, even if the goal of restricting public spending, with an estimated impact of 2.05 billion lei, is achieved, given the limited ability to intervene in NHIF's goods and services expenses, an additional 3 billion lei, equivalent to 0.2% of GDP, would have been in line with the budget execution dynamics. Additionally, we point out that the restriction of goods and services spending, similar to last year, may lead to payment delays, which will be carried over into the 2025 budget execution.
- *Interest*: +2.4 billion lei. The increase in this category is driven by the rising financing needs and, consequently, the contracting of new loans due to the widening deficit. The 7-month execution shows a 17.1% increase in interest expenditures compared to a programmed

value of 13.8%. The new target in the revision project is 21.6%, higher than the execution, due to probable new loans in the last part of the year.

- *Subsidies*: +3.8 billion lei. The revision of the aggregate only partially takes into account the dynamics of budget execution. In the first 7 months, subsidy expenditures increased by 18.8% compared to the same period last year, versus a target of -29.2% in the budget draft. The supplementation of the aggregate in the revision project adjusts the target to -8.3%, significantly below the budget execution dynamics. An increase of approximately 5.0 billion lei, equivalent to 0.3% of GDP, would have ensured a dynamic in line with the budget execution.
- *Transfers between public administration units*: +1.2 billion lei. The supplementation reflects changes in the budgets of several credit authorizing officers, for the payment of salary rights of personnel in subordinate institutions and to ensure funds for state social security contributions related to unemployment benefits.
- *Other transfers*: +3.7 billion lei.
- *Projects funded by non-reimbursable external funds*: +13.2 billion lei.
- *Social assistance*: +9.8 billion lei. The supplementation of this aggregate indicates a 4.67% increase compared to the budget draft, reflecting a rise in the Social Insurance Budget by approximately 0.98 billion lei for the payment of recalculated pensions, an increase in the Ministry of Labor's budget by around 4 billion lei, and smaller increases at other credit authorizing officers. The 7-month execution shows a 13.9% increase in social assistance expenditures, exceeding the budget draft's forecast of 9.7%. Given the supplementation of the aggregate in the revision project, the new estimated growth is around 14.8%.
- *Projects funded by external post-accession grants 2014-2020*: +6 billion lei. The increase is about 41% compared to the budget draft.
- *Other expenses*: +1.8 billion lei.
- *Projects financed from the amounts representing the non-refundable financial assistance related to NRRP*: -16.5 billion lei. The revision of this category indicates a decrease of almost 50% compared to the target in the budget draft.
- *Projects financed from the amounts related to the loan component of the NRRP*: +1.8 billion lei. The revision indicates a 21.67% increase compared to the budget draft.
- *Reserve funds*: Analyzing the Government decisions through which allocations were made from the budgetary reserve fund up to September 20, 2024, it is noted that the practice initiated last year has been maintained, where the unspent resources of the main authorizing officers are redistributed to other areas. Allocations from the reserve fund have already reached 30 billion lei, and it is likely that they will exceed last year's level (32.08 billion lei).
- *Expenditure funded from reimbursable funds*: +0.3 billion lei.
- *Capital expenditures*: +11.1 billion lei. The supplementation of this aggregate is driven by the significant increase in capital expenditures in the first part of the year (reflected in the 7-month budget execution, which shows a 97% increase compared to the same period last

year), following under-execution and the postponement of some capital expenditures in 2023. In the budget draft, the growth target for capital expenditures compared to 2023 was 7.9%. The revision of the aggregate indicates a projected growth of around 36.5% compared to 2023.

Total public investment expenditures, from both internal and external sources, are reduced in the planning by 0.5 billion lei (-0.5%) compared to the level set in the budget draft (changing as a percentage of GDP from 6.9% to 6.8%, due to both the increase in nominal GDP and the marginal reduction of funds allocated for investments). In structure, the share of public investment expenditures in GDP consists of:

- projects funded by non-reimbursable external funds (2.4% of GDP);
- projects funded by non-reimbursable financial assistance and loans under the NRRP (1.5% of GDP);
- expenditures funded from reimbursable funds (0.1% of GDP);
- capital expenditures (2.6% of GDP) and other investment-related transfers (0.2% of GDP).

Compared to the initial budget, the main changes are found in the indicator for projects funded by non-reimbursable financial assistance and loans under the NRRP (-14.7 billion lei, representing a 35.5% decrease from the level in the budget draft). This decrease is partially offset by an 11.7 billion lei increase in funds allocated for investments from own and borrowed sources (these consist of capital expenditures for investments, expenses related to programs with repayable funding, and other investment-related transfers) and a 2.4 billion lei increase in funds for projects financed by post-accession non-reimbursable external funds.

It is noteworthy that there has been a shift towards conducting investments from internal sources, which now account for 40.9% of total investments, compared to 31.2% in the initial budget. Moreover, according to the Report on the Economic and Budgetary Situation for the first 6 months of 2024, the execution of investment expenditures recorded a level of approximately 46.27 billion lei in the first semester (of which internal resources accounted for 52.84%), while the programmed level of this aggregate for the entire year, according to the revision project, is 119.5 billion lei.

The situation outlined above raises several principled and practical issues. Why is there not a higher absorption of resources from the NRRP? Why do capital expenditures need to increase so much, given that they are financed by borrowed money? Why is it still being claimed that the budget deficit is overwhelmingly due to public investments? As the budget revision shows, European funds will represent the source of financing for more than half of public investments. These funds appear on both the expenditure and revenue sides. Public investments are necessary, and Romania needs better infrastructure in many areas. However, public investments do not automatically lead to an increase in the production of *tradables*, meaning goods that can be exported or substitute imports. This is evident from the rapid growth in the trade deficit and the

current account deficit. The argument that Romania can afford deficits of over 7% of GDP because public investments are being made is unconvincing. Those who cite deficits of over 3% of GDP in many EU countries in previous years (before the pandemic) ignore at least three aspects: a) there is a big difference between structural deficits of, say, 4% and 7-8% of GDP; b) Romania suffers from the twin deficit syndrome, also having large external deficits, which are mainly financed through external loans; c) Romania also faces currency risk, as it is not a member of the Eurozone.

