Romania

Fiscal Council

Annual Report

2021

Note:

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List of abbreviations

CEE	Central and Eastern Europe
CPI	Consumer Price Index
DESI	Digital Economy and Society Index
EAGF	European Agricultural Guarantee Fund
EC	European Commission
EBRD	European Bank for Reconstruction and Development
EDP	Excessive Deficit Procedure
EMFF	European Maritime and Fisheries Fund
ESA 2010	European System of National and Regional Accounts 2010
ESA 95	European System of Accounts 1995
ESIF	European Structural and Investment Funds
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
MTO	Medium-term objective
NAFA	National Agency for Fiscal Administration
NBR	National Bank of Romania
NCSP	National Commission for Strategy and Prognosis
NIS	National Institute of Statistics
NPISH	Non-profit institutions serving households
NLDP	National Local Development Program
NREF	Non-reimbursable external funds
NRRP	National Recovery and Resilience Plan
OP	Operational Program
pp	percentage points
RRM	Recovery and Resilience Mechanism
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)

VAT	Value Added Tax
WB	World Bank

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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 analyzes the conduct of fiscal-budgetary policy during the previous year against the framework set out in the Fiscal Strategy (FS) and the annual budget, to assess the macroeconomic and fiscal developments as well as the objectives, targets and indicators included in the FS and in the annual budget.

In 2021, Romania recorded a real GDP growth of 5.9%, marking a rapid return to pre-pandemic levels. The economic recovery was driven by household consumption and by the positive contribution of the change in inventories, gross fixed capital formation and government consumption, partially offset by the negative contribution of net exports. 2021 was characterized by an upward inflation trend and an increase in the current account deficit which reached 7% of GDP at the end of the year. Thus, the average external deficit in the last 3 years exceeds the 4% threshold set by the European Scoreboard. Romania's economy is characterized by a high level of the twin deficits, which involves important challenges for the economic stability of the country.

Romania's economy grew, in real terms, by 5.9%, both due to the base effect (a 3.9% contraction in 2020) and to the impact of government fiscal measures, being also supported by the return of consumers' and businesses' confidence, which used their forced savings from the pandemic period. On the demand side, household consumption had the largest contribution to the positive dynamics of real GDP (by 4.7 pp), followed by government consumption (+0.8 pp) and gross fixed capital formation (+0.6 pp). The positive contribution of the change in inventories (+1.6 pp) was offset by the net export of goods and services (-1.8 pp, amid the disruption of global supply chains). From a supply perspective, the GDP advance was driven by almost all economic sectors, especially retail and wholesale (+1.8 pp), industry (+1.1 pp), the information and communications sector and net taxes per product (with +0.8 pp each), while being slowed marginally by the construction sector together with financial intermediation and insurance.

While 2020 was characterized by low inflation, it registered a recrudescence towards the end of 2021 – from 3.0% in January to 8.2% in December. The GDP deflator also surpassed the level anticipated in the 2021-2023 FS, reaching 5.4%, compared to 2.8%. The current account deficit continued its upward trend, increasing to 7% in 2021 (+2 pp compared to 2020), while its coverage through non-debt generating cash flows (the balance of equity investments related to foreign direct investments, including reinvested earnings and European funds associated to capital transfers) diminished to 65% (from 70.7% in 2020). It should be noted that the average current account deficit recorded in the last 3 years is 5.6% of GDP, exceeding the 4% threshold set by the European Scoreboard, which highlights a major external macroeconomic imbalance and a high vulnerability to shocks. The Romanian economy is characterized by a high level of the twin deficits, which involves important challenges for the country's economic stability and calls for fiscal consolidation.

The labor market exhibited a positive evolution, with the average number of employees increasing by 1.5% compared to the previous year, which corresponds to a 0.5 pp reduction in the ILO unemployment rate. The average gross earnings continued its upward trend from previous years, registering a 7% advance compared to 2020.

The dynamics of non-governmental credit remained on an upward trajectory, recording an increase of 6.1% in real terms compared to the previous year, due to an increase in the volume of loans granted in lei. The programs implemented during 2020 to combat the consequences of the pandemic (IMM Invest with the AGRO IMM Invest sub-program) were also extended in the first half of 2021, thus, exerting a positive effect on credit dynamics. In 2021, labor market data showed an average number of employees of 5,105 thousand people (+1.5% compared to the previous year), as well as an ILO unemployment rate of 5.6% (-0.5 pp compared to 2020). The average gross earnings across the economy was 5,577 lei (+7.0% compared to 2020), the average net earnings was 3,448 lei (+7.2%), while the real earnings registered an increase of 2%, given an average annual inflation of 5.1%.

The two budget revisions carried out during 2021 recorded a large upward adjustment of budget revenues due to the recovery, above initial expectations, of taxes deferred from payment by companies during the previous year, as well as due to the impact of more favorable macroeconomic developments than anticipated when drafting the initial budget. However, the two revisions did not stipulate a reduction of the targeted budget deficit, as it was needed, the additional revenues being fully allocated for increases in expenditures and even recording additional increases in budget expenditures. This situation has complicated the budget consolidation process, all the more so since part of the

The general consolidated budget for 2021 (drafted in February 2021) was based on a macroeconomic scenario that projected a real GDP growth of 4.3% and a GDP deflator of 2.8%. Considering Romania's placement in the excessive deficit procedure, the 2021-2023 FS set a return path for the budget deficit, in ESA 2010 terms, below the reference level of 3% of GDP by 2024.

The two budget revisions carried out during 2021 recorded a large upward adjustment of budget revenues due to the recovery, above initial expectations, of taxes deferred from payment by companies during the previous year, as well as under the impact of more favorable macroeconomic developments than anticipated when drafting the initial budget. However, the two revisions did not stipulate a reduction of the targeted budget deficit, as it was needed, the additional revenues being fully allocated for increases in expenditures and even recording additional increases in budget expenditures. This situation has complicated the budget consolidation process, with the FC emphasizing in its Opinions that it is mandatory to combine the rigorous control of public spending (expenditures that ensure basic public goods for citizens and which, at the same time, take into account the constraints imposed by budget consolidation) with a significant increase in tax revenues.

additional revenues collected in 2021 was temporary or due to the favorable cyclical dynamics of the economy, while an even greater part of the increase in expenditures was generated by permanent expenditures.

Increasing tax revenues has become a matter of national economic security, considering current economic emergencies and important future challenges for Romania.

The 2021 budget execution recorded a cash deficit of 6.8% of GDP (lower than the initial target of 7.2%), mainly due to an increase in nominal GDP above initial estimates. According to the European methodology, the deficit was 7.1% of GDP, significantly below the level of 8.2%, projected in the initial budget. Although the budget deficit decreased by 2.2 pp of GDP compared to the previous year, the structural deficit decreased by only 1.5 pp of potential GDP to the level of 6.3%. This situation stems from the fact that part of the additional revenues collected in 2021 was temporary or due to the favorable cyclical dynamics of the economy, while an even greater part of the increase in expenditures was generated by permanent expenditures that affect the structural budget balance.

Investment expenditures stood at 5% of GDP, a level similar to the one from the previous year, when an investment recovery has been recorded. The Fiscal Council appreciates that, by improving the absorption of the European resources made available to Romania, it is possible to boost investments in the coming years.

In 2021, investment expenditures stood at 5% of GDP, a level similar to that recorded in the previous year, but under the conditions of a nominal GDP growth of 11.6%. The nominal increase compared to the previous year was 6.1 billion lei, the advance being due to projects financed from post-accession non-refundable external funds (+6.9 billion lei), while sources from the domestic economy were lower by approximately 1.3 billion lei compared to 2020. In the context of the significant volume of European funds allocated for investments, that Romania benefits from, increasing public investments through an improved absorption of EU funds is essential to eliminate infrastructure gaps, simultaneously with increasing the quality of programming and implementation of investment projects.

The Fiscal Council advocates stepping up efforts to implement public investment reform measures in order to use as much as possible the significant volume of European funds allocated through the National Recovery

Given the limited progress made in the reform of public investment management, the FC advocates increasing transparency and a better prioritization of public investments, streamlining the allocation and spending of public money, increasing investment in research, development and innovation, in physical and digital infrastructure. In this sense, achieving a much better absorption of European funds from the 2021-2027 financial framework and obtaining additional resources through the Recovery and Resilience Mechanism[1], are prerequisites for a significant increase in public

[1] The total amount of the two resources is about 80 billion euros: 29.2 billion euros through the Recovery and Resilience Mechanism (RRM) and about 51 billion euros through the 2021-2027 Multiannual Financial Framework

and Resilience Plan and the Multiannual Financial Framework.

investment expenditures in the following period. The realization of reforms set in the National Recovery and Resilience Plan (NRRP) can boost the investment process, allowing a higher economic growth together with the adjustment of the budget deficit according to Romania's commitment within the EDP, as well as the achievement of budget consolidation.

Romania has a very low level of budget revenues and fiscal revenues relative to GDP, ranking second to last in the EU in 2021, similar to the 2016-2020 period.

Romania recorded in 2021, according to the ESA 2010 methodology, a level of budget revenues of 32.8% of GDP (14.1 pp below the European average), among the lowest in the EU27, being followed only by Ireland. The level of fiscal revenues (including social security contributions) was 27.2% of GDP, Romania being on the penultimate place, with a gap of 14 pp relative to the EU27 average. Romania's share of fiscal revenues (including social security contributions) in GDP was significantly lower than those recorded by Slovenia (37.9%), Poland (37.6%), Czechia (34.9%), Hungary (33.6%) and Bulgaria (31.8%) in 2021. This situation is also the result of the large-scale tax cuts implemented after 2016 which resulted in the reduction of the share of budget revenues (including non-tax revenues and European funds) in GDP by 2.7 pp in 2021 compared to 2015, and of tax revenues by 0.8 pp of GDP, while across EU27 their share increased by 0.7 and, respectively, by 0.8 pp of GDP.

In what concerns the efficiency and streamlining of the tax administration, the reform initiated in Romania in this area seems to stagnate, with unsatisfactory results from the perspective of budget revenues relative to the obligation to reduce the budget deficit, following the placement of our country in the EDP, and relative to the obligations deriving from the need to maintain public finances on a sustainable path under tense geopolitical and economic

Romania's placement at the bottom of the ranking from the perspective of the collection of budget revenues as share of GDP in the last 6 years is also the effect of an insufficiently modernized tax administration, the reforms initiated in this regard 10 years ago being either carried out at a slow pace or cancelled, as is the case with the *Revenue Administration Modernization Project* (initiated in 2013 and abandoned in 2019), a program similar to that carried out by Bulgaria between 2002-2008 which resulted in increasing budget revenues. The launch of *the Strengthening the capacity of NAFA to support modernization initiatives* program in 2019, which introduced electronic public services oriented towards the business environment, respectively, the launch in March 2021 of the *NAFA Strategy 2021-2024* and the *Digital Strategy 2021-2025* with an ambitious plan aimed at the modernization and digitalization of the tax administration, financed through NRRP, can support a real

(MFF), which includes 31.5 billion .euro from the cohesion policy and about 20 billion euros in funds for agriculture and rural development.

conditions. The Fiscal Council appreciates that sustained efforts are needed to increase investments in the infrastructure of the tax administration, especially in digital technology to ensure the digital transformation of the economy.

reform of NAFA. It should be noted that, from the perspective of the Digital Economy and Society Index, according to the 2021 EC Report, Romania ranked last in the EU27 in 2020. The Fiscal Council appreciates that sustained efforts are needed to increase investments in the infrastructure of the tax administration, especially in the digital one. From the experience of EU and OECD Member States that have progressed in digital transformation, it has been demonstrated that these investments improved the functioning of public institutions, leading to increased tax revenues.

In 2021, there was a relative improvement in the use of the contingency reserve fund available to the Government, both from the perspective of the total expenditures incurred and of the number of Government decisions adopted to allocate amounts from this fund. Compared to the previous year, total allocations from the contingency reserve fund decreased by 42.7%, transfers to the central administration by 64.8% and those to local authorities by only 12.8%.

Given that 2021 was marked by an economic recovery after the impact of the COVID-19 pandemic in 2020, there was a relative improvement in the use of the contingency reserve fund, both from the perspective of the total expenditures incurred and of the number of Government decisions adopted to allocate amounts from this fund. However, excluding those expenditures generated by combating the socio-economic effects induced by the pandemic waves, a significant part of the contingency reserve fund was allocated for expenditures that cannot be considered unforeseen and, consequently, should have been taken into account at the elaboration of the state budget. Thus, in 2021, approximately 4.6 billion lei were allocated from the contingency reserve fund (1% of total expenses, respectively 0.4% of GDP), out of which 1.6 billion lei to the central administration and almost 3 billion lei to the local one. Compared to the previous year, total allocations from the reserve fund decreased by 42.7%, transfers to the central administration by 64.8% and those to local authorities by only 12.8%.

The Fiscal Council considers that it is necessary to amend the legislation governing the use of the contingency reserve fund.

The Fiscal Council considers that it is necessary to amend the legislation governing the use of the contingency reserve fund, reiterating the recommendation to explicitly specify the expenditures that can be incurred from the reserve fund together with greater transparency, including by regularly reporting to Parliament on the manner and level of use of the reserve fund.

Starting from 2016, the appeal to discretionary increases of permanent expenditures, led to an increasingly rigid structure of budget expenditures. The decrease of the ratio between

Starting from 2016, with the implementation of the new Fiscal Code that led to a large-scale fiscal relaxation (which caused the reduction of budget revenues), the appeal to discretionary increases of permanent expenditures has been perpetuated, resulting in an increasingly rigid structure of budget expenditures. It should be noted that the rapid increase in public sector wage

personnel/social assistance expenditures and total budget revenues was achieved in 2021 due to obtaining temporary revenues. Funding permanent expenditures with such revenues entails increased risks to the sustainability and stability of public finances.

expenditures has led to Romania occupying, from 2018, the first place in the EU in terms of their ratio to total budget revenues, although it should be noted its decrease from 37% in 2020, to 33.8% in 2021. Also on a downward trend is the ratio between social assistance expenditures and total budget revenues, with a decrease of 0.8 pp in 2021 compared to 2020. This fact is due to the evolution of the economy and to the revenues received by the state from recovering taxes deferred from payment in the previous year. It should be noted that funding permanent expenditures with cyclical, temporary revenues entails increased risks to the sustainability and stability of public finances, being imperative to keep these rigid expenditures under control.

In 2021, personnel and social assistance expenditures represented 87.4% of tax revenues (including social security contributions). Reducing the structural budget deficit requires increasing the level of tax revenues, as well as caution regarding the increase of permanent expenditures.

After the peak reached in 2020, when personnel and social assistance expenditures represented 94.3% of tax revenues (including social security contributions), respectively 23.9% of GDP, the ratio between these expenditures and tax revenues (including social security contributions) improved in 2021, decreasing to 87.4% (21.4% of GDP). This improvement is not due to corrective measures, but to obtaining cyclical and one-off revenues, this fact being demonstrated by the evolution of tax revenues (including social security contributions), namely +10.1% in 2021 compared to 2020, while personnel and social assistance expenditures increased by only 1.6%. Reducing the structural budget deficit requires increasing the level of tax revenues, as well as caution regarding the increase of permanent expenditures.

2022 began in a macroeconomic landscape marked by great uncertainties and the war in Ukraine induced new shocks on supply and production chains, contributing to the slowdown of economic growth. The EC estimates for Romania an economic growth of 3.9% in 2022, above the IMF projection of 2.2%. The NBR anticipates an increase in CPI inflation to 12.5% at the end of

The significant return of demand, simultaneously with the problems arising in the supply and production chains and with the energy crisis, led to a macroeconomic landscape marked by great uncertainties regarding the future evolution of the global economy. The war in Ukraine induced new shocks including on the supply, production and distribution chains, accentuating the increase in the prices of raw materials and energy, which accelerated the dynamics of other prices, contributing to the slowdown of economic growth.

In its summer forecast that was recently published[2], the European Commission anticipates for Romania an economic growth of 3.9% in 2022 (above the IMF estimate of 2.2%), its determining factors being private consumption and gross fixed capital formation, the

[2] European Economic Forecast - Summer 2022, Brussels, July 2022.

2022.

evolution of investments being also supported by the forecasted absorption of the European funds allocated through both the multiannual financial framework and the NRRP. The latest NBR projections place the annual CPI inflation rate at 12.5% at the end of 2022, due to the evolution of exogenous prices, especially those for energy goods, fuel, fruits, vegetables, eggs, alcohol and tobacco.

Given the high level of inflation and, by implication, of the deflator, nominal GDP growth in 2022 may appear to be underestimated. Such an evolution could lead, given a stronger dynamics of the economy that is reflected in fees and taxes, to the registration of higher budget revenues.

In its opinion on the draft budget for 2022 and the fiscal strategy for the 2022-2024 period, the Fiscal Council considered that high inflation could affect future real growth. On the other hand, the fiscal effect is favorable in the short term because, under the conditions of a much faster evolution of the deflator, nominal GDP growth for 2022 could appear to be underestimated. Such an evolution could lead, given a stronger dynamics of the economy that is reflected in fees and taxes, to the registration of higher budget revenues. These assessments are based on the assumption of a course without sudden changes in the economy, which does not and cannot take into account the rapid, large-scale developments determined by the changing geopolitical context, by the change in financing conditions, by events that affect the absorption of European funds.

The draft budget for 2022 envisaged a deficit target of 5.9% of GDP, according to the cash methodology, and of 6.2% of GDP, according to the European methodology. Taking into account a prudent evaluation of the revenue and expenditure projections, the FC assessed in its Opinion that the draft budget for 2022 was compatible with a cash deficit of around 7% of GDP, making the budget consolidation process more difficult, because not enough adjustment measures have been identified to support the achievement of the budget deficit target. Moreover, after the preparation of the draft budget, a series of measures were adopted

The draft budget for 2022 envisaged a deficit target of 5.9% of GDP, according to the cash methodology, and of 6.2% of GDP, according to the European methodology. The reduction of the deficit was expected to be achieved partly by increasing budget revenues (mainly by increasing collection efficiency/reducing tax evasion) and partly by freezing the majority of public sector wages, respectively by growth rates lower than the nominal GDP dynamics for expenditures with goods and services, social assistance and other transfers. Taking into account a prudent evaluation of the revenue and expenditure projections, the FC assessed in its opinion that the draft budget for 2022 was compatible with a cash deficit of around 7% of GDP (equivalent to 7.5% of GDP according to the European methodology), making the budget consolidation process more difficult, since not enough adjustment measures have been identified to support the achievement of the budget deficit target. Moreover, after the preparation of the draft budget, a series of measures were adopted with an additional impact on budget expenditures and, implicitly, on the deficit, such as: support measures to protect the population and the economy by capping electricity and natural gas prices, the "Support for Romania"

with an additional impact on budget expenditures and, implicitly, on the deficit.

program which includes measures to support the economy and social measures to protect the population, granting salary increases for employees in different sectors etc.

The medium-term adjustment of the budget deficit is partly explained by a reduction in the share of budget expenditures in GDP, combined with an increase in the share of budget revenues. In this sense, the FC considered that a combination of macroeconomic measures is needed to try to avoid entering recession, which implies a firm but gradual implementation of the budget consolidation process. Therefore, the increase of tax revenues represents a problem of economic security and national solidarity so that the public budget can cope with very large current and future needs.

The adjustment of the budget deficit in the medium term (2023-2025) will be determined, according to the projections of the Convergence Program, by a reduction in the share of budget expenditures in GDP by 1.7 pp, combined with an increase in the share of budget revenues by 1.6 pp. In this sense , the FC considered that, given the complicated international context and overlapping crises faced by both Romania and the EU, a combination of macroeconomic measures is needed to try to avoid entering recession, which implies a firm but gradual implementation of the budget consolidation process.

The FC emphasizes that macroeconomic adjustment and fiscal consolidation require a significant increase in tax revenues, which are at an unacceptably low level in relation to Romania's needs and compared to EU benchmarks. In this sense, it is necessary to remove exemptions and loopholes from the current legislation, as well as to increase collection efficiency by discouraging tax optimization and reducing evasion. It should be borne in mind that such measures have a significant distributional impact, so, their implementation may face difficulties and the opposition of certain interest groups. However, the overall interest of the economy and society must prevail.

The budget consolidation process cannot be achieved only by restricting expenditures, the increase of tax revenues representing a problem of economic security and national solidarity so that the public budget can cope with very large current and future needs. Taking into account that public health and education are chronically under-funded, the military and geopolitical context calls for increased defense and security spending, the very severe impact of climate change requires state intervention in difficult times, a significant increase of tax revenues is vital and it should be a priority of economic policy.

A fiscal-budgetary consolidation that is too slow increases the risks to the smooth financing of external and internal imbalances, as well as in terms of financing conditions. Achieving fiscal consolidation in a climate of contractionary policies is much more difficult. Precisely for this reason, the use of the financing made available by the EU, which replaces as much as possible the use of domestic resources, is essential for the stability of the Romanian economy.

The FC considers, taking into account the newly adopted or announced fiscal-budgetary policy measures and the prevalence of certain budget expenditures in the second part of the year, that the deficit target for 2022, despite the budget execution in the first semester, is difficult to achieve. It is more likely that the deficit according to the cash methodology will be placed between 6.3-6.8% of GDP and the one according to the European methodology between 6.6-6.9%.

The budget execution in the first semester of 2022 exhibited a deficit of 1.7% of GDP, largely influenced by the evolution of nominal GDP. However, considering the newly adopted or announced fiscal-budgetary policy measures and the prevalence of certain expenditures in the second part of the year, the FC considers that the budget deficit target for 2022 is still difficult to achieve. It is more likely that the deficit according to the cash methodology will be placed between 6.3-6.8% of GDP and the one according to the European methodology between 6.6-6.9%. The FC favorably revised its assessments regarding the budget deficit for 2022 compared to those from its opinion on the draft budget. This revision is mainly attributable to the significant increase in the nominal GDP projection for the current year which is likely to lead to important additional revenues.

There is a need for firm fiscal/budgetary consolidation measures in the coming period, in the following years, which will allow Romania to maintain access to financing (internal and external) at costs that do not overwhelm the public budget. These measures can be applied through a gradual macroeconomic correction which should take into account the very complicated international context, the strengthening of monetary policies in the world, the unfortunate implications of the war in Ukraine.

European resources (NRRP and MFF) are a vital tool, the only one with counter-cyclical action under the current conditions; they can boost structural reforms, help the energy transition and improve the competitiveness of the domestic economy.

II. Macroeconomic framework in 2021

In 2021, the economic activity in Romania entered a process of rapid return to pre-pandemic levels, related to 2019 and the first quarter of 2020. Rapid recovery process - real growth of 5.9%[3] – has its determinants both in a base effect - located, in particular, at the level of the second quarter of 2021 - and in the positive impact of government fiscal measures, as well as a return of confidence at the level of economic operators, who thus used their forced savings from the pandemic period (*pent-up demand*).

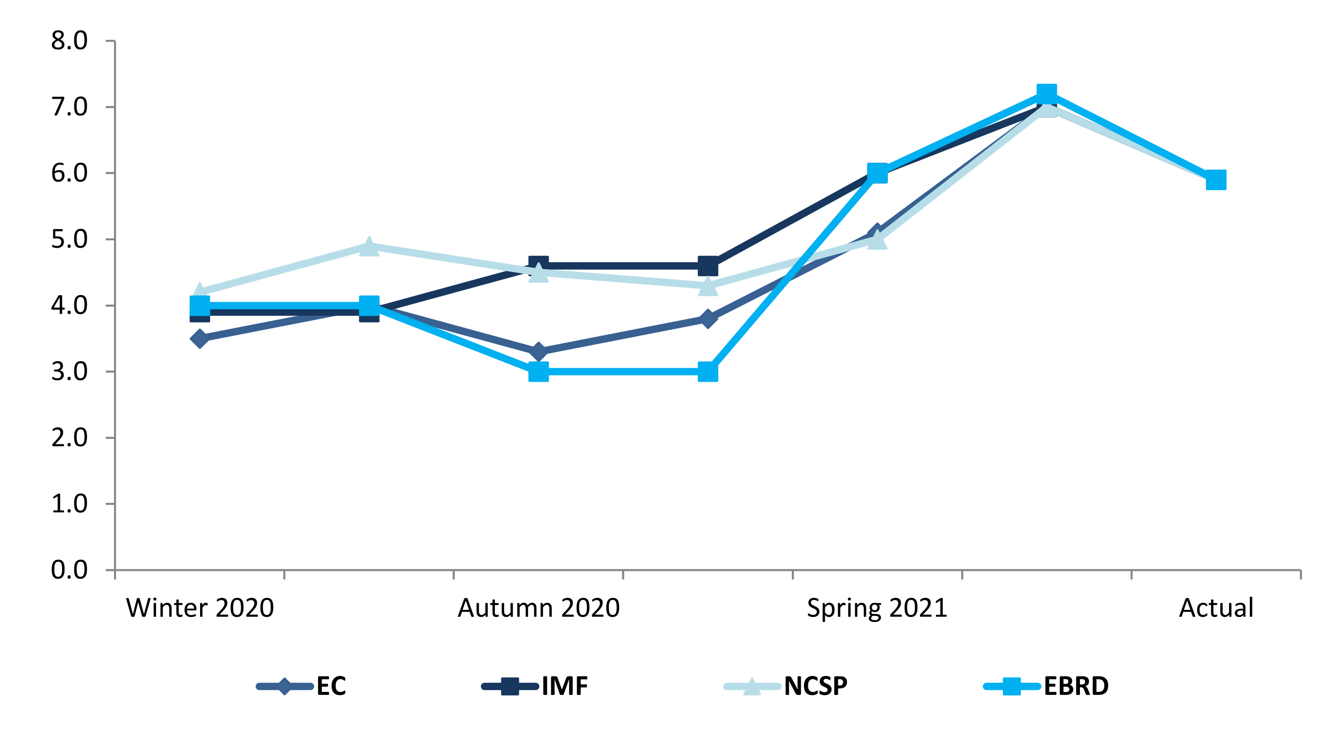
Household consumption expenditure contributed [4] to the economic recovery, to the greatest extent, with 4.7 pp – and against the background of the major reduction during the pandemic period. On the supply side, value added from retail and wholesale trade (contribution of 1.8 pp to GDP growth of 5.9%), together with value added from the information and communications sectors (0.8 pp) as well as industry (1.1 pp), to which is added the positive evolution of the added value from agriculture (contribution of 0.4 pp), all led to the rapid recovery of real GDP. The trajectory of the Romanian economy was in line with the trends observed at the global and European level, the EU countries with a faster recovery being Ireland (13.5%), Croatia (10.2%) and Malta (9.3%). Romania occupies, according to the criterion of real growth from the year 2021, a median position among the 27 EU states - the 13th position -, the average GDP growth being, both within the EU bloc and within the euro zone, approximately 5 ,4%. Romania's real gross domestic product exceeded, in the second quarter of 2021, the maximum pre-pandemic value, thus confirming the European Commission's forecast in this regard made during the past year.

From the analysis of *Figure 1*, it appears that the forecasts of the international financial institutions (EC, IMF and EBRD) from 2020 anticipated, for 2021, an economic growth in the range of 3-4.6%. The NCSP forecast was more optimistic, being in a range of 4.2-4.9%. Subsequently, as statistical data for 2021 accumulated, forecasts were progressively revised upwards, with the maximum values of GDP growth forecast by international financial institutions being around 7-7.2%. NCSP followed this trend, the forecasts made during 2021, regarding the growth in the same year, reaching the value of 7% in the immediate temporal proximity of the publication of the data. Finally, the GDP growth rate was lower compared to the last versions of the projections (by about 1 pp), mainly due to a slower-than-expected evolution in the last quarter of 2021, amid multiple problems and shocks adversities faced by the world economy as well as the national one - from blockages in the supply chains, to the high prices of production inputs. An element specific to Romania was represented by the poor performance of the agricultural sector in the last quarter of the year, accompanied by that of sectors such as financial intermediation and insurance, construction and industry.

[3] According to the GDP data in the first quarter of 2022 (provisional data 2), published by the NIS on July 8, 2022, the calculations of the contributions using the nominal weights of the components in the GDP.

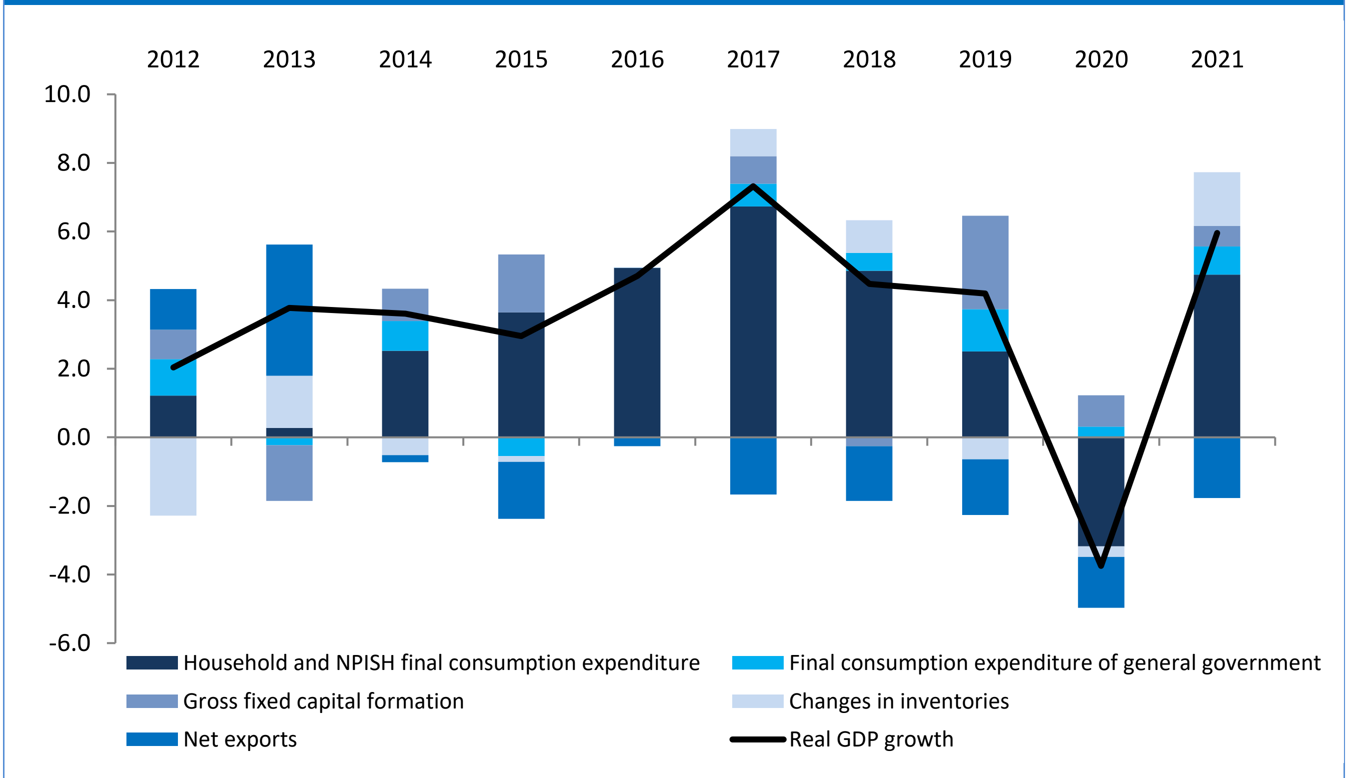
[4] Contributions to GDP dynamics were calculated by FC based on NIS data.

Figure 1: The evolution of economic growth forecasts for 2021



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*), household consumption had the biggest contribution to the positive dynamics of GDP (+4.7 pp) accompanied by public administration consumption and gross fixed capital formation (with a contribution of 0.8 pp and 0.6 pp respectively). This confirms, thus, the return of expectations and confidence of the population and, therefore, a use of *forced saving* (during the pandemic) to satisfy repressed consumption accompanied by investments made by both the private and public sectors. In addition, government programs to support the economy alongside public investment lead to a positive contribution of this sector to annual economic growth. The variation in stocks - historically characterized by very large changes - has a positive contribution to economic growth (+1.6 pp), but overcompensated by the negative contribution of the net export of goods and services (-1.8 pp). The latter is due both to a more accelerated dynamics of imports in relation to exports in the analyzed year, and to a greater weight in GDP, at the initial moment, of imports in relation to that of exports.

On the supply side, the rapid recovery of GDP is explained by the positive contributions of most sectors of the national economy, thus:

- retail and wholesale trade (+1.8 pp), with a share in training of 19%, against the background of the increase in sales in the context of the return of confidence;
- industry (+1.1 pp), against the background of the economic recovery, having a weight of 21.2%;
- the information and communications sector (+0.8 pp), with a share in GDP formation of 6.3%;
- net taxes on the product also had a positive contribution, of approximately 0.8 pp, representing, in the overall GDP, 9.7%;
- performance, cultural and recreational activities; repairs of household products and other services contributed 0.4 pp to GDP growth, with a share in its formation part of 3%;
- professional, scientific and technical activities; administrative service activities and support service activities contributed 0.4 pp to the positive dynamics of GDP, with a share for 2021 of 7.1%;
- agriculture, forestry and fishing contributed 0.3 pp to the GDP advance, having, cumulatively, a weight of 4.3% on the part of its formation.

The dynamics of the financial intermediation and insurance sectors, as well as the construction sector, acted in the opposite direction, both with marginal values of contributions to the GDP dynamics.

In 2021, in contrast to 2020 – when inflation evolved on a downward trajectory, from 3.6% in January 2020, to 2.1% in December 2020, so broadly within the range targeted by the bank central rate, of 2.5% plus/minus 1 pp -, there is a recrudescence of inflation especially towards the end of the year - from an inflation rate of 3.0% in January to 8.2% in December 2021. The average rate of inflation in 2021 was 5.1% compared to 2.6% - the average for the previous year. The determining factor of this general rise in prices was, in the main[5], increasing energy prices – fuels, electricity and natural gas – and passing these increases on to production and distribution chains. The inflation rate within the Fiscal Strategy 2021-2023 was anticipated at 2.5% in December 2021 and 2.4% on average for the entire year, the

[5] The increase in these prices explaining, regardless of the period, more than 50% of their variation as a whole.

differences from the values actually recorded being +5.7 pp and +2.7, respectively pp. The large and unanticipated increase in prices has its causes in the increase in the prices of energy raw materials, food, but also non-energy raw materials. In addition, the sudden, widespread and synchronized recovery of demand in most of the world's economies led to persistent problems in global value-added chains that amplified and accelerated the transmission of multiple supply shocks at the level of consumer goods. Similar developments were also recorded at the level of the GDP deflator - which measures price dynamics at the level of the entire economy, not only at the level of final goods and services - which was anticipated, for 2021, in the FS 2021-2023, at 2.8%, but the actual value far exceeded the forecast, being 5.4%.

Inflation followed an upward trajectory throughout 2021, exceeding in May (with a 3.75% year-on-year variation of the CPI) the upper limit of the range targeted by the NBR - of 3.5%. At the end of the second quarter of 2021, inflation recorded a value close to 4%, and at the end of the next two quarters values of 6.3% and 8.2%, respectively. The shocks on the supply side, from prices exogenous to the influence of monetary policy (administered prices for electricity, gas, fuels, fruit, vegetables and eggs, tobacco and alcohol), were the main determinant of this evolution, their contribution to total inflation exceeding two thirds in the last two quarters of the year. It should also be noted that the increases in gas and electricity prices (at the end of 2021 they were approximately seven times and four times higher, respectively, than at the end of 2020) began to be transmitted, towards the end of 2021, on production chains and other prices in the economy, subsequently registering a deterioration of short-term inflationary expectations. It can also be mentioned that the CORE3 inflation rate was marginally below 3% in the first two quarters of the year (2.8% and 2.9%, respectively) and left the range of variation related to the stationary target of the NBR (2, 5% plus/minus 1 percentage point) starting from the third quarter of 2021 - the recorded value being 3.6% - and in the following quarter 4.7%.