Without major public investments, it is difficult for Romania to continue its real convergence with the most developed economies in the EU. One remaining advantage (for now) of our economy is that public debt is still reasonable (below 53% of GDP). However, these positive aspects must take into account both internal and especially external financial constraints, in a world that may again experience "freezes" in financial markets. Therefore, it is essential for the Government to launch the macroeconomic correction program for the public budget starting in 2025. The final-structural plan is key in this regard, as are political will and the clarity of decision-making.

The analysis of budget expenditure categories indicates a possible underestimation for expenditures related to goods and services (by about 0.2% of GDP) and subsidies (around 0.3% of GDP). Additionally, there are risks concerning the social assistance aggregate, given the uncertainties regarding the impact of the recalculation of pensions in the public system.

In light of the above findings, the Fiscal Council estimates that the revenues in the budget revision may be overestimated by approximately 0.6% of GDP. Additionally, the FC highlights uncertainties regarding the inclusion in the revenue projection of the impact of the tax amnesty (around 7.9 billion lei, representing 0.45% of GDP), as well as risks concerning the evolution of macroeconomic bases that could influence revenues. Budget expenditures are possibly underestimated by around 0.5% of GDP. Moreover, there are risks concerning the evolution of social assistance expenditures and capital expenditures.

Based on the new data, **the Fiscal Council estimates that the cash budget deficit will be around 8% of GDP in 2024, in line with the analysis from its annual report[6].**

Given the Government's negotiations with the European Commission regarding Romania's fiscal-structural plan, within the context of the new economic governance framework in the European Union, it is possible that some expenditures may be further reduced, resulting in a deficit noticeably below 8% of GDP. On the other hand, underestimating the risks generated by rapidly increasing expenditures could lead to a deficit significantly above 8% of GDP.

The government should attempt to strictly control expenditures for the rest of the year. As in previous years, postponing certain payments does not solve the structural issues of the public budget.

[6] https://consiliulfiscal.ro/CF%20RA%202023.pdf

4. The new economic governance framework of the European Union

In November 2022, the European Commission launched a public consultation on the new EU economic governance framework, and, in April 2023, it published the proposed form of the governance framework. After negotiations between the European Commission, the European Parliament, and the EU Council, on April 29, 2024, the EU Council adopted the final version of the new economic governance framework. It retains the two main rules from the Maastricht Treaty as key references: a budget deficit of less than 3% of GDP and public debt below 60% of GDP. To simplify fiscal rules and increase transparency, the new framework proposes a single operational indicator – *the net expenditure path* – to ensure that the two references are maintained within sustainable and balanced limits. Based on the net expenditure path, each member state will commit to *a medium-term fiscal-structural plan* that will include reforms and investments and promote sound fiscal policy.

For member states whose public debt exceeds 60% of GDP or whose public deficit exceeds 3% of GDP, the European Commission will provide a reference trajectory of net expenditures for a four-year adjustment period. There is the possibility for member states to commit to an additional set of reforms and investments that meet specific criteria, allowing the adjustment period to be extended to seven years. Compliance with the net expenditure trajectory should ensure that, at the end of the adjustment period, in a *no-policy-change* scenario, the public debt-to-GDP ratio is placed on a plausible downward path or remains below 60% of GDP in the medium term, and that the budget deficit falls below 3% of GDP during the adjustment period and remains below this level in the medium term.

The European Commission monitors the progress made by each member state in implementing their fiscal-structural plans, particularly the adherence to the net expenditure trajectory and the reforms and investments that justify the extension of the adjustment period. For this purpose, the Commission will create a control account where cumulative deviations from the trajectory will be recorded: on the debit side, deviations where expenditures exceed the trajectory, and on the credit side, those where expenditures are below the trajectory.

Following the report prepared by the EC, the Council decides whether an excessive deficit exists and makes recommendations to the member state, setting a maximum period of six months for the adoption of effective measures and a deadline for correcting the excessive deficit. The governance framework allows member states to request independent fiscal institutions to evaluate, in a separate report, the measures adopted and those planned to meet revenue and expenditure targets. If, based on the report presented by the member states, the Council decides that no deficit-reducing measures have been taken, it will issue a warning requesting the implementation of a corrective trajectory of net expenditures and will indicate the measures supporting 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 Treaty on the Functioning of the European Union (TFEU).

The provisions of the directive will be transposed into national legislation by December 31, 2025.

5. Absorption of European funds

As mentioned in other FC's documents, the highest possible absorption of European funds (MFF and NRRP) is of vital importance for Romania, representing the only large-scale counter-cyclical force that can offset the contractionary effects of fiscal consolidation. This will help the Romanian economy, through reforms and investments, to become more robust and competitive, considering the state of the public budget and the vulnerabilities of the external balance, in an extremely unfavorable international context.

Corroborating the data from the Ministry of Investments and European Projects[7] and the Ministry of Finance[8], it is observed that, for the 2014-2020 financial framework, benefiting from the N+3 rule, by the end of August 2024, a reimbursement/allocation absorption rate of over 90% for structural and investment funds had been achieved, with a high likelihood of reaching close to 100% by the end of the year. In stark contrast, for the 2021-2027 MFF, at the halfway point of this framework (August 2024), the absorption rate for structural and cohesion funds (with allocations of 31 billion euros, from which the Government estimated 2.5 billion euros in reimbursements from the Cohesion Fund in 2024) was practically zero.

The implementation of the National Recovery and Resilience Plan (NRRP) (with allocations of 28.4 billion euros for the 2022-2026 period, including 13.5 billion euros in grants and 14.9 billion euros in loans) is facing significant delays and major challenges. So far, under the European Union's Recovery and Resilience Facility (RRF), Romania has received pre-financing of 4 billion euros (2.1 billion euros in grants and 1.9 billion euros in loans), managing to secure approval from the European Commission for only two payment requests totaling 5.3 billion euros (3.6 billion euros in grants and 1.7 billion euros in loans). This represents an absorption rate of less than 20% at the halfway point of the period.

The third payment request, amounting to around 2 billion euros (excluding pre-financing) and corresponding to the achievement of 76 milestones and targets scheduled for completion in the third and fourth quarters of 2022, was only submitted in December 2023, with a delay of 9 months compared to the initial timeline. This request is still under evaluation by the European Commission, with 4 milestones currently undergoing clarification, particularly those concerning the regime for micro-enterprises and the reform of state-owned companies. It is possible that the

[7] https://mfe.gov.ro/stadiul-absorbtiei-fondurilor-ue/
[8] https://mfinante.gov.ro/static/10/Mfp/buget/sitebuget/BFN31august2024.pdf

European Commission will approve only a partial payment and trigger the payment suspension procedure for unmet milestones.

It is essential for the authorities to take into account that, unlike the EU Cohesion Policy related to multiannual programming, which allows the financing of projects after the end of the period (N+3 rule), in the case of the NRRP, all the milestones and targets must be achieved by the end of August 2026, and the related payment requests must be executed by the end of 2026. Any failure to meet these deadlines could result in losses or even the return of funds.

The disruption of the entire timeline of financial flows related to the NRRP exposes Romania to further risks of payment suspensions, with both direct and collateral effects on the absorption rate of allocated funds, both in terms of grants and loans. This also impacts reform and investment programs, as well as Romania's macroeconomic and fiscal stability, the financing costs of internal and external imbalances, especially in light of the constraints imposed by the entry into force of the new EU economic and fiscal governance framework.

Despite the positive experience from the previous financial framework, it is evident that institutional weaknesses persist in both the 2021-2027 MFF and the NRRP. The limited administrative capacity of many central and local authorities restricts the chances of achieving a high absorption rate of European funds in a balanced and timely manner. The loss of European funds would further complicate Romania's already difficult public finance situation, in addition to impacting the real economy, as it would require increasing compensatory national co-financing and would affect the fiscal consolidation process according to the timeline agreed with the European Commission.

6. Compliance with fiscal rules

The first budget revision for 2024 provides for the modification of nominal ceilings for some of the indicators specified in the 2024 fiscal-budgetary framework, established by Law no. 417/2023, as follows:

- the nominal ceiling for the general consolidated budget (GCB) deficit is increased by 36.2 billion lei, reaching a total of 122.8 billion lei;
- the nominal ceiling for total GCB expenditures, excluding financial assistance from the European Union and other donors, is increased by 62.16 billion lei, reaching a total of 665.9 billion lei;
- The nominal ceiling for GCB personnel expenditures is increased by 16.5 billion lei, reaching a total of 164.2 billion lei.

Regarding the primary deficit of the general consolidated budget, it has increased by 33.8 billion lei compared to the limit set by Law no. 417/2023, while interest expenses have increased by 2.4 billion lei compared to the budget draft. Additionally, the indicators expressed as a percentage of

GDP have also increased compared to the limits set by Law no. 417/2023 (6.94% of GDP compared to 5% of GDP for the GCB deficit, and 9.3% compared to 8.3% of GDP for GCB personnel expenditures).

Regarding the public debt ceiling, according to the European Union's methodology, it was raised during the budget revision to 51.5% of GDP, compared to 49.8% of GDP at the time the budget draft was prepared. Given that the draft normative act did not include a derogation from Article 13, paragraph (2) of the Fiscal Responsibility Law (FRL), the Government will need to consider its application.

The draft Government ordinance regarding the 2024 state budget revision stipulates the necessary derogations from the fiscal rules established by the FRL and redefines the budgetary aggregate ceilings in line with the levels outlined in the proposed revision.

Conclusions

- Romania has one of the highest budget deficits in the EU, and the fact that seven other countries have also come under the excessive deficit procedure should not provide comfort to our authorities. Romania suffers from the "twin deficits" syndrome, with large external imbalances (trade balance and current account) that are significantly financed through external borrowing. Romania has the largest current account deficit as a percentage of GDP among the Central and Eastern European countries and is not in the Eurozone, which implies a currency risk.
- It is a risky statement to claim that deficits are explained by investments and that they are sustainable; the effects of investments depend on their composition, on the extent to which they develop the production of exportable goods and those that can replace imports (the so-called *tradables*). Additionally, a large portion of European resources is reflected in the public budget on both the expenditure and revenue sides. The Draghi report emphasizes the need for quality, future-oriented investments in the EU.
- A 7-year structural budget plan makes sense, given the size of the deficit and the impact of structural reforms. The correction cannot be achieved overwhelmingly through expenditures cuts; a significant increase in budgetary (fiscal) revenues is needed, including through changes in the tax system, a drastically reduction in the VAT collection gap, the expansion of the tax base, and combating tax evasion and tax optimization practices.
- The Fiscal Council has frequently mentioned that Romania has among the lowest fiscal revenues (including contributions) in the EU – around 26-27% of GDP. This level is completely inadequate given the increasing pressures on the budget resulting from the effects of climate change (see also this year's floods), the need to invest more in education and healthcare, defense, physical infrastructure, and to create fiscal space.

- Financial markets can “freeze” again for various reasons, and countries caught off guard (with large deficits) pay a high price. Romania has already gone through a bitter episode as a result of the 2008-2009 financial crisis.
- Economic growth in Romania is not robust because it relies on significant internal and external imbalances.
- The budget revision foresees a significant nominal increase in both budget revenues and expenditures. The estimated level of the deficit of the general consolidated budget is 6.94%, about 1.94 percentage points higher than the target in the original budget draft.
- Based on the new data, the Fiscal Council estimates that the cash budget deficit will be around 8% of GDP in 2024, consistent with the analysis in its annual report.
- Given the government’s negotiations with the European Commission regarding Romania’s structural budget plan, within the context of the new economic governance framework in the European Union, it is possible that some expenditures may be further reduced, potentially resulting in a deficit slightly below 8% of GDP. On the other hand, underestimating the risks generated by rapidly increasing expenditures could lead to a deficit significantly above 8% of GDP.
- The government should strictly control expenditures for the remainder of the year. As in previous years, postponing certain payments does not resolve the structural problems of the public budget.
- According to the budget revision, total investment expenditures, from both internal and external sources, are estimated at 6.8% of GDP. Structurally, investments financed from internal resources account for 40.9% (compared to 31.2% in the initial budget proposal), while investments financed from European funds account for 59.1%.
- The absorption of European funds in the first 8 months of 2024 was limited to reimbursements totaling approximately 2.5 billion euros from the 2014-2020 Multiannual Financial Framework (benefiting from the N+3 rule). For the 2021-2027 Multiannual Financial Framework, the absorption rate of structural and cohesion funds was zero as of August 2024. Regarding the Recovery and Resilience Facility (NRRP), the third payment request submitted in December 2023, amounting to approximately 2 billion euros, is still under evaluation by the European Commission. This highlights institutional weaknesses in attracting and absorbing European funds.
- Romania risks developing a dependence on European funds that could prove dangerous. This is particularly concerning because the Recovery and Resilience Facility (NRRP) has a limited lifespan (until August 2026), and structural and cohesion funds will enter a different allocation logic. Additionally, Romania’s GDP per capita is expected to reach a level that will no longer entitle it to receive net funds on the same scale as in the last decade (as a percentage of GDP).