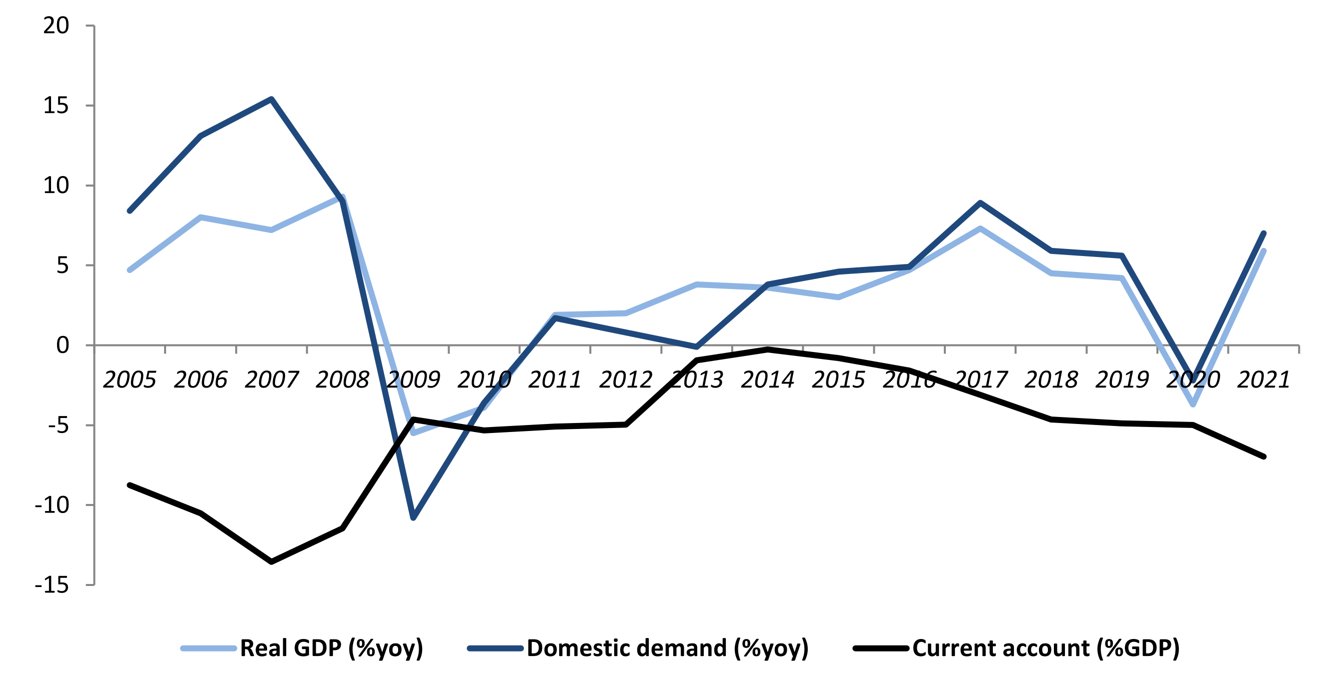
As a result of these upward developments in inflation, concentrated especially towards the end of 2021, the NBR operated two interest rate increases in 2021, both by 0.25 pp, from 1.25% monetary policy rate at the beginning of 2021 to 1 .50% (in October) and then 1.75% (in November). Regarding the minimum reserve ratio (MRR), they were maintained at 8% for liabilities in national currency, while for foreign currency liabilities the MRR rate was 5%.

The current account deficit[6], as an indicator of Romania's external position, it recorded a constant increase during 2021, reaching 7% of GDP at the end of the year, a significant increase of +2 pp, compared to the value of the previous year. The deepening trajectory of the current account deficit over the last few years raises questions about the evolution of external imbalances and the degree of competitiveness, with the European Dashboard establishing an alert threshold when the average current account deficit over the last 3 years exceeds 4% of GDP . In the case of Romania, this average reached the level of 5.6% of GDP in 2021, thus exceeding this threshold in each of the last three years, the Romanian economy being, thus, characterized by a high level of twin deficits that pose important challenges for economic stability of the country. It can also be mentioned that the budget deficit, in

[6] Data source: NBR, interactive database.

some years[7], it even exceeds the current account deficit of the balance of payments, which points to it as the main source of external imbalance and implies the objective necessity of adjusting the fiscal stance.

Figure 3: The evolution of real GDP, domestic demand and current account balance between 2005-2021



Source: NBR, Eurostat, Fiscal Council's calculations

The increase in the current account deficit was mainly determined, similarly to the previous year, by the significant deepening of the goods and services balance deficit, from 9.5 billion euros in 2020 to 13.6 billion euros in 2021 (the equivalent an increase of 43.2%), this being determined by the unfavorable evolution of the goods balance, whose deficit increased by 4.2 billion euros, from 19 billion euros in 2020 to 23.2 billion euros in 2021, while the balance of services acted only marginally in the opposite direction, its surplus increasing by 0.1 billion euros, from 9.4 billion euros in 2020 to 9.5 billion euros. In order to increase the current account deficit of the balance of payments, both the balance of primary incomes and the balance of secondary incomes acted. Thus, the primary income balance shows an increase in the deficit by 0.9 billion euros (the equivalent of +26%), from 3.3 billion euros in 2020 to 4.2 billion euros in 2021, and the secondary income balance of registered a surplus reduced by 0.9 billion euros, from a positive result of 1.9 billion euros in 2020 to only 1.1 billion euros in 2021 (the equivalent of -46%).

Analyzing the evolution of the current account from the perspective of the savings-investment balance, we can see that the savings rate, as a share of GDP, decreased by 0.5 pp, and the investment rate increased by 1.5 pp, which explains the increase in the current account deficit by 2 pp between 2020 and 2021, from 5% to 7% of GDP. Compared to 2007, which marked the largest deficit as a share of GDP

[7] For example in the years 2009-2010, 2013-2014, 2016 as well as in 2020-2021.

of the current account of the balance of payments, of 13.6%, the adjustment to the current level, of 7% of GDP, occurred as a result of a reduction of 5.4 pp in the investment rate and a 1.1 pp increase in the saving rate.

Regarding the financing of the current account deficit (of 16.8 billion euros), this was achieved, for the most part, through the financial account of the balance of payments (13 billion euros) and, to a lesser extent, through the contribution capital account (5.2 billion euros). Within the financial account, direct investments (in the form of equity participations but also debt instruments) explain the majority of available financing. Thus, direct investments increased, between 2020 and 2021, by 4.3 billion euros, from 3.0 billion euros to 7.3 billion euros, representing +147%. This shows a significant return of direct investment after the pandemic period to a level higher than their pre-pandemic values. However, in the conditions of the deterioration of the current account deficit, its coverage by non-debt generating flows (these being considered to be the balance of the capital account, and from the financial account, only "equity participations") reduced to 65.5 % at the end of 2021, from 70.7% in the previous year.

In 2021[8], Romania's gross external debt increased by 6.2% compared to the previous year, to a level of around 135 billion euros at the end of December, its share in GDP decreasing by 2.0 pp compared to December of the previous year , up to the level of 56.4%. It should be noted that, before 2021, the share of external debt in GDP was gradually reduced compared to the period 2010-2012, when the indicator was around 75%. On the other hand, it is expected that the trend of increasing the rate of growth of external debt, initiated in 2020, will continue in the coming years.

Of the total external debt at the end of 2021, 72.2% was represented by long-term debt, this category slightly decreasing in structure, from the level of 73.8% reached previously (however registering an increase of 3.9% , from approximately 93.5 billion euros to 97.1 billion euros). The short-term external debt also evolved in the same direction, which increased by 4.2 billion euros (+12.6%), reaching the level of 37.5 billion euros, and its share in the total external debt increased by 1.6 pp, to 27.8% in 2021. Thus, there is an interruption of the trend of rescheduling external debt by maturities manifested by the continuous reduction of the share of long-term debt (located around the level of 80% in the period 2013-2014) in favor of short-term external debt, with the year 2021 recording a share of long-term external debt above the 70% level, but decreasing compared to the previous year. Moreover, the recent trend of increasing the share of long-term debt seems to have stopped and even reversed, with the year 2021 recording a first decrease in its share in total.

The evolution of long-term debt in 2021 was mainly determined by the increase in the volume of commercial loans and advances (+2 billion euros) as well as the increase in the value of special drawing rights held by the central bank (+2.2 billion euros) . Direct external public debt increased by only 0.7 billion euros at the end of 2021 compared to 2020, after a more significant evolution in the previous year - and as a result of bond issues carried out by the MF on foreign markets.

[8] Data source: NBR, interactive database.

The dynamics of non-governmental credit[9] remained on an upward trajectory, registering a 6.1% year-on-year increase in real terms in December 2021. The lei component of non-governmental credit increased by 10.5% in real terms, while foreign currency credits continued to lose ground, in relative terms, with an increase of only 2.2% in euro equivalent. The programs that were created to combat the consequences of the pandemic, during 2020 - for example IMM Invest with the AGRO IMM Invest subprogram - were also extended in the first half of 2021, thus exerting a positive effect on lending dynamics. The "New Home" program also contributed to credit growth, even if it decreased compared to the previous period. In the segment of loans granted to the population in lei, their dynamics continued their alert pace, accelerating their growth in 2021 (+15.3%, the equivalent of +6.6% in real terms). Foreign currency loans granted to the population registered, in the same period of time, a significant nominal decrease of 11.9%, which corresponds to a contraction in real terms of 18.6%. Loans granted to non-financial companies and non-monetary financial institutions continued to accelerate their growth, both in lei (+26.2% in nominal terms and +16.6% in real terms) and in foreign currency (+12.8%, the equivalent of +4.3% in real terms).

The NPL ratio continued the downward trend from previous years, reaching 3.34% in December 2021, compared to 3.71% in December 2020. The provision coverage ratio reached the end of 2021 at 66.1% from 62.75% in 2020 – well above the European average of 44.5%. Also, from a macroprudential point of view, a comfortable liquidity can be found at the level of the banking system, with the liquidity requirement coverage indicator standing, at the end of 2021, at 238.8%. At the same time, the ratio of loans to deposits for the population and non-financial companies was placed at approximately 64% - highlighting problems in the absorption of credit both at the level of companies and at the level of households. For companies, the generating factor is the decapitalization problems of the real sector, which also lead to the lack of bankable economic agents in the economy (only about 9.2 thousand out of about 700 thousand companies). At the household level, the strong sub-unit ratio between loans and deposits also reflects the high income inequality - one of the highest in the EU - which also reduces the appetite for bank loans, as well as the creditworthiness of potential borrowers.

In 2021, data on the labor market highlight an average number of employees that increased slightly to 5105[10] thousands persons (+1.5% compared to the previous year), as well as a BIM unemployment rate that decreased by 0.5 pp compared to 2020, to 5.6%. The average gross salary gain for the economy as a whole was 5,577 lei [11] (+7.0% compared to 2020). The average net salary was 3,448 lei (+7.2% compared to the previous year), and the real salary increased by 2%, in the conditions of an average annual inflation of 5.1%

Considering the obligation of the Fiscal Council to include in its annual report an ex post evaluation of the macroeconomic and budgetary forecasts contained in the fiscal-budgetary strategy that is the subject of the report (according to art. 61 of the FRL), *Table 1* presents the main macroeconomic forecasts from the FS 2021-2023 compared to the values actually achieved in 2021, according to the latest

[9] Data source: NBR, interactive database.

[10] According to the NCSP spring forecast of April 2022.

[11] According to the NCSP spring forecast of April 2022.

available data. It should be emphasized that the accuracy of the Fiscal Strategy forecast must also be evaluated considering the exceptional circumstances of the post-pandemic period.

Table 1: Main macroeconomic indicators in 2021 (Fiscal Strategy forecast versus actual)

	Fiscal Strategy 2021-2023	Actual 2021
	- %, change, year on year, -	
GDP		
GDP (mil. lei)	1,116,837	1,181,917.9
Real GDP	4.3	5.9
GDP deflator	2.8	5.4
GDP components		
Final consumption	3.5	6.6
Private consumption expenditure	3.7	7.9
Government consumption expenditure	3.0	0.4
Gross fixed capital formation	6.5	2.3
Exports of goods and services (volume)	8.1	12.5
Imports of goods and services (volume)	10.6	14.6
Inflation		
December 2021	2.5	8.2
Annual average	2.4	5.1
Labour market		
ILO unemployment rate (end of period)	4.5	5.6
Average number of employees	1.3	1.5
Net average wage	4.5	7.2

Source: NCSP, Eurostat, MF

III. Fiscal policy in 2021

III.1. Main features of the fiscal-budgetary policy in 2021

After in 2020 the budget deficit recorded a substantial deepening to the level of 9.8% of GDP in national standards, respectively 9.4% of GDP according to the ESA 2010 methodology (against the effects generated by the COVID-19 pandemic which determined a contraction of 3.9% of the real GDP), the year 2021 raised important challenges for the fiscal-budgetary policy in Romania considering the urgent need to initiate a macroeconomic correction to control the deficits in the following years. In the following, the main features of the fiscal-budgetary policy from 2021 will be summarized, these being detailed later in this report:

- The construction of the budget for the year 2021 and the subsequent deficit correction trajectory (national, ESA, structural) projected through the FS 2021-2023 signaled, in the opinion of the FC at that time, a change in approach to the fiscal-budgetary policy and the entry into -another philosophy of budget construction from the perspective of the sustainability of public finances. Thus, the draft budget for 2021 provided for a deficit target of 7.16% of GDP according to the national methodology (-2.6 pp compared to the previous year), respectively of 8.23% of GDP according to the ESA 2010 methodology (-1.2 pp compared to the previous year). The projected reduction of the deficit was significantly supported by two exceptional elements: the amounts expected to be collected in 2021 from the budget obligations related to 2020 deferred for payment by economic agents and the expected rental in 2021 of the 5G frequency bands. However, this element does not represent structural adjustment measures, justifying the smaller scale reduction of the deficit calculated according to the European methodology. At that time, the FC considered it feasible to reach the deficit target and recommended that the eventual materialization of additional revenues be used to reduce the budget deficit, easing the consolidation effort in the following years.
- The analysis of the medium-term budget projection revealed that the deficit adjustment trajectory was expected to be achieved almost exclusively on the side of budget expenditures, with revenues forecasted to remain at the level of 31% of GDP at the end of the 2021-2023 interval. In this context, the FC warned that the fiscal-budgetary consolidation process must consider a restructuring of budget expenditures, but it is difficult to achieve in the absence of a significant increase in revenues.
- The first budget revision for 2021 marginally adjusted the projection of the deficit, according to the national methodology, to the level of 7.13% of GDP under the conditions of a large-scale review of budget revenues (+17.6 billion lei, based on the incorporation of the recovery of taxes deferred for payment by companies in the revenue forecast and the favorable revision of the macroeconomic framework) counterbalanced by a proportional increase in budget expenditures (+21.4 billion lei, expressing in fact the inability to keep expenditures under control, an under-budget in the initial budget construction and above-expected price increases for government-

purchased goods and services). This budget revision is unique in the history of those evaluated by the FC by the magnitude of the positive revision of budget revenues and expenditures, and it should be emphasized that amounts greater than the increase in programmed revenues were allocated to expenditures. The FC assessed that the first revision in 2021 weakened the budget consolidation process, given that part of the revenue surplus was temporary (especially those deferred for payment from 2020), and another part was due to the favorable cyclical dynamics of the economy, this revenue surplus being redirected to finance a significant proportion of permanent budget expenditure increases, which accentuates the risks related to the sustainability of the budget consolidation process and the fiscal position of the public sector.

- The second budget revision in 2021 took place under more complicated conditions than those previously anticipated due to the strong slowdown in the economy, the manifestation of an inflationary spike (caused by the energy price shock and disruptions in supply chains), as well as by the recrudescence of the pandemic. This revision recorded a new upward revision of budget revenues (+5.2 billion lei, as a result of the increase over previous expectations of the nominal GDP forecast and the behavior of companies that reimbursed a significant proportion of taxes and fees deferred for payment in the previous year), counterbalanced by even larger increases in budget expenditures (+6.3 billion lei, against the background of additional current expenditures – mainly personnel, goods and services, social assistance – partially offset by the decrease in investment expenditures) . Under these conditions, the second budget revision maintained the deficit target according to the national methodology at the level of 7.13% of GDP. Thus, although the revisions carried out during 2021 recorded a large upward revision of revenues, these developments did not determine a decrease in the targeted budget deficit, the additional revenues being fully allocated to increases in the expenditure aggregates and even recording additional increases in budget expenditures . This situation complicates the process of budget consolidation, the FC underlining that it is mandatory as a rigorous control of the spending of public money, expenses that ensure basic public goods for citizens (health, education, etc.) and which at the same time take into account the constraints imposed by the consolidation budget, to be combined with the increase in tax revenues.
- The budget execution of 2021, according to the national methodology, recorded a deficit of 6.8% of GDP, about 0.4 pp below the projection from the second revision, mainly as a result of not meeting the budgeted targets for the amounts received from The EU, counterbalanced mainly by savings achieved in investment spending, but also against the background of a slower rate of economic growth compared to the forecast from the second revision.
- The insufficient fiscal-budgetary consolidation step in 2021 means that the window of opportunity for this is narrowing. At the same time, the consolidation process cannot be achieved simultaneously with the provision of a critical mass of essential public goods, only by restricting budget expenditures. On the contrary, taking into account that public health and education are chronically under-funded, the military and geopolitical context calls for increased defense and security spending, and the impact of climate change requires state intervention at critical moments, a significant increase in budget revenues is an urgent necessity.

- The use of the financing made available by the EU, which replaces as much as possible the use of own budgetary resources, is essential for a favorable trajectory of the Romanian economy in the medium and long term. NRRP, together with the resources available through the multiannual financial framework, can be a vital tool for facilitating budgetary consolidation, by supporting a higher level of economic activity than that induced by a negative fiscal impulse and monetary policy tightening – to avoid entering a zone of precarious balancing or even instability of the economy.

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

According to article 61, para. (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 preceding budget year;

d) Recommendations and opinions 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 the year 2021, the following will be analyzed: the draft budget for the year 2021, the budget corrections made during the year and the execution of the budget.

1. The draft budget for 2021

According to the provisions of art. 26 paragraph (1) of the FRL, by July 31 of each year, the Ministry of Finance (MF) has the obligation to submit to the Government the fiscal-budgetary strategy for the next 3 years accompanied by the draft law for the approval of the ceilings specified in the fiscal-budgetary framework . The fiscal strategy (FS) for the period 2021-2023 was sent simultaneously with the budget proposal[12], which involved an identical fiscal-budgetary framework for the year 2021 in the two above-

[12] The FS was received by the FC on February 11, 2021, together with the draft Law for the approval of the ceilings of certain indicators specified in the fiscal-budget framework for the year 2021 and the draft budget for the year 2021.

mentioned documents. Under these conditions, the obligation of the Fiscal Council (FC) to evaluate in the Annual Report the objectives, targets and indicators established by the fiscal-budgetary strategy and by the budget is reduced to an exclusive *ex-post* analysis of the projections contained in the draft budget, monitoring compliance *ex-ante* of the rules regarding compliance with the limits established for the budgetary indicators provided for by the Law on Ceilings being, similar to the situation in previous years, irrelevant. Even if the FRL stipulates in art. 33, lit. c) the possibility of revising the fiscal-budgetary framework defined by the FS in the event of a change of Government, 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 the relevance of the ceilings established for the budgetary indicators and undermines the guiding role that a medium-term fiscal-budgetary strategy must have for the budget, as it remains recurrently dependent on short-term objectives.

FS for the period 2021-2023 established for the year 2021 a budget deficit, according to the national methodology, of 7.16% of GDP, respectively, a decrease of 2.63 pp of GDP compared to the level of 9.79% of GDP estimated at that date for the year 2020[13]. Expressed in ESA 2010 terms, the budget deficit was estimated at 8.23% of GDP, down by 0.87 pp compared to the level assessed by the Ministry of Finance for 2020. The level of structural adjustment was 0.34 pp, from 7.76 % to 7.42% of potential GDP. The general consolidated budget for the year 2021 was based on a macroeconomic evolution scenario that estimated a GDP growth in real terms of 4.3% and a GDP deflator of 2.8%.

In the medium term, considering Romania's placement in the excessive deficit procedure [14] (EDP), The FS projected the return of the budget deficit in ESA 2010 terms below the reference level of 3% of GDP by 2024[15].

In its opinion[16] regarding the *Budget Law for 2021*, The FC appreciated that the construction of the draft budget, as well as the medium-term budgetary framework associated with it, indicates a change in the conduct of the strongly expansionary fiscal-budgetary policy of recent years towards a sustainable trajectory of public finances. Among the aspects mentioned by FC we list:

- the significant reduction of the deficit, according to the national methodology, in 2021 compared to 2020 was mostly based on two exceptional elements: the amounts estimated to be collected from the budget obligations deferred for payment by economic agents related to 2020 and the expected rental of 5G frequency bands, and not on structural adjustment measures, a fact highlighted by the smaller reduction of the deficit expressed in European standards;

[13] The latest GDP data published by Eurostat (April 2021) indicates a cash deficit of 9.61% of GDP for 2020.
[14] 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.
[15] The calendar is established by the EC within the framework of the EDP, under the conditions of the suspension of fiscal rules at the EU level in the period 2021-2023.
[16] http://www.fiscalcouncil.ro/FC%20opinion%20budget%20proposal%202021%20and%20FS%202021%202023.pdf.

- the size of one-off measures intended to support the economy in the context of the impact of the COVID-19 pandemic, which is smaller compared to 2020, represented a source of budget deficit adjustment (by approx. 0.4% of GDP);
- the assessment of the MF for the budget revenues related to the year 2021 was considered conservative, i.e. an amount of the budget obligations deferred for payment in 2020 and recovered in 2021 lower compared to that estimated by the FC based on the data sent by the MF by about 5.5 billion lei;
- The FC considered that the eventual materialization of additional revenues in 2021 should be used exclusively to reduce the budget deficit, easing the consolidation effort in the following years;
- FC considers it feasible to reach the budget deficit target in 2021, both according to the national methodology and the European one;
- FC evaluates the gradual correction of the budget deficit in the medium term as a rational attitude that allows the consolidation of the economy's recovery; however, the reduction of the budget deficit according to the national methodology by 4.4 pp of GDP in the medium term (2022-2024) almost exclusively through budget expenses (personnel expenses, goods and services and social assistance) was appreciated by the FC as unrealistic;
- FC considers it insufficient that the fiscal-budgetary consolidation process should only take into account the restructuring of budget expenditures, and budget revenues should remain at the level of 31% of GDP at the end of the 2021-2023 interval, considering the acute needs present, including in the field public health and public education as well as future pressures from climate change and other non-conventional threats;
- FC mentioned as possible sources of increase in budget revenues in the medium term: improving the efficiency of collection, broadening the tax base, narrowing the exceptions and loopholes that negatively deviate the taxes paid by some taxpayers from the standard rates, the firm fight against tax evasion, of unfair fiscal competition and optimization of tax/charge rates.

2. The two budget revisions during 2021

The first budget revision (approved by GEO no. 97/2021) was characterized by the unprecedented scale in the history of budget revisions in the recent past of increases in the total revenues and expenses of the GCB (+17.2 billion lei, respectively +21.0 billion lei), the budget deficit in nominal terms was 3.8 billion lei above the initial target, and as a percentage of GDP of 7.13%, slightly below the level of the initial budget construction (7.16% of GDP), against the background of the increase in the GDP projection by 58.1 billion lei. The revision of the proportions of budget revenues had two main sources: the incorporation of the recovery of taxes deferred for payment by companies in the forecast of revenues not taken into account in the initial budget and the favorable revision of the macroeconomic framework - economic growth being estimated at 7% compared to the initial forecast of 4.3%.

By revenue category, the estimates from the initial budget, considering net swap values[17], were significantly increased to the level:

- *Fiscal revenues,* with 9.8 billion lei, against the background of achievements exceeding initial expectations in the first semester of the year (confirming the estimates of the Fiscal Council in its Opinion on the initial budget), the significant increase in the macroeconomic indicators that underpin the tax base of the main categories of taxes and duties, as well as from the recovery of some amounts to be collected in the account of 2020 following the call for the facility to postpone the payment of obligations to the GCB of economic agents. Of these, the estimates were increased for*: income from the corporate tax (+0.9 billion lei); from the personal income tax (+1.3 billion lei); from VAT (+4.4 billion lei) and from excise duties (+1.6 billion lei)*;
- *Social contributions,* with 3.9 billion lei (of which 3.6 billion lei by considering the amounts recovered from deferred budgetary obligations*)*.
- *Non-fiscal revenues,* with 0.9 billion lei by incorporating additional amounts related to greenhouse gas emission certificates allocated to investment projects[18].

The amounts received from the EU/other donors on account of the payments made and pre-financing related to the 2014-2020 financial framework were increased: +2.25 billion lei, mainly by increasing the estimates for the amounts that transit the general consolidated budget intended for pre-financing non-governmental sector projects in case of temporary unavailability of European funds (+1 billion lei), amounts related to European funds for agriculture (+0.76 billion lei), and those from structural and cohesion funds (+0.5 billion. lei).

The FC assessed as plausible the forecast for most tax revenues and social security contributions (considered in line with the updated macroeconomic framework), less so for the amounts coming from the lease of frequency bands (2.5 billion lei, respectively 0.21% of GDP), in view of the existence of relevant risks that they may not materialize. Also, the FC emphasized the temporary nature of the high amount of sums recovered from the previous year's taxes deferred for payment by economic agents (about 10 billion lei collected in the account of 2021), which will not be found again in the following years.

<u>The review of total expenses </u>marked an increase in proportions (+21 billion lei) compared to the parameters approved by the draft budget, with the following categories of expenses being increased:

- *Personnel expenses,* with 1.7 billion lei, intended for the payment of front-line medical personnel in the fight against the COVID-19 pandemic, the premiums granted to them being financed by European funds.
- *Goods and services,* with 3.9 billion lei, FC appreciating that the substantial increase was only partially justified by higher inflation or the additional needs to fight the pandemic.
- *Other transfers:* +3.9 billion lei (of which +2 billion lei related to greenhouse gas emissions certificates allocated to investment projects, +0.7 billion lei for the reintegration of revenues

[17] Increased by 413.8 million lei compared to the estimate from the initial budget.

[18] These also have a symmetrical impact on budget expenditures in the category of *other transfers*.

resulting from privatization used for granting a financing in the form of a grant to the "Complexul Energetic Oltenia" - S.A., +0.6 billion lei supplementing Romania's contribution to the EU budget, +0.5 billion lei transfers to enterprises within state aid schemes).

- *Projects with financing from non-refundable external funds post-accession 2014-2020:* +2.4 billion lei.
- *Social assistance* +1.2 billion lei, as a result of supplementing the amounts related to the unemployment insurance budget (+0.6 billion lei) and the single national health insurance fund (FNUASS +0.8 billion lei). Given the up-to-date budget execution, the FC considers this revision insufficient, and identifies an additional need of around 3.5 billion lei or 0.3% of GDP (of which 2 billion lei to the state budget).
- *Capital expenditures* with 5.8 billion lei. From this addition, the territorial administrative units (UAT) received 3.9 billion lei, of which 2 billion lei for PNDL1 and PNDL2, FC expressing reservations regarding the way to allocate these resources.

The FC noted in its Opinion the manifestation of a major slippage on the part of budget expenditures, having as the main causes, in addition to the higher than expected increase in the prices of some goods and services, the inability to keep current expenses under control and an under-budget in the initial budget construction.

Considering the stringency of the budget consolidation, the FC expresses its concern relative to the postponement of the trajectory agreed with the EC regarding the reduction of the budget deficit to below 3% of the GDP in 2024 through the budget construction proposed for revision through which revenues, mostly of a non-permanent nature, finance, in an important proportion, permanent budget expenses, with the potential to accentuate the risks related to the sustainability of the fiscal position of the public sector. In the conditions of the more favorable evolution of the economy and the higher amount compared to the initial projection of the revenues coming from the recovery of taxes deferred for payment, an optimal and achievable level of the budget deficit target should have been, in the opinion of the FC, significantly below 7% of GDP - around 6.5% of GDP.

The second budget revision[19] (approved by GEO no. 122/2021), increased compared to the budgetary parameters approved at the first revision, both the revenues and the total expenses of the GCB[20] by 5.2 billion lei, respectively, by 6.3 billion lei, the budget deficit deepening by another 1.1 billion lei. Expressed as a percentage of GDP, the estimated level of the budget deficit was maintained at 7.13% of GDP, against the background of the increase in nominal GDP projection by 15.4 billion lei over the previously

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[19] The revision proposal was submitted to the FC on November 24, 2021, for which the FC urgently issued a Preliminary Opinion (November 26, 2021, http://www.fiscalcouncil.ro/FC%20preliminary%20opinion%20second%20budget%20revision%202021.pdf). Since there were differences between the form published in the OM and the one originally sent, at the request of the FC, the MF completed and updated the information set, the FC issuing a complete and updated Opinion on December 7, 2021 (http://www.fiscalcouncil.ro/FC%20Opinion%20second%20budget%20revision.pdf).

[20] The sums related to the chain compensation scheme of swap-type arrears to GCB, with a symmetrical impact on revenues and expenses, were maintained at the same level as in the first revision (1.26 billion lei).

considered level. The upward revision of total budget revenues was the effect of both the increase in the forecast for nominal GDP due to the increase in the GDP deflator[21], as well as the reimbursement by companies of the taxes and fees deferred for payment in the previous year substantially above the level estimated on the occasion of the first revision carried out in August.

In the structure of GCB's total revenues, positive revisions of previous estimates were made for almost all revenues dependent on the dynamics of nominal GDP, opposite developments being registered in the case of amounts coming from European funds and those whose source is the rental of 5G frequency bands, as follows:

- *Fiscal revenues* were increased by 6.1 billion lei (+3.4%), of which: corporate income tax (+1.75 billion lei, in line with the execution for the first 10 months), personal income tax (+0.6 billion lei, in line with the new forecast regarding the evolution of the average number of employees in the economy and the average gross wage earnings, as well as the amounts deferred for payment and recovered in the account of the previous year), *other taxes on income, profit and capital gains* (+0.2 billion lei); *VAT* (+5 billion lei, in line with the receipts for the first ten months, against the background of a more favorable dynamic of consumption in nominal terms, as well as the recovery of a significant part of the amounts deferred for payment), *property taxes* (+0.25 billion lei). Reductions were made at the level of the *taxes on the use of goods, the authorization of the use of goods or the performance of activities* (-2.1 billion lei[22]) by eliminating the revenues related to the exploitation of radio frequencies in the new frequency bands harmonized at European level for land mobile communication systems of 5G broadband (-2.5 billion lei, confirming the reserve expressed by the FC in August) compensated to a small extent by the increase in revenues from gambling taxes (+0.2 billion lei).
- *Social contributions:* +1.1 billion lei, FC considering the increase in line with the reevaluation of the macroeconomic framework and up-to-date receipts, including a realization of the amounts estimated to be recovered in the last year's account.
- *Non-fiscal revenues:* +1.3 billion lei, at the level of revenues from dividends and payments from the net profit of autonomous companies, according to Memorandum no. 679681/2021[23].
- *Amounts received from the EU/other donors on account of payments made and pre-financing related to the 2014-2020 financial framework:* -3.4 billion lei, of which the amounts from structural and cohesion funds were reduced by approximately 2.3 billion lei (confirming the reservation expressed by the FC in the Opinion regarding the first revision).

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[21] From the 4% estimated in August to 5.4% as a result of the higher-than-expected increase in prices across the entire economy – especially for electricity, natural gas and fuels.

[22] This non-realization of revenues in 2021 will slightly affect the budget execution according to the ESA2010 methodology, according to which the revenues associated with the lease of frequency bands are distributed over the entire duration of the contracts.

[23] Through which the distribution of at least 90% of the net profit made in the form of payments to the state budget, in the case of autonomous governments, or dividends, in the case of national companies, national companies and companies with full or majority state capital, was approved; of these, according to the MF, 0.9 billion lei represented dividends to be paid by the CEC.

The Fiscal Council appreciated in the Opinion on the second revision that the new level of revenues was compatible with the last macroeconomic forecast of the NCSP and with the budget execution, but emphasized the temporary nature of a large part of the receipts in the first 10 months, determined by a dynamic favorable cyclical nature of the economy and a collection beyond expectations of the sums recovered from the taxes and fees related to the previous year deferred for payment by economic agents.

Budgetary expenses were increased by 6.3 billion lei compared to the parameters approved in the first revision, mainly due to the additions of current expenses (especially to the aggregates: *goods and services and social assistance*, confirming the FC warning from August regarding their undervaluation), partially offset by the decrease in *investment expenses*. The following revisions have been made compared to previous estimates:

- *Personnel expenses:* +1.2 billion lei, mainly for the payment of salary rights established by court decisions for personnel in the judicial system.
- *Goods and services:* +3.1 billion lei. The FC noted in the Opinion regarding the second revision that the increase, although partially justified by the higher inflation compared to the initial estimate for 2021 and the additional needs to fight the pandemic (+1.8 billion lei for the FNUASS), reflected the realization the previously reported risks, being also the consequence of the lack of adequate control of expenditure on goods and services.
- *Interest:* +1.5 billion lei, against the background of the increase in public debt and interest rates on new loans.
- *Subsidies:* +1.1 billion lei, mainly under the effect of the support schemes introduced in response to developments on the energy market.
- *Social assistance:* +3.6 billion lei. confirming the evaluations of the FC in the Opinion on the first budget revision, which identified an additional need of about 3.5 billion lei for this aggregate. The following were supplemented*: the state budget (+2.4 billion lei)* for the compensation of electricity and gas bills according to the adopted schemes, the payment of some social assistance rights[24], *the state social insurance budget* (+0.5 billion lei, additional funds needed for the payment of pensions)*, the budgets of administrative-territorial units* (+0.4 billion lei) and *FNUASS* (+0.2 billion lei).
- *Capital expenditures:* -1.2 billion lei. The amounts allocated to institutions fully/partially financed from own revenues were reduced (-0.8 billion lei) and administrative-territorial units (-0.6 billion lei), counterbalanced to a small extent by the increase in the amounts allocated to C.N.A.I.R.
- *Projects with financing from non-reimbursable external funds related to the financial framework 2014-2020:* -3.6 billion lei, of which expenses related to projects financed from structural and cohesion funds (-2.5 billion lei, including a decrease in national co-financing with 0.2 billion lei).

[24] Payment of allowances granted in the event of interruption of activity in conditions of the pandemic, state allowances for children, rights of persons with disabilities, allowance for bringing up the child and full payment of pensions, allowances and heating allowance.

Expenditures intended for public investments, from internal and external sources, were reduced by 3.4 billion lei compared to the level estimated at the first revision, mainly by reducing the amounts allocated to projects with financing from non-refundable external funds after accession (-2.25 billion lei). FC noted on this occasion, that the continued high level of investments in the new program would have imposed their increase in the last 2 months of the year with an average of 3.6 times higher than in the first 10 months, emphasizing that the perpetuation of the trend of acceleration of investments in the last part of the year, manifested in recent years, calls into question the efficiency of the budget programming process both from the perspective of the way of managing investment projects, and from that of establishing prioritization criteria in accordance with the importance and usefulness of investments.

In essence, regarding the two budget corrections carried out during 2021, the Fiscal Council assessed that the increase in the slippage on the expenditure side, partially justified by adverse conditions (higher inflation, successive waves of the pandemic, social protection measures to counteract the increase steep rise in energy prices), or the initial under-budgeting of some expenditure aggregates, expresses the inability to keep them under control and implicitly, a reduced probability of achieving the budget consolidation process in the next period exclusively by limiting budget expenditures.

3. Compliance with fiscal rules in the budget programming process

Romania is the subject of the Excessive Deficit Procedure (EDP) started previously [25] the triggering of the temporary derogation clause from the Stability and Growth Pact (SGP), whereby the budgetary rules were suspended in the period 2020-2023 [26] 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, the Council adopted the recommendation within the EDP that established that Romania should put an end to the excessive deficit situation in 2024 at the latest, the new deadline for its correction allowing a gradual effort and a balance between budgetary consolidation and economic recovery. According to the EC recommendation, in order to meet the deadline, Romania should reach a deficit target of 8.0% of GDP in 2021, 6.2% of GDP in 2022, 4.4% of GDP in 2023 and 2.9% of GDP in 2024.

Considering the above, the assessment of compliance with fiscal rules is made exclusively through the lens of the modification of the ceilings established by Law no. 14/2021 through the exemptions established on the occasion of the budget revision laws during the year.

It should be noted that Law no. 14/2021 for the approval of the ceilings of certain indicators specified in the fiscal-budget framework for the year 2021 established the deficit limit of 7.16% of GDP for the year

[25] Following the exceeding in 2019 of the threshold of 3% of GDP (deficit estimated at 3.8% of GDP), on the recommendation of the Commission of March 4, 2020, the Council decided on April 3, 2020 to apply Romania's EDP with the recommendation to reduce the excessive deficit until the year 2024.

[26] 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.