The opinions and recommendations formulated above by the Fiscal Council were approved by the Chairman of the Fiscal Council, according to the provisions of art. 56, para (2), letter d) of Law no. 69/2010 republished, following their approval by the Council members, through vote, in the meeting of September 23, 2024.

September 23, 2024

Chairman of the Fiscal Council
Professor Daniel DĂIANU

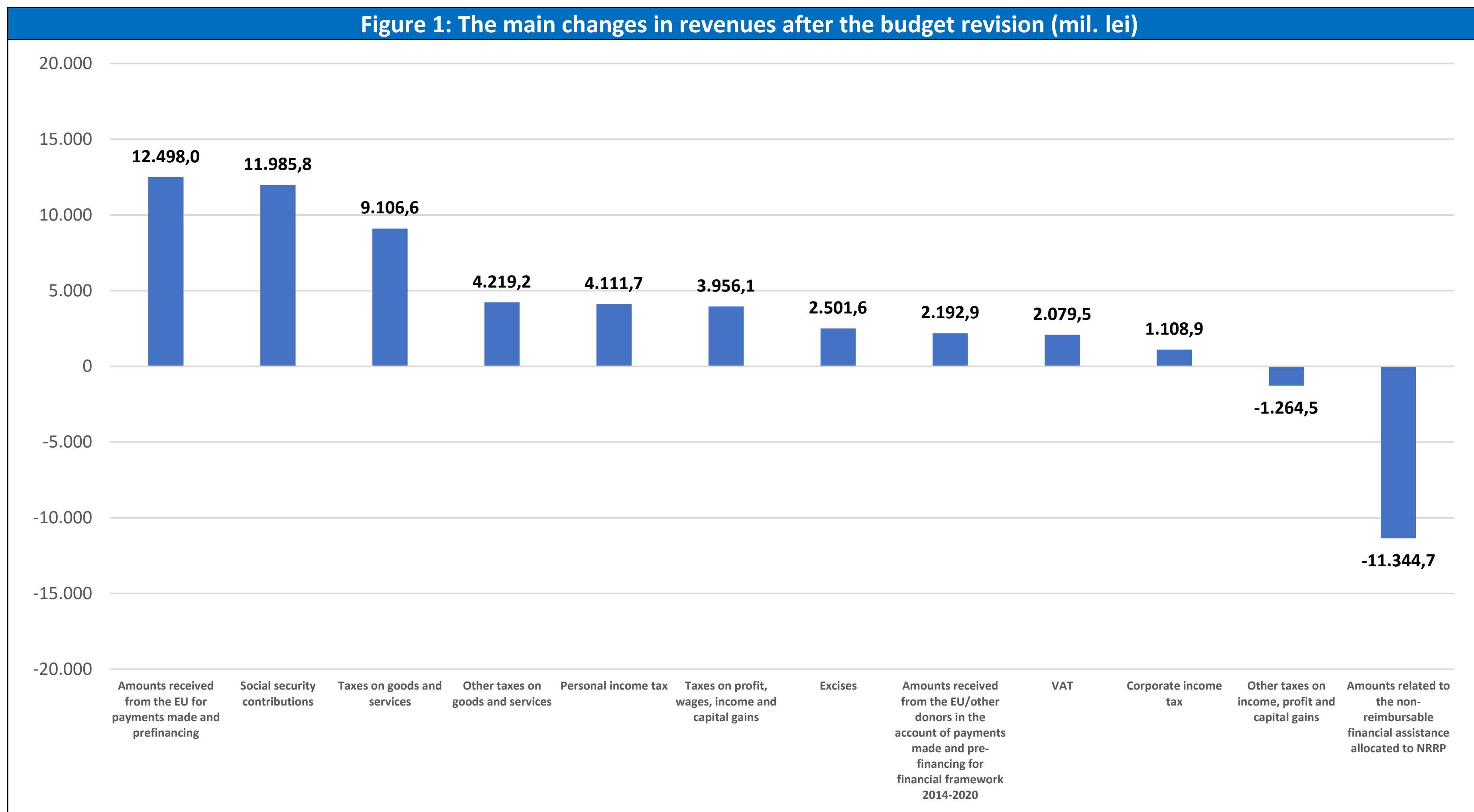
ANNEX I - Budget revision vs initial budget	Budget execution 2023	Initial budget 2024	First budget revision (R1) 2024	R1 - Budget execution 2023	R1 - Initial budget 2024	R1/Budget execution 2023 %	R1/Initial budget 2024 %
	1	2	3	4=3-1	5=3-2	6=3/1	7=3/2
TOTAL REVENUE	**521.447,3**	**586.130,60**	**615.761,24**	**94.313,96**	**29.630,64**	**18,09%**	**5,06%**
Current revenue	452.346,8	505.180,62	531.220,46	78.873,69	26.039,84	17,44%	5,15%
Tax revenue	251.032,9	276.389,78	289.576,14	38.543,25	13.186,36	15,35%	4,77%
Taxes on profit, wages, income and capital gains	75.024,4	88.633,82	92.589,92	17.565,48	3.956,10	23,41%	4,46%
Corporate income tax	29.127,3	35.344,05	36.452,97	7.325,66	1.108,92	25,15%	3,14%
Personal income tax	40.411,5	46.061,65	50.173,36	9.761,88	4.111,71	24,16%	8,93%
Other taxes on income, profit and capital gains	5.485,6	7.228,12	5.963,60	477,95	-1.264,52	8,71%	-17,49%
Property tax	7.242,9	8.290,70	8.370,20	1.127,26	79,50	15,56%	0,96%
Taxes on goods and services	165.720,4	176.159,82	185.266,37	19.546,00	9.106,56	11,79%	5,17%
VAT	104.334,7	119.407,05	121.486,53	17.151,80	2.079,48	16,44%	1,74%
Excises	37.260,3	40.765,33	43.266,90	6.006,60	2.501,57	16,12%	6,14%
Other taxes on goods and services	17.090,7	8.009,50	12.228,73	-4.862,02	4.219,23	-28,45%	52,68%
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	7.034,6	7.977,94	8.284,21	1.249,62	306,28	17,76%	3,84%
Taxes on foreign trade and international transactions (customs duty)	1.713,5	1.835,05	1.835,05	121,60	0,00	7,10%	0,00%
Other tax revenue	1.331,7	1.470,39	1.514,59	182,91	44,20	13,74%	3,01%
Social security contributions	158.655,4	183.065,82	195.051,59	36.396,19	11.985,77	22,94%	6,55%
Nontax revenue	42.658,5	45.725,01	46.592,73	3.934,25	867,72	9,22%	1,90%
Subsidies	0,0	0,00	0,00	0,00	0,00		