2021 corresponding to a deficit in ESA terms of 8.2% of GDP, close to the target for the year 2021 according to the EC recommendation of June 2021 within the EDP (8.0% of GDP). The law included the derogation from the provisions of art. 14 paragraph (1) of the LRFB regarding the adjustment path towards the medium-term budgetary objective of 1% of potential GDP, considering the high starting value of the structural deficit (estimated at 7.4% of potential GDP) and the approach of a gradual adjustment (up to 4.8% of potential GDP in 2023), according to FS 2021-2023.

Table 2 shows the limits of the main indicators established by Law no. 14/2021 and, respectively, through the two budget corrections carried out during the year. The figures in italics represent the values of the indicators as a percentage of GDP recalculated with updated GDP data (EUROSTAT, May 2022), respectively, 1,189.1 billion lei, compared to 1,116.8 billion lei (estimated level in the initial budget).

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

	Law no. 14/2021			GEO no. 97/2021			GEO no. 122/2021		
	GCB balance	Total expenditure*	of which: Personnel expenditure	GCB balance	Total expenditure*	of which: Personnel expenditure	GCB balance	Total expenditure*	of which: Personnel expenditure
mil. lei	(80.000,00)	397.515,30	109.511,70	(83.800,00)	416.733,20	111.231,20	(84.905,10)	425.438,20	112.324,50
% of GDP budget draft	-7,2%	35,6%	9,8%	-7,1%	35,5%	9,5%	-7,1%	35,7%	9,4%
% of GDP budget execution	*-6,8%*	*33,6%*	*9,3%*	*-7,1%*	*35,3%*	*9,4%*	*-7,2%*	*36,0%*	*9,5%*

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

As can be seen from the table above, the two budget revision projects established, by way of derogation from the Ceilings Law, new increases in the nominal ceilings compared to the initial budget project, for almost all the indicators specified in the fiscal-budgetary framework (in line with the evolution during the year of the income and expenditure aggregates).

This practice reflects the persistence of some major weaknesses in the construction of public budgets in Romania, confirming the arbitrariness in the reorientation of the allocation of some categories of expenses, at the expense of some national fiscal rules that can thus be easily evaded, limiting the role they should play in the orientation in the medium term of the fiscal-budgetary policy. Moreover, similar to the situation in previous years, the Government Ordinances regarding the revision of the state budget for 2021 (GO No. 97/2021 and, respectively, GEO No. 122/2021) stipulated the necessary exemptions from the fiscal rules established by the LRFB and the redefinition the ceilings of the budgetary aggregates in accordance with their new levels.

The indicators expressed as a share in GDP have remained within the limits initially provided by Law no. 14/2021 (7.16% of GDP in the case of the *GCB deficit*, respectively 9.8% of GDP in the case of *GCB personnel expenses*), as a result of the successive increases in the nominal GDP projection on the occasion of the two budget corrections, respectively to 1,174.9 billion lei estimated at the first revision and at 1,190.3 billion lei at the second budget revision compared to 1,116.8 billion lei in the initial budget.

If the indicators expressed as share in GDP are recalculated considering the updated GDP value in May 2022 (second row of *Table 2*, the increase in the *budget deficit* from 6.77% of GDP in the initial budget to 7.2% of GDP in the second revision, namely the increase in the weight of *personnel expenses* from 9.3% to 9.5% of GDP, while the weight of t*otal expenses excluding financial assistance from the EU and other donors* increased from 33.6% to 36% from GDP.

It should be emphasized that, although the budget corrections recorded the largest upward revision of revenues in the history of budget constructions evaluated by the FC, the additional revenues were fully allocated for increases in the expenditure aggregates, given that part of the additional revenues collected in year 2021 were temporary (having as the main source taxes and fees deferred for payment in the previous year) or due to the favorable cyclical dynamics of the economy, while an even more significant part of the increase in expenses was generated by increases in permanent expenses.

Even if the derogatory clause was extended until the end of 2023, it does not suspend the SGP procedures, but allows the deviation from the budget requirements that would normally apply, and the commitments assumed by Romania with the EC regarding the reduction of the budget deficit below the level of 3 % of GDP (ESA 2010 terms) remain valid, being reiterated in the 2022-2025 Convergence Program.

4. The budget execution

During 2021, the fiscal-budgetary policy remained expansionist, with the aim of supporting the recovery of economic activity and promoting investments. The results of the budget execution (including the swap scheme) indicate a budget deficit of 80 billion lei (according to the national methodology), a level similar to the target assumed in the initial budget. As a weight in GDP, the deficit, calculated by the national methodology, registered a lower level than originally planned (6.8% compared to 7.16%) on the background of the nominal GDP advance of 65.1 billion lei. According to the ESA methodology, the budget deficit reached 84 billion lei, respectively 7.1% of GDP, significantly below the level projected in the initial budget (8.2% of GDP).

The difference between the nominal levels of the budget deficit according to the two methodologies can be explained by elements that act in both directions, respectively some that affect only the budget deficit according to the national methodology, and others only the one according to the European methodology. Thus, the main elements that explain the gap of 4 billion lei between the deficit according to ESA 2010 and the one according to the national methodology were represented by:

- fees and taxes deferred for payment in 2020 collected in 2021 (+10.9 billion lei);
- amounts to be collected from taxes, taxes and social security contributions as differences between the receipts from taxes and social security contributions according to ESA and national methodology (-6.2 billion lei [27]);

[27] Amounts related to January 2022, mostly from VAT and tax on additional income made by electricity producers.

- income from property treated as super dividends (+2.3 billion lei)[28];
- payment of advances for the purchase of military equipment to be recognized in ESA 2010 standards only upon delivery (difference: -0.7 billion lei);
- payment of amounts on account of Law 85/2016 already registered in the execution of the ESA in 2016 (court decisions in the amount of 1.31 billion lei, payments made in the amount of 1.38 billion lei, resulting in a difference of +0.07 billion lei);
- differences in the treatment of interest expenses (- 1.9 billion lei);
- revenues from operations with gas emission certificates (difference of -2.4 billion lei);
- the contribution of consolidated state companies in the public administration sector (-0.48 billion lei).

Execution of the year 2021 (excluding the swap type scheme [29]) reveals that both GCB's total revenues and expenses significantly exceeded the original budget estimates. *Table 3* presents the evolution of the main budgetary aggregates during 2021 in national standards.

Table 3: The evolution of the main budgetary aggregates during 2021 (billion lei)

	Initial budget	First revision	Second revision	Budget execution
Total revenues, of which:	**364.1**	**381.3**	**386.5**	**379.0**
Tax revenues	168.6	178.4	184.5	185.8
Social security contributions	120.3	124.2	125.3	127.1
EU funds	47.4	49.6	46.3	38.4
Total expenditures, of which:	**444.1**	**465.1**	**471.4**	**459.0**
Current expenditure, of which:	414.2	429.4	436.9	427.2
Projects from EU funds	48.7	51.1	47.5	41.4
Capital expenditures	29.9	35.7	34.5	33.5
Budget balance	**-80.00**	**-83.80**	**-84.91**	**-80.02**

Source: MF

Note: Amounts without the compensation schemes impact

Total budget revenues, net of the impact of swap compensation schemes, were 14.9 billion lei above the initial estimate. In terms of structure, developments beyond expectations were recorded for *tax revenues* (+17.2 billion lei) and *insurance contributions* (+6.8 billion lei) against the background of an advance of the economy and the labor market clearly above the forecast for the indicators macroeconomic factors that substantiated the budget project and the recovery in a larger proportion

[28] Respectively, from reserves previously accumulated by state companies and from the NBR; the decision to oblige the distribution of additional dividends from the reserves accumulated in previous years does not influence the budget deficit according to the European methodology.

[29] In execution, these amounted to 658 million lei, below the initially projected level (850 million lei)

compared to the initial projection of the amounts deferred for payment in 2020. Developments below initial expectations were recorded at the level of *non-fiscal revenues* (-0.8 billion lei) and the *amounts reimbursed by the European Union on account of payments made and donations* (including sums received from the EU for operational programs financed under the convergence objective) for which the failure to achieve compared to the initial program reached 9 billion lei.

In the structure of *fiscal revenues*, significant increases were recorded compared to the initial provisions at the level of receipts from: *VAT* (+9.6 billion lei, mainly due to the favorable dynamics of consumption in nominal terms and the recovery of a significant part of the deferred payment amounts in 2020), *corporate income tax* (+2.6 billion lei, as an effect of the relaunch of economic activity), excises (+1.4 billion lei, advance also supported by the increase in excise duty on cigarettes), *tax on wages and income* (+1.8 billion lei, on the background of the evolution above the initial estimates of the labor market indicators).

The level of <u>budget expenditures</u> exceeded the initially programmed amount by 14.9 billion lei. The main expenditure aggregates that registered significant increases were: *goods and services* (+8.4 billion lei, as a result of the initial under-budgeting and partially justified by the impact of the price increase well above the initial expectations and the additional needs to fight the new variants of the coronavirus), *social assistance* (+4.3 billion lei, due to insufficient initial budgeting, but also some active measures aimed at mitigating the effects of the pandemic in the amount of approx. 2 billion lei), *capital expenditures* (+3.6 billion lei, to support public investment projects in the context of the reduction of external funds compared to the initial programming), *personnel expenses* (+2.4 billion lei, mainly for medical staff and payments decided by court decisions), *subsidies* (+1.7 billion lei, as an effect of the support schemes introduced in response to developments on the energy market). Significant reductions were made in *expenses related to projects with financing from non-refundable external funds after accession 2014-2020* (-7.35 billion lei, in line with the non-realization of 6.6 billion lei of *European funds related to the financial framework 2014-2020*).

Table 4 presents the evolution of budget revenues and expenses from the perspective of the national methodology (cash), expressed as a share in GDP. The benchmarks for 2021 are 2020 and 2009, which marked the peak of the recession.

Compared to the previous year, in the context of the amelioration of the effects of the pandemic and the return of the economy, in 2021 the reduction of the budget deficit was recorded, by 2.84 pp of GDP, the budget revenues registered an increase of 1.70 pp of GDP, having as a benchmark the base reduced from 2020 (by about 12 billion lei, representing sums deferred for payment by economic agents), and budget expenditures were lower by 1.1 pp of GDP.

<u>The GCB revenues</u> that had the most favorable evolution were: *tax revenues* (+1.50 pp of GDP), *receipts from social security contributions* (+0.21 pp of GDP) and *amounts received from the EU on account of payments made* (+0.08 pp of GDP), and *non-fiscal revenues* decreased by 0.1 pp of GDP.

At the level of *tax revenues*, significant increases compared to the previous year were recorded in *VAT* receipts (+0.97 pp, on the basis of the advance of population consumption and the sums recovered on account of those deferred for payment by economic agents in 2020), *corporate income tax* (+0.21 pp, evolution supported by the effect of the relaunch of economic activity), *personal income tax* (+0.08 pp, due to the improvement of labor market indicators).

Table 4: The evolution of budgetary revenues and expenditures (national methodology, % of GDP)

	2009	2015	2019	2020	Initial budget 2021	Budget execution 2021	Initial budget 2021- 2020	Execution 2021-2020	Execution 2021-2009
Total revenues	**29.6**	**32.8**	**30.3**	**30.4**	**30.8**	**32.1**	**0.4**	**1.7**	**2.4**
Tax revenues (without SSC)	16.4	19.4	14.8	14.2	14.3	15.7	0.0	1.5	-0.7
Personal Income Tax	3.5	3.7	2.2	2.3	2.2	2.4	-12.0	0.1	-1.1
Corporate Income Tax	2.0	1.9	1.7	1.5	1.5	1.7	0.0	0.2	-0.3
Property tax	0.6	0.8	0.6	0.6	0.5	0.6	0.0	0.0	-0.1
VAT	6.5	8.0	6.2	5.7	5.9	6.7	0.2	1.0	0.2
Excise duties	2.9	3.7	3.0	2.9	2.8	2.9	-0.1	0.0	0.0
SSC	9.0	8.1	10.5	10.5	10.2	10.8	-0.4	0.2	1.7
Non-fiscal revenues	3.1	2.7	2.6	2.3	2.3	2.2	0.0	-0.1	-0.9
Donations	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.6
Amounts received from the EU for payments made	0.4	2.4	2.4	3.2	4.0	3.2	0.8	0.1	2.8
Total expenditures	**36.6**	**34.2**	**34.9**	**40.0**	**37.6**	**38.8**	**-2.4**	**-1.1**	**2.3**
Personnel expenditures	8.8	7.3	9.7	10.4	9.3	9.5	-1.1	-0.9	0.6
Goods and services	5.3	5.7	5.0	5.4	4.7	5.4	-0.7	0.0	0.1
Interest	1.1	1.3	1.1	1.4	1.4	1.5	0.1	0.2	0.4
Subsidies	1.4	0.9	0.7	0.8	0.6	0.7	-0.2	0.0	-0.6
Projects funded by post-accesion non-reimbursable external funds	0.5	3.4	2.6	3.3	4.1	3.5	0.8	0.2	3.0
Social assistance	12.0	10.7	10.8	13.1	12.1	12.5	-1.0	-0.6	0.4
Capital expenditures	4.1	2.6	2.9	3.1	2.5	2.8	-0.6	-0.3	-1.3
Budget balance	**-6.95**	**-1.45**	**-4.59**	**-9.61**	**-6.77**	**-6.77**	**2.8**	**2.8**	**0.2**

Source: MF, FC's calculations

Note: Amounts without the compensation schemes impact

On the GCB's total expenditure side, compared to the previous year for the following budget aggregates, significant reductions were recorded: *personnel expenses* (-0.92 pp of GDP under the conditions of maintaining a prudent salary policy in the public sector, with an increase (+1.8%) much below that of nominal GDP - of 11.6%), *social assistance* expenses (-0.63 pp of GDP, their dynamics, respectively +9.6%, against the background of the increase in the pension point and the increase of state allowances for children being lower than nominal GDP dynamics) and *capital expenditure* (-0.3 pp of GDP).

Increases reported in 2020 were recorded for: *projects with financing from external non-refundable post-accession funds* (+0.2 pp of GDP) and *interest expenses* (+0.2 pp of GDP, as a result of the increase in financing requirements and loan costs). Compared to 2009, in 2021 the budget cash deficit was higher by 0.18 pp of GDP, total revenues being higher by 2.44 pp of GDP, and total expenses by 2.27 pp of GDP.

Table 5 shows the evolution of budget revenues and expenses in ESA 2010 standards[30], expressed as percentages of GDP. The analysis of the year 2021 is made in comparison with the developments of the previous year and, respectively, of the year 2009.

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

	2009	2015	2016	2019	2020	2021	Changes 2021/2020	Changes 2021/2009
Total revenues, of which:	**30.3**	**35.5**	**32.0**	**31.9**	**32.7**	**32.8**	**0.1**	**2.5**
Indirect taxes, of which:	10.2	13.3	11.3	10.6	10.4	10.7	0.3	0.5
VAT	6.3	8.1	6.4	6.2	6.1	6.5	0.4	0.2
Excises + custom duties	3.9	5.2	4.9	4.4	4.3	4.2	-0.1	0.3
Direct taxes, of which:	5.9	6.6	6.4	4.9	4.7	5.1	0.4	-0.8
Personal Income Tax	3.3	3.7	3.7	2.3	2.4	...	...	...
Corporate Income Tax	2.3	2.3	2.2	2.1	1.9	...	...	...
Other current revenues	1.4	2.0	1.6	1.9	1.9	1.6	-0.3	0.2
SSC	9.7	8.1	8.8	11.3	11.9	11.4	-0.5	1.7
Amounts from the EU	0.5	2.8	1.3	1.1	1.7	2.0	0.3	1.5
Total expenditures, of which:	**39.4**	**36.1**	**34.6**	**36.2**	**42.0**	**39.9**	**-2.1**	**0.5**
Intermediate consumption	6.0	5.9	5.6	5.6	6.0	5.9	-0.1	-0.1
Compensation of employees	10.3	7.8	9.0	11.3	12.1	11.1	-1.0	0.8
Interest	1.4	1.6	1.5	1.1	1.4	1.4	0.0	0.0
Social assistance	12.7	11.5	11.5	11.8	13.4	13.2	-0.2	0.5
Subsidies	1.1	0.4	0.3	0.4	1.0	0.6	-0.4	-0.5
Other current expenditures	1.7	2.3	1.3	1.4	2.0	2.2	0.2	0.5
Gross fixed capital formation	5.8	5.2	3.7	3.5	4.6	4.2	-0.4	-1.6
Budget balance	**-9.1**	**-0.6**	**-2.6**	**-4.3**	**-9.3**	**-7.1**	**2.2**	**2.0**

Source: Eurostat

[30] The data contained in this table is not fully comparable with that in Table 4, the differences come from the different scope of coverage in the two standards, ESA2010 and the national standard.

The fiscal consolidation initiated in 2010 in order to correct the existing major imbalances in the position of public finances was characterized by an alert pace, Romania succeeding in a relatively short period of time, reducing the budget deficit according to ESA 2010 from 9.1% of GDP in 2009 to 0.6% of GDP in 2015. In the years 2016-2019, the lax fiscal policy led to the reversal of this trend, registering an important increase in the budget deficit compared to 2015, against the background of the massive decrease in revenues (with 3.7 pp in 2019). Thus, the year 2019 marked the crossing of the 3% of GDP threshold, Romania being placed in the EDP in April 2020. The impact of the fiscal measures taken in 2020 to mitigate the social and economic effects in the context of the outbreak of the Pandemic further accentuated the budgetary imbalance, the GCB deficit placing by 0.2 pp of GDP above the record level reached in 2009. The year 2021 marked the economic return against the backdrop of government support measures and the improvement of the health situation and compared to the previous year, budget revenues advanced marginally (+0.1 pp of GDP) , while total expenditures decreased by 2.1 pp of GDP, recording a deficit of 7.1% of GDP, 2.2 pp of GDP below the level reached in 2020.

In 2021, budget revenues recorded a share of 32.8% of GDP. The most significant increases compared to 2020 were recorded for receipts from: *corporate income tax* (+0.4 pp of GDP), *taxes on production and imports* (+0.3 pp of GDP, mainly due to receipts from *VAT* which advanced by 0.4 pp of GDP), and the *sums from European funds* (+0.3 pp of GDP). The share of receipts in GDP for the aggregate of *other current revenues* was reduced (-0.3 pp due to the decrease of revenues from property) and *social contributions* (-0.5 pp, the increase in GDP exceeding the increase in the wage bill in the economy).

Compared to 2009, total revenues recorded in 2021 increased by 2.5 pp of GDP, mainly due to *social security contributions* (+1.7 pp of GDP, following the transfer of social contributions from employer to employee from 2018), of *amounts from European funds* (+1.5 pp of GDP) and indirect taxes (+0.5 pp of GDP). Direct taxes were 0.8 pp of GDP lower, as a result of the reduction of the personal income tax rate from 16% to 10% starting in 2018.

The share of budget expenditures in 2021 was 39.9% of GDP, 2.1 pp less than the previous year. The decrease was located in most of the components, they recorded a moderate growth rate, below the nominal GDP dynamics. *The gross formation of fixed capital and expenditure* on subsidies were reduced by 0.4 pp each, the expenditure on *social assistance* by 0.2 pp of GDP, and the *remuneration of employees* by 1 pp of GDP, under the conditions of a nominal growth rate of *personnel expenses* significantly lower than the nominal GDP.

Compared to 2009, budget expenditures were 0.5 pp of GDP higher, increases being recorded at the level of the following components: *remuneration of employees* (+0.8 pp of GDP), other *current expenses and social assistance* (with +0 .5 pp of GDP). In contrast, the share in GDP was significantly reduced for the components: *gross fixed capital formation* (-1.6 pp), *subsidies* (-0.5 pp) and *intermediate consumption* (-0.1 pp).

It should be noted that the fiscal adjustment in the period 2009-2015 was mainly carried out at the level of investment, personnel and social assistance expenses, the process being reversed in the period 2016-2021 through the sharp increase in expenses of a permanent nature, respectively the *remuneration of* *employees* (+3.3 pp of GDP in 2021 compared to 2015, supported by alert wage dynamics and the change in the fiscal treatment of social security contributions starting in 2018) and *social assistance* (+1.7 pp of GDP).

FC records the persistence of some risks regarding the amplification of the deterioration of the structural fiscal position, on the side of permanent expenses (personnel expenses, social assistance). Their possible materialization is likely to further complicate the situation of the public budget considering the current context complicated by the war in Ukraine and the continued escalation of the increase in the prices of energy and raw materials, as well as the need to continue the budget consolidation process in the following years under the conditions compliance with the calendar committed by Romania within the EDP.

In the case of Romania, there is also an additional constraint, related to the relatively high size of the public debt compared to that of the domestic financial sector, with a limited capacity to absorb an additional stock of public debt.

The FC emphasizes that, in the context of high financing needs and in the coming years, taking into account the aversion of the financial markets to risk, respectively, at high levels of the budget deficit for a long period, even if the fiscal rules in the EU remain suspended in the period of 2021 -2023 a correction leading in the medium term to lower levels of the budget deficit and anchoring creditors' expectations towards a sustainable fiscal-budgetary policy trajectory is mandatory. Moreover, great challenges for the economy deriving from the energy transition, climate change, increased defense financing needs (announced to increase to 2.5% of GDP), implications of the geopolitical context must be taken into account. FC emphasizes that this correction needs a significant increase in tax revenues, which are at an inadmissibly low level in relation to Romania's needs, as well as compared to EU benchmarks. The implementation of a rigorous multi-year plan for fiscal consolidation and the efficient use of European funds made available to Romania constitute the basis of a gradual adjustment, which minimizes the associated economic and social costs and boosts sustainable economic growth in accordance with the EU programs in the field of digitization, promotion of the economy circulars, reducing dependence on conventional energy sources in the joint effort to ensure the "greening" of European economies.

III.3. The structural budget balance in Romania

The signing and ratification by Romania of the Treaty on Stability, Coordination and Governance within the Economic and Monetary Union (TSCG) in 2012 established a fiscal-budgetary framework based on rules, with as its objective in the case of Romania a structural deficit target of maximum 1% of potential GDP[31]. The provisions of TSCG and Directive no. 85/2011 were incorporated into the national legislation

[31] The TSCG requires the contracting parties to ensure convergence towards the country-specific MTO (according to the SGP), with a structural deficit limit of 0.5% and 1% of GDP, respectively, for Member States with a public debt significantly below 60% of GDP (Romania's case). Achieving the MTO should ensure a safety margin for

by amending Law no. 69/2010 (FRL) in December 2013, so medium-term budget planning was constrained by the new structural budget deficit rule[32], provided by the TSCG, starting with the preparation of the budget for 2015. Theoretically, with the achievement of the MTO in 2015, the fiscal consolidation process initiated in Romania in 2010 could be considered completed. However, this constraint no longer worked after that, **since 2016 there has been a deliberate and large-scale deviation from the rule regarding the maximum level of 1% of the structural deficit. In the 2017-2019 period, Romania was twice subject to the Significant Deviation Procedure from the OTM - the preventive arm of the SGP, from March 2020 being the only EU country placed in the Excessive Deficit Procedure - the corrective arm of the SGP.**

It should be borne in mind that the definition of the target in terms of structural deficit implies an actual deficit objective adjusted according to the position of the economy within the economic cycle, so that when the GDP deviation (output gap) enters positive territory, compliance with the structural deficit target of 1% of GDP requires lower effective deficit levels (the cyclical component[33] of the budget balance being positive). The structural budget balance, although it more faithfully reflects the fiscal position of an economy, presents a series of disadvantages, the most important being related to the uncertainties associated with its estimation. Thus, the value of the structural balance is dependent on the level of GDP deviation, this being calculated in relation to the level of potential GDP - an unobservable quantity often subject to more or less significant revisions, depending on the updating of statistical data and the methodology used. For example, the GDP deviation estimate for Romania, presented in the FC Annual Report for 2020, has been revised from 1.59% for 2019, -5.34% for 2020 and -3.64% for 2021 (AMECO, May 2021) to 2.04% for 2019, -4.76% for 2020 and -2.52% for 2021 (AMECO, June 2022).

The evolution of the structural deficit, fiscal impulse and excess demand (presented in *Figure 4*) illustrates how in the period 2003-2021 Romania mainly practiced a pro-cyclical fiscal-budgetary policy[34]. The discretionary policy of intense, but useless and counterproductive stimulation of the economy during the period of pre-crisis expansion (2006-2008), respectively of braking during the period when it operated below potential (2010-2015), contributed to amplifying the fluctuations of the economic cycle through the character its pronounced pro-cyclicality, the automatic, beneficial and stabilizing action of the automatic stabilizers being thus nullified.

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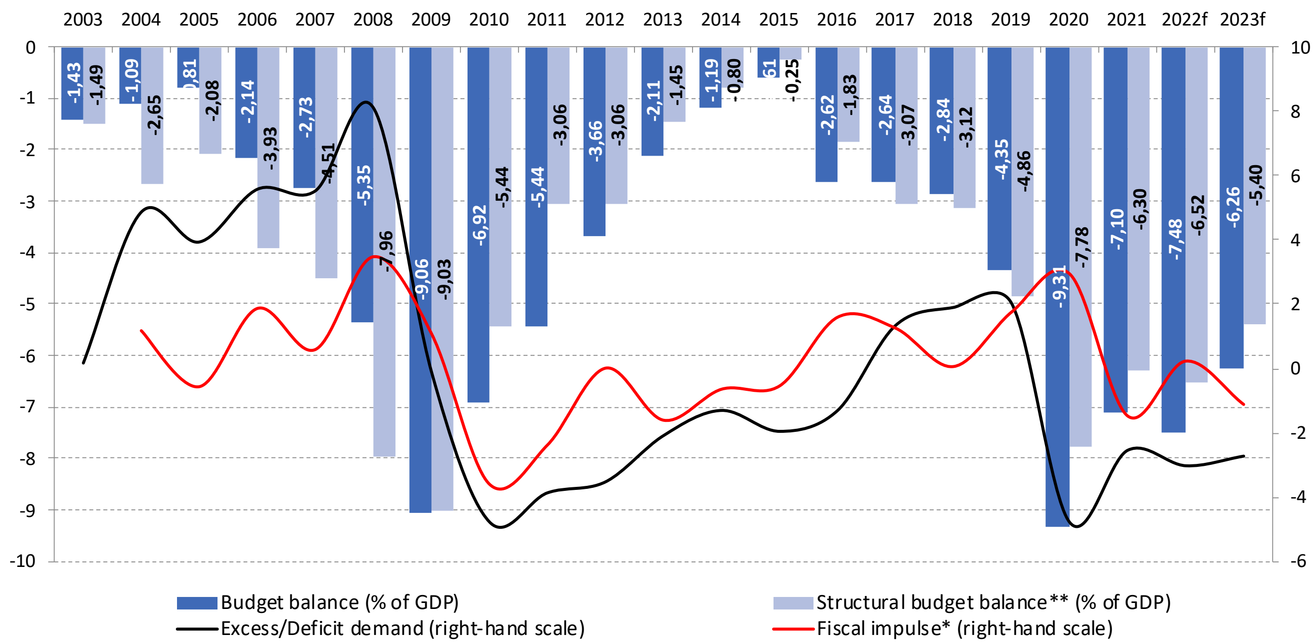
meeting the 3% of GDP ceiling for the ESA budget deficit and sufficient fiscal space for some discretionary measures.

[32] It is calculated by subtracting from the actual budget balance the cyclical component of the budget deficit and the one-off and temporary measures. For details, see http://www.fiscalcouncil.ro/annualreport2012.pdf, pg. 45-57.

[33] The cyclical component of the budget balance = output gap * ε, where ε represents the semi-elasticity of the budget deficit to the economic activity changes.

[34] Except for the years 2005, 2009, 2016 and 2020.

Figure 4: Structural deficit, fiscal impulse and the excess demand



*Defined as variation in structural balance (%of GDP) (+stimulus effect, -contractionary effect)
** For the period 2003-2009, the data refers to the cyclically adjusted budget balance

Source: AMECO, FC's calculations

Over the period 2010-2015, the structural budget deficit was reduced from 9% of potential GDP in 2009 to 0.3%, with an average rate of adjustment of 1.5 pp per year. The starting level being very high in relation to financing constraints, the rapid adoption of some radical measures was required in 2010 and 2011, the fiscal consolidation being carried out with an average adjustment step of 3 pp annually, mainly on the expenditure side. However, this process was suddenly reversed starting in 2016, following the entry into force of the new Fiscal Code which brought a wide fiscal relaxation simultaneously with the legislation of important increases in permanent expenses (salaries and pensions[35]). Maintaining the expansionary character of the fiscal policy in the conditions of a positive GDP deviation starting from 2017, as well as the deliberate circumvention of the rules established by TSCG and FRL regarding the maintenance of the structural deficit target, contributed to the rapid deterioration of the position of public finances, the budget execution of 2019 ending with an ESA deficit of -4.4% of GDP, significantly above the allowed limit of 3%. Thus, Romania came under the Excessive Deficit Procedure from March 2020, this being maintained even in the context of the activation of the general derogatory clause of the SGP.

The outbreak of the COVID-19 pandemic occurred in the conditions where Romania had a structural deficit of almost 5% of potential GDP, the highest in the EU, which greatly limited the room for maneuver

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

in combating the effects generated by it, the year 2020 ending with a structural deficit of 7.8%[36] of potential GDP. In the conditions of the adverse cyclical evolution[37] caused by the pandemic, the 2020 fiscal-budgetary policy was anti-cyclical, having a strong stimulatory character (fiscal boost of 2.9 pp), against the background of measures to support the economy, the population and the health sector, to which were added spending increases (increases in the pension point and child allowances) and reductions in fees and taxes decided before the start of the pandemic (elimination of the surcharge and the tax on banking assets).

The year 2021 recorded a reduction of the budget deficit according to the ESA 2010 methodology to the level of 7.1% of GDP against the background of the recovery of the macroeconomic framework and the recovery beyond expectations of the budget obligations related to the year 2020 that had been postponed for payment by economic agents. These favorable developments would have allowed a wider reduction of the budget deficit compared to the actual level recorded, but the additional revenues were fully allocated for increases in the expenditure aggregates, with additional increases in budget expenditures even being recorded. This situation complicates the perspective of the budget consolidation process in the medium term because part of the additional revenues collected in 2021 are temporary or due to the favorable cyclical dynamics of the economy, while an even more significant part of the increase in spending was generated by increases of permanent expenses affecting the structural budget balance. Thus, although the budget deficit decreased by 2.2 pp in 2021 compared to the previous year, the adjustment step of the structural deficit was only 1.5 pp, from 7.8% in 2020 to 6.3% in 2021.

The budget construction for the year 2022 had in mind a budget deficit target of 6.2% of GDP according to the ESA 2010 methodology, with a trajectory of return below the threshold of 3% of GDP starting from 2024 projected. This evolution is compatible, according to MF, with a reduction of the structural deficit by 3.6 pp of potential GDP until 2025, at the end of the forecast horizon persisting a deviation of 1.8 pp from the medium-term objective[38]. The consolidation process is supported, in the view of the Ministry of Finance, on the revenue side by increasing the efficiency of collection and accelerating the absorption of European funds (from MFF and NRRP), and on the expenditure side by freezing the majority of salaries in the public sector and by growth rates in nominal terms lower than nominal GDP dynamics for goods and services and social assistance expenditures. At the same time, it is worth noting that the medium-term budgetary consolidation process is substantially projected on the expenditure side.

In its analyses, the FC emphasized the particularly difficult fiscal situation in which Romania finds itself, illustrated by the insufficient level of budget revenues in relation to expenditures, as well as by the size of the structural deficit and external deficits. Given the complicated international context and the overlap of crises faced by both Romania and the EU, a combination of macroeconomic measures is needed to try to avoid entering recession, which implies the gradual implementation of the budget

[36] According to the AMECO database. It should be noted that the level of structural deficit is identical in the EC assessment with that of the cyclically-adjusted deficit.

[37] According to EC, from an excess demand of 2% of potential GDP, to a demand deficit of 4,8% in 2020.

[38] According to the 2022-2025 Convergence Program.

consolidation process. The FC emphasized that this consolidation cannot be achieved only on the budgetary expenditure side because critical areas (such as public health and education) are chronically under-funded, the military conflict on the borders calls for increased defense and security spending, and the impact of climate change and the energy transition requires strengthening the capacity of the state to intervene in very complicated moments.

Thus, the budgetary consolidation by increasing tax revenues represents a problem of economic security and national solidarity so that the public budget can cope with very large current and future needs. In this sense, FC appreciates that Romania can obtain a considerable increase in budget revenues through better collection and by reducing the multitude of exceptions and loopholes existing in the current fiscal regime[39].

III.4. Budgetary revenues

GCB's revenues, net of the impact of compensation schemes for outstanding obligations against the swap type budget (in the amount of 0.66 billion lei), increased in 2021 by 17.9% (+57.5 billion lei) compared to from the previous year under the impact of two main factors: the recovery of budgetary obligations related to the year 2020 that had been postponed for payment by economic agents and the recovery of the macroeconomic framework, with real GDP registering a growth rate of 5.9%. Thus, budget revenues were at a level of almost 379 billion lei (representing about 32.1% of GDP), which records an increase of 1.7 pp compared to the level of 30.4% of GDP recorded in 2020 This evolution was mainly determined by the increase in the share of *tax revenues* (+1.5 pp), the other categories registering smaller changes: *social security contributions* (+0.2 pp), *amounts received from the EU* (+0.1 pp), respectively *non-fiscal revenues* (-0.1 pp). As mentioned above, it should be borne in mind that the cash execution of tax revenues and social security contributions, related to 2021, was favorably influenced by the recovery of deferred payment obligations by economic agents in the previous year. This revenue surplus, with a significant impact on the budget execution related to 2021, is of an exceptional and temporary nature, so it is not expected that similar developments will occur in the following years.

Fiscal revenues registered increases at the level of most component aggregates, the largest being recorded in the case of revenues from: *VAT* (+1 pp, and against the background of the increase in the final consumption of households by 13.9%), *profit tax* (+0.2 pp), *the tax on the use of goods, the authorization of the use of goods or on the performance of activities* (+0.1 pp), and the *personal income tax* (+0.1 pp, supported by the positive dynamics of the average gross wage earnings and the number

[39] For a more in-depth analysis of the need to increase tax revenues in Romania and the search for solutions to achieve this goal, you can consult the study "Budgetary consolidation and increase of tax revenues - Vital necessity for the stability and economic security of Romania" carried out by a Working Group under coordination of the Fiscal Council (http://www.fiscalcouncil.ro/Analiza_sistem_fiscal%20EN%2031%20mai.pdf).

average of employees, these factors also exerting a favorable impact on receipts from *social security contributions).* As for *non-fiscal revenues (-0.1 pp),* the decrease in their share in GDP reflects a faster dynamics of nominal GDP (which increased by 11.6%, against the background of a deflator of 5.4%) compared to the dynamics to this budgetary aggregate which increased by 1.6 billion lei, representing an advance of only 6.6%. Last but not least, the evolution of the *amounts received from the EU reflects,* apart from the amounts intended for the fight against the COVID-19 pandemic, the impact of the funds intended for agriculture[40] and pre-financing granted to the non-governmental sector that do not represent actual revenues of the public administration. Thus, the amounts related to the 2014-2020 financial framework have increased by approximately 5.9 billion lei compared to 2020 (the increase being approximately 5 billion lei if the impact of funds intended for agriculture is eliminated), while the actual absorption of funds structural, calculated on the basis of EC reimbursements, advanced by almost 13.9 billion lei[41].

Compared to the initial budget projection, GCB's revenues collected in 2021, net of the impact of swap compensation schemes, recorded a large increase, by 14.9 billion lei (representing +1.3 pp of GDP). This favorable evolution was due to significant exceedances of the initial projections in the case of *tax revenues* (+1.5 pp) and *social security contributions* (+0.6 pp), partially counterbalanced by the minuses recorded in the *amounts received from the EU* (-0.8 pp) and *non-fiscal revenues* (-0.1 pp). It should be noted that exceeding the collection targets proposed by the budget draft is mainly due to the following factors: macroeconomic developments more favorable than those anticipated at the time of drafting the budget draft and the behavior of companies that reimbursed a significant proportion of taxes and deferred taxes at payment in 2020, above the level estimated in the initial budget.