Additional revenues collected from digitalization	0,0	10.500,00	10.500,00	10.500,00	0,00		0,00%
Capital revenues	1.285,5	1.434,03	1.359,44	73,95	-74,59	5,75%	-5,20%
Grants	16,0	10,30	10,30	-5,69	0,00	-35,60%	0,00%
Amounts received from the EU for payments made and prefinancing	8.639,4	33.198,23	45.696,21	37.056,83	12.497,98	428,93%	37,65%
Financial operations	0,0	0,00	0,00	0,00	0,00		
Amounts collected in the single account, at the state budget	101,3	0,00	0,00	-101,31	0,00	-100,00%	#DIV/0!
Other amounts received from the EU for operational Programmes funded under the convergence objective	2.093,5	0,55	319,72	-1.773,79	319,17	-84,73%	58030,91%
Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	55.011,8	10.694,42	12.887,37	-42.124,44	2.192,95	-76,57%	20,51%
Amounts related to the non-reimbursable financial assistance allocated to NRRP	1.953,0	25.112,46	13.767,74	11.814,73	-11.344,71	604,95%	-45,18%
TOTAL EXPENDITURE	**611.349,7**	**672.765,69**	**738.586,72**	**127.237,07**	**65.821,04**	**20,81%**	**9,78%**
Current expenditure	574.562,4	630.888,63	685.581,82	111.019,38	54.693,19	19,32%	8,67%
Personnel	132.695,5	146.208,44	164.199,83	31.504,29	17.991,39	23,74%	12,31%
Goods and services	77.158,8	81.569,25	92.201,94	15.043,11	10.632,69	19,50%	13,04%
Interest	30.620,1	34.837,81	37.224,21	6.604,07	2.386,39	21,57%	6,85%
Subsidies	18.012,0	12.750,31	16.521,22	-1.490,81	3.770,91	-8,28%	29,58%
Total Transfers	315.201,1	351.394,31	372.384,66	57.183,52	20.990,35	18,14%	5,97%
Transfers for public entities	2.600,6	3.728,61	4.919,21	2.318,65	1.190,60	89,16%	31,93%
Other transfers	28.780,7	29.586,55	33.327,36	4.546,65	3.740,82	15,80%	12,64%
Projects funded by external post accession grants	10.107,5	37.913,40	51.086,34	40.978,85	13.172,95	405,43%	34,74%
Social assistance	191.013,8	209.545,96	219.330,69	28.316,92	9.784,72	14,82%	4,67%
Projects funded by external post accession grants 2014-2020	65.898,8	14.728,69	20.760,77	-45.138,08	6.032,08	-68,50%	40,95%

Other expenditure	10.905,3	14.505,18	16.260,20	5.354,95	1.755,02	49,10%	12,10%
Projects with financing from the amounts representing the non-reimbursable financial assistance related to NRRP	2.402,8	33.053,93	16.562,30	14.159,49	-16.491,63	589,29%	-49,89%
Projects financed from the amounts related to the loan component of NRRP	3.491,7	8.332,00	10.137,79	6.646,09	1.805,79	190,34%	21,67%
Reserve funds	0,0	3.000,00	1.628,67	1.628,67	-1.371,34		-45,71%
Expenditure funded from reimbursable funds	874,8	1.128,50	1.421,30	546,53	292,80	62,48%	25,95%
Capital expenditures	38.817,7	41.877,06	53.004,91	14.187,17	11.127,85	36,55%	26,57%
Financial operations	0,0	0,00	0,00	0,00	0,00		
Payments made in previous years and recovered in the current year	-2.030,5	0,00	0,00	2.030,52	0,00	-100,00%	
EXCEDENT(+) / DEFICIT(-)	**-89.902,4**	**-86.635,09**	**-122.825,48**	**-32.923,11**	**-36.190,40**	**36,62%**	**41,77%**