In the case of *tax revenues*, the situation above the initial projection is mainly due to receipts from: *VAT* (+0.8 pp), *corporate income tax* (+0.2 pp), *personal income tax* (+0.2 pp, this aggregate also benefiting from a more favorable evolution of the labor market in relation to the initial estimates), *excise duties* (+0.1 pp) and *other taxes and duties on goods and services* (+0.1 pp), while the target for *tax receipts on the use of goods, the authorization of the use of goods or on the performance of activities* (-0.1 pp) was not fulfilled due to the postponement of the auction for the lease of 5G frequency bands by mobile operators. Exceeding the scheduled receipts from *social security contributions* is also due to the more favorable evolution of the labor market in relation to the initial estimates, while the minus recorded by *non-fiscal revenues* reflects the failure to meet the forecasted level of receipts from dividends paid by state companies or their late collection. The income category that recorded the largest non-fulfillment of the target proposed by the 2021 budget is represented by the *amounts received from the EU*, the execution of all the components of this aggregate being significantly below the initial projections, as follows: the funds intended for agriculture (-3.5 billion lei compared to the initial budget), structural funds (-3.1 billion lei), respectively other amounts received from the EU (-2.4 billion lei).

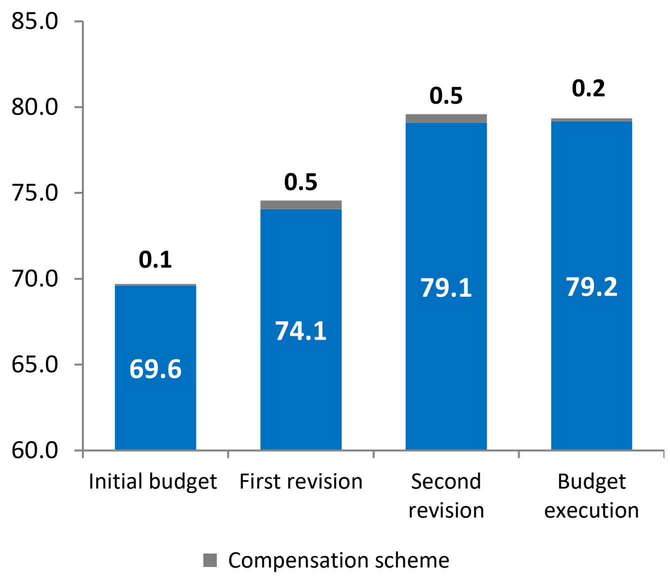
[40] Amounts granted through the European Agricultural Guarantee Fund (EAGF), through the European Agricultural Fund for Rural Development (EAFRD) and through the European Fisheries and Maritime Affairs Fund (EFMAF).

[41] According to the stage of absorption on December 31, 2020, respectively on December 31, 2021, published by the Ministry of European Investments and Projects (MEIP).

III.4.1. VAT and excise duties

VAT receipts in national standards, net of the impact of swap type compensation schemes, recorded a level of 79.2 billion lei in 2021, being 9.6 billion lei above the level provided for in the initial draft budget . The adjacent graph shows the evolution of the receipts and the compensation schemes programmed in the draft budget and on the occasion of the budget corrections, compared to the values actually recorded in the budget execution. Thus, both budget revisions operated large-scale positive revisions of this budgetary aggregate (+4.4 billion lei, respectively +5 billion lei) as a result of the fact that the economic agents reimbursed the taxes and fees deferred for payment in the year 2020, but also against the background of more favorable macroeconomic developments than those originally anticipated.

Figure 5: VAT revenues in 2021 (billion lei)



Source: MF

In its opinions on the budget revision projects, the FC did not express reservations about the proposed levels of VAT receipts, considering that they are justified by the two factors mentioned above. The final execution of 2021 confirmed the positive revisions made along the way, with the level of VAT revenues exceeding by 0.1 billion lei the estimates from the second revision.

It should be noted that the significant exceeding (+9.6 billion lei) of the programmed level of VAT receipts occurs in the context of the manifestation of the following factors:

- At the time of the budget draft, the Ministry of Finance substantiated the revenue forecast based on a conservative approach that only partially reflected the recovery of some amounts deferred for payment by economic agents. Thus, adjusting the starting point of the projection (VAT receipts from the year 2020) with the volume of VAT obligations deferred for payment by economic agents (over 5 billion lei) and with the accelerated VAT refunds made in 2020 (of approximately 2.2 billion lei, representing an exceptional element), and applying the 6.1% increase, forecast at that time by NCSP for the final consumption of households, excluding the self-consumption component and NPISH[42] (the relevant macroeconomic base [43] for VAT revenues), it turns out that this aggregate was underestimated in the initial budget by about 2-3 billion lei, without taking into account the amounts expected to recover in 2021;

[42] Non-profit institutions serving households.

[43] Macroeconomic aggregate on which receipts from a certain category of budget revenues depend.

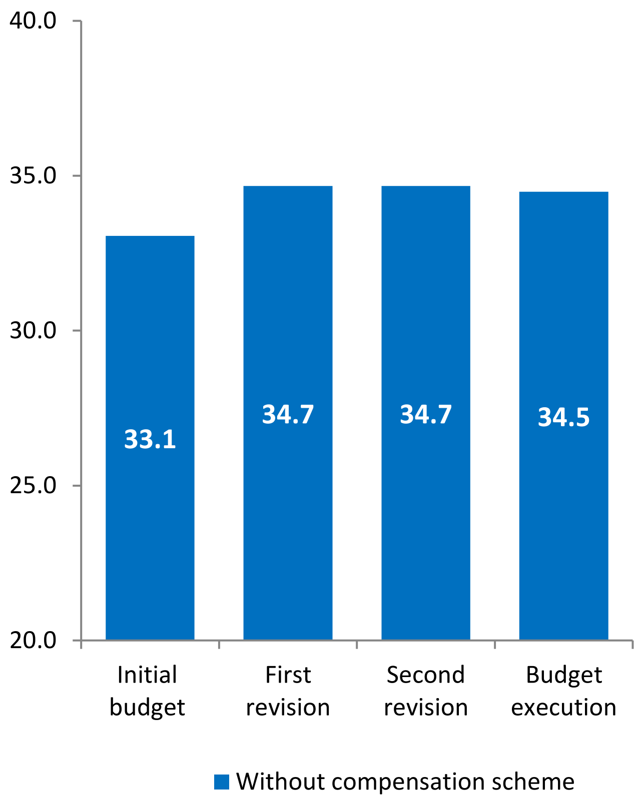
- The latest available data indicate an effective increase of the relevant macroeconomic base by approximately 13.9%, which justifies an increase in VAT receipts by approximately 5 billion lei compared to the programmed level;
- Last but not least, the budget execution of 2021 indicates an above-expected recovery of obligations deferred for payment by economic agents in the previous year, in the case of VAT receipts, an additional income of about 4 billion lei was recorded.

Cumulating the effects of all the previously mentioned factors, it is found that they justify an increase in VAT receipts compared to the level provided for in the initial budget, most likely between 11 and 12 billion lei. In this context, exceeding the programmed level for VAT receipts by only 9.6 billion lei may suggest a worsening of the collection of this budgetary aggregate.

Compared to the previous year, the level of receipts corresponding to this budgetary aggregate, net of the impact of swap schemes, increased by 30.5% (+18.5 billion lei). To substantiate the results of the above analysis, the performance of VAT collections can also be investigated by making an *ex-post* projection of this budgetary aggregate and comparing it with the actual achievements. Thus, starting from the 2020 budget execution of VAT revenues (adjusted, as previously mentioned, with the volume of deferred payment obligations by economic agents and with the value of accelerated VAT refunds), the 13.9% increase was applied final consumption expenses of the population (excluding the self-consumption component and IFSLSG) and then added the amounts recovered from deferred VAT obligations for payment in 2020 (estimated at around 4 billion lei). Under the impact of these factors, the *ex-post* projection of VAT receipts for 2021 stands at 81-82 billion lei, while the actual execution recorded a level of 79.2 billion lei. These results confirm the existence of an unfavorable difference that may suggest a worsening of collection in the case of VAT revenues.

Revenues collected from **excise duties**, net of the impact of swap compensation schemes, amounted 34.5 billion lei in 2021, this level being about 1.4 billion lei higher than the estimates taken into account in substantiating the draft budget. Thus, the initial program provided for revenues from excise duties in the amount of 33.1 billion lei, taking into account a forecasted growth of the macroeconomic base (final consumption of the population in real terms) of 3.7%, as well as obtaining an increase of receipts of about 1.1 billion lei as a result of the increase in the excise duty on tobacco products. The first budget rectification revised upwards the initially estimated level by 1.6 billion lei against the background of a more favorable evolution of the relevant macroeconomic base, compared to the estimates in the draft budget. The second budget revision made no changes to the revenue target for this budget aggregate, and the actual execution recorded a level of excise revenues of 34.5 billion lei, 0.2 billion lei less than the projection of at the first correction.

Figure 6: Excise duty revenues in 2021 (billion lei)



Source: MF

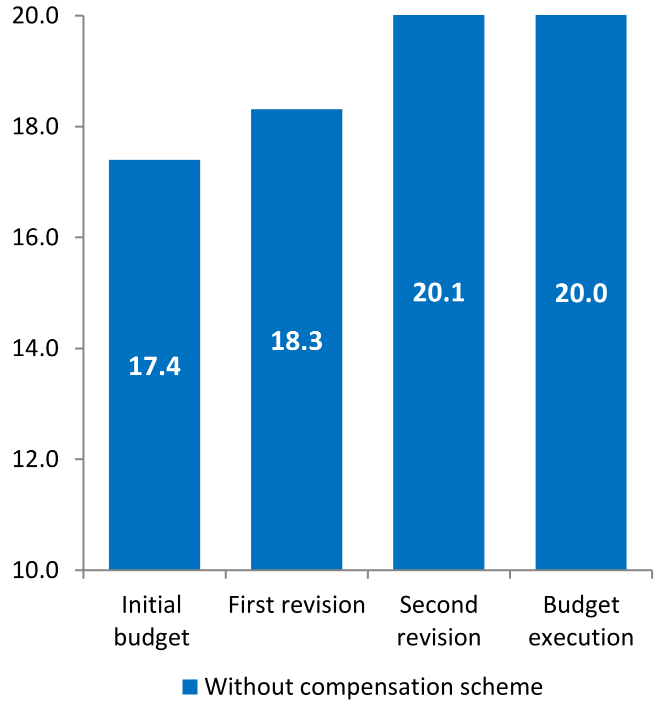
Compared to the previous year, the level of revenues collected from excise duties increased by 3.8 billion lei (+12.4%) in the context of an 8.3% advance in the final consumption of the population (excluding the self-consumption component and IFSLSG) in real terms and the increase in the excise duty on tobacco products in two stages during 2021 (from 533.97 lei/1,000 cigarettes to 546.21 lei/1,000 cigarettes starting January 1, followed by a further increase to 563.97 lei/1,000 cigarettes starting April 1). Given that excise taxes are presented in an aggregated manner in the budget construction, which does not allow studying the impact of the change of a single category, it is of interest to carry out an analysis of the structure of excise revenues. Thus, with a share of 50.1% of receipts (compared to 49.5% in the previous year), excise duties on energy products continue to represent the most important component of excise duty receipts even if the elimination of the excess excise duty on fuel in 2020 had a significant impact on them, the share in total receipts decreasing significantly compared to 2019 when it was around 55%. On the other hand, although excise duties on tobacco products increased during 2021, the share of this category in total receipts decreased to 45.6% from 46.8% in 2020. Receipts from excise duties on alcohol, distillates and alcoholic beverages maintained a share of around 4% of total receipts, while the rest of the categories continued to be below 1%.

Analyzing the changes registered compared to 2020 at the level of each product category, it is found that the receipts from excise duties on energy products increased by 13.6% (+2.1 billion lei), exceeding the dynamics of the relevant macroeconomic base (+8.3%) to which is added the update with the increase in consumer prices communicated by the NIS (+3%, for the period October 2019-September 2020). Revenues from excise duties on tobacco products increased by 9.36% (+1.3 billion lei), exceeding the estimates regarding the materialization of an increase in revenue of approximately 1.1 billion lei as a result of the increase in the level of these excise duties. The third category, represented by excise duties on alcohol, distillates and alcoholic beverages, increased by 19.6% (+0.3 billion lei), also significantly exceeding the dynamics of the relevant macroeconomic base combined with the update for the increase in consumer prices , but due to the low weight in total, the impact of this category of excise duties at the level of the entire budgetary aggregate is not a significant one. Consequently, considering that the volume of obligations related to excise duties deferred for payment by economic agents is a small one (estimated at around 0.1 billion lei) and does not fully explain the evolution beyond expectations of receipts for almost all categories of excise duties, it can be concluded that excise duty collection performance improved during 2021, which may suggest an increase in collection efficiency in this area.

III.4.2. Direct taxes

Corporate income tax revenues in cash standards, net of the impact of compensation schemes, amounted to approximately 20 billion lei, representing an increase of 4.3 billion lei (+27.7%) compared to 2020, and exceeding by 2.6 billion lei the estimates from the adopted budget for the year 2021. Thus, the initial program provided revenues from the corporate income tax amounting 17.4 billion lei, in the context in which an increase of the relevant macroeconomic base was anticipated (nominal GDP) by 7.3%. This value was revised upwards during the budget revision (+0.9 billion lei at the first revision, respectively +1.8 billion lei at the second revision) considering the more favorable developments of the macroeconomic framework, compared to the initial estimates , as well as the up-to-date situation of receipts that reflected an over-expected recovery of deferred payment obligations in 2020.

Figure 7: Corporate income tax revenues in 2021 (billion lei)



Source: MF

In its analysis of the budget revision projects, the FC assessed that the revisions carried out are plausible, a fact confirmed by the final execution of this budgetary aggregate which recorded a value very close to the level estimated at the second revision (difference of only -29 million lei).

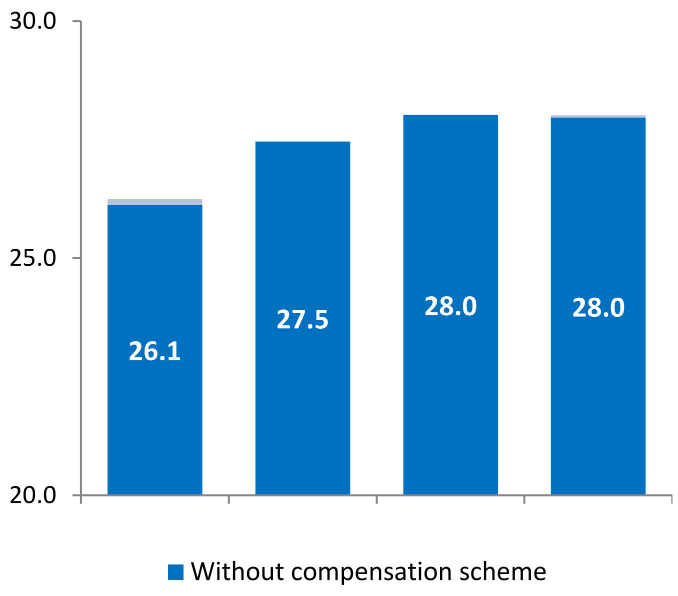
The strong upward evolution of income tax receipts compared to the previous year (+27.7%, representing +4.3 billion lei) was much more pronounced than the dynamics of the relevant macroeconomic base (nominal GDP, which increased by only 11.6%). Even taking into account the volume of deferred tax obligations by economic agents (valued at around 0.5 billion lei) and assuming a high degree of their recovery, a potential revenue increase of around 1-1.5 billion lei emerges which could be justified by an improvement in the level of collection.

An analysis of the structure of receipts related to this budgetary aggregate shows that the greatest impact was exerted by the evolution of the profit tax paid by economic agents in the non-financial sector (this representing the main component of the revenue from the corporate income tax with over 95% of the total receipts) which increased by 4.2 billion lei (+28.5%) compared to the previous year. On the other hand, revenue from the corporate income tax paid by commercial banks decreased by 0.2 billion lei (-16%), which represents a mitigation of the volatility that has characterized this category in the recent years (increase of over 70% in 2019, followed by a decrease of 44% in 2020[44]) and which significantly influenced the evolution of the entire budgetary aggregate. The difference of 0.3 billion lei was caused by the reduction of the swap compensation scheme in 2021 compared to 2020. Consequently, the strongly increasing evolution of revenue from the corporate income tax paid by economic agents in the non-financial sector, a category that represents the overwhelming majority of corporate income tax receipts, confirms the conclusions formulated above regarding the perspective of improving collection efficiency for this budgetary aggregate in 2021.

[44] The volatile evolution of income from the profit tax paid by commercial banks occurred against the background of the decision from June 2019 of the High Court of Cassation and Justice in the dispute between the Court of Accounts and the savings banks-crediting in the housing field which determined the establishment of substantial provisions for litigation or for credit risk, as well as the impact of the tax on financial assets. In the case of banks, according to the Fiscal Code, the base of taxation for the profit tax paid in the current year is represented by the profit obtained in the previous year, they make advance payments based on last year's profit tax (updated with inflation), which is regularized the following year.

Revenues from **personal income tax**, according to cash standards, were about 28 billion lei, which represents an excess of 1.8 billion lei of the budgeted level at the beginning of 2021. Thus, the initial program provided for revenues of 26.1 billion lei due to an estimated increase in the average number of employees of 1.3%, respectively a 4.5% advance in the average gross salary. This level was revised upwards on the occasion of the budget rectifications (+1.3 billion lei at the first budget revision, respectively +0.6 billion lei at the second revision) considering the more favorable developments of the labor market, compared to the initial estimates , as well as the recovery beyond expectations of the sums representing deferred payment obligations in 2020. In its opinions on the budget revision projects, the FC assessed that the revisions carried out are plausible, a fact confirmed by the final execution of this budgetary aggregate which recorded a value of receipts very close to the level estimated at the second revision (difference of only -57 million lei).

Figure 8: Personal income tax revenues in 2021 (billion lei)



Source: MF

Compared to the previous year, personal income tax revenues increased by 15.5% (+3.7 billion lei), the dynamics of this category of budget revenues being consistent with the evolution of the relevant macroeconomic bases during 2021. Thus, starting from the budget execution of 2020 (adjusted to take into account the volume of deferred payment obligations by economic agents, valued at around 0.7 billion lei) and extrapolating with the dynamics of the average number of employees and the average gross salary in year 2021 (+1.5%, respectively +7% according to the latest available data), a level of revenues of over 27 billion lei appears justified. Adding the recovery in a high proportion of deferred payment obligations in 2020, the ex-post projection of revenues for this aggregate is close to the actual level from the budget execution of 28 billion lei, apparently not being a significant surplus of revenues that could result from an improvement in collection.

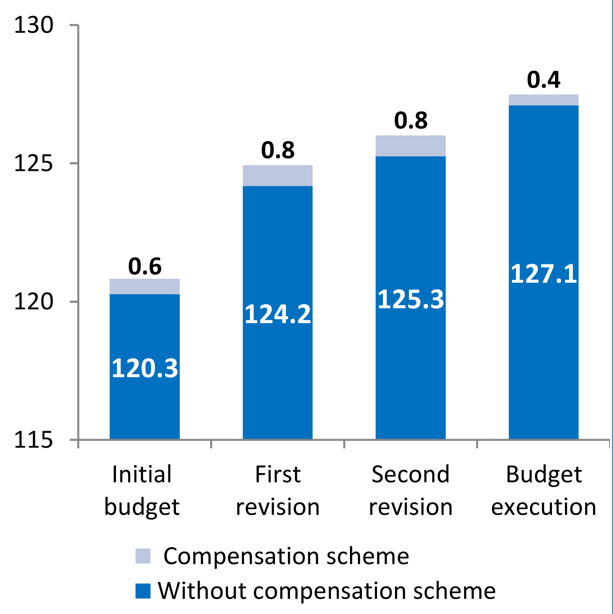
In order to investigate in more detail the evolution of personal tax revenues, an analysis of their structure was carried out on the main components. Thus, the payroll tax (which represents 73.7% of the receipts related to this budgetary aggregate) had a slightly more alert dynamic than that of the relevant macroeconomic bases, recording an increase of 10.8% (+2 billion lei) compared to the previous year. This evolution would justify a partial recovery of the amounts representing deferred budgetary obligations for payment in 2020, but does not indicate the existence of a revenue surplus that would suggest a greater collection efficiency. The faster pace of growth on the whole personal tax revenues (+15.5% compared to the previous year) was achieved as a result of the favorable contributions made by its other main components: income tax revenues from dividends (weight of 9.1% in total revenues) increased by 32% (+0.6 billion lei), revenues from the tax on pension incomes (weight of 7.1% in total revenues) increased by 38.6 % (+0.5 billion lei), and the revenues from the income tax established on the basis of the single declaration (weight of 7.2% in total revenues) increased by 18.8% (+0.3 billion lei). Concluding the analysis carried out at the level of the main components of the personal income tax, it is found that their dynamics confirm the recovery beyond expectations of the obligations deferred for payment by economic agents in 2020, but there are no indications regarding the possibility of an improvement in the collection efficiency.

III.4.3. Social security contributions

SSC revenues in cash standards, net of the impact of compensation schemes, stood at the end of 2021 at a level of 127.1 billion lei, exceeding by 6.8 billion lei the estimates from the draft budget in the conditions in which the average number of employees increased by 1.5%, compared to the initial projection of +1.3%, and the average gross salary increased by 7%, compared to the initial projection of +4.5%. Exceeding the programmed level of receipts for this budget aggregate also occurred in the context in which the effective execution includes the recovery to a large extent (almost 4 billion lei) of the obligations related to SSC postponed for payment by economic agents in 2020 (valued at around 4.7 billion lei). On the other hand, the executive titles paid during 2020 should also be taken into account, including Law 85/2016 on the payment of salary differences due to teaching staff in state education for the period October 2008 - May 13, 2011, as well as GEO 75/2020 regarding the recalculation of the official salaries for police officers from the structures of the Ministry of Internal Affairs and for active military personnel. The planned value of enforceable titles for 2021 was approximately 1.2 billion lei, while the actual payments represented approximately 1.3 billion lei, which led to a marginal increase in SSC revenues compared to the programmed level with approximately 38 million lei.

Analyzing the projection of revenues from the SSC during 2021, it is observed that both budget revisions have operated positive revisions of this category of revenues (+3.9 billion lei in the first budget revision, respectively +1.1 billion lei in the second budget revision) in the conditions of a more favorable evolution of the labor market, compared to the initial estimates, as well as of the recovery above expectations of the amounts representing deferred payment obligations in 2020. In its opinions on the revision projects, the FC assessed that the revisions carried out are in concordance with the evolution of the macroeconomic framework and the situation of budget revenues at the respective moments of time. The budget execution at the end of 2021 recorded a level of SSC revenues higher by 1.8 billion lei compared to the one estimated at the second revision.

Figure 9: Social security contributions revenues in 2021 (billion lei)



Source: MF

Compared to the previous year, SSC revenues, net of the impact of compensation schemes, increased by 15.4 billion lei (+13.4%) in 2021, mainly due to the positive evolution of the wage bill in the economy and the recovery of an important part of the obligations deferred for payment by economic agents in 2020. For a more detailed analysis of the performance of the revenues related to this budgetary aggregate, an ex-post projection will be carried out, the starting point of which is represented by the budget execution at the level of 2020 (adjusted by including SSC obligations deferred for payment by economic agents, valued at around 4.7 billion lei). Indexing the starting point with the dynamics actually recorded by the relevant macroeconomic bases in 2021 (+1.5% average number of employees, respectively +7% average gross salary for the economy) and adding the recovered amounts (about 4 billion lei) from deferred obligations upon payment in the previous year, a level of receipts of approximately 130 billion lei appears justified, which is higher than that recorded in the actual budget execution of 2021 (127.1 billion lei). These results indicate the existence of an unfavorable gap that could suggest a worsening of the collection of SSC revenues during 2021.

In order to more faithfully reflect the dynamics of the SSC during the period 2018-2021, the table below shows the adjusted series of this budgetary aggregate[45], as well as its gross series obtained by removing the adjustments related to swap compensation schemes and transfers to the Pillar II:

Table 6: Social security contributions (million lei)

		Budget execution 2018	Budget execution 2019	Budget execution 2020	Budget execution 2021
Adjusted series	**1**	**98,101.1**	**111,473.5**	**112,250.7**	**127,493.4**
Swap	2	490.9	464.3	552.4	396.6
Pilon II	3	7,717.8	8,487.3	8,912.2	9,768.6
Gross series*	**4=1-2+3**	**105,327.9**	**119,496.5**	**120,610.5**	**136,865.4**
*out of which enforcement titles		55.0	668.0	537.9	461.5

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

Thus, if the gross series is taken into account, it can be seen that in 2021 SSC revenues amounted to almost 137 billion lei, exceeding the revenues from 2020 by 13.5% (+16.3 billion lei), the dynamics being slightly slower than the increase in SSC revenues from budget execution (+13.6%), because the gross series also includes transfers to Pillar II which had a smaller advance (+9.6%). Eliminating the impact of enforceable titles from the gross series, cash revenues from SSC increased in 2021 compared to the previous year by approximately 13.6% (+16.3 billion lei) against the background of the marginal decrease in payments related to this category.

[45] Taken from each year's budget execution.

III.5. Budgetary expenditures

Budgetary expenditures, net of the impact of swap compensation schemes (in the amount of 0.66 billion lei), recorded an advance of 8.4% compared to the previous year (+35.7 billion lei), reaching the end year 2021 to almost 459 billion lei. In the conditions of the significant increase in nominal GDP (+11.6%, against the background of a deflator of 5.4%), the share of budget expenditures in GDP decreased by about 1.1 pp, respectively from 40% to 38.9% of GDP. Among the expenditure aggregates that registered a positive dynamic are *transfers between public administration units* (+113.7%), *other transfers* (+33.5%), *interest* (+23.9%), *projects with financing from non-reimbursable external funds post-accession 2014-2020* (+19%), *goods and services* (+12.5%), *social assistance* (+6.3%) and *subsidies* (+6.2%). On the other hand, some expenditure aggregates registered a downward trend, among them being the *projects with non-reimbursable external financing* (-44.5%), the *expenditures related to programs with reimbursable financing* (-9.4%), respectively the *payments made in previous years and recovered in the current year* (-7%).

The decrease in the share of budget expenditures in GDP was mainly determined by the decrease in the share of *current expenditures* (-0.8 pp) and *capital expenditures* (-0.3 pp). At the level of current expenditures, the largest reductions in the share in GDP were recorded by *personnel expenditures* (-0.9 pp) and those with *social assistance* (-0.6 pp), which recorded lower growth rates than nominal GDP in the context of the relaunch of economic activity during 2021. The evolution of these aggregates was partially counterbalanced by the dynamics of *other transfers* (+0.4 pp, against the background of the increase in Romania's contribution to the EU budget and the amounts for greenhouse gas emissions certificates allocated to projects of investments), of *projects with financing from non-reimbursable external funds post-accession 2014-2020* (+0.2 pp, against the background of the intensification of the absorption of European funds) and of *interest expenditures* (+0.2 pp, in the context of the increase in the volume of public debt and the gradual tightening of the climate on the international financial markets). On the other hand, the other expenditure aggregates registered marginal changes in the weight in GDP compared to the execution of 2020.

In relation to the allocations established by the draft budget for 2021, budget expenditures were at a net higher level, being higher by 14.9 billion lei (+3.4%), respectively by 1.3 pp from GDP, exceeding the initially budgeted amounts being recorded at the level of most expenditure aggregates: *expenditure on goods and services* (+0.7 pp), *social assistance expenditure* (+0.4 pp), *capital expenditure* (+0.3 pp), *personnel expenses* (+0.2 pp), *subsidies* (+0.1 pp), *other transfers* (+0.1 pp), *other expenses* (+0.1 pp) and *interest* (+0.1 pp). It should be noted that, although the budget corrections carried out during 2021 recorded a large upward revision of revenues, they were fully allocated to increases in expenditure aggregates, with additional increases in budget expenditures even being recorded. Even if the higher inflation, the additional medical expenses intended to fight the COVID-19 pandemic and the need to react to the situation on the energy market partially justified the increase in budget spending, the slippage was also fueled by the inability to keep expenses under control. This situation is all the more problematic, since the increases took place at the level of some categories of permanent expenditures, which will also be found in the coming years. The main expenditure category that registered a failure to meet the levels provided for the 2021 budget is represented by projects with financing from non-reimbursable external funds post-accession 2014-2020 (-0.6 pp), an unfavorable situation caused by a lower absorption of European funds compared to the initial planning.

Similar to previous years, also in 2021 the analysis of the quarterly execution of GCB expenditures[46] shows a concentration of them in the last, the total weight of the growth of the IV quarter in the year 2020 (31.5% compared to 30.5%). Thus, total expenses in the fourth quarter of 2021 amounted to approximately 145 billion lei (compared to 129.4 billion lei in the fourth quarter of 2020, i.e. an increase of about 12%), being 38.8% higher than the level of the previous quarter (compared to a 24.9% increase in spending in the fourth quarter compared to the third quarter of 2020).

Analyzing the evolution of the expenditure structure in the fourth quarter of 2021 compared to the previous quarter, the acceleration of the proportions of *projects with financing from non-reimbursable external funds post-accession 2014-2020* (+180.5%, respectively a contribution of 32.4% of the increase total IV/III quarter), of *capital expenditures* (+183.7%, respectively a contribution of 27.1% of the total increase IV/III quarter), of *goods and services expenditures* (+44%, respectively a contribution of 16.3% of the total growth IV/III quarter) and *other transfers* (+73.3%, respectively a contribution of 9.3% of the total growth IV/III quarter). The other categories of budget expenditures had a total contribution of only 14.9% to the increase of total expenditures in the fourth quarter compared to the previous quarter, and *personnel expenses* can be mentioned with a contribution of 5.3% (+8% compared to the third quarter), *subsidies* with a contribution of 4.8% (+114.6% compared to Q3) and *interest* with a contribution of 3% (+31.1% compared to Q3).

Figure 10: Quarterly evolution of GCB revenues in 2021 (billion lei)

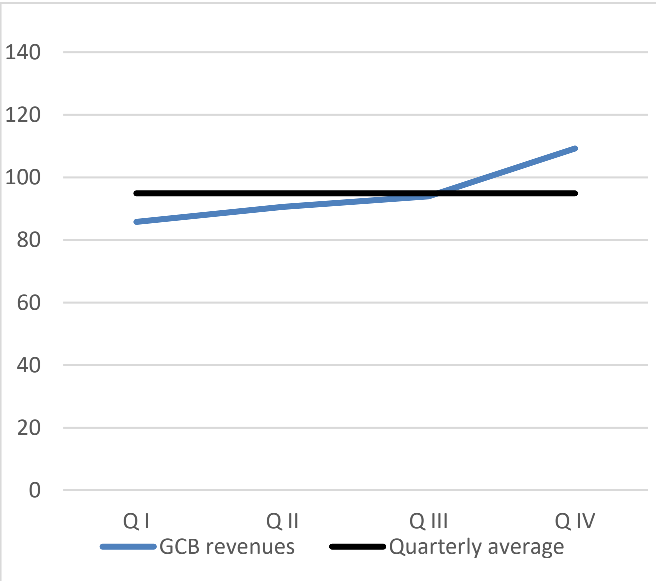
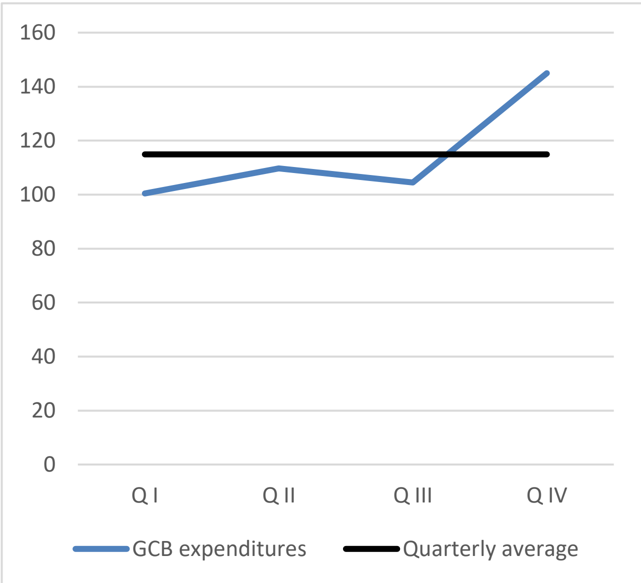


Figure 11: Quarterly evolution of GCB expenditures in 2021 (billion lei)



Source: MF

[46] Including the swap scheme.

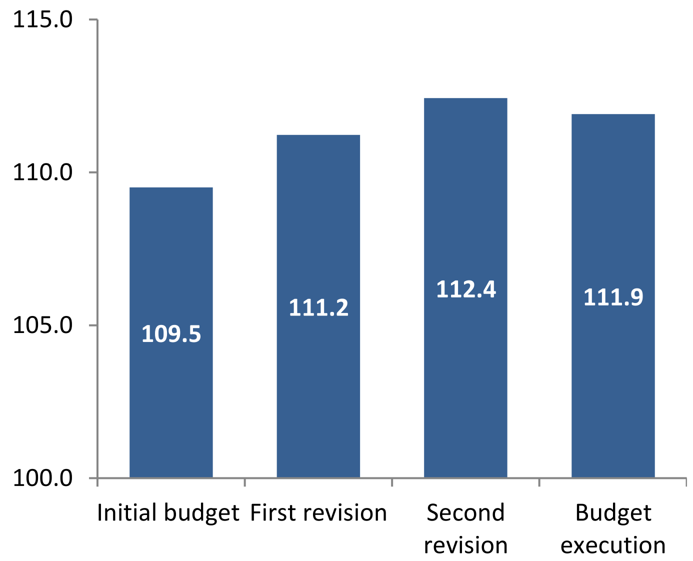
The concentration of expenditures in the last quarter of the year highlights serious deficiencies in the budget programming process, especially for public investment expenditures (financed from capital expenditures and European funds), even if the principle of prudence could partially justify the postponement of some expenditures until the moment when the projection of budget receipts are a lower degree of uncertainty. On the other hand, in 2021, the quarterly evolution of budget revenues indicates that they were achieved mostly in the last quarter of the year, but in a lower proportion compared to the previous year (with a total year share of 28.8% compared to 29.4% in 2020, respectively an increase compared to the previous quarter by around 16.3%, compared to 16.4% in 2020). The Fiscal Council reiterates the recommendation from previous years regarding the reduction of the quarterly volatility of the execution of budget expenditures.

III.5.1. Personnel and social assistance expenditures

The execution of **personnel expenditures** recorded an increase of 2.4 billion lei compared to the level considered when preparing the draft budget for 2021. Initially estimated at a level of 109.5 billion lei, the final value of these expenditures was of 111.9 billion lei, respectively 9.5% of GDP.

The forecasted evolution during the year 2021 for personnel expenses recorded a fall in relation to the ceilings defined by Law no. 14/2021 *regarding the approval of the ceilings of certain indicators specified in the fiscal budget framework for the year 2021*. Thus, on the occasion of the first budget revision, the level provided for this expenditure aggregate was increased by approximately 1.7 billion lei (+1.55%), while the nominal GDP was revised up by 58.1 billion lei (+5.2%) compared to the estimates used in the initial budget construction. In the second budget revision, personnel expenses increased by 1.2 billion lei (+1.08%) compared to the previous budget iteration and by 2.9 billion lei (+2.65%) compared to the draft budget. At the same time, the nominal GDP level was 73.5 billion lei (+6.58%) higher than the one estimated at the time of establishing the initial budget.

Figure 12: Personnel expenditures in 2021 (billion lei)



Source: MF

On the occasion of the first budget revision, the Fiscal Council showed that the additional amounts allocated to personnel expenses were directed to the payment of staff from public health units, for the granting of the risk incentive, increases for special dangerous conditions and for the payment of overtime, these expenses being financed from European funds. Moreover, considering that the increase in personnel expenses compared to the one considered in the draft budget is not negligible and took place under the conditions of the salary freeze, the FC drew attention to the fact that additional explanations regarding this increase would be necessary, as well as a strict control of these expenses. At the same time, falling within the ceiling proposed on the occasion of this rectification carries risks.

In the second budget revision, the FC showed that the addition of personnel expenses was intended mainly for the payment of salary rights established by court decisions for the personnel of the judicial system.

Compared to 2020, personnel expenses increased by 1.93 billion lei, respectively by 1.75%. In 2021, for the second consecutive year, a reduction of the amounts paid on account of court rulings regarding the payment of salary differences for some categories of budget workers is observed. Thus, we note that for 2021, the enforcement titles paid (1,348 million lei) were lower than those paid in the previous year (1,571.5 million lei). At the level of newly issued enforceable titles, a reduction of 56.17% is observed in 2021 (1,237.3 million lei) compared to 2020 (2,822.6 million lei), however, the amount recorded in 2021 will continue to affect the cash execution of the following years.

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

		2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total
Enforceable titles issued, including Law no. 85/2016	Central administration (State budget)	3,239.5	531.7	8.5	3.8	82.3	1,599.4	67.4	996.9	1,461.6	2,812.3	1,163.3	11,966.6
	Local administration	3,059.6	580.7	867.6	1,614.4	1,064.1	2,094.3	20.3	0.0	0.0	10.3	74.0	9,385.2
	Social security budget	115.6	14.5	28.6	5.5	12.2	7.6	1.2	0.0	0.9	0.0	0.0	185.9
	Total	**6,414.7**	**1,126.8**	**904.7**	**1,623.6**	**1,158.5**	**3,701.2**	**88.9**	**996.9**	**1,462.5**	**2,822.6**	**1,237.3**	**21,537.7**
Enforceable titles paid, including Law no. 85/2016	Central administration (State budget)		162.0	311.3	1,531.7	1,234.6	363.1	476.2	80.8	999.7	1,551.5	1,314.6	8,025.5
	Local administration		153.0	306.0	2,447.2	2,806.1	544.6	705.0	79.2	947.7	17.5	31.4	8,037.7
	Social security budget	5.8	24.2	72.6	59.3	0.0	0.6	0.6	0.6	4.2	2.4	2.3	172.5
	Total	**5.8**	**339.2**	**689.8**	**4,038.2**	**4,040.7**	**908.4**	**1,181.8**	**160.6**	**1,951.6**	**1,571.5**	**1,348.3**	**16,235.7**

Source: MF

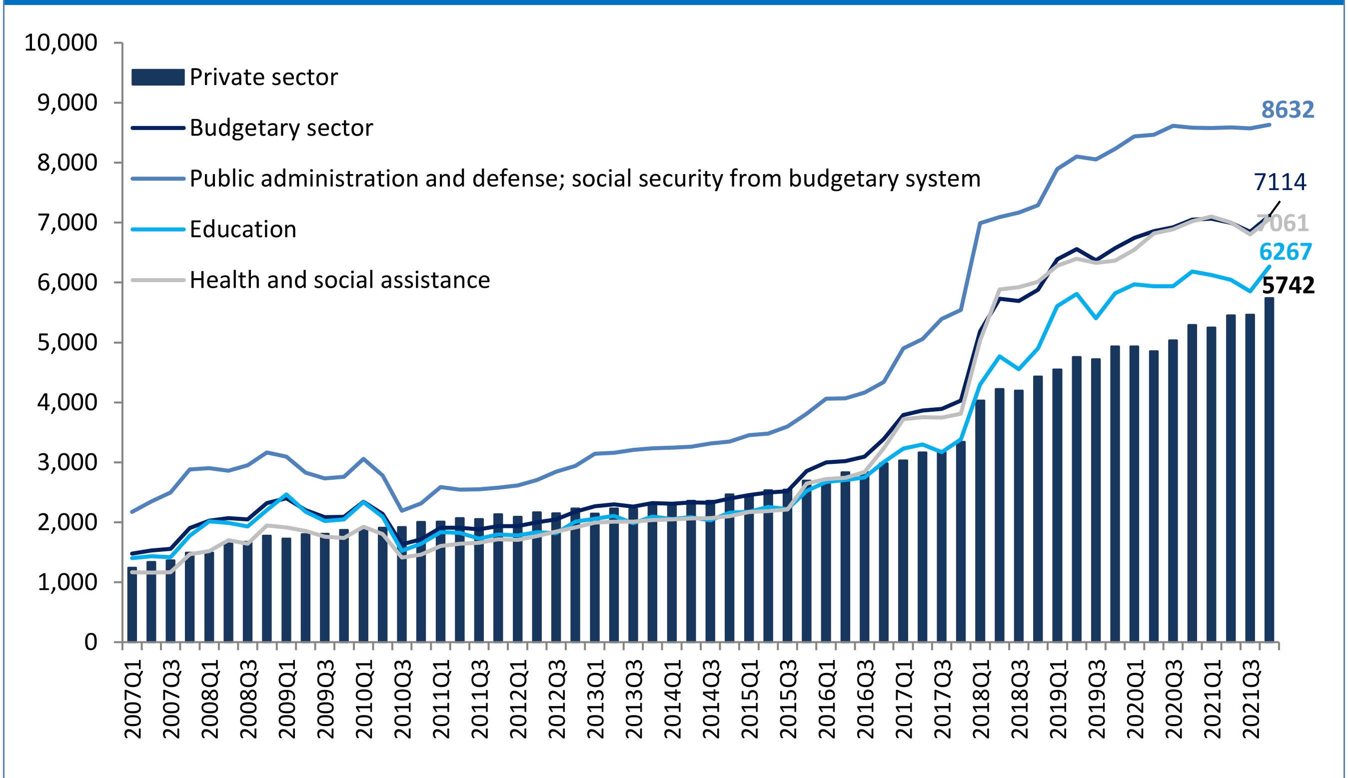
The draft budget for the year 2021 aimed at freezing salaries in the public sector and renouncing the granting of holiday vouchers, these representing some of the most important structural measures taken by the Government with the aim of reducing the budget deficit and starting budget consolidation.

The average gross salary in the public system reached 7,004 lei/month in 2021, 1.59% higher than in 2020, surpassing by 27.91% the one in the private sector, which stood at 5,476 lei/month (increasing by 8.89% compared to the previous year). Considering quarterly averages, the average gross monthly salary in the public sector for the fourth quarter of 2021 recorded a level of 7,114 lei, 0.88% more than in the same period of 2020, while the salary in the private system was 5,742 lei, up 8.5% compared to the fourth quarter of 2020.

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 IV quarter of 2021 compared to the IV quarter of 2020: in public administration and defense the dynamic recorded was 0,79%, in education the increase was 1.09%, and in health the highest increase was recorded, of 2.54%. The latter dynamic is mainly attributable to the granting of increases to medical personnel on the front line against the fight against the COVID-19 pandemic.

Following the increase of 165,600 persons recorded in the period 2005-2008, the total number of employees in the government sector decreased by 135,904 persons in the interval December 2008 - December 2021, to a level of 1.26 million (*Figure 14*). Practically, most of the staff reduction took place in the period 2009-2011, when the number of employees in the budgetary sector decreased by about 180 thousand, while in the period 2012-2014 the decrease was about 9,540 positions. The adjustment registered in the period 2009-2021 occurred especially at the level of local executive authorities (-34,261 filled positions), the Ministry of Internal Affairs (-25,333 filled positions), other institutions financed entirely from own revenues (-11,744 filled positions), the Ministry of Finance (-9,332 filled positions), the Ministry of Agriculture and Regional Development (-4,898 filled positions), the Ministry of National Defense (-3,811 filled positions). On the other hand, in the same period there were increases at the level of the Ministry of Justice (+3,368 filled positions), the General Secretariat of the Government (+2,201 filled positions), the Ministry of Economy, Entrepreneurship and Tourism (+1,347 filled positions), the Ministry of Investments and European Projects (+1,334 filled posts), the Ministry of Labor and Social Justice (+1,066 filled posts) and the Public Ministry (+976 filled posts).

Figure 13: Average gross earnings in the private and public sectors between 2007-2021 (lei/month)

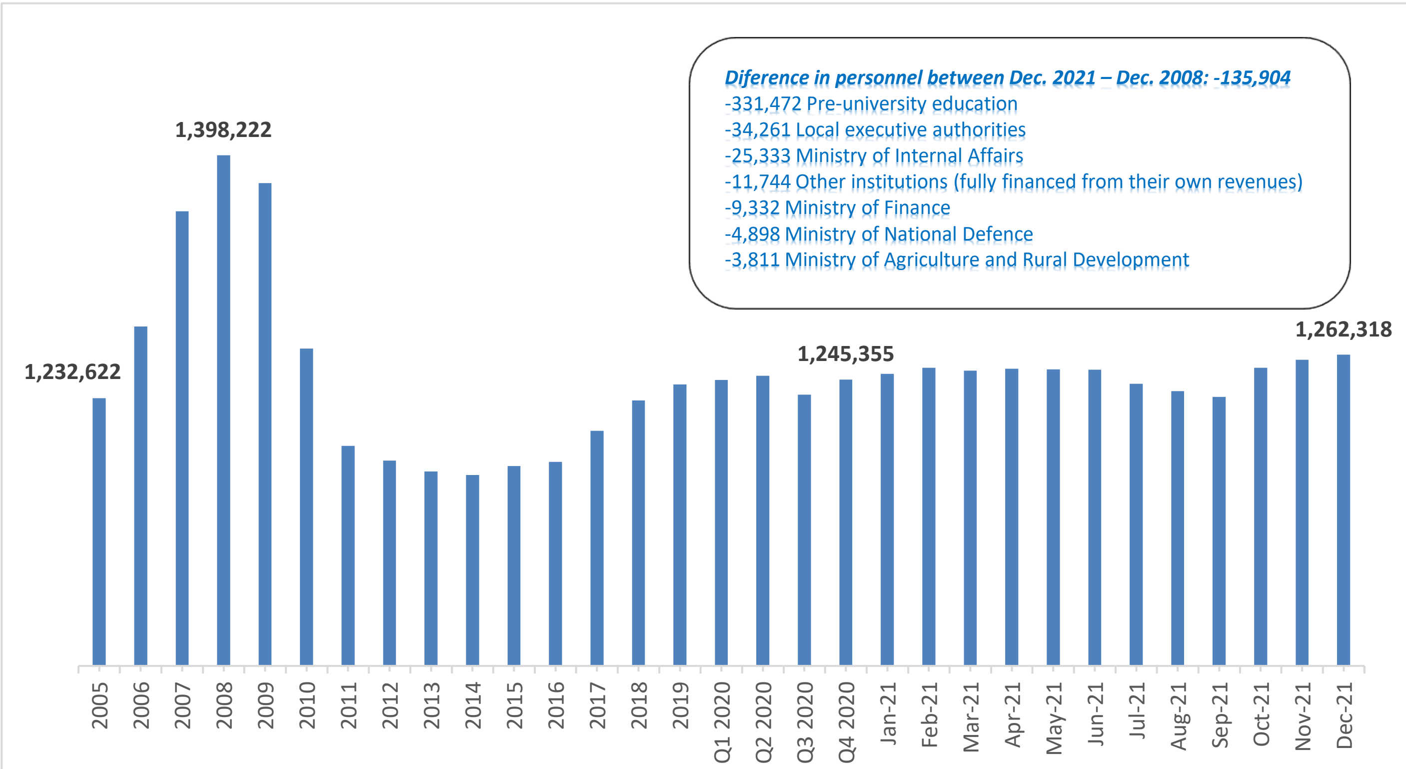


Source: NIS, FC's computation

At the same time, it should be mentioned that in 2021, the growth rate of the number of employees was higher compared to the one recorded the previous year, namely 1.02% (+12,694 people) compared to 0.6% (+7,515 people). Staff increases were recorded especially at the level of the health system, including the Ministry of Health (+10,870 posts), the Ministry of National Defense (+2,050 posts), local executive authorities (+1,706 posts), the Ministry of Education (+1,040 occupied positions) and the General Secretariat of the Government (+452 occupied positions). On the other hand, the most important staff reductions were recorded at the level of the Ministry of Internal Affairs (-4,859 occupied positions) and state higher education units (-1,643 occupied positions).

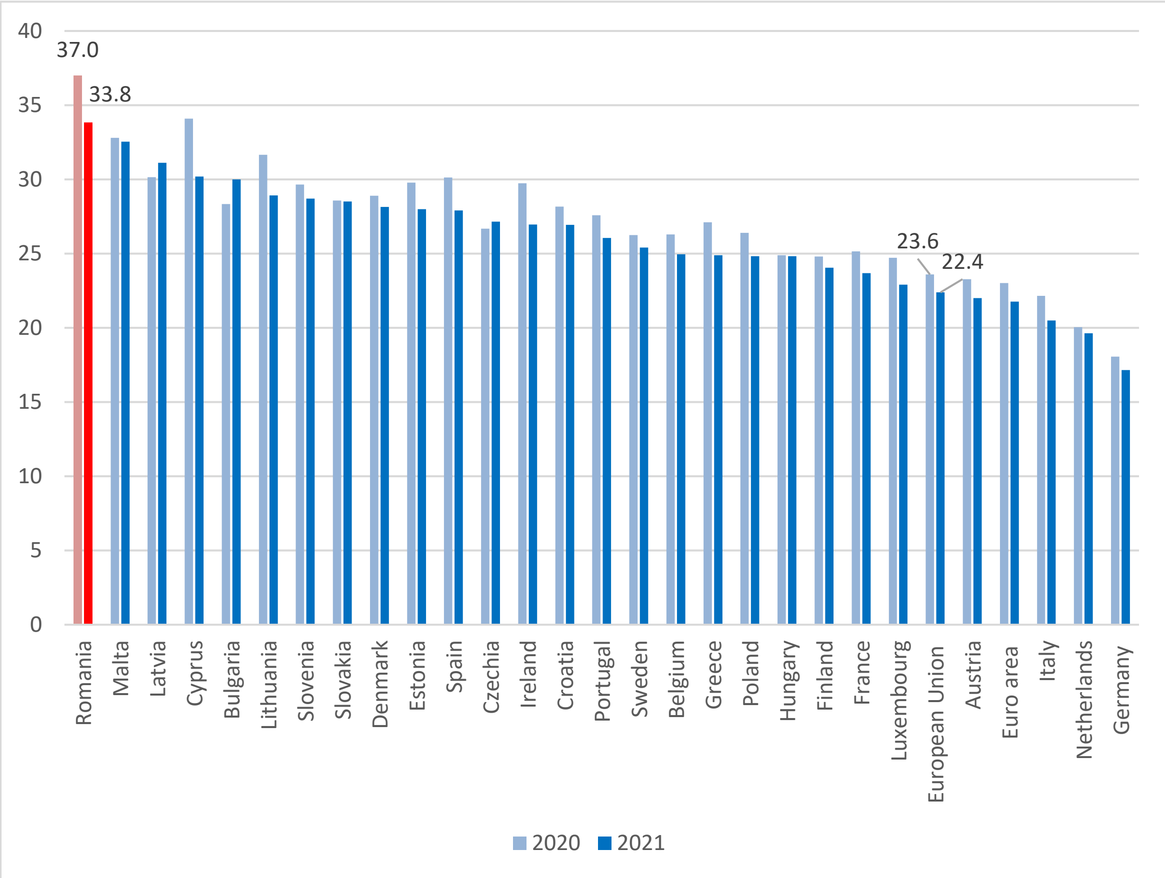
The adjustment from 2009-2012 was mainly the result of the application of the rule of "1 new employee per 7 departures" in the conditions where most of the exits from the system were made through voluntary departures or retirement. The abandonment of this rule starting in 2013 was intended to reduce adverse selection and allow the operation of some changes in the structure of the employed personnel. Thus, the reduction operated in the period 2009-2012 was achieved only to a small extent starting from qualitative criteria, such as reducing staff where a surplus of employees is identified simultaneously with new hires in deficit areas based on cost standards rigorously defined and by establishing an optimal level of operation. The Fiscal Council considers this approach appropriate and recommends that new hires be made in identified deficit areas, 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 14: The evolution of public sector employment between 2005-2021



Source: MF

Figure 15: Personnel expenditures as a share of total budget revenues in EU27 countries



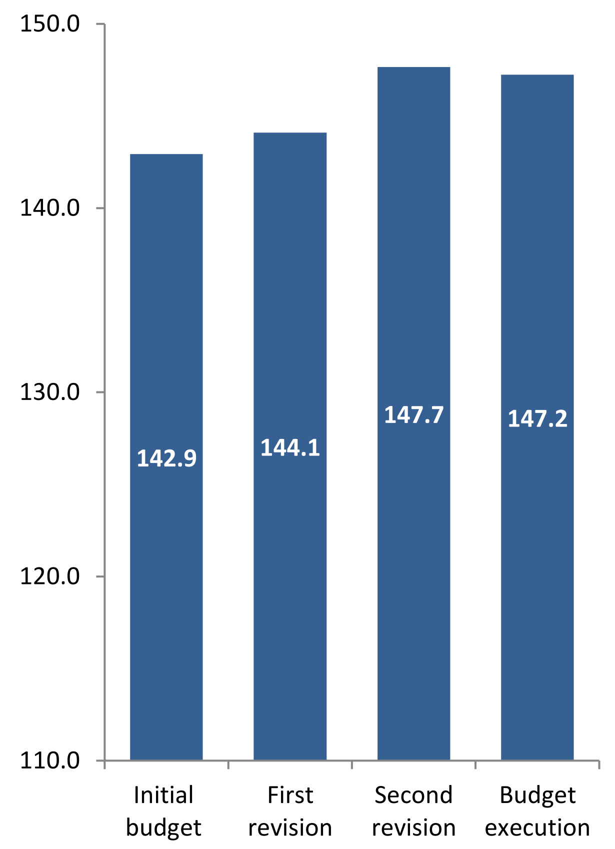
Source: Eurostat

Note: Given the change in the statistical treatment of special pensions by Eurostat, they are included in income from insurance contributions and in staff costs without an actual collection/payment taking place. Accordingly, in order to avoid double recording, the expenditure on special pensions has been removed from the income from insurance contributions and from personnel expenditure.

In terms of the ratio between budget sector salary expenditures and total revenue received, according to ESA 2010 standards, in 2021, Romania ranked first in the ranking of the 27 EU countries, as in the previous year. If until 2009 Romania was placed in the first half of the ranking in terms of the ratio of salary expenses to total income (in eighth position in 2008 and tenth in 2009), in 2011 as a result of the 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 in this ranking, due to salary recoveries and the salary increase of some categories of budget officers, in 2015 it ranked 20th out of 27, on the basis of a slight increase in the revenues received by the budget and the maintenance of the expenditure on salaries as a percentage of the GDP. Starting with 2016, however, the situation changes and Romania climbs steeply to 10th place, reaching second place in 2017, and occupying the first position in 2018. In 2021, there is a **tendency to slow down the growth rate of personnel expenses compared to the previous year**.

In 2021, **social assistance expenditures** registered a level higher than that envisaged in the draft budget, being revised upward on the occasion of the two budget corrections mainly due to the evolution of the Pandemic and the need for state support for employees in the sectors affected by it. Although estimated in the budget proposal for 2021 at a level of 142.9 billion lei, the actual execution of social assistance expenditures, net of the impact of compensation schemes, was 147.2 billion lei, with 3% (the equivalent of about 4.3 billion lei) more than in the initial program.

Figure 16: Social assistance expenditures in 2021 (billion lei)

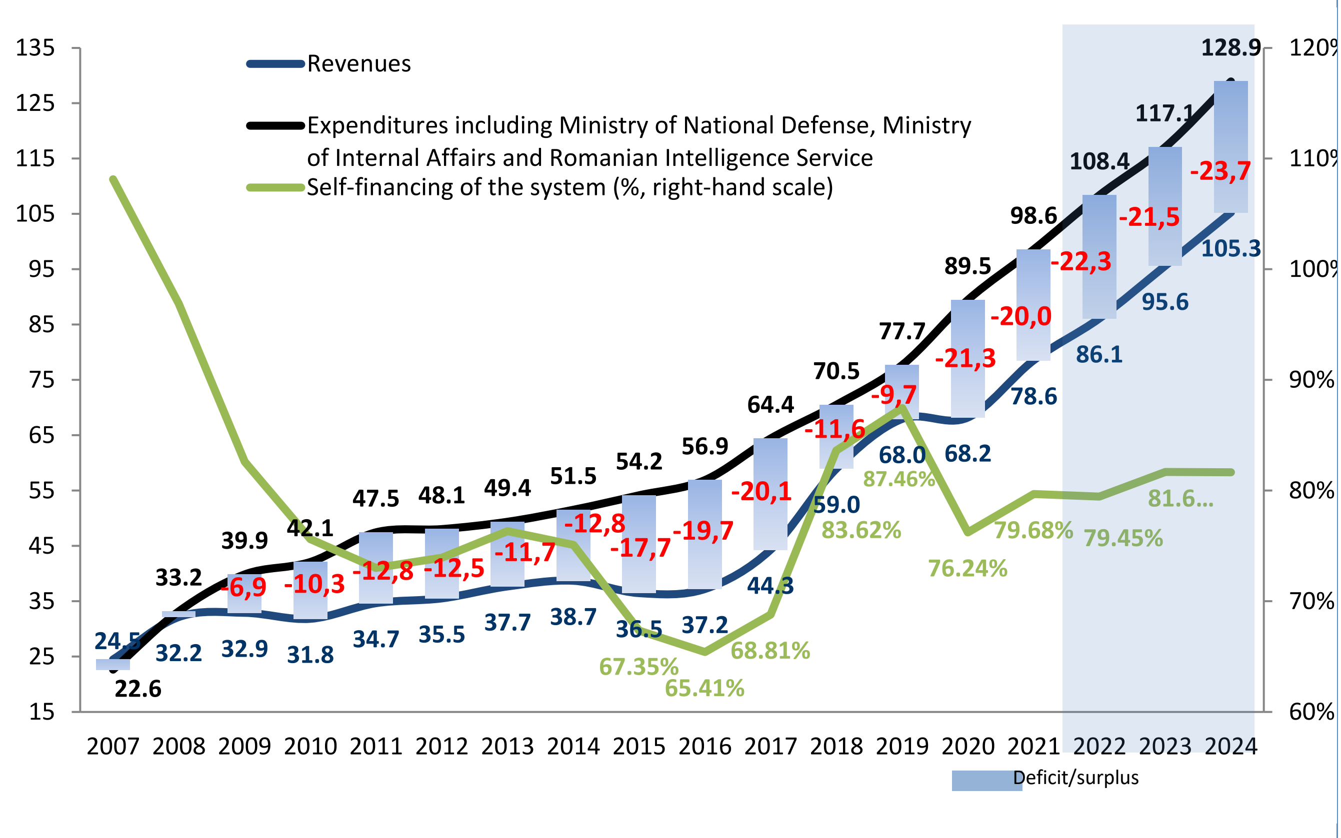


Source: MF

Starting from 2009, the deficit of the social security budget, considering also special/service pensions, has deepened significantly, reaching the level of 20.03 billion lei in 2021. In 2018, it was significantly reduced, reaching the level of 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 the employee determined a significant increase in the gross salary, practically leading to an increase in the level of taxation through insurance contributions by about 13.9%. In addition to the increase in labor taxation through the SSC, the reduction in the deficit in 2018 is also explained by the reduction in the share of contributions 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. In 2020, the deficit in the social insurance budget deepened both due to the increase in pensions and the unfavorable evolution of incomes, as a result of the recession generated by the pandemic.

Estimates for the following years, according to the data from the fiscal-budgetary strategy for the period 2022-2024, show that the deficit of the social insurance budget will remain on an upward trend in 2022, registering an increase to the level of 22.3 billion lei, after which follows a moderate decrease to 21.5 billion in 2023 and an increase to 23.7 billion lei in 2024. In the Opinion on the draft budget for 2022, the Fiscal Council drew attention to the fact that risks still persist regarding this expenditure aggregate, due to the higher pensions of those who retire in 2022, compared to those who retired previously. At the same time, social expenses (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 17: The evolution of revenues and expenditures from the social security budget (billion lei)



Source: MF, cash standard data

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 Defense, Ministry of Internal Affairs and Romanian Intelligence Service.

From the perspective of expressing the deficit as a percentage of GDP, the achievements indicate its decrease from 2.29% in 2011 to 1.92% in 2014, followed by a new increase in 2015 to 2.48%, a significant decrease in 2018, when it reached 1.21% of GDP and in 2019, when it reached 0.92%. The downward trend of the deficit as a share of GDP was reversed in 2020, its level reaching 2.01% of GDP based on the economic contraction caused by the COVID-19 pandemic, but also the significant increase in the aggregate of social assistance 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 upward trend, reaching 1.69%, and the projection for next year indicates the same level for this indicator. In 2023 it is expected to decrease, followed by a slight increase in 2024[47] (1.49% and 1.52%).

The deficit entry of the state social insurance budget took place due to the excessive increase in social insurance budget expenditures from 2007-2009 (+75.8%) and in the context of a favorable dynamic of contribution receipts in the period preceding the financial crisis, as a result of the economic boom, but also anticipating the maintenance of this trend in the future. However, a significant part of the increase in contribution income 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 2006 (from 111.8%) to 2011 (73.02%), reaching the historical minimum in 2016 (65.4%) and remained at a close value in 2017 (68.84%). In 2018, the self-financing capacity recorded a slight recovery, reaching 83.6%, and the growth continued in 2019 when the value was recorded at 87.5%. For the year 2020, there was a reduction in the degree of self-financing of the system, its value being 76.24%. In 2021, the self-financing capacity was on a slightly upward trend, reaching the value of 79.68%. Estimates show a similar value for the year 2022, with a projected level of 79.45%. The premises for the years 2023 and 2024 are more optimistic, this indicator being projected at 81.67% in 2023 and 81.65% in 2024.

The decision to increase some permanent expenses, such as those related to pensions, should take into account the trend of revenues from contributions, as well as the forecasts regarding the employee-pensioner ratio, especially since, in the context of the accentuation of the demographic aging phenomenon, on January 1, 2018 the elderly population aged 65 and over numerically exceeded the young population aged 0-14 (3,596 thousand compared to 3,042 thousand people), according to NIS data. At the same time, it became evident the need to find an indexation rule that would ensure the long-term sustainability of the social security budget instead of the discretionary approach of the past.

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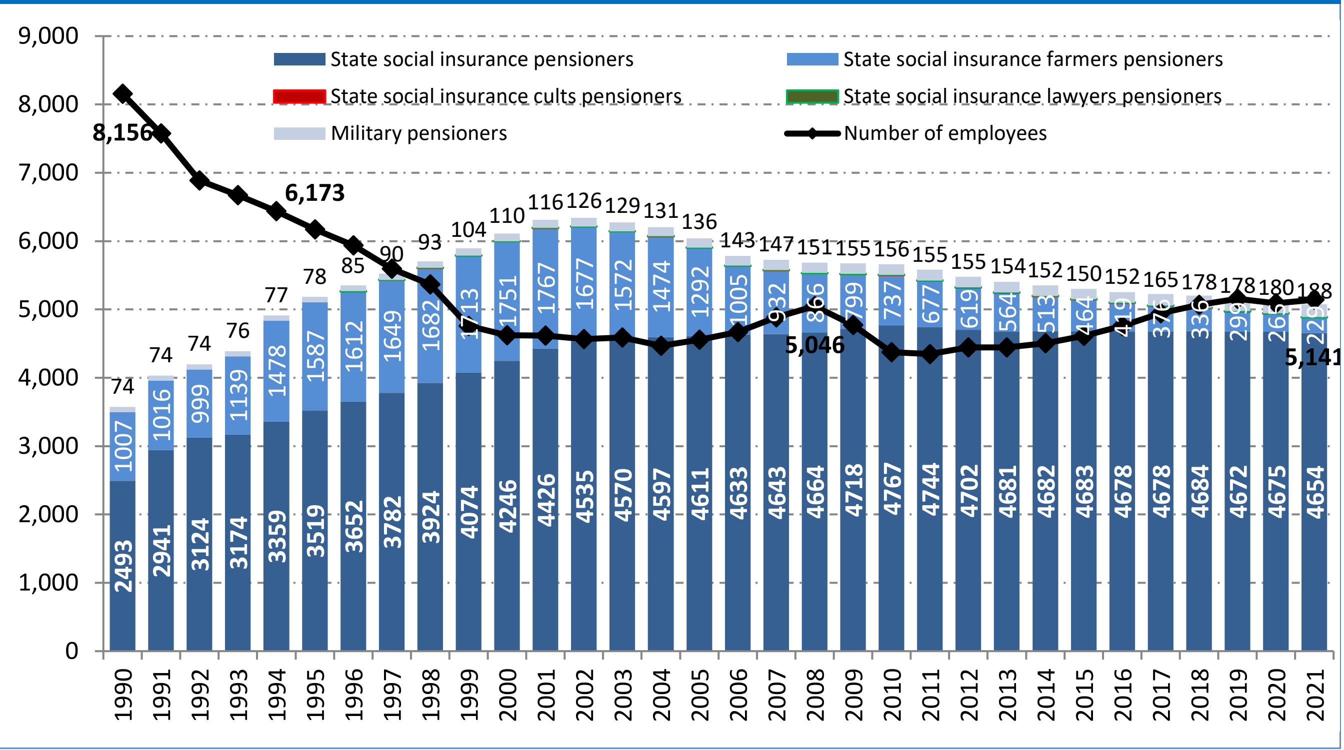
[47] According to the growth assumptions presented by the Ministry of Finance in the fiscal-budgetary strategy for the period 2022-2024.

Figure 18: The evolution of the number of pensioners versus the number of employees (thousand persons)



Source: NIS, except for the 2021 number of employees provided by the NCSP 2022 Winter Forecast

The ratio between the number of taxpayers and the number of beneficiaries has decreased very strongly in the last 30 years, from 2.28 employees to one pensioner in 1990 to only 1.01 in 2021, the number of state social insurance pensioners having an increasing trend, while the number of employees had a decreasing trend, especially until the years 1999-2002. The European Commission's projections[48] indicate that this ratio will decrease from 1.1 employees to one pensioner in 2019 to 0.74 in 2050.

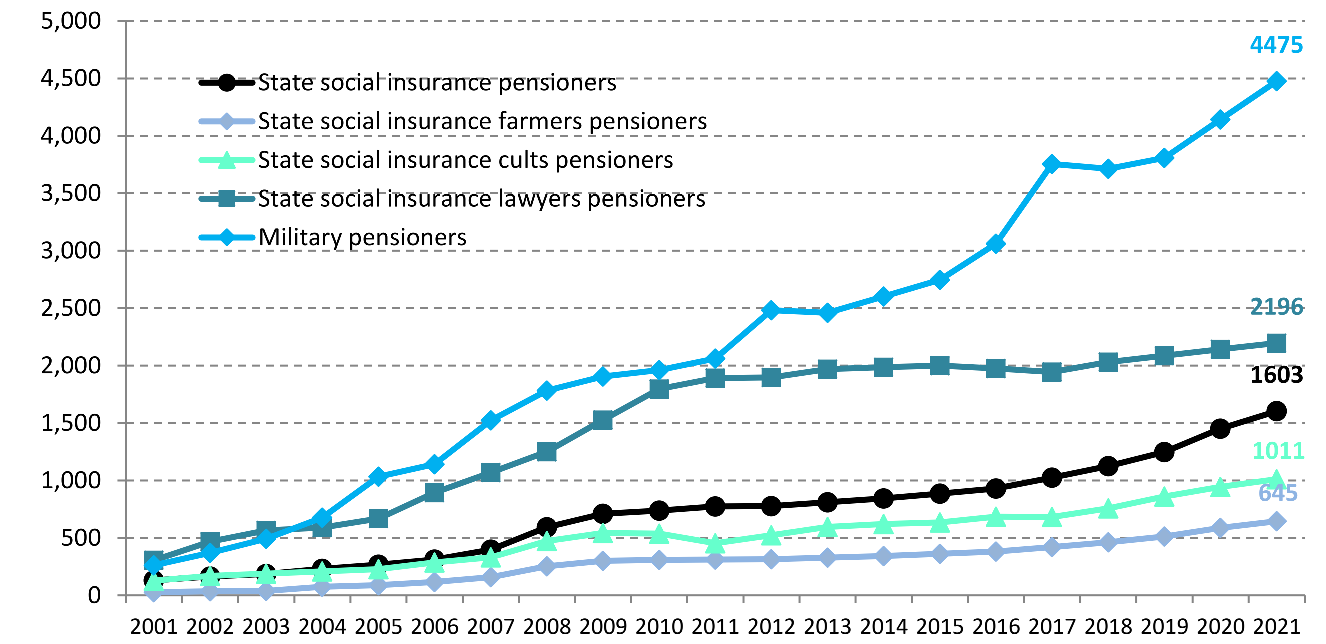
The year 2021 marked significant developments from the point of view of the aggregate of social assistance expenses, on the occasion of the second budget revision, from the perspective of: supplementing the sums related to the state budget (+2.4 billion lei) for the compensation of invoices electricity and gas, payment of allowances granted upon interruption of activity during the pandemic, state allowances for children, rights of disabled persons, allowance for child rearing and full payment of pensions, allowances and heating aid; supplementing the amounts related to the state social insurance budget (+0.5 billion lei, to cover the additional funds required for the payment of pensions); supplementing the budgets of administrative-territorial units (+0.4 billion lei); supplementing the budget of the single national social health insurance fund (+0.2 billion lei).

[48] The 2021 Ageing Report: Economic and Budgetary Projections for the EU Member States (2019-2070), https://economy-finance.ec.europa.eu/publications/2021-ageing-report-economic-and-budgetary-projections-eu-member-states-2019-2070_en#files.

FC appreciates that substantial overruns at the level of this budget aggregate signal deficiencies in budget programming and a lack of control in the management of this category of expenses.

According to NIS reports, in 2021, the average monthly pension was 1,666 lei, an increase of 11% compared to the previous year, the value of the pension point remaining at the level of September 2020, of 1,442 lei. The pensions paid from the social insurance budget were at an average level of 1,603 lei, and those corresponding to agricultural pensioners were on average 645 lei. At the same time, the pensions granted to the military reached an average monthly level of 4,475 lei, an increase of 334 lei (8%) compared to the level of 2020. The average monthly pension corresponding to beneficiaries from the defense, public order and national security system registered an increase of approximately 128% in the period 2010-2021. During the same period, the average monthly pension of pension beneficiaries from the state social insurance budget increased by 117%.

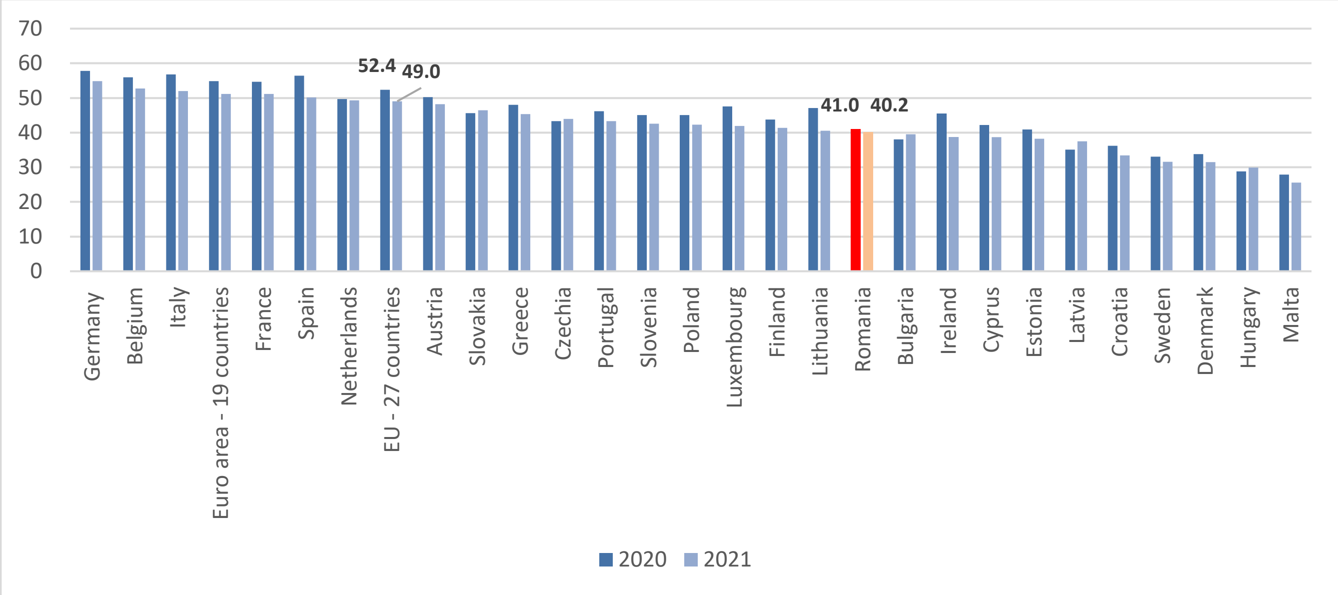
Figure 19: The evolution of the average pension (lei) between 2001-2021



Source: NIS

At the level of 2021, Romania was 2 positions higher in the ranking of EU member states according to the share of social assistance expenses in total revenues, i.e. the 19th position, in 2020 occupying the 21st position. In 2021, the share of social assistance expenses in total budget revenues decreased by 0.73 pp compared to the previous year. This decrease was also determined by the slower growth rate of this expenditure category compared to the growth rate of budget revenues in GDP.