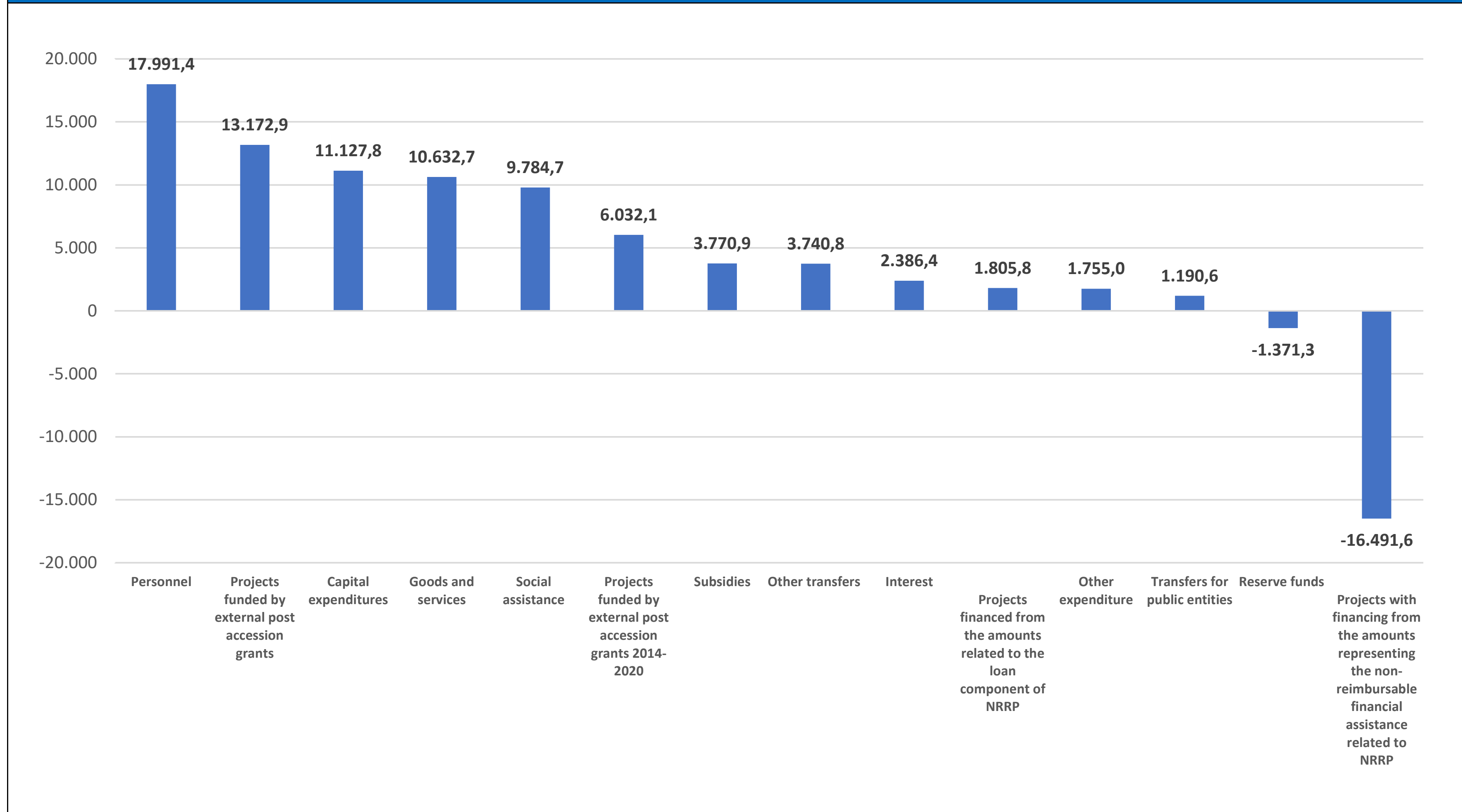
Source: MF, FC's calculations

Annex II



Source: MF, FC's calculations

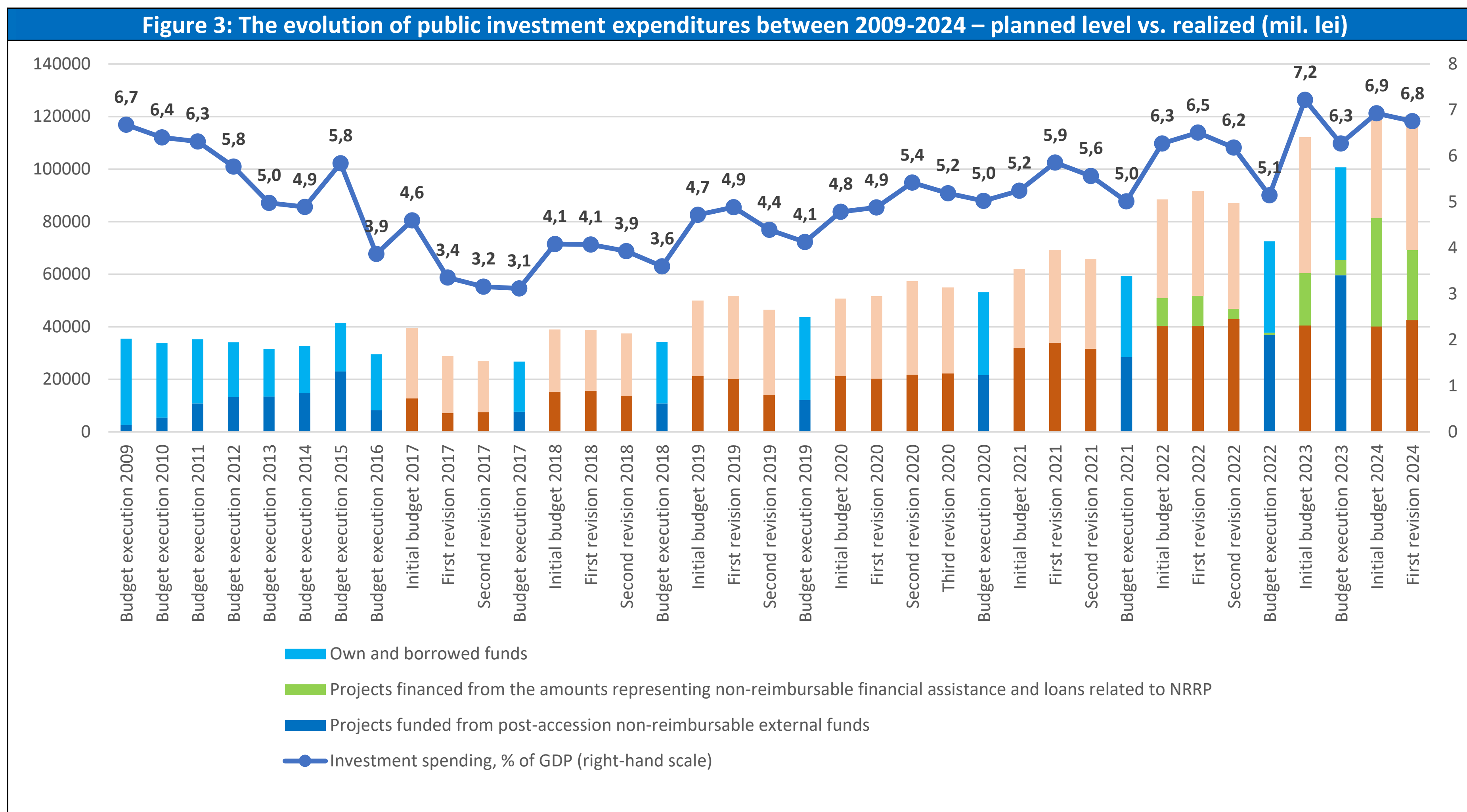
Figure 2: The main changes in expenditures after the budget revision (mil. lei)



Source: MF, FC's calculations

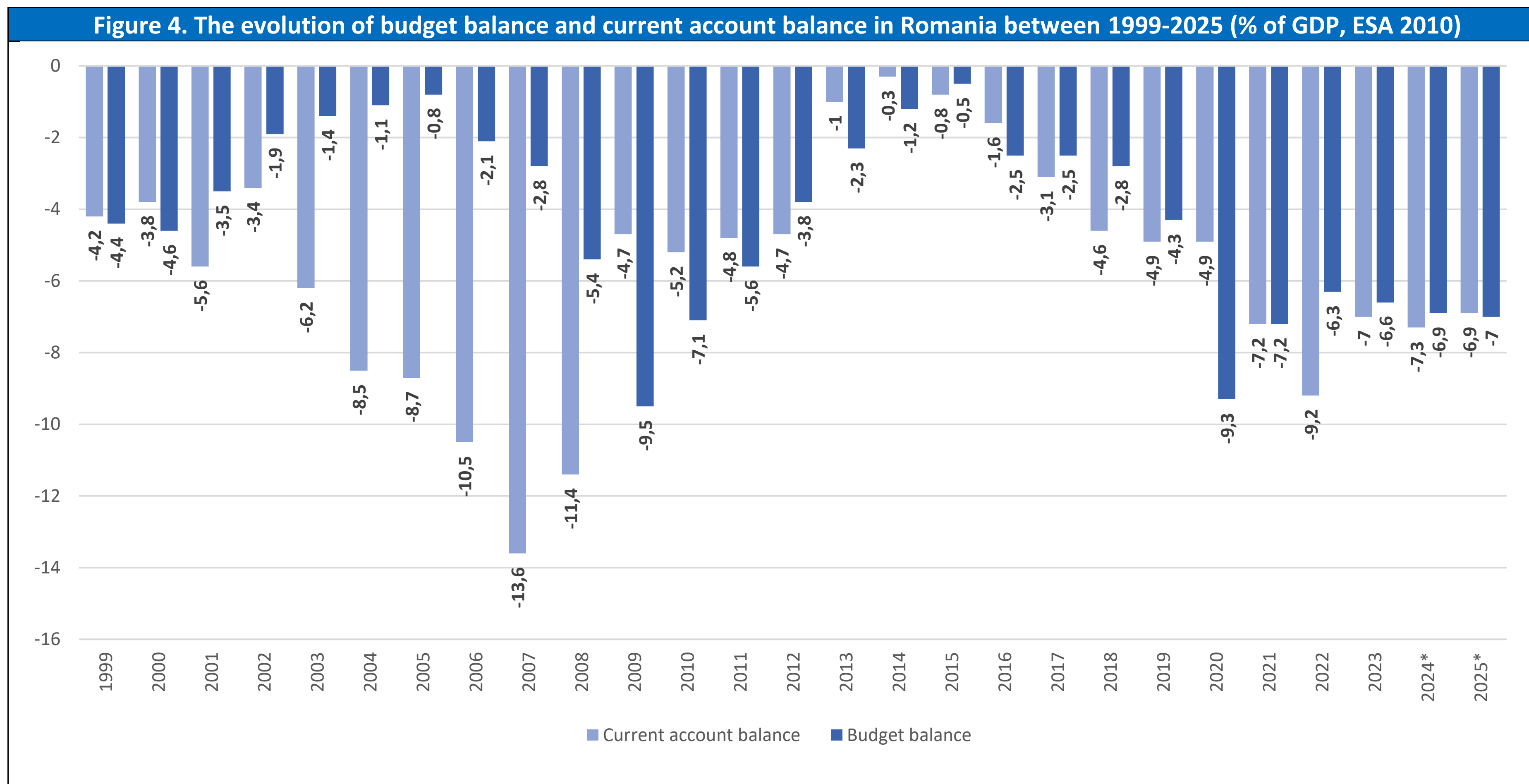
Annex III

Figure 3: The evolution of public investment expenditures between 2009-2024 – planned level vs. realized (mil. lei)