Figure 20: Social assistance expenditures as a share of total budget revenues in EU27 countries



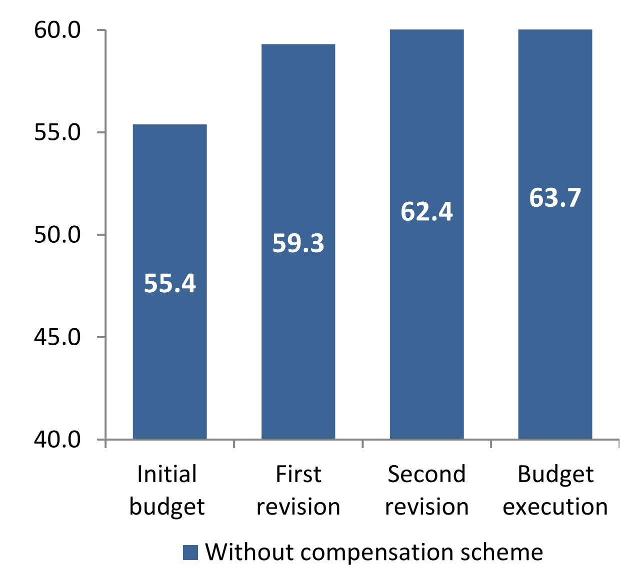
Source: Eurostat

Note: Given the change in the statistical treatment of special pensions by Eurostat, they are included in the income from insurance contributions and in staff costs without an actual collection/payment taking place. Accordingly, in order to avoid double recording, the expenditure on special pensions has been removed from the income from insurance contributions and from personnel expenditure.

III.5.2. Goods and services expenditures

The execution of expenditure on **goods and services** recorded a much higher level, both compared to the one envisaged in the draft budget (+8.4 billion lei), and compared to the values projected on the occasion of the two budget corrections carried out during year mainly as a result of the measures taken by the authorities to combat the effects of the pandemic. Initially projected at 55.4 billion lei, the final execution of this aggregate reached a level of 63.7 billion lei, being 4.4 billion lei higher than the value estimated in the first budget rectification and by 1.3 billion lei higher than the value programmed in the second budget revision.

Figure 21: Goods and services expenditures in 2021 (billion lei)



Source: MF

Expressed as a share of GDP, spending on goods and services increased by 0.03 pp compared to 2020, reaching the level of 5.4% of GDP. By reference to the execution of 2020 (56.7 billion lei), this category of expenses (net of the impact of swap-type compensation schemes) was projected, in the initial version of the budget, at a lower level by about 1.3 billion lei.

During 2021, the budget allocation was increased on the occasion of each of the two budget corrections carried out. At the first budget revision, carried out in April 2020, the amount of the aggregate expenditure on goods and services was revised upwards by 3.9 billion lei, respectively by 4.6% above the nominal level of this aggregate from 2020 (the growth rate from 2020 compared to 2019 being 8.1%, and in 2019 compared to 2018 8%). In the first six months of 2021, the growth rate of this budgetary aggregate was 8.3% compared to the same period last year. FC noted the substantial increase in this category of expenses, partially justified by the higher inflation in 2021, as well as the additional needs given by the fight against the pandemic. FC has already noted from the opinion on the budget that the 2021 target for this category of expenses is ambitious and difficult to achieve in the absence of deep reforms in the public procurement system.

On the occasion of the second budget revision, expenditure on goods and services was revised upwards. The considerable increase in this category of expenses on the occasion of the second revision, although partially justified by the higher inflation in 2021 and the additional needs for the fight against the pandemic (1.8 billion lei being additionally allocated for the single national fund of social health insurance), reflected the materialization of the risks signaled by the FC both on the occasion of the budget draft and on the occasion of the first revision, but the magnitude of this increase (+3.1 billion lei compared to the first revision and +7 billion lei compared to the initially program) exceeded previous expectations, being also the consequence of the lack of adequate control of expenditure on goods and services.

From the note accompanying the execution of the general consolidated budget for 2021[49], the main explanation for the fact that this aggregate was increased on the occasion of each budget revision that took place during 2021 refers to the need to support the medical system in the fight against the COVID-19. Thus, according to the data communicated by the main credit officers, 7.85 billion lei of the total expenditure with this budgetary aggregate represented payments for medicines, sanitary materials, reagents and other necessary products for the diagnosis and treatment of patients infected with the SARS-CoV-2 coronavirus, as well as payment for vaccines against COVID-19. For this budgetary aggregate, there is an increase of 21.1% in the state budget and 11.4% in the budget of the single national fund of social health insurance compared to the previous year.

The cumulative increases operated in the context of the budgetary revisions of the allocations related to this expenditure aggregate, as well as the final execution, confirmed the observations of the Fiscal Council regarding the need for additional allocations compared to the amounts programmed at the time.

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[49] Note on the execution of the consolidated general budget - December 2021.

In the previous years, aggregate spending on goods and services has proven difficult to control. Thus, in the periods 2011-2013 and 2017-2020, the level of expenditure on goods and services (net of the impact of compensation schemes) recorded in the budget executions was higher than the initially budgeted one or even those revised upwards on the occasion of the budget revisions, while the period 2014-2016 was characterized by a different situation, with the final execution registering a lower level of expenditure compared to the last budget iteration.

The Fiscal Council notes a chronic lack of transparency in the projection of this expenditure aggregate, regarding the assumptions that underpin the trajectory of this expenditure chapter, the motivation of the large-scale revisions carried out during the year not being explained in the documents accompanying the successive iterations of the budget. These explanations are all the more necessary as the changes are often substantial with the potential to influence the achievement of the budget deficit target or compliance with fiscal rules. The Fiscal Council advocates for a budget programming that considers the inclusion of all expenses considered within this budget chapter within the budget draft together with an appropriate detailing of the destination of the funds, as well as for comprehensive explanations on the occasion of budgetary revisions in relation to the sources of potential increases in this category of expenses. An increase in transparency could be a good starting point in the efficiency of spending on goods and services, but this needs to be accompanied by an extensive reform of the public procurement system in general.

III.5.3. Public investment expenditures

Investment expenditures include, according to the budget classification*, capital expenditures* (non-financial assets), *projects financed from non-reimbursable external funds after accession, expenditures related to reimbursable financing programs, capital transfers* and *other transfers of an investment nature*. In this chapter, the structural analysis of this budget aggregate follows the above definition.

In the initial budget construction of 2021, the investment expenses, in cash standards, were estimated significantly above the value of the 2020 program (by 11.3 billion lei, respectively at 62 billion lei, including the amounts related to the swap-type compensation scheme). The funding structure was designed in favor of external funding sources (52% of the total compared to the 42% share of the 2020 program), with internal sources (*capital expenditures* and *other investment-type transfers*) accumulating 48% of the total, with 10 pp below the weight from the initial construction of the previous year), in line with the desire to increase the weight of sources of financing public investments from European funds, consistently supported by the Fiscal Council.

In the execution, the increase compared to the previous year was 6.1 billion lei (at a level of 59.3 billion lei), respectively, an increase of 11.5% in nominal terms[50], or 5.8%[51] in real terms. In terms of structure,

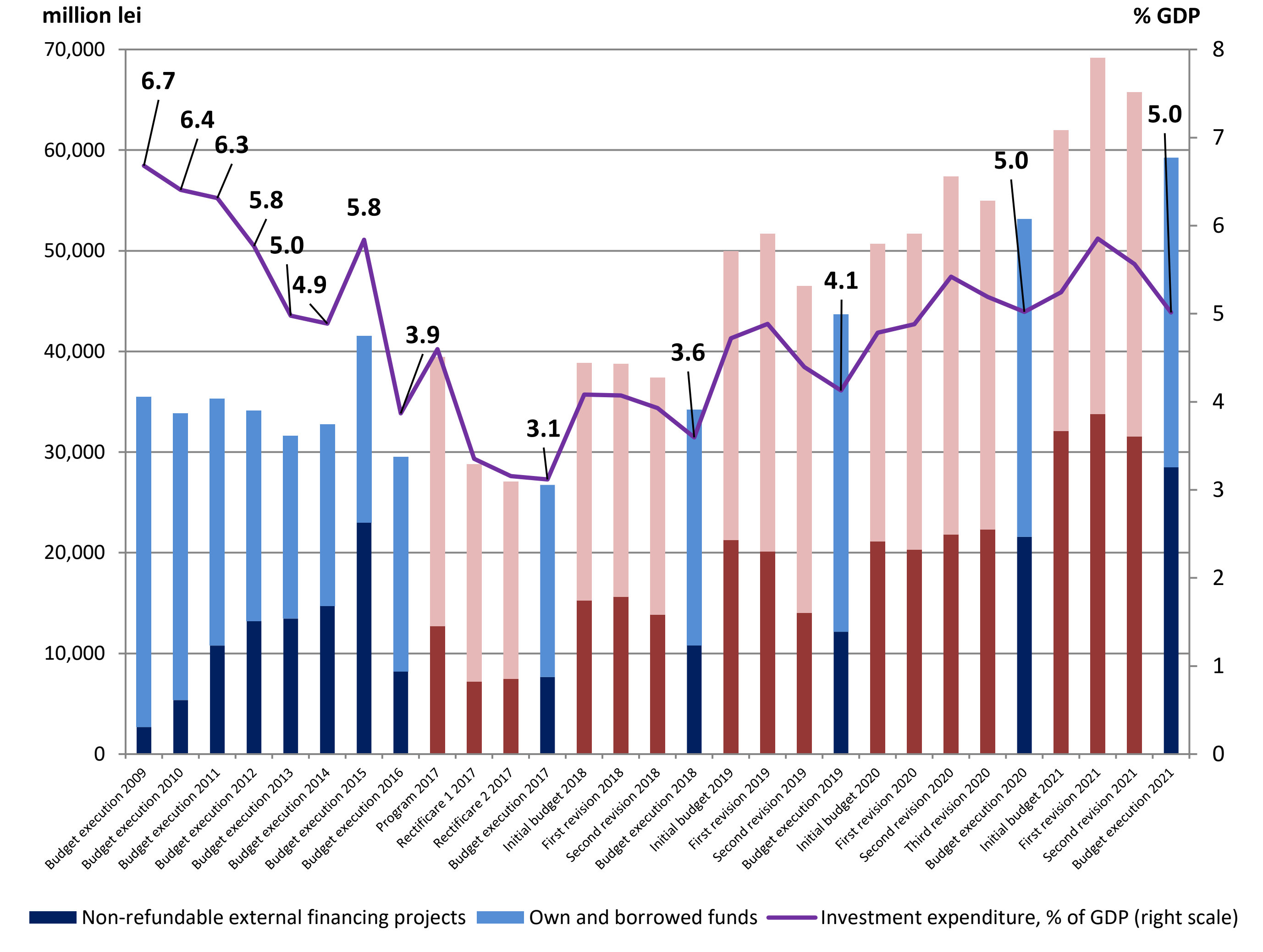
[50] Similar to the advance in nominal terms of GDP.

[51] Using the GDP deflator as the price index. If the FBCF deflator is used, the increase relative to the year 2020 it is only 1.2%.

compared to the previous year, the advance was made exclusively on account of *projects financed from non-reimbursable external funds after accession* (+6.9 billion lei), the sources from the domestic economy being smaller by approx. 1.3 billion lei compared to 2020. Thus, in 2021, the ratio between internal and external sources of financing the state's investment expenses became, for the first time since 2015, sub-unit[52].

The share of investment expenditure in GDP was 5% in 2021, a level similar to that recorded in the previous year, when an investment revival[53] was recorded (+9.4 billion lei compared to 2019), confirming an advance of 1.34 pp compared to the 2016-2019 average, but still below the 2009-2015 average (5.8% of GDP).

Figure 22: Investment expenditures in 2009-2021



Source: MF

[52] Respectively, 99% from 134% in 2020 and 235% in 2019.

[53] Decisively contributing to mitigating the economic downturn in the first part of 2020.

The evolution of this budget 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 revisions is illustrated in *Figure 22* for the period 2017-2021 (and execution for the years 2009-2016). In the last 5 years, a high volatility of forecasts during the year regarding public investment expenditures has been observed, the results of the executions being usually lower than the estimates from the initial budgets (except for 2020) and without exception those estimated in the revisions.

The evolution in 2021 does not deviate from this trend, with a gap between execution and the level programmed in the initial budget of 2.7 billion lei (of which, a non-realization of 3.6 billion lei from European funds, partially compensated by increase in capital expenditure). Compared to the estimate from the first budget revision, the difference reached a record level (-9.9 billion lei), against the background of a failure to realize the proportions of both investments from non-reimbursable external funds and those from internal sources. Between the execution and the level proposed in the second rectification carried out in November, there was a gap of -6.5 billion lei, a minus of 3.1 billion lei at the level of investments financed from European funds and of 3.5 billion lei from internal sources.

And the quarterly distribution of the share of investment expenditure in total execution shows high volatility, fluctuating from 13.6% in the first quarter, to 22.4% in the second quarter, 20.9% in the third quarter and 43.1 % in the last quarter, roughly in line with the quarterly evolution of amounts from non-reimbursable external funds.

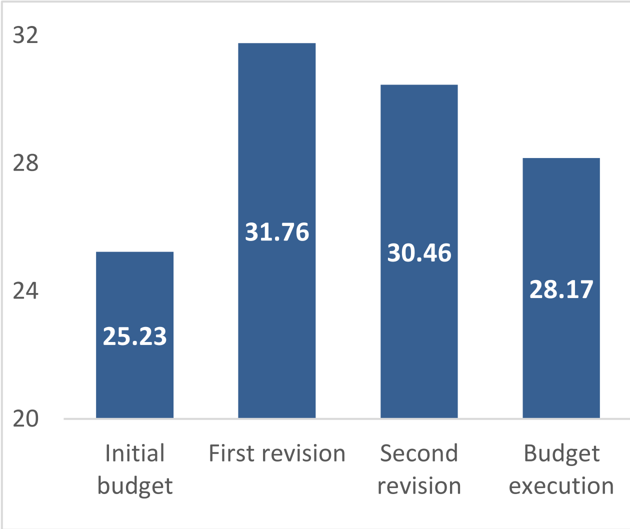
Practically, in the last 3 months of the year, investment expenses were 2.3 times higher than the average of the previous three quarters, and even if the uncertainty in the context of the pandemic, would partially justify (as in 2020) their concentration in the last part of the year, the fact that in previous years the same pattern was systematically manifested, calls into question the efficiency of the budget programming process from the perspective of the way of managing investment projects and establishing the criteria for their realization in accordance with their importance and usefulness.

Next, the evolution of the main components of investment expenses during 2021 is presented (summed up, they represent over 95% of the total) by comparing the execution levels with those programmed in the initial budget and in the two budget revisions, illustrated in *Figures 23* and *24*.

In 2021, the *capital expenditures* for public investments[54] were projected in the initial budget 1.7 billion lei lower than that provided for the initial program of the previous year. Compared to the amounts actually achieved in 2020, the negative gap was significantly larger, by 3.8 billion lei, relying on a better absorption of European funds, as the Fiscal Council also showed in its opinions.

The final execution recorded a level of 2.9 billion lei above the program established in the initial budget of 2021 (+11.6%), and partially compensated for the failure to meet the programmed parameters of the amounts intended to finance investments through projects from non-reimbursable external funds.

Figure 23: Capital expenditure in 2021 (billion lei)



Source: MF

The two budget revisions during the year proposed significant increases in capital expenditures (+6.5 billion lei, respectively +5.2 billion lei), approximately in line with the increase in public investment expenditures (+7.2 billion lei, respectively +3.8 billion lei).

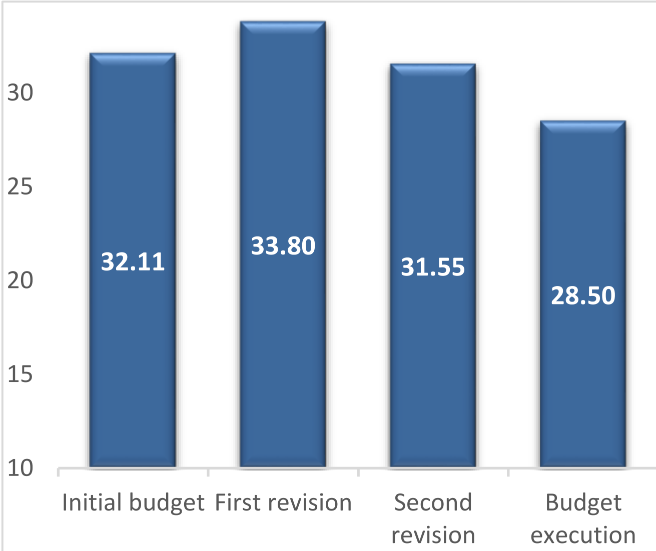
It should be noted that in its Opinion on the first budget revision, the Fiscal Council expressed reservations regarding the allocation of a significant part of the increase in capital expenditures to LDP1 and LDP2 (approx. 2 billion lei of the supplemented amounts) considering the uncoordinated nature, the lack of a well-grounded prioritization of projects financed through LDP and, consequently, a lower efficiency of investments from this source in relation to investment needs, with possible negative effects on the objective of achieving the proposed budget consolidation.

[54] They represent the main component of capital expenditures in GCB (which also include transfers of capital and stocks).

The projects with financing from non-reimbursable external funds (NREF) for public investments were estimated by the initial budget of 2021 at a net level higher than in the previous year's program (+11 billion lei), respectively by 11.2 billion lei above the level recorded in the execution of 2020.

The final execution of 2021 recorded a failure of 3.6 billion lei compared to the initially programmed level (-11.2%); compared to the 2020 execution of NREF projects intended for public investments, an excess of 7.5 billion lei was recorded.

Figure 24: Projects with financing from NREF in 2021 (billion lei)



Source: MF

From the perspective of the degree of achievement of the program, in 2021 it reached a level of 88.7%, lower than the previous year, for which the execution reported to the initial program was 99.2%[55].

At the level of the total amounts related to the 2014-2020 financial framework, the increase compared to 2020 was about 5 billion lei (excluding the impact of funds intended for agriculture).

Box 1: Changing the scope of budget revenues and expenditures for projects funded by non-reimbursable funds during 2016-2021

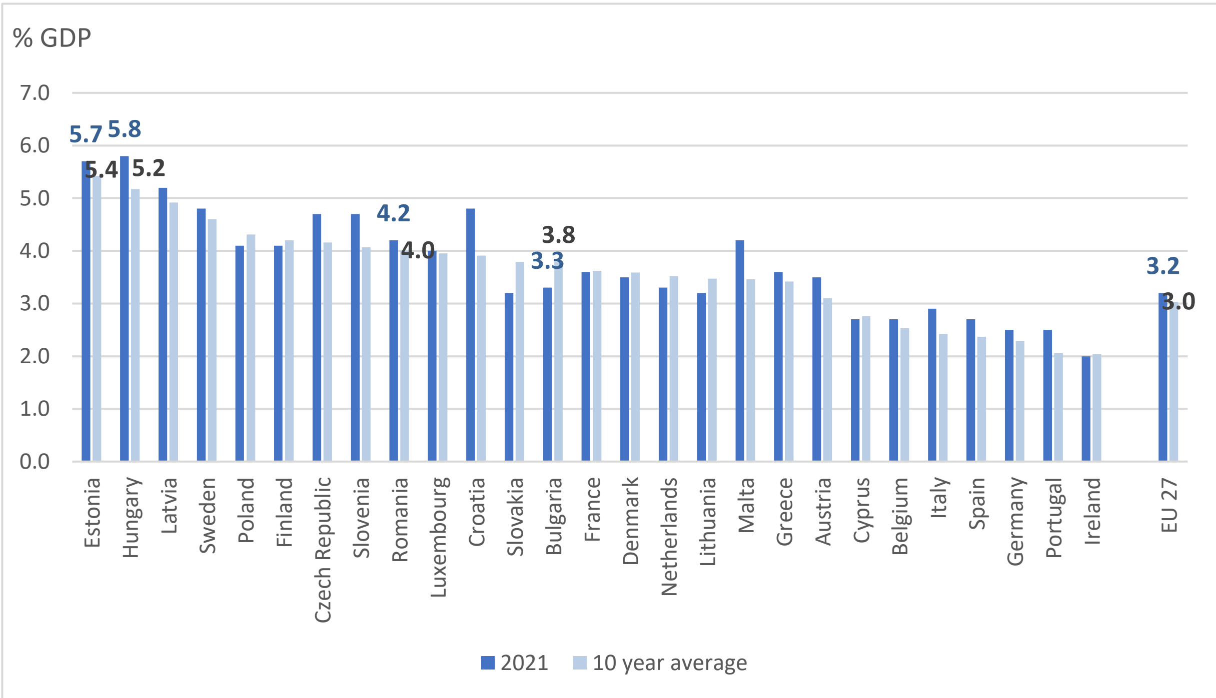
Starting with 2016, the aggregate of *projects with financing from non-reimbursable external funds (NREF) post-accession* (most of which was for investment) also includes funds for agriculture, which in previous years were not included in NREF, considering that these funds does not transit the state budget, being intended for the private sector. Since 2017, in addition to funds for agriculture have been included, according to art. 10 of GEO no. 40/2015, and transitional amounts representing funds intended for pre-financing of non-governmental sector projects in case of temporary unavailability of European funds (TUEF). Thus, in 2021, out of the total of 49.6 billion lei related to payments for projects financed from NREF 2014-2020, 16.2 billion lei were allocated to payments for agriculture (respectively EAGF and EMFF related to the financial year 2014- 2020) and 1.8 billion lei for FIT. From the difference of 31.6 billion lei representing structural and cohesion funds whose final beneficiary is the state (SCF), 28.5 billion lei (90% of the SCF) were allocated to investment expenditures. In 2015, the maximum year for attracting NREF related to the financial year 2007-2013, the projects financed from NREF post-accession amounted to 24.6 billion lei (of these, 0.5 billion lei NREF related to the financial year 2014-2020), of which 23 billion lei were allocated for investment expenditures (94% of the total post-accession NREF). We mention that, from the perspective of the ESA10 methodology,

[55] This being the last year in which projects related to the 2014-2020 financial year were submitted.

only the structural funds whose final beneficiary is the state are relevant, the amounts intended for agriculture and the pre-financing granted to the non-governmental sector, not being included in the public administration sector. Moreover, the transit of the GCB by the amounts representing funds intended for agriculture and FIT makes it practically impossible, at an aggregate level, to compare the data from the budget execution for the years 2016 - 2021 with the flows of European funds from the financial year 2007-2013.

An analysis of the efficiency of investment spending[56] over the last 10 years reveals an unsatisfactory result for our country compared to the evolution of the indicator in other EU member states, given that Romania had, in the last decade, one of the highest shares in the GDP of capital expenditure compared to the EU average, infrastructure is insufficient both in terms of quantity and quality, a sign of low efficiency of public investment expenditure. Thus, in the period 2012-2021 the share of capital expenditure in GDP (*Figure 25*) placed Romania in the first half of the ranking (9th place in the EU 27), respectively with a 10-year average of 4% of GDP, with 1 pp above the EU27 average. Compared to the first ranked, Estonia, the gap is 1.4 pp, and compared to the second ranked, Hungary, 1.2 pp. The gap deepens at the level of 2021 (-1.5 pp compared to Estonia and -1.6 pp relative to Hungary).

Figure 25: Capital expenditures – in 2021 and 10 year average (% GDP, ESA 2010)



Source: Eurostat

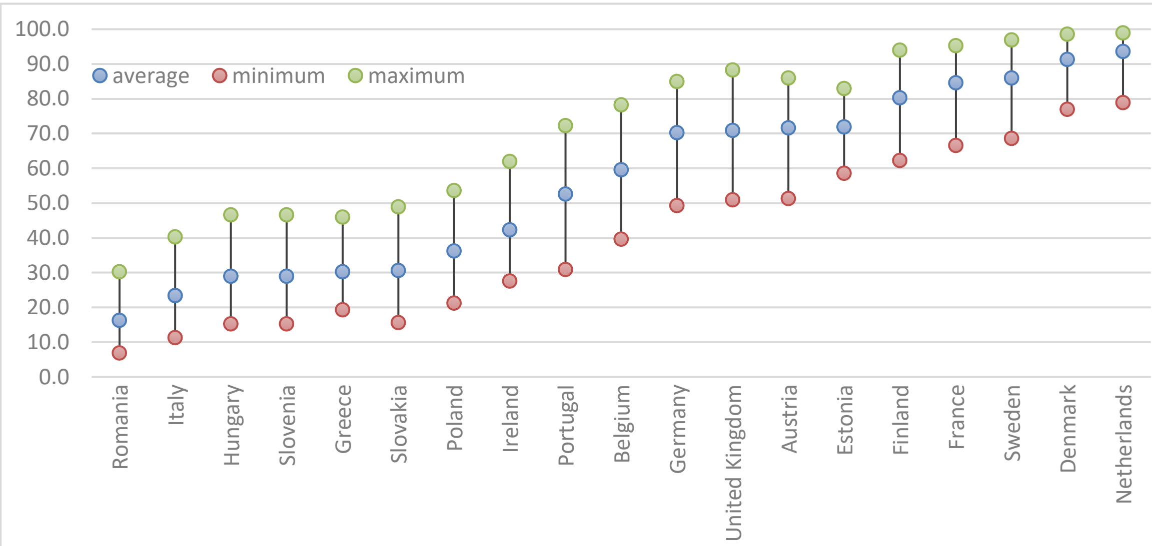
The analyzes developed by the EC and various international financial institutions (IMF, WB, OECD, EBRD) in recent years show that the infrastructure in Romania, in terms of quality, is among the lowest at the European level, especially in critical sectors, such as road, rail and energy infrastructure due to the

[56] For comparability with other countries, the gross capital formation indicator in the government sector is used, ESA 2010 standards.

extremely modest performance of most state-owned enterprises - the main infrastructure providers in these areas - and the lack of progress in restructuring loss-making enterprises. According to a recent FC analysis[57], the rate of new investments (% of total assets) in state-owned companies has had a fluctuating evolution over time and, although slightly increasing in the last two years (5.3% in 2020, 5.8% in 2019 compared to 1.3% in 2018 or 4.7% in 2015) is still at a level well below the average of the pre-crisis period (around 12%).

The impact of governance quality on infrastructure development is also highlighted by the Infrastructure Governance Assessment study developed in December 2020 by the World Bank[58]. Romania is positioned last in the EU in terms of infrastructure governance[59], with an average of 16%, compared to 29% Hungary, 31% Slovakia, 46% Poland, 70% Germany, 72% Estonia, 85% France and 94% Netherlands (*Figure 26*). This result indicates for Romania a very weak infrastructure governance, and is largely determined by the inefficiency of investment planning practices and public procurement procedures.

Figure 26: Infrastructure governance (%)



Source: World Bank, Hertie School of Governance

This correspondence between the quality of governance and infrastructure is confirmed by a series of indicators calculated by the WB in various publications and attests to Romania's weak capacity to adequately spend the funds intended for public investments. Thus, the poor quality of the infrastructure (especially that of road transport) places us, according to the Global Competitiveness Report for 2019[60], in the last position in the EU. From the perspective of the performance index for logistics services,

[57] http://www.consiliulfiscal.ro/SOE%202020%20RO.pdf

[58] https://thedocs.worldbank.org/en/doc/96550c14d62154355b6edc367d4d7f33-0080012021/infrastructure-governance-assessment-framework-december-2020

[59] https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-romania-2022_e2174606-en

[60] As of 2021, publication has been suspended.

Romania was placed in a low place[61] in 2018 (the last year for which the report is available), the quality below European standards of the infrastructure being the factor directly responsible for the low efficiency with which Romania can deliver its goods and connect producers with consumers compared to its main trading partners in the EU, with the effect of accentuating regional disparities and limiting integration in the value chain of the European market.

A recent study published by the EBRD[62] shows that, despite significant public investment, Romania's transport infrastructure is in a poor state, far behind EU standards in both quality and coverage, with the slow development of the road network being driven by weak institutional capacity. Even though the share of rail freight transport in Romania was 30% in 2017, well above the EU28 average of 17%, the traffic (measured per km of railways) was lower than in most similar countries in the region - Slovenia, Slovakia, Poland, Hungary and the Czech Republic.

Moreover, in the Country Report elaborated by the EC[63], it is reiterated, similar to reports from previous years, that despite a relatively high level of public expenditure for investments, Romania is characterized by an insufficiently developed and outdated transport infrastructure with a negative impact on connecting to the main transport corridors, labor mobility, which deepens territorial disparities and undermines economic prosperity.

And the Report prepared by the OECD in 2022[64] mentions the precarious state of the transport infrastructure, its quality being at a very low level. The study shows that compared to countries that have similar institutional arrangements (a centralized model) the difficulties in infrastructure development in Romania denote problems in the implementation of specific investment projects.

Similarly, the EC and the OECD report indicate as factors that contributed to this state: the low degree of absorption of European funds, together with substantial time and cost overruns; low quality of preparation of investment projects with economic impact, inefficiency in the preparation, prioritization and implementation of projects, frequent changes in legislation, poor quality of governance of state enterprises in the field.

The year 2021 continued the investment revival initiated from the previous year, the share of public investments in GDP being above the average of the last 10 years, respectively, 4.2% compared to an average of 4.0% of GDP (but below the value recorded in 2015, of 5.2% of GDP). Against a 10-year average of the share of investments in budget revenues of 12.1%, in 2021 they represented 12.8% (compared to 14.6% in 2015). In the context of the significant volume of European funds allocated to Romania[65], increasing public investments through an improved absorption of EU funds is essential to

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[61] Indicator developed by the World Bank. According to the Report for 2018, Romania was in 51st place, far away from Germany (1st), France (13) and Italy (19).

[62] Romania Diagnostic, Milatovic, J. and M. Szczurek (2020)

[63] https://ec.europa.eu/info/sites/default/files/2022-european-semester-country-report-romania_ro.pdf

[64] OECD Economic Surveys: Romania 2022

[65] Cohesion policy funds for the period 2021-2027 for the achievement of development objectives on long term through investments of 32.4 billion euros, plus 985.3 million euros through the Interconnection Mechanism

eliminate infrastructure gaps, simultaneously with increasing the quality of programming and implementation of investment projects.

Given that the reservations regarding the efficiency of spending public funds allocated to investments are high, the Government initiated a reform process regarding the management of public investments in the period 2013 - March 2014[66].

- On this line, a technical assistance contract on "Improving the management of public investments" was signed with the WB, with the aim of improving the process of preparation, selection and strategic prioritization of public investment projects, which was completed in December 2015, during 2016 the recommendations for improving the selection process of public investments and strengthening the role of the Public Investment Evaluation Unit in the related legislation have been implemented (GO no. 88/2013[67], GD no. 225/2014).
- From 2017, the provisions of Decision no. 907/2016 regarding the elaboration stages and the framework content of the technical-economic documentation related to the investment objectives/projects financed from public funds, in order to eliminate the deficiencies reported in the development of the investment process, to optimize the financing and the achievement of the investment objectives and to increase the efficiency of the use of public funds.
- By *Decision no. 363/2018 for the modification and completion of the Methodological Norms regarding the prioritization of public investment projects*, new clarifications have been brought to the procedure for prioritizing new investments, but efforts are needed for the prioritization of public investment projects and their preparation.
- Romania's General Transport Master Plan (GTMP) adopted in 2016, represented an important step towards improving the implementation of strategic investments in road and railway transport infrastructure, the GTMP Implementation Strategy for the period 2014-2030, constituting the general framework of prioritization and implementation of infrastructure projects. Until now the application of the GTMP registers a very slow pace of progress.

The experience of the investment revival in 2020, which, in the context of the temporary shutdown of some production capacities and an extremely high level of uncertainty, significantly contributed to mitigating the economic contraction, showed the positive effect of a sustained dynamic of productive investments. 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

Europe, for specific projects on strategic transport networks, and Horizon 2020, with 299.8 million euros. To these, starting 2022, PNRR resources are added to them.

[66] In accordance with the requirements of the new legal framework, before approving the budget, the Ministry of Finance is obliged to present The Government's list of prioritized significant public investment projects to be financed through the state budget, these being selected according to opportunity, economic and social justification, financial affordability, the remaining period until completion, the commitments undertaken by Romania with international financial institutions.

[67] Amended in 2015 in order to align the process of prioritizing significant projects with the calendar budgetary.

of the opportunity to access European funds of over 80 billion euros for the implementation of reforms that address Romania's acute investment priorities.

The Fiscal Council pleads in favor of the firm application of the legal framework regarding the management of public investments and appreciates that extremely limited progress has been made regarding the reform in this area, decisive steps being necessary to increase transparency in the process of prioritizing public investments and making the allocation process more efficient and spending public money. Here we can list: the streamlining of the public procurement process, the resumption of the corporate governance reform in state-owned companies, strategic planning in the field of investments, with their direction to the key policy areas and the strengthening of the prioritization of public investment projects, the consultation the private environment in adopting some impact measures on it and creating a legal institutional framework for evaluating the impact of legislative regulations in the field.

The Fiscal Council appreciates that a good prioritization of investments, their orientation towards research, development and innovation activity 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 financial year 2021-2027 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 high pace of 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 intervention fund at Government’s disposal

According to the Public Finances Law no. 500/2002, article 30 para. (2), the contingency reserve fund at the Government’s disposal is allocated to main authorizing officers from state government and local governments, based on Government decisions, for the financing of urgent or unforeseen expenditures incurred during the budgetary exercise.

The legal framework provided by the Law no. 500/2002 specifies only in general terms the allowed allocations from the contingency reserve fund (for “unforeseen and urgent” situations respectively), without explicitly specifying the categories of expenses that can be undertaken from this fund or the allocations amount, thus providing space for discretionary and non-transparent allocations. In this regard, the Fiscal Council maintains its request for a legislative clarification of the way of using amounts from this fund and the allowed destinations, while increasing transparency and public control over the reserve fund.

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 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 too low of the contingency reserve fund might be insufficient to cover unforeseen expenditures, while an oversized fund might grant too much power for the authorities to make excessive outlays, without the Parliament's approval.

This section of the report studies the use of the **contingency reserve fund** at Government's disposal during 2021, based on the Government decisions published in Romania's Official Gazette by which are allocated amounts to main authorizing officers and to specific destinations.

Given that the year 2021 was marked by the return of the economy after the large-scale economic and social impact associated with the outbreak in 2020 of the pandemic caused by the SARS-CoV-2 virus, there is a relative amelioration of the unending practice to enact a lot of government decisions during the year for the use of money from the contingency reserve fund beyond the framework enforced by the Public Finances Law no. 500/2002, respectively for spending that cannot be classified as urgent or unforeseen expenditures

However, excluding those expenses related to the socio-economic effects induced by the successive waves of the pandemic, the use of a significant part of the contingency reserve fund at the disposal of the Government was approved during 2021 by derogation from the provisions of art. 30 para. (2) from Law no. 500/2002 was intended for expenses that cannot be considered unforeseen and should have been taken into account when establishing the state budget, such as:

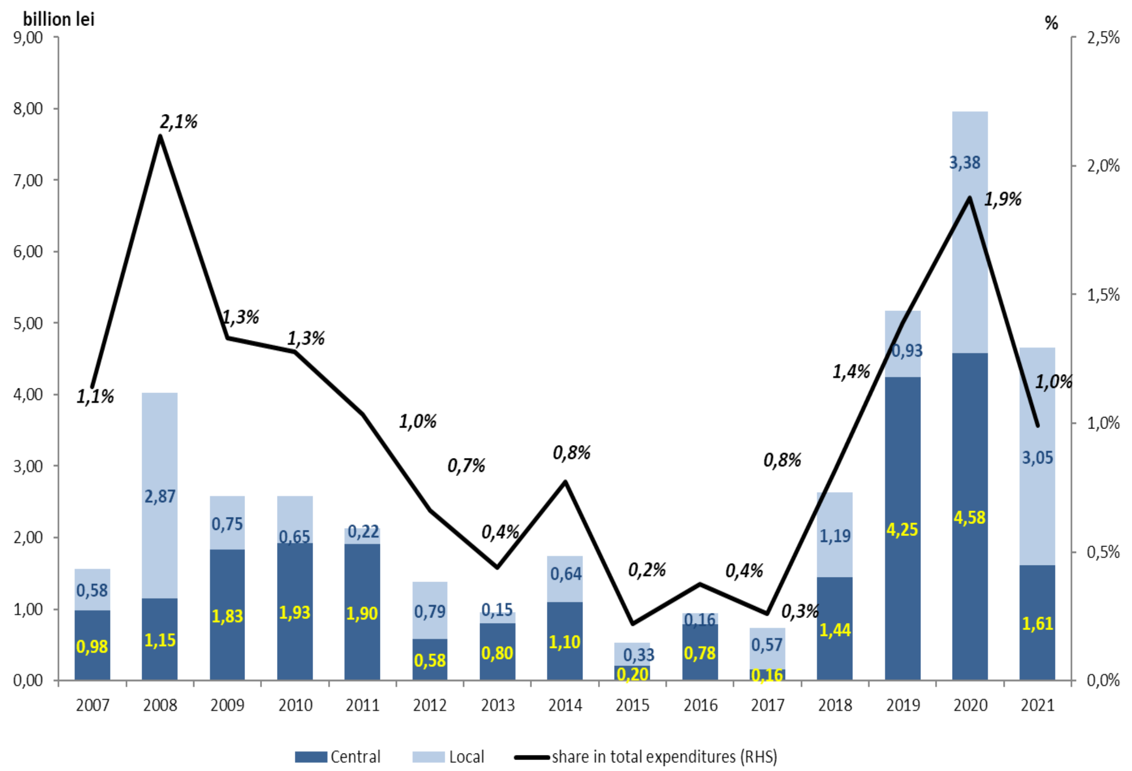
- payment of current and capital expenses for some administrative-territorial units;
- funding of the National Local Development Program (NLDP), stages I and II;
- ensuring the continuity of the public thermal energy supply service;
- payment of salary claims and claims related to enforceable titles in files aimed at road infrastructure investment objectives carried out within the programs financed by European funds;
- payment of arrears to the general consolidated budget;
- expenses necessary for the preparation and holding partial local elections;
- organizing and holding sports championships or festivals, etc.

In 2021, 4,559.2 million lei were allocated from the contingency reserve fund, representing 1% of total expenses, respectively 0.4% of GDP. Out of these, 1,610.8 million lei were allocated to the central administration and 2,948.4 million lei to the administrative-territorial units.

Compared to the previous year, there is a considerable decrease in the total allocations from the contingency reserve fund (-42.7%), mostly realized at the level of transfers to the central administration (-64.8%), while the amounts allocated to the local administration reduced by only 12.8%. Thus, the year 2021 records a decrease of 0.9 pp in the share of the amounts used from the budget reserve fund in the total budget expenses compared to the previous year (1.9%), standing at the average level of the period 2007-2019 (1% in total budget expenditures).

The evolution of the amounts allocated from the contingency reserve fund at the disposal of the Government and the share of the amounts used from the reserve fund in the total budget expenditures is shown in *Figure 27*.

Figure 27: Total contingency reserve fund allocations (billion lei)



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

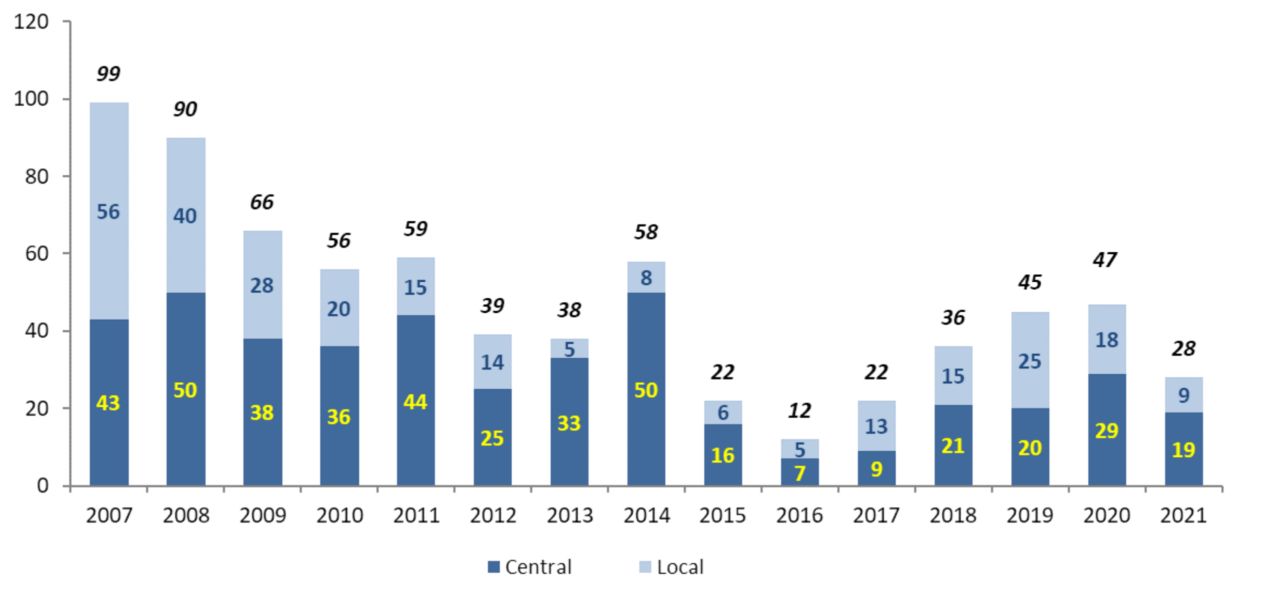
In 2021, 28 decisions were adopted by the Government in order to allocate some amounts from the contingency reserve fund, compared to 47 decisions in the previous year, that was characterized by the manifestation of exceptional circumstances determined by the Pandemic (see *Figure 28*).

It is noteworthy that the tendency from previous years to commit most of the expenses from the contingency reserve fund at the end of the year, 7 of the 28 decisions being approved in December, respectively in the amount of 1,889.7[68] million lei, representing over 41% of the allocations for the whole year. This practice makes it extremely difficult to track the amounts spent from the reserve fund and constitutes an additional argument for the discretionary nature of the formation and utilization of this

[68] Of these amounts, at the local level 1,589.7 million lei (54% of the total allocated to local authorities) for the payment of current and capital expenses, supporting regional airports in order to overcome financial difficulties in a pandemic context, and at the central level, 300 million lei, of which 67% expenses intended to supplement the budget of the Ministry of Transport and Infrastructure for the payment of arrears to the budget and the rest to supplement the NLDP.

fund. The FC acknowledges, however, that multiple emergencies put a high pressure on the use of the contingency reserve fund. Therefore, a clearer specification of the conditions generated by such situations is required.

Figure 28: Number of Government decisions regarding contingency reserve fund allocations



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

Comparing the amounts allocated from the reserve fund in the last two years (*Figure 29*), it is observed that the main beneficiary in 2021 is represented by the local authority which received 2,948.36 million lei (434.2 million lei less than 2020), accumulating a share of 64.7% of the total, while the central authority benefited from 1,610.8 million lei (2,967.4 million lei less than in the previous year), with a share of 35.3 % of the total. In 2020, 57.5% of the contingency reserve fund were directed to the central authority (4,245.3 million lei), and the administrative-territorial units received 3,382.5 million lei, respectively 42.5% of the allocated amounts from the reserve fund.

From the perspective of the allocations from the reserve fund available to the Government in 2021, directed to the central authority, the main beneficiaries were: the Ministry of Health with 23.5%[69] of the total allocations from the budget reserve fund at central and local level, which were intended mainly for the purchase of medicines necessary for the treatment of patients with COVID-19, medical devices and personal protective equipment for medical personnel, the Ministry of Transport and Infrastructure with 6.6%[70] of the total allocations, the Ministry of Development, Public Works and Administration with

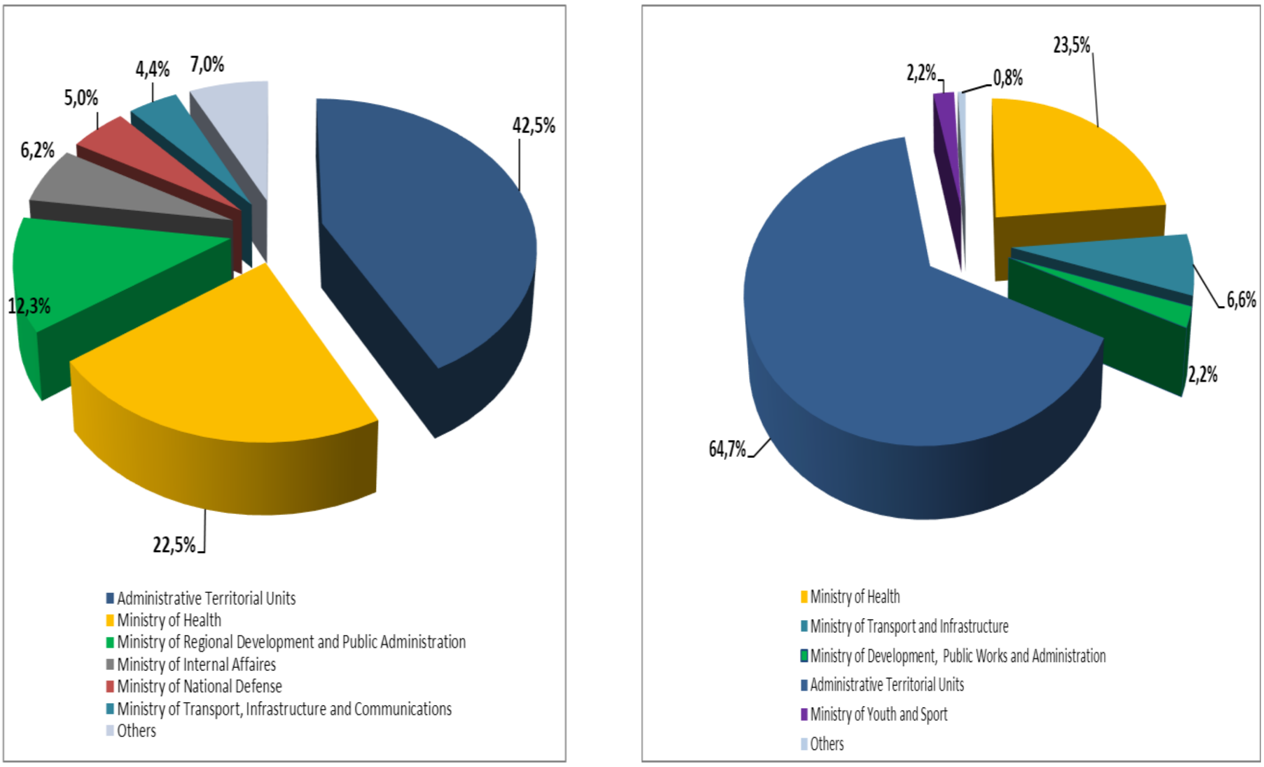
[69] Respectively, 1,071.5 million lei, representing 66.5% of the amounts allocated to the central authority.

[70] Respectively, 300 million lei, or 18.6% of the sums allocated to the central authority for the payment of debts related to road infrastructure investments of national interest, as well as the payment of arrears to the state budget.

2.2%[71] and the Ministry of Youth and Sports with 1.9%[72] of the total amounts allocated from the reserve fund.

Figure 29: The beneficiaries of the contingency reserve fund (% of total allocations)

2020 **2021**



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

In 2021, local authorities benefited from almost two thirds of the total allocations from the reserve fund. A significant share of these was intended to finance current and capital expenses (86%) and to ensure the continuity of the public heat energy supply service in a centralized system for the population (11%). To combat the effects of the pandemic, about 3% were allocated from the reserve fund, representing the compensation of the losses of some regional airports.

The Fiscal Council notes for the year 2021 that, with the exception of the allocations for combating the effects generated by the pandemic caused by the variants of the SARS-CoV-2 virus and the energy shock, continues the regression highlighted by the annual analyzes regarding the framework for the use of the reserve fund from the perspective of the allocation destination, as well as the way of using the amounts from the reserve fund by derogation from the provisions of the Public Finance Law no. 500/2002.

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[71] Respectively, in the amount of 100 million lei, about 6.2% of the sums allocated to the central authority, destined to finance the National Program for Local Development stages I and II.

[72] Respectively, 84.8 million lei, or 5.3% of the sums allocated to the central authority, intended for organizing sports championships and rewarding athletes participating in the Tokyo Olympics.

Similar to the situation in previous years, the Fiscal Council notes the lack of transparency of the destination of allocations from this fund, the nonexistence of explicit identification criteria of the expenditure that can be made from the contingency reserve fund, the absence of a Parliamentary or of other institution's control of the money utilization, the absence of clear criteria and procedures of its use, exclusively for destinations according to the law.

Thus, considering the evolution in recent years of the amounts spent from this fund that are not intended as urgent or unforeseen situations, the Fiscal Council advocates for the amendment of the legislation that establishes how to use the reserve fund in order to establish clear criteria and procedures for its use, exclusively for destinations related to the unpredictable and urgent situations that cannot be predicted in the budgetary allocation process.

Considering the best international practices in this field, as well as the conclusions formulated by the Court of Accounts in its annual reports[73], the Fiscal Council reiterates its recommendation from the previous reports regarding the explicit identification of expenditure that can be made from the contingency reserve fund and a higher transparency, including through reporting on a regular basis to the Parliament about the use of this fund, including the amounts actually spent.

It is worth noting that, despite the recommendations made by the Court of Accounts to combat the recurring use of a significant share of the reserve fund for expenses largely driven by underestimating the need for budget credits at the time of drafting the budget projects of the main authorizing officers that are not intended for urgent or unforeseen situations[74], in Law no. 317/2021 of the state budget for 2022, the use by way of derogation from the provisions was established the use by derogation from the provisions of art. 30 para. (2) from Law no. 500/2002 of some sums during the year 2022 from this reserve fund for financing the NPDL (including stage II), for the compensation of electricity and natural gas consumption, according to Law no. 259/2021, as well as some current and capital expenses that cannot be covered from the approved budget.

According to the article 30, paragraph (4) of the Public Finance Law no. 500/2002, **the intervention reserve fund** at Government's disposal is allocated, based on government decisions, to main authorizing officers of the state budget and local budgets, to finance urgent expenditures designed to eliminate the effects of natural disasters and to support the individuals affected. If the possible destinations of the allocations from the contingency reserve fund can be interpreted differently, in the case of the intervention fund, the allocations' destinations are clearly indicated in the law, the existence of such a fund being fully justified. During a year, this fund may be increased by allocations from the contingency

[73] The latest reports published this spring on the institution's website are *2020 Public Report* and *Findings of the Audit Missions in Authorities and Institutions of the Central Public Administration for 2020*.

[74] In the *2020 Public Report*, the Court of Accounts notes that the initial budget provisions of the Contingency Reserve Fund were increased 10 times during the budget year and 66.8% of the allocations were made by way of derogation from the law. Even at the level of the Ministry of Health, 40.8% of the allocations were not used, nor returned.

reserve fund, depending on the needs regarding the amounts that are necessary for the removal of the effects of natural disasters.

In 2021, the allocations from the intervention fund amounted to 563.8 million lei, by 264.3 million lei (32%) lower compared to the previous year, the destinations being in accordance with the provisions of the Law of public finances no. 500/2002.

III.5.5. Arrears of the general consolidated budget

The evolution of the stock of arrears of the GCB[75] to the private sector indicates that in present these are no longer a major problem as a result of improving financial discipline during recent years both at central and local levels. At the end of 2021, a year still marked by the manifestation of the effects of the SARS-COV-2 pandemic, through the appearance of new variants of the virus, the level of arrears stood at 168.9 million lei, by 57.4 million lei lower than in December 2020 (226.4 million lei).

In what concerns the situation of outstanding payments with a delay of less than 90 days, that do not belong to the category of arrears according to the Public Finance Law no. 500/2002, after in the previous year they had a significant increase, up to 1,843 million lei, in 2021 they decreased to 1,238.2 million lei (-575.4 million lei, or -31.7%).

Compared to 2020, the reduction in 2021 was located at the level of local budgets (-509.3 million lei, respectively, a decrease of 36%) and of the social insurance budget (by 172.8 million lei, or -37.1%). Increases in *outstanding payments with a delay of less than 90 days* were recorded for the state budget (+49.1 million lei, respectively +29.9%).

The GCB's total outstanding payments (0-360 days) at the end of December 2021 recorded 1,410.3 million lei, compared to 2,043.2 million lei at the end of the previous year, and were recorded overwhelmingly (1,402.4 million lei) for the private sector companies, by 624 million lei lower compared to the level in December 2020 (2,026.2 million lei). This decrease *in GCB's total overdue payments (0-360 days) to private sector firms* was mainly achieved for *outstanding payments with a delay of less than 90 days,* which registered at aggregate level 1,233.4 million lei (compared to about 1,800 million lei in December 31, 2020). In the structure of the total outstanding payments of the GCB to the private sector, the reduction of 566.4 million lei (-31.5%) was located at local budgets (-443.2 million lei) and social insurance budget (-172.8 million lei), while the state budget increased by about 50 million lei.

The GCB' arrears (90-360 days) to the private sector companies decreased by 57.4 million lei, respectively by 25.4%, and are located at the level of local budgets.

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

The following table shows the quarterly evolution of the stock of *total outstanding payments of the GCB (arrears and overdue payments with a delay of less than 90 days)* in total and in the structure of: state budget, local budgets and social insurance budget, compared to the previous year.

Table 8: Quarterly evolution of GCB outstanding payments (0-360 days) in 2021 (million lei)

	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021
State budget	**164.1**	**127.5**	**157.9**	**189.2**	**213.2**
Under 90 days	141.0	105.,0	141.3	170.6	190.1
Over 90 days	3.1	3.3	2.3	3.3	4.3
Over 120 days	7.7	7,0	3.1	5.1	9.6
Over 360 days	12.3	12,1	11.0	10.2	9.1
Local budgets	**1,413.8**	**1,140.6**	**1,082.5**	**1,580.5**	**904.5**
Under 90 days	1,207.2	903.8	841.2	1,366.6	755.5
Over 90 days	68.7	81.6	56.7	73.2	56.3
Over 120 days	102.9	84.8	105.0	95.4	57.8
Over 360 days	35.1	70.4	79.7	45.3	34.9
Social security budget	**465.4**	**13.6**	**10.4**	**4.2**	**292.,6**
Under 90 days	461.1	12.9	10.2	4.2	271.6
Between 90 and 360 days	4.3	0.7	0.2	0.0	21.0
Total overdue payments	**2,043.2**	**1,281.7**	**1,250.8**	**1,773.9**	**1,410.3**
Under 90 days	**1,813.6**	**1,022.5**	**993.0**	**1,541.4**	**1,238.2**
Over 90 days	71.8	84.9	59.0	76.5	60.6
Over 120 days	110.6	91.8	108.1	100.5	67.,4
Over 360 days	47.4	82.5	90.7	55.5	44.0
Total arrears (90-360 days)	**234.0**	**259.2**	**257.8**	**232.5**	**172.1**

Source: MF

Overall, there is a considerable reduction in the *GCB outstanding payments (90-360 days) to the private sector* in the last 9 years (from 3.8 billion lei in 2012 to less than 0.2 billion lei in 2021), which is explained, mainly, by the implementation of the EU Directive no. 7/2011 on combating late payments in commercial transactions (Law no. 72/2013) and of other legislative measures taken in recent years which aimed to reduce the stock of arrears (GEO no. 29/2011 for regulating the facility of payment rescheduling, GEO no. 3/2013 which restricts the local authorities' possibility of contracting new loans in order to reduce their arrears, GEO no. 12/2013 which introduced a mechanism for the settlement of reciprocal payment obligations).

Moreover, it should be noted the effect of the measures involved by art. 21 of *GEO no. 122/26 November 2021 regarding the 2021 state budget revision*, concerning the continued payment of outstanding payments recorded by local budgets in October 31, 2021, for which 785 million lei were allocated, as shown in *Table 8* regarding the reduction *of total arrears of GCB (0-360 days)*, at the level of local budgets in December compared to September 2021 with 676 million lei (of which 611 million lei related to overdue payments with a delay of less than 90 days).

From the worrisome perspective of the current global economic situation (sharp increases in the prices of energy, raw materials, food) and geopolitical instability (the war in Ukraine), the Fiscal Council considers that increased attention is necessary concerning a possible upsurge in the stock of arrears under the conditions of the prolongation of the difficult economic context and the deterioration of the fiscal-budgetary situation given the macroeconomic framework this year, as well as in the perspective of the new measures imposed by increasing the defense spending and the costs needed to adapt to climate change.

III.6. The public debt

Interest expenses in cash standard increased in 2021 by almost 3.5 billion lei (+23.9%) compared to the previous year and, against the background of the increase by 11.4% of nominal GDP, their share in GDP rose from 1.4% to 1.5%. This evolution occurs in the context of an accelerated growth of the public debt stock in recent years (+33.8% in 2020, respectively +15.5% in 2021), as a result of increasing financing needs of Romania due to the shock induced by the COVID-19 pandemic.

Public debt, measured according to the ESA 2010 methodology, increased by 77.3 billion lei (+15.5%) in 2021 compared to the previous year, and its share in GDP advanced by 1.6 pp from 47.2% to 48.8%. On the other hand, from the perspective of the national methodology[76], the public debt increased by about 105.6 billion lei (+17.9%), and its share in GDP advanced by 2.9 pp, from 55.9% in 2020 to 58.7% in 2021. This increasing evolution, however, marks a deceleration compared to 2020 in the context that the budget deficit, although still at a high level (7.1% of GDP, according to the ESA 2010 methodology), was adjusted by 2.2 pp of GDP during 2021.

The average interest paid on public debt[77] had a downward evolution in 2021, after an increase of 0.5 pp during the last 2 years, reducing from 3.9% in 2020 to almost 3.2% in 2021. The downward trend was manifested in the context of maintaining low interest rates in the international markets in terms of quantitative easing programs undertaken by the central banks.

From the perspective of the ESA 2010 methodology, interest expenses registered a smaller increase compared to the previous year (+1.7 billion lei, representing +11.9%). The difference between the results could be explained by the different treatment of issue premiums in the two approaches, related to the reopening of previous issues of government bonds, which are fully included in interest expenses according to cash standards, while in ESA 2010 methodology the amounts are gradually amortized throughout the loan lifetime.

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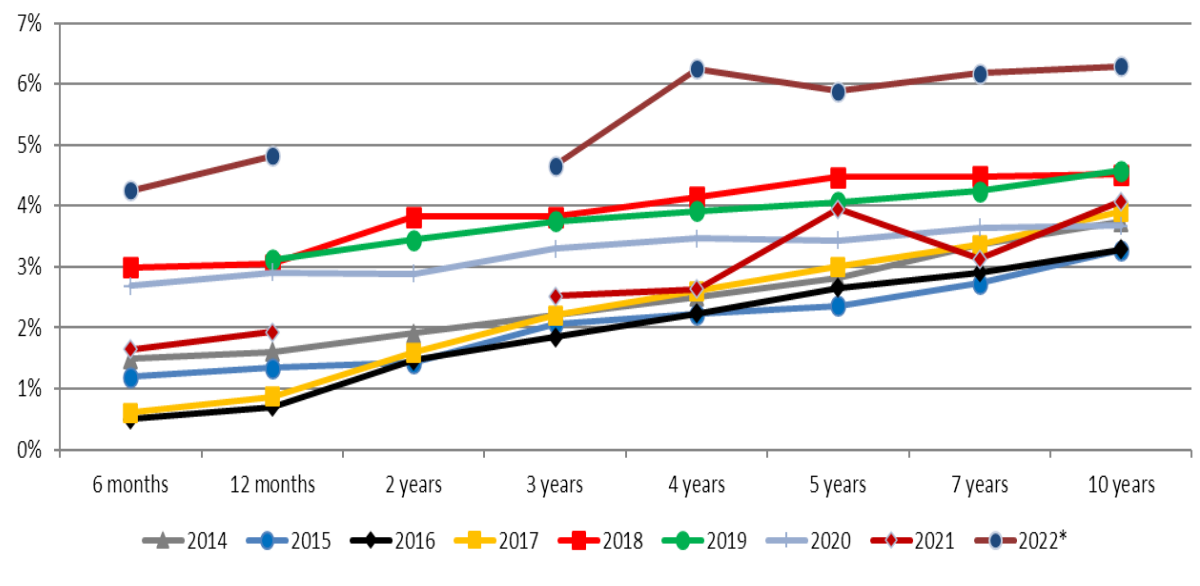
[76] Public debt, according to the national methodology, includes, in addition to the public debt according to the European methodology, the debt guaranteed by the Government, as well as loans from the general account of the State Treasury.

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

The cost of attracting new resources in national currency (see *Figure 30)* registered a positive development between 2014-2016 due to the inclusion, beginning with July 2014 , of the bonds issued by the Romanian government in the calculation of the GBI-EM Global Diversified index series by JP Morgan, the extension of the average maturity of public debt, the relaxed monetary policy conducted by the central bank, the achievement of a BBB- rating from Standard & Poor's in May 2014[78], but also due to a liquidity surplus in the financial markets. However, starting with 2017, there was a reversal of this trend manifested by an increase in the cost of attracting new loans in national currency, the upward trajectory accentuating considerably during 2018 amid the sharp rise in inflation. The year 2019 marked a slight reduction (between 0.1 and 0.4 pp) in the cost of attracting new resources in national currency for most of the considered maturities, a trend manifested in 2020, with reductions averaging 0.5 pp. In 2021, a new decrease in the cost of attracting resources in national currency was recorded, for most of the considered maturities, on average by 0.5 pp: the biggest reductions (by 1 pp) were noted for maturities of 6 and 12 months, while the cost increased by about 0.5 pp for maturities of 5 and 10 years. The downward trend manifested during the last years was strongly reversed in the first half of 2022, the cost of attracting new loans in national currency increasing for all maturities considered, increased on average by 2.3 pp.

Figure 30: The yield curve for government securities issued in domestic currency between 2014-30 June 2022[79]



Source: NBR

This trend of new loans was positively influenced by the liquidity in the market and the intervention measures adopted by the National Bank of Romania. NBR decreased the monetary policy interest rate

[78] Some investors have restrictions on investing in debt securities issued by countries that are not classified in the investment grade category.

[79] In the period January 1, 2021 - June 30, 2022, no new loans were attracted in national currency with maturities between 12 and 24 months

from 1.5% to 1.25% (in January), but then, against the backdrop of rising inflation, it operated two successive increases up to 1.5% (in October) and 1.75% (in November), this level being maintained until the end of the year. At the same time, the BNR also undertook repo operations[80] and the purchase of government securities in lei from the secondary market[81], although their scale was much smaller compared to 2020.

Regarding attracting new resources in foreign currency from foreign markets[82], an increasing evolution was observed amid the gradual tightening of the climate on international financial markets. Thus, the yields of government bond issues were 1.8% for the 9-year maturity (compared to 1.5% in the previous year), 2.1% for the 12-year maturity (compared to 2% in the year previously), respectively of 2.8% and 3% for the 20-year maturity (compared to 2.7% in the previous year), the increases being more obvious in the case of issues made in July 2021, compared to those in April.

Regarding the structure of public debt[83], in 2021 the gradual expansion of central government debt continued (97.4% of the total, compared to 97% in the previous year) to the detriment of local public debt (2.6% of the total, compared to 3% in the previous year). Government bonds maintained their position as the main instrument of government public debt, accumulating 36.4% of the total (compared to 40.4% in 2020), followed by Eurobonds with 32.2% (compared to 30.9% in 2020), government loans (14.7% compared to 14.6% in 2020), bonds for the population through the Tezaur Program (2.5% compared to 1.8% in 2020) and treasury certificates in lei and euro (maintaining at a share of 1%), while loans from the general account of the State Treasury registered a slight contraction (12.3% compared with 11.3% in 2020). The structure by currencies reveals a small increase in the share of loans in national currency from 53.8% in 2020 to 54.2% in 2021, while the share of loans contracted in US dollars reduced from 7% in 2020 to 6.5% in 2021, and those contracted in euro maintained almost at the same level (39.1% in 2021, compared to 39% in 2020).

Regarding the maturity structure of government securities in national currency issued on the domestic market in 2021, is noted a return to the trend of attracting longer-term resources, in recent years, reversed temporary in 2020, registering an advance of the bonds with a maturity of 5 and 10 years, partial counterbalanced by a small increase in short term financing. Thus, treasury certificates with maturities of up to 1 year accounted for 15.4% of the value of new loans contracted in 2021, an increase compared to the share of 9.7% recorded in 2020. However, one can note that the share of financing for longer periods has advanced significantly compared to the period 2009-2012 (the share of treasury certificates with a maturity of up to 1 year being 65% in 2009).

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[80] Repo operations are a category of money market operations available at the disposal of the NBR for liquidity injection, in which the NBR buys from credit institutions eligible assets for trading, with a commitment to repurchase those assets at a later date and at a set price on the date of the transaction.

[81] According to the NBR Bulletin in December 2021.

[82] During 2021, Romania attracted financing from foreign markets through several Eurobond issues, carried out in April and July, with a total value of 7 billion euros and maturities of 9, 12 and respectively, 20 years.

[83] According to the national methodology, the data being available on the MF website.

Bonds with a maturity between 1 and 5 years accounted for 28.3% of the value of new loans contracted in 2021 (a sharp decline compared to the value of 53.6% recorded in 2020), those with a maturity between 5 and 10 years had a share of 44.8% in 2021 (a big increase from 26.3% in 2020), and those with a maturity over 10 years had a share of 11.5% in 2020 (representing an advance of 1.2 pp compared to of the value of 10.3% registered in 2020). As a result of the increase in the volume of resources attracted on longer terms (mainly on maturities between 5 and 10 years), the average residual maturity of state securities in national currency newly issued on the domestic market increased from 5.1 years in 2020 to 5.9 years in 2021, surpassing the level of 5.6 years recorded in 2019. It has thus returned to a trajectory of orientation the government's public debt towards longer maturities that allows a reduction of vulnerability to short-term developments in the interest rate, as well as to possible difficulties encountered in the process of refinancing maturing loans.

The evolution of the public debt as a share of GDP can be analyzed starting from the following relationship[84], derived from the budget 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 denotes the stock of public debt at time t, y_t denotes the nominal GDP at time t, pb_t denotes the primary deficit at time t, sfa_t denotes the stock-flow adjustment at time t, and

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

where y_t - real GDP growth rate during time t, i_t – interest rate at time t, and π_t – inflation rate at time t.

Essentially, the relationship shows that the share of public debt in GDP at time t depends on the share from the previous period multiplied by the difference between the real interest rate and economic growth, to which is added the GCB primary deficit expressed as a percentage of GDP. Given an economic growth rate higher than the real interest rate on public debt, the share of public debt expressed as a percentage of GDP will have a downward trend that can compensate for the increase caused by a primary deficit. Therefore, it is possible to reduce public debt as a percentage of GDP even if the GCB deficit has a primary surplus below the level of interest expenditure, only if the economic growth rate is higher than the real interest rate on public debt. Thus, the λ_t coefficient can be interpreted as the real interest rate adjusted with economic growth.

The year 2021 registered a moderate increase (+1.6 pp) in the share of public debt as a percentage of GDP. Using the dynamics equation presented above, we notice that only the primary deficit acted in the

[84] 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 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.

sense of increasing the share of public debt in GDP (+5.7 pp), while the other factors partially offset the effect of primary deficit: real economic growth (-2.6 pp, amid the recovery of the economy after the shock caused by the lockdown measures taken in 2020 to combat the COVID-19 pandemic, in the context of the accelerated growth of inflation, particularly in the second half of the year), real interest rate (-1 pp) and stock-flow adjustment (-0.4 pp). It can be seen, therefore, that the most important contribution was made by the primary deficit, in the context of a budget balance of -7.1% in GDP, manifested against the background of efforts to combat the pandemic and measures to support the economy. Regarding the stock-flow adjustment, a favorable, but relatively small, contribution of this indicator can be observed in terms of reducing the share of public debt in GDP. This evolution was mainly influenced by the recovery in 2021 of approximately 10.9 billion lei from the budget obligations deferred from payment by economic agents in the previous year (which are recorded in the 2020 revenue, according to the ESA 2010 methodology) and by the favorable differences recorded between the issue value and the nominal value of the government bonds (valued at 0.5 billion lei), partially offset by the appreciation of the foreign currencies in which a significant part of Romania's public debt stock is denominated (especially the euro and USD) which led to a public debt increase by 4.4 billion lei.

It should be noted that in 2021 the situation from 2017-2019 returned, with an economic growth of 5.9% overlapping with a negative real interest rate (-2.3%, against the background of rising inflation), which led to a negative value of the coefficient λt and, implicitly, to a favorable impact on the dynamics of public debt expressed as a percentage of GDP. Thus, the effect of the high budget deficit was largely offset by the real economic growth rate, supported by recording a negative real interest rate. In 2020, under the impact of the COVID-19 pandemic, this differential was temporarily reversed, the real GDP decline (-3.7%) taking place in the context of a positive real interest rate (0.1%), which led to a positive value for the λt coefficient, which claimed a primary surplus for the public debt stabilization.

Analyzing the level of public debt at the end of 2021, it should be noted that it exceeded the alert threshold of 45% of GDP, set by the FRL, the MF being required to submit a report justifying the increase in public debt and proposals to maintain it at a sustainable level. This justification is not a problem in the conditions of the Pandemic, but the warning signal is relevant given the large structural budget deficit. The level of debt is very sensitive to the future evolution of the differential between the real growth rate and the cost of financing, represented by the real interest rate. Although this differential was favorable in 2021 and in the period 2017-2019 (which allowed a relatively stable level of public debt as a share of GDP even amid budget deficits), the pandemic shows that the impact of severe shocks may lead to an accelerated increase in public debt as a result of the reversal of the ratio between economic growth and the real interest rate, in 2020 the share public debt in GDP increasing by 11.9 pp.

An additional constraint is related to the size of the public debt compared to the depth of the domestic financial sector and the most likely limited capacity to absorb an additional stock of public debt at the current level of financial intermediation. Thus, at the end of 2021, the ratio of Romania's public debt to total bank assets was about 83% (compared to about 82% in the previous year), and the exposure to the government sector related to the assets of local banks (these being the main debt holder public on the domestic market) reached almost 25% (compared to 24% in 2020), the levels of these indicators being among the highest in the EU. This situation has the potential to lead to increased reliance on non-resident investors, coupled with increased vulnerability to interest rate and exchange rate shocks[85], changes in risk appetite in global financial markets, as well as a possible change of sovereign rating.

[85] Also, the EC assesses, in its Fiscal Sustainability Report (2021 edition), that Romania presents a high risk in terms of dependence on non-resident investors and level of public debt denominated in foreign currency.

IV. The absorption of EU funds

The multiannual budget of the European Union for the 2021-2027 period (1,074 billion euros) and the Next Generation EU instrument (750 billion euros)[86], totaling 1,824 billion euros and representing the largest package of financial assistance in the history of the Union, is intended to support the recovery of member states' economies after the shock of the pandemic in 2020, as well as the achievement of the EU's long-term priority objectives, mainly the green and digital transition.

An exceptional budget for exceptional times, marked not only by the pandemic, which has become a recurring threat, but also, in the second part of 2021, by an unprecedented increase in the prices of energy, fuel and raw materials, heightened in 2022 by the outbreak of the war in Ukraine, having strong inflationary effects on the global economy.

In this less favorable international context, under the pressure of multiple crises, at maximum levels of uncertainty and instability regarding even the near future, which put the economic, monetary, fiscal and social policies of the governments, including those inside the EU, to a hard test, the European funds represent a key financial resource for Romania's economic and social development, through the lens of investment strategy, as well as budgetary sustainability. It is of vital importance for Romania to capitalize on this historic opportunity, benefiting from the EU's allocations of around 80 billion euros (31.5 billion euros from the cohesion policy[87] and around 20 billion euros from the Common Agricultural Policy related to the multiannual financial framework for the 2021-2027 period, to which 14.2 billion euros are added in grants and 15 billion euros in the form of loans, through the Recovery and Resilience Mechanism - RRM, the most important financial facility within the NGEU).

Romania's chance to utilize as much as possible from the European funds during the 2021-2027 period must be based on the lessons learned from the experience of the previous financial frameworks, which resulted in the achievement of relatively low absorption rates, as well as on coordinated efforts to increase the administrative capacity at the central and local level. This will lead, on the side of macroeconomic stability, to emphasizing the contribution of the investment factor to the increase of potential and real GDP, to countering the contractionary impact of the macro correction and to the preservation of internal and external financial balances and, on the side of the real economy, to the implementation of structural reforms, supporting directly and indirectly the progress of fiscal consolidation while restricting budget expenditures, at a time when Romania is facing major challenges generated by the impact of external factors and the volatility of the international economic, financial and geopolitical framework.

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

[87] European Commission (2022). *EU Cohesion Policy: €31.5 billion for Romania's economic, social and territorial cohesion, competitiveness and green and digital transition in 2021-2027*, EC Press Release, Brussels, July 25, 2022.

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

The EU's cohesion policy aims to alleviate economic and social disparities between regions, promotes convergence between member states, supports the increase of their competitiveness and level of employment.