Source: MF, FC's calculations

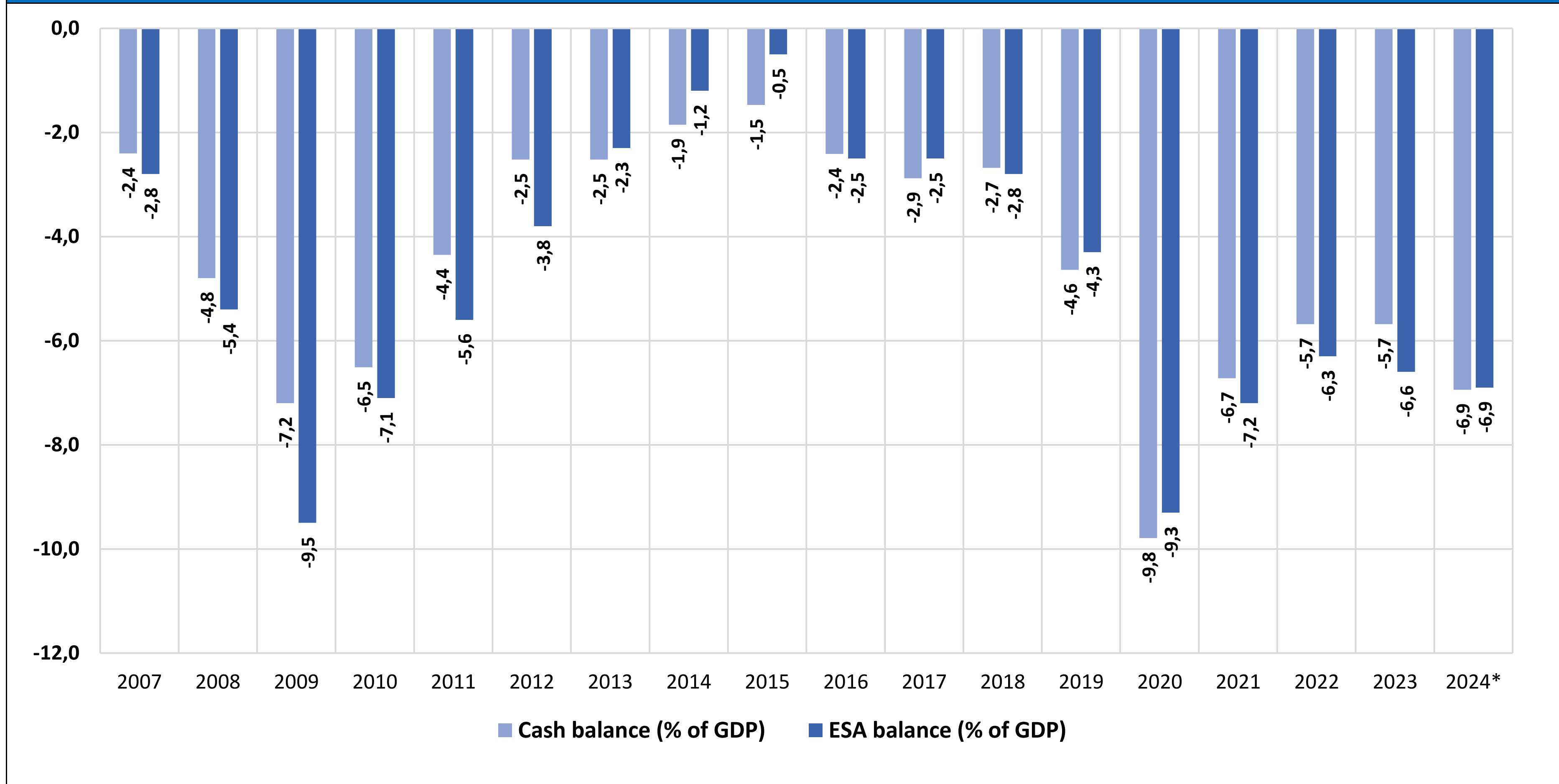
Annex IV



Source: AMECO

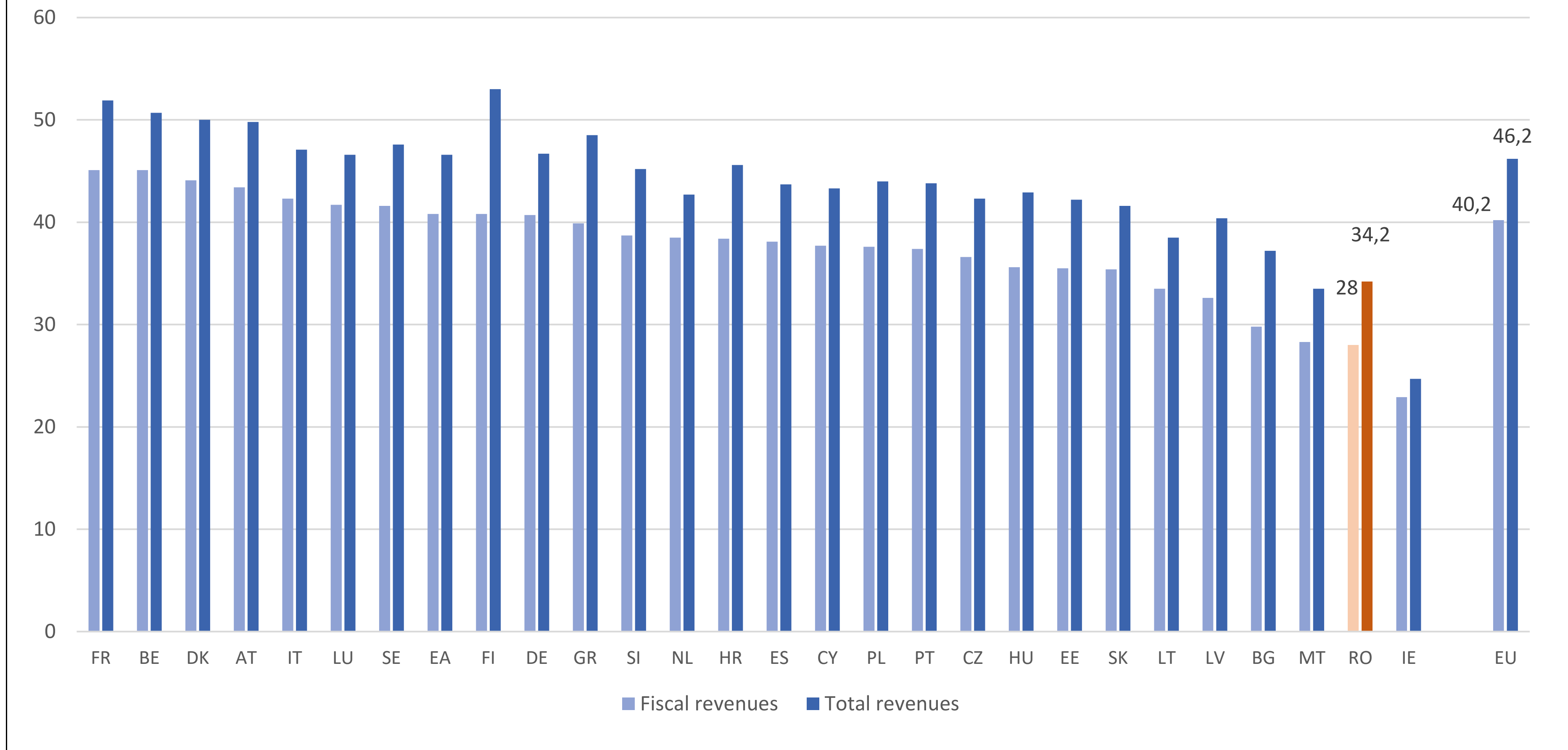
**For 2024 and 2025, the values represent AMECO prognosis.*

Figure 5. The evolution of budget balance between 2007-2024 according to cash and ESA methodologies (% of GDP)



Source: MF (cash balance), AMECO (ESA balance)

**For 2024, the ESA value represents AMECO prognosis.*



Source: AMECO

Note: Fiscal revenues are composed of direct taxes, indirect taxes and received SSC.

**The values represent AMECO prognosis.*

Annex V: 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[9] and launched a public debate on its future[10]. On March 20, 2020, the Commission decided to suspend the SGP's provisions[11] 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[12], and in April 2023 it published the proposed version of this framework[13]. 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[14]: (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*[15] – 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

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

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

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

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

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

[14] 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.

[15] 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.

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 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[16]; 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

[16] 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.

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.

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, analyzing 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[17].

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.

[17] 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