In the 2014-2020 multiannual financial framework, as it appears from the data provided by the Ministry of Investments and European Projects (MIEP)[88], in order to achieve the objectives of the cohesion policy, Romania was allocated structural and cohesion funds of around 24.1 billion euros. These financial instruments were allocated to six operational programs (OP): Regional OP, Large Infrastructure OP, Competitiveness OP, Human Capital OP, Administrative Capacity OP and Technical Assistance OP. It should be noted that seven operational programs had been initially defined (the above and the SME Initiative OP), but in October 2018 the integration of the SME program into the Regional OP was approved, benefiting from a reallocation of over 150 of millions of euros[89].

Analyzing the data available in March 2022 (see *Table 9*), an improvement in the absorption rate of European funds can be observed relative to the results recorded by the Fiscal Council in March 2021[90]. Thus, compared to the situation at that time, the absorption rate (including pre-financing[91]) increased by almost 10 pp from 43.7% to 53% of the total structural and cohesion funds allocated for the 2014-2020 programming period. At the level of operational programs, it is noted that, contrasting to Competitiveness OP (31.6% compared to 28.1% in March 2021), Human Capital OP (54.6% compared to 48.0% in March 2021) and Technical Assistance OP (72.8% compared to 63.9%), the absorption rate for all the other OPs increased by more than 10 pp: Regional OP (54.0% versus 41.9%), Large Infrastructure OP (56.3% versus 45.6%) and Administrative Capacity OP (52.1% versus 41.9%). Thus, with the exception of Competitiveness OP (which recorded a much lower level of the indicator) and Technical Assistance OP (which recorded a much higher level of the indicator), it can be noted a tendency to record similar absorption rates for the remaining four operational programs.

[88] According to the absorption report for ESIF funded programs from March 4, 2022.

[89] https://ec.europa.eu/romania/news/20181017_modificare_program_operational_regional_utilizare_fonduri_ue_romania_ro

[90] See the 2020 Annual Report of the Fiscal Council.

[91] According to GEO no. 64/2009, pre-financing is the amount transferred from structural instruments to beneficiaries through direct payment or indirect payment at the initial stage to support the start of the projects and/or during their implementation under the terms of the contract/decision/order for financing concluded between a beneficiary and the Managing Authority/the responsible intermediary body, in order to ensure the proper execution of the projects financed under the operational programs.

Table 9: Structural funds absorption by operational program for the 2014-2020 programming period (million euro)						
	Total allocations 2014-2020 (cumulative)	Payments March 2022			Absorption rate March 2022	Absorption rate excluding pre-financing March 2022
		Total, out of which:	Pre-financing	EU refunds		
Regional	6,860.0	3,707.5	534.8	3,172.7	54.0%	46.2%
Large Infrastructure	9,338.6	5,253.5	797.4	4,456.2	56.3%	47.7%
Competitiveness	2,379.8	752.1	180.2	571.9	31.6%	24.0%
Human Capital	4,596.1	2,510.1	328.3	2,181.7	54.6%	47.5%
Administrative Capacity	563.6	293.4	46.8	246.6	52.1%	43.8%
Technical Assistance	332.8	242.3	18.7	223.6	72.8%	67.2%
Total	**24,070.8**	**12,758.9**	**1,906.2**	**10,852.7**	**53.0%**	**45.1%**

Source: EC, Fiscal Council's calculations

Table 10 presents an analysis of the situation in Romania compared to the other EU member states from Central and Eastern Europe based on the data available as of March 2022. The vast majority of these countries (including Romania) received higher allocations of structural and cohesion funds for the 2014-2020[92] period compared to the previous financial framework, the exceptions being represented by Czechia (22.7 billion euros compared to 26.5 billion euros), Slovenia (3.3 billion euros compared to 4.1 billion euros) and Hungary (22.4 billion euros compared to 24.9 billion euros). It is worth mentioning the case of Latvia, which, following the additional allocations from 2021 for the 2014-2020 period, exceeded the allocations from the previous financial framework (4.6 billion euros compared to 4.5 billion euros). On the other hand, comparing the allocations received to the number of inhabitants[93], it can be seen that Romania stands on the penultimate place with approximately 1,207 euros/inhabitant, surpassing only Bulgaria (1,082 euros/inhabitant). On the opposite side, seven of the eleven states analyzed have allocations of over 2,000 euros/inhabitant, the highest values being recorded by Estonia (2,791 euros/inhabitant) and Slovakia (2,615 euros/inhabitant).

[92] Compared to previous editions of the Fiscal Council's Annual Report, the total allocations for the 2014-2020 financial framework have been revised, following additional allocations through *React EU*.

[93] Population on January 1, 2014 (the start of the 2014-2020 multiannual financial framework), according to the data provided by Eurostat.

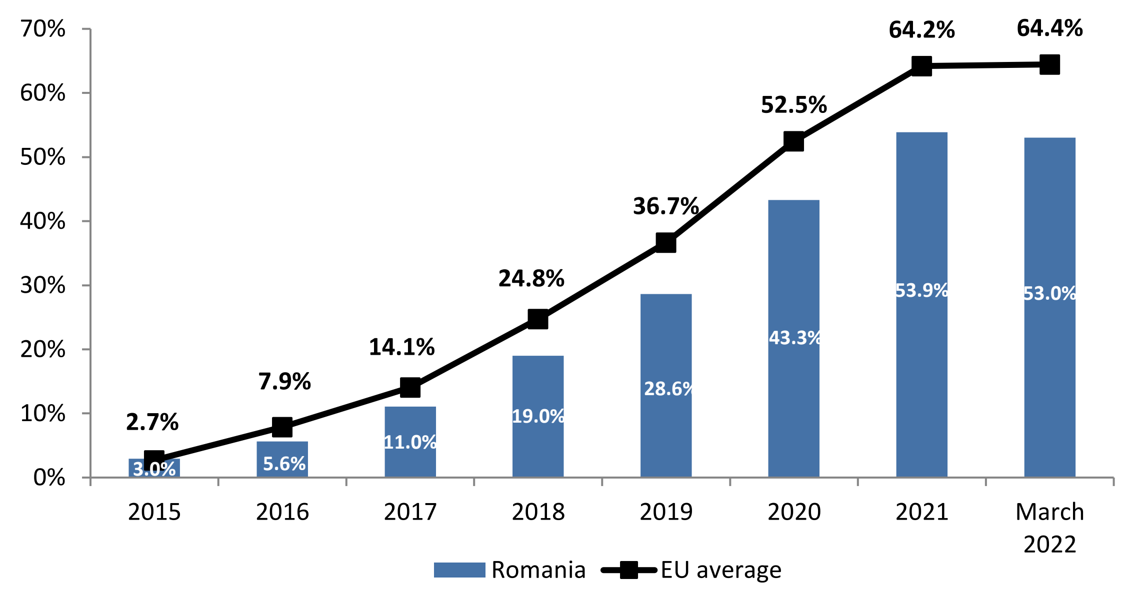
Table 10: Absorption of structural funds for the 2014-2020 programming period – comparison with other EU Member States					
	Total allocations 2014-2020 billion euro	Payments March 2022 billion euro	Absorption rate March 2022 %	Total allocations 2014-2020 /inhabitant euro	Total payments/ inhabitant March 2022 euro
Bulgaria	7.8	4.9	62.1	1,081.7	672.2
Czechia	22.7	15.7	69.3	2,157.1	1,493.9
Croatia	9.0	4.5	49.5	2,122.5	1,049.7
Estonia	3.7	2.8	75.5	2,791.0	2,107.4
Latvia	4.6	3.0	65.2	2,309.4	1,506.8
Lithuania	7.0	5.3	75.3	2,372.4	1,786.5
Polonia	78.6	59.6	75.8	2,067.8.	1,566.4
Romania	**24.1**	**12.8**	**53.0**	**1,206.7**	**639.6**
Slovakia	14.2	8.0	56.8	2,615.1	1,486.3
Slovenia	3.3	2.5	75.0	1,611.4	1,208.7
Hungary	22.4	16.7	74.5	2,270.4	1,691.7

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 in March 2022, Romania and Croatia continue to occupy the last positions in the ranking, our country remaining in the penultimate place (with an absorption rate of 53%) while maintaining a slight lead over Croatia (with an absorption rate of 49.5%). With the exception of Slovakia (56.8%), all the other states included in the analysis reached absorption rates of over 60%, the highest being recorded in the case of Poland (75.8%), Estonia (75.5%), Lithuania (75.3%) and Slovenia (75%). Thus, although Romania recorded an advance of almost 10 pp compared to March 2021, the growth rate is lower than most of the member states in Central and Eastern Europe, and the gap towards them is maintained and even widened relative to the developments from previous years. In this sense, it should be noted that the average absorption rate of the states included in the analysis (excluding Romania and Croatia which rank in the last two places) is 66.5%, highlighting an unfavorable gap of 13.5 pp in the case of our country.

Figure 31: Evolution of EU funds absorption rate: Romania versus EU average, 2015 – March 2022 (2014-2020 financial framework)



Source: EC, Fiscal Council's calculations

The beginning and deepening of this gap can also be seen from the analysis of the evolution of absorption rates of structural and cohesion funds in Romania compared to the EU average[94] (see *Figure 31*). Thus, the 2014-2020 multiannual financial framework started with difficulty both in Romania and at the EU level, due to the late completion of the related legislative, institutional and functional framework. Consequently, the first years of the period recorded low absorption rates, Romania being close to the European average. However, starting from 2016, an unfavorable gap appeared relative to the EU average, which continued to increase every year, so that in March 2022 it reached almost 11.4 pp.

In the context in which the structural and cohesion funds allocated for the 2014-2020 period can be spent until the end of 2023 (according to the n+3 rule), the unfavorable results regarding their absorption rate, both in relation to the EU average and to the member states from the region, raise questions regarding the persistence of difficulties for Romania in the absorption of European funds and their possible impact on the 2021-2027 multiannual financial framework.

Cohesion policy from the 2021-2027 Multiannual Financial Framework

The absorption of non-reimbursable European funds from the 2021-2027 MFF constitutes a priority objective of vital national interest in the short, medium and long term, representing an essential financial resource for the sustainable development of the economy, through a series of positive and driving effects, such as: reducing disparities between regions, poverty and social exclusion, developing a sustainable transport network and making infrastructure investments, promoting the competitiveness

[94] For the 2020 - March 2022 period, without the United Kingdom.

of companies, as well as research and innovation capacity, improving the quality of the education and health systems, improving management systems of water and waste etc.

The new cohesion policy of the European Union for the 2021-2027 period established five priority objectives, respectively:

- **A smarter Europe**, through innovation, digitalization, economic transformation and supporting SMEs;
- **A greener Europe**, without carbon emissions, through investments in the energy transition, the development of energy from renewable sources and the fight against climate change;
- **A more connected Europe**, through the development of strategic transport and digital networks;
- **A more social Europe**, by supporting the quality of jobs, education, skills, social inclusion and equal access to the health system;
- **A Europe closer to its citizens**, through locally managed development strategies and sustainable urban development.

Within the Cohesion Policy of the European Union 2021-2027, Romania was allocated 31.1 billion euros (to which 13.6 billion euros of national contribution is added). Following the negotiations on the preliminary versions of the Partnership Agreement with the EU[95] for this programming period, the following operational programs resulted: **Sustainable Development OP, Transport OP, Intelligent Growth, Digitalization and Financial Instruments OP, Inclusion and Social Dignity OP, Health OP, Education and Employment OP, Technical Assistance OP, Just Transition OP**, as well as **8 Regional Operational Programs**, through which the key areas will be supported by using all available material, human and financial resources.

In the context of Romania's commitments within the EDP, regarding the course of fiscal consolidation in the 2022-2024 period, and of the pressure exerted, especially by external factors, on the economic and financial stability of the country, the importance of absorbing European funds becomes even more significant in order to reduce the tightening of the public budget. Considering the unfavorable evolution of the absorption rates in the previous financial frameworks, the gaps relative to the EU average and to the member states in the region persisting from one year to the next, the intensification of the absorption rate of European funds is an urgent necessity for the implementation of the 2021-2027 MFF.

In this sense, taking into account the limited progress registered in the application of EC recommendations, efforts to improve the absorption of European funds must mainly aim at: strategic planning of investments in key areas, increasing the administrative capacity for project management,

[95] At the end of June 2022, the Government approved the updated version of the 2021-2027 Partnership Agreement which integrates the observations of the European Commission on the document originally sent by Romania. All 16 operational programs have been sent to the European Commission for approval https://mfe.gov.ro/romania-a-finalizat-documentatia-pentru-accesarea-celor-peste-44-de-miliarde-de-euro-din-politica-de-coeziune

prioritizing large projects and accelerating their implementation, improving the efficiency of the public procurement system and ensuring the predictability of the legislative and institutional framework.

The National Recovery and Resilience Plan (NRRP)

Romania is faced with an extraordinary opportunity: apart from the 31.1 billion euros allocated through the cohesion policy (2021-2027 MFF), a supplementary amount of 29.2 billion euros was initially added through the facility of the Recovery and Resilience Mechanism (RRM), 14.3 billion euros being in the form of grants and 14.9 billion euros in the form of loans. The RRM, which was approved at European level on February 12, 2021, makes available to EU member states grants of up to 312.5 billion euros and loans of up to 360 billion euros to support reforms and investments. This mechanism is the central element of the European Union's *Next Generation EU*, the plan to enable the EU to counter the negative consequences of the shock induced by the COVID-19 pandemic. It is important to note that 70% of the value of the grants must be contracted by the end of 2022, and the remaining 30% by December 31, 2023. **Unlike the Cohesion Policy, NRRP projects cannot be extended after the end of the period and cannot be phased, thus, their completion by 2026 being imperative.**

Romania gets access to the MRR facility through the **National Recovery and Resilience Plan** (NRRP), a strategic document that underpins reform priorities and investment areas at the national level, approved by the EU Council in October 2021. The key principles in the elaboration of the NRRP are represented by the priorities set for the Member States within the European Semester of 2019 and 2020 (Country Specific Recommendations). In the case of Romania, the main recommendations refer to the application of a fiscal consolidation strategy to correct the excessive deficit, for the success of which it is important to be supported by broad structural reforms, as well as the promotion of mature investment projects, both public and private, focused on the green and digital transition. Thus, the investments and reforms provided for in the NRRP must contribute to strengthening the potential for economic growth, job creation and economic and social resilience. According to EU rules, a minimum of 37% of the total sums related to the NRRP must be allocated to achieving the climate objectives and respectively a minimum of 20% to the achievement of the digitalization objectives, with the mention that at the level of the European Union the effective percentages are 40% and 26%, respectively[96].

In the case of Romania, the NRRP aligned the national objectives with the priorities of the European Union through a coherent package of public investments and reforms having six pillars:

(i) **Green transition – 15.314 billion euros** (Component 1: Management of the water and sewage system – 1.462 billion euros; Component 2: Reforest Romania and protect biodiversity – 1.173 billion euros; Component 3: Waste management – 1.239 billion euros ; Component 4: Sustainable Transport – 7.620 billion euros; Component 5: Fund for the Renovation Wave – 2.200 billion euros; Component 6: Energy – 1.620 billion euros);

[96] https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard/

- **(ii)** **Digital transformation – 1.884 billion euros** (Component 7: Government cloud and digital public systems – 1.884 billion euros);
- **(iii)** **Smart, sustainable and inclusive growth - 3.014 billion euros** (Component 8: Fiscal reforms and pension system reform – 0.456 billion euros; Component 9: Support for the private sector, research, development and innovation – 2.558 billion euros);
- **(iv)** **Social and territorial cohesion – 2.549 billion euros** (Component 10: Local fund for green and digital transition – 2.1 billion euros; Component 11: Tourism and culture – 0.449 billion euros);
- **(v)** **Health and institutional resilience - 2.811 billion euros** (Component 12: Health – 2.450 billion euros; Component 13: Social reforms – 0.196 billion euros; Component 14: Reform of the public sector, increasing the efficiency of justice and strengthening the capacity of social partners – 0.165 billion euros);
- **(vi)** **Policies for the next generation, children and youth, such as education and skills – 3.605 billion euros** (Component 15: Education – 3.605 billion euros).

Although there were delays in the operationalization of the organizational structures necessary for the initiation of the NRRP implementation (to ensure the functions of evaluation, management and control, contracting, authorization and payment of expenditures), respectively in signing the financing contracts with the beneficiaries, at the end of May 2022 MIEP submitted to the European Commission the first payment request within the NRRP, in the amount of almost 3 billion euros, of which about 2 billion euros related to grants and 0.9 billion euros related to loans[97]. From this amount, after subtracting the pre-financing received up to now, Romania will effectively collect 2.56 billion euros (1.78 billion euros from grants and 0.78 billion euros from loans). This payment request includes all the supporting documents regarding the fulfillment of the 21 milestones/targets related to the last quarter of 2021. The next payment request will include the milestones/targets related to the first two quarters of 2022 and will be submitted to the European Commission by the end of September this year.

According to Art. 11 (1) of the Regulation establishing the Recovery and Resilience Mechanism (RRM) published in February 2021[98], the allocation of grants for each EU member state is calculated according to a methodology that is based 70% on the population and the ratio of inverse proportionality with GDP per capita, and 30% on the change in real GDP in 2020 and the aggregate change in real GDP during 2020-2021 (form the EC Autumn 2020 forecast). According to Art. 11 (2) of the same Regulation, taking into account the Commission's Spring 2022 estimates regarding the actual results of the real GDP variation in 2020 and 2021, the allocations for each EU member state were to be recalculated (until the end of June 2022).

Thus, the amount initially allocated to Romania through non-reimbursable grants from the NRRP, namely 14.24 billion euros (of which 4.03 billion euros represented the equivalent of the 30% share),

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

[98] The European Parliament and the Council of the EU (2021). *REGULATION (EU) 2021/241 of 12 February 2021 establishing the Recovery and Resilience Facility*, L 57/17, Official Journal of the European Union, 18.2.2021.

was calculated based on a 5.2% contraction of real GDP in 2020 and a 3.3% recovery in 2021[99], respectively a situation in which the GDP decline due to the COVID-19 pandemic would not have been recovered in the following year. According to the spring forecast of the European Commission from May 2022, the actual results in the case of Romania showed a better performance than the anticipated one, the 3.7% decrease in real GDP in 2020 being lower than previous estimates and the economic growth of 5.9% recorded in 2021 ensuring the recovery of the decline[100].

As anticipated[101], the application of the provisions of Art. 11 (2) of the Regulation on the RRM led to the reduction of the amount corresponding to the 30% share from 4.03 billion euros to 1.91 billion euros, respectively of the total grants allocated to Romania from 14.24 billion euros to 12.12 billion euros[102], which makes it necessary to identify other funding sources to compensate for this reduction in order not to affect the budgets of the projects set in the NRRP, including in order to comply with the implementation schedule and to reach the milestones/targets agreed with the EC.

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[99] European Commission (2020). *European Economic Forecast Autumn 2020*, European Economy Institutional Paper 136, November.

[100] European Commission (2022). *European Economic Forecast Spring 2022*, European Economy Institutional Paper 173, May.

[101] Darvas Z. (2022). *How has growth changed what countries get from the European recovery fund*?, Bruegel Blog, 17 February.

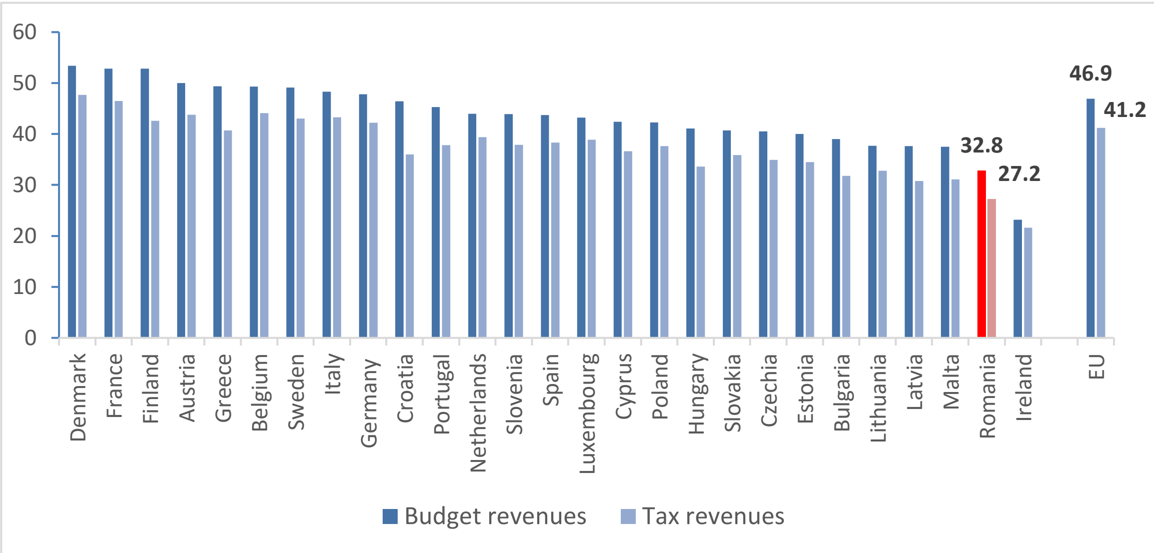
[102] European Commission (2022). *RRF: Update of the maximum financial contribution*, Commission note to the Council and European Parliament, June 30, 2022.

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

V.1. Tax collection in Romania – international comparisons

Romania recorded in 2021, according to the ESA 2010 methodology, a level of the share of budget revenues in GDP of 32.8%, well below the European average of 46.9% (difference of 14.1 pp), one of the smallest relative to EU member states, followed only by Ireland. The level of fiscal revenues (taxes and social security contributions) reached 27.2% of GDP in 2021, Romania still being in the penultimate place, with a gap of 14 pp relative to the EU average (41.2% of GDP). Analyzing the evolution of these indicators compared to the previous year, the gap that separates Romania from the EU27 average deepened both in the case of budget revenues - by 0.6 pp (14.1 pp from 13.5 pp in 2020), and in the case of tax revenues (by 0.2 pp).

Figure 32: Budget revenues and tax revenues in 2021 (% of GDP, ESA 2010)



Source: Eurostat

Note: Tax revenues include social security contributions

The share of fiscal revenues in GDP recorded by Romania in 2021 is significantly below that recorded in other countries with similar economies, such as Slovenia (37.9%), Poland (37.6%), Czechia (34.9%) and Hungary (33 .6%). Compared to Bulgaria, the share of budget revenues in GDP is lower by 6.2 pp, and for fiscal revenues by 4.6 pp.

This unfavorable evolution is also the effect of the large-scale fiscal relaxation that started in 2012 through the application of the new Fiscal Code, which resulted in the reduction of the share of budget revenues in GDP in 2021 compared to 2015 by 2.7 pp (at EU27 level this increased by 0.7 pp), and that of tax revenues by 0.8 pp (for the EU as a whole the share increased by 0.8 pp).

From the perspective of the structure of fiscal revenues, Romania's share of indirect taxes in total fiscal revenues remains in 2021 higher than the European average (39.3% compared to 33%), but below the level recorded by Hungary (52.1%), Bulgaria (50.6%) and Poland (40.4%). The share of social security contributions in fiscal revenues reached a level of 41.9%, 7.2 pp above the EU average (of 34.7%), Romania ranking fourth in the EU27, after Czechia (47.6%), Slovakia (44.8%) and Slovenia (44.3%). Regarding direct taxes, Romania has one of the lowest shares in tax revenues in the EU, at 18.8%, 13.5 pp below the EU27 average[103].

The structure of budget revenues in Romania is predominantly oriented towards indirect taxes and social security contributions (together they represent 82.6% of tax revenues, the highest figure in the EU), while at European level there is a tendency to balance the weights between direct taxes, indirect taxes and social security contributions (respectively, an EU average of 32.3%, 33% and 34.7%).

According to a recent study[104], lower fiscal revenues in Romania compared to similar economies in the EU can be attributed to the following three factors: (i) low level of the collection rate; (ii) exemptions and loopholes that reduce the taxable base and preferential regimes for certain sectors of activity/categories of taxpayers; (iii) tax rates in some cases below those of the EU. The OECD analysis[105] of the fiscal situation in Romania similarly mentions poor fiscal compliance (also determined by frequent changes in fiscal policies and exemptions without adequate justification) and low levels of some taxes compared to the OECD average as causes of the low level of budget revenues.

Next, a brief analysis is presented from the perspective of the collection of VAT revenues and social security contributions in Romania compared to CEE countries.

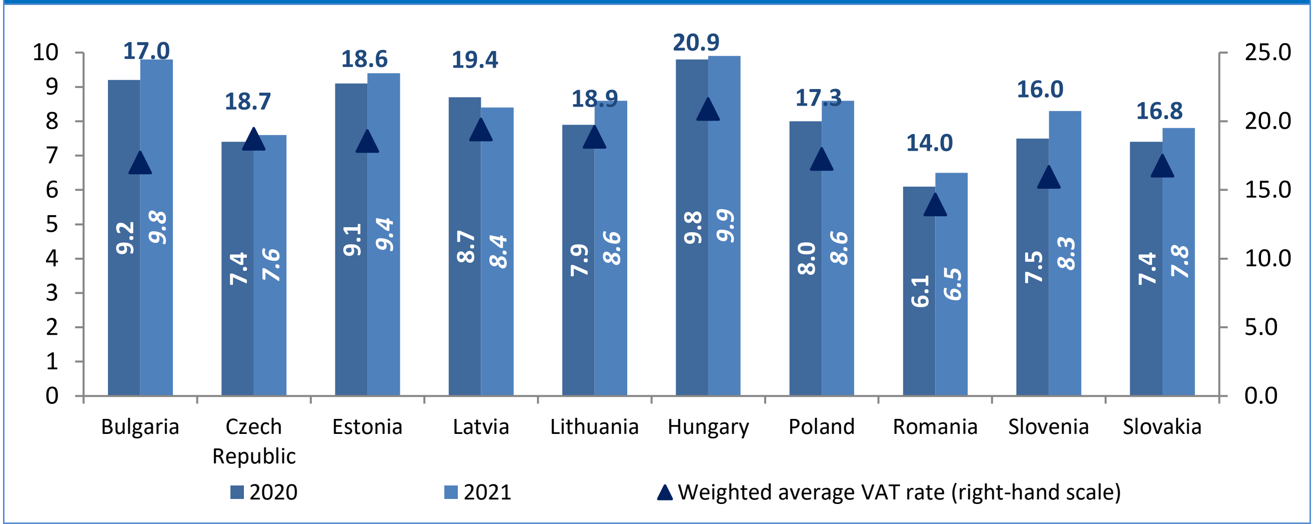
Compared to similar economies in Central and Eastern Europe, it can be seen that Romania has an unsatisfactory level of VAT revenue collection in relation to GDP (*Figure 33*). It is also true that the level of the weighted average VAT rate is the lowest among CEE countries. Similar to the previous years, in 2021 Romania ranked last among CEE countries from the perspective of VAT revenues relative to GDP and the level of the weighted average VAT rate.

[103] The reduction of income tax from 16% to 10% in 2018 contributed to this result.

[104] *Budget Consolidation and Higher Fiscal Revenues – A Vital Need for Romania's Stability and Economic Security* (2022, http://www.fiscalcouncil.ro/Analiza_sistem_fiscal%20EN%2031%20mai.pdf)

[105] *OECD. Economic Surveys Romania* (2022, https://www.oecd.org/countries/romania/oecd-economic-surveys-romania-2022-e2174606-en.htm)

Figure 33: VAT revenues in 2021 compared with the previous year (% of GDP)



Source: EC, Eurostat

At a weighted average VAT rate of 14% (compared to a legal rate of 19%), Romania collected about 6.5% of GDP from VAT, 1.8 pp of GDP away from Slovenia, which collected 8.3% of GDP at a level of the weighted average VAT rate of 16%.

It is worth noting the very good performance of Bulgaria, with an economy structure relatively similar to that of our country and a weighted average VAT rate of 17%, which collected 9.8% of GDP, being surpassed only by Hungary with 9.9% of GDP but at a much higher weighted average VAT rate (20.2%) and surpassing countries that benefit from a higher average VAT rate, such as Latvia, Lithuania, Estonia or Poland.

The modest VAT revenues reported in the CEE states are also the result of an extremely high level of the VAT gap[106], an indicator that measures the effectiveness of measures to ensure compliance with VAT legislation. It is calculated as the difference between the VAT revenues theoretically estimated 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 most recent evaluations (September 2021) from the European Commission's annual study[107] on this indicator, for 2019 a level of VAT collection deficit of 7.4 billion euros was estimated for Romania, respectively, a share of 34.9% of theoretical revenues to be collected, the highest value in the EU and CEE (*Figure 34*). Compared to the previous year, the deficit in Romania deepened by 2.2 pp, and in the EU as a whole it decreased by 0.8 pp (to 10.3% from 11.1%). Estonia recorded a collection deficit compared to VTTL of only 4.5%, Bulgaria of 8.3%

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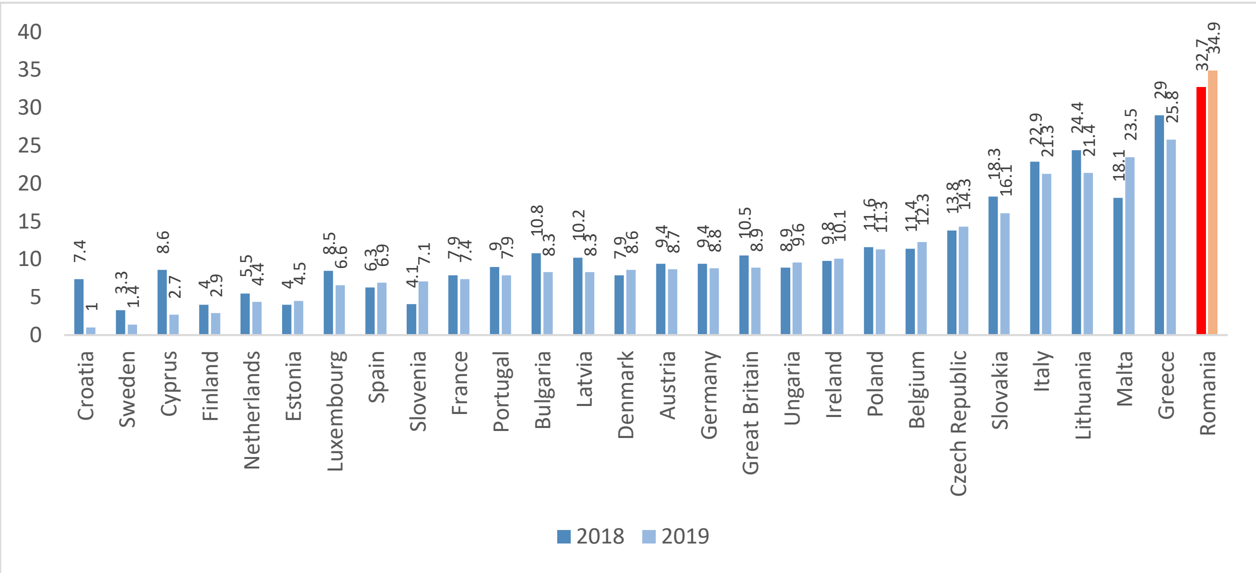
[106] The calculation of the VAT gap is based on a common methodology for all EU states. It is determined in relation to the amounts remaining in the budget after the reimbursements and tax amnesties, including accessory. Includes: non-compliance with payment, tax fraud, tax evasion, tax optimization, errors of registration. It does not include the influence of fiscal policy (the deficit resulting from the application of reduced quotas and the regime exemptions).

[107] https://op.europa.eu/en/publication-detail/-/publication/bd27de7e-5323-11ec-91ac01aa75ed71a1/language-en/

(from 10.8% in 2018), Hungary of 9.6%, Poland of 11.3%, the Czech Republic of 14.3% and Slovakia 16.1% (2.2 pp less than the previous year). It should be noted the positive evolution of Bulgaria, Poland and Hungary, which applied consistent reform programs. Thus, compared to 2015, by the end of 2019, Poland managed to reduce the value of this indicator by 13.4 pp, Bulgaria by 11.3 pp, Hungary by 6.8 pp, while in Romania it increased by 0.3 pp, remaining at the highest level in the EU throughout the period.

Figure 34: VAT Gap (% VTTL)



Source: EC, VAT Gap in the EU Report 2021

The huge VAT gap in Romania (more than three times higher than the EU average) is mainly determined by the poor computerization of NAFA. Modern solutions, specific to digital transformation, which have been applied for many years by most EU states, have been implemented in Romania only partially and with long delays (connecting cash registers to NCFI or e-Invoice servers only in 2021).

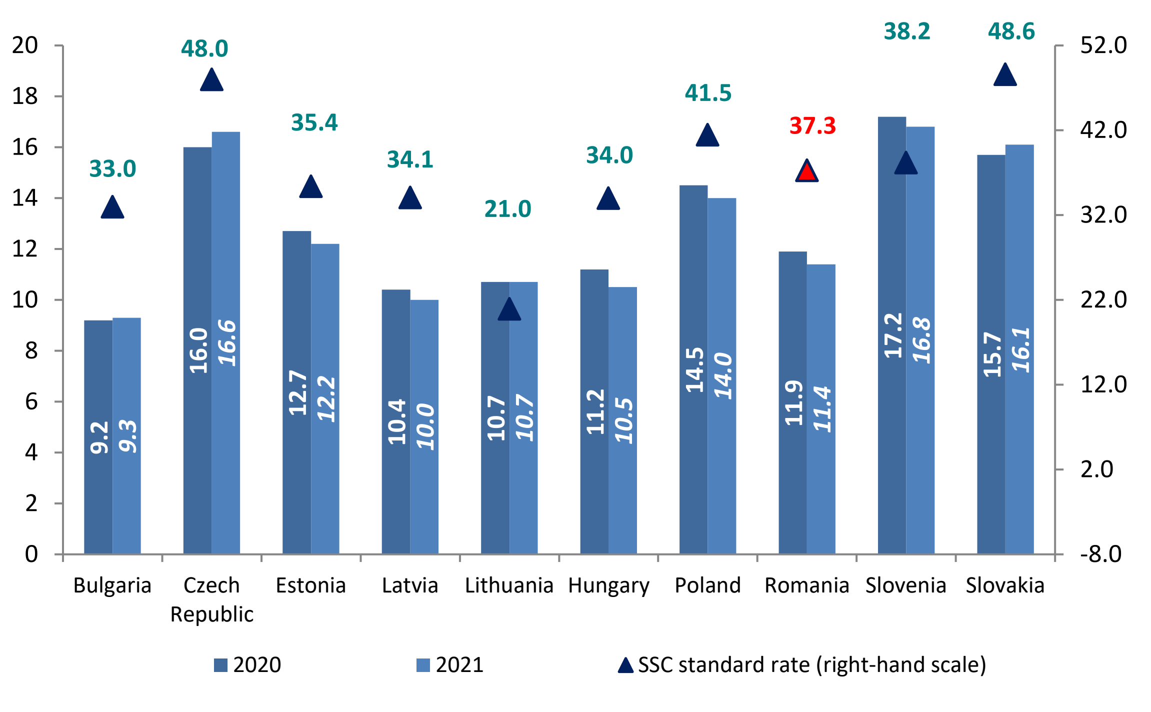
And from the perspective of the revenues collected from social security contributions (SSC) paid by employees and employers (expressed as a share in GDP), compared to the same set of countries, Romania is positioned at the bottom of the ranking, with a low level of collection compared to the legal quota of social contributions (*Figure 35*).

In 2021, SSC revenues decreased compared to the previous year (-0.5 pp of GDP), registering a level of 11.4% of GDP, but at an equivalent legal rate of 44.7%[108] (level corresponding to the legal rate of 37.25% adjusted with the increase of the tax base to make possible the comparison with the other countries).

Given that this equivalent tax rate is the third largest for the states analyzed (after Slovakia and the Czech Republic), the revenues collected are practically higher only in Hungary (10.5% of GDP but at a legal rate of 34%), Lithuania (revenues of 10.7% of GDP in the context of a legal rate of only 21%), Latvia (with 10% of GDP, at a legal rate of 34.1%) and Bulgaria (9.3% of GDP, but at a legal rate of 33%).

[108] Level calculated to correct the legal rate with the increase in gross wages following the passage of social contributions from the employer's responsibility to the employee's since 2018.

Figure 35: Social security contributions revenues in 2020 (% of GDP)



Source: EC, Eurostat

Slovenia (revenues of 16.8% of GDP) and Estonia (12.2% of GDP) surpassed Romania, given that the legal rates of social security contributions are lower.

Compared to Poland, which collected about 14% of GDP from SSC, the equivalent legal share in Romania is higher by 3.6 pp, and compared to the Czech Republic, which leads this ranking with SSC revenues of 16.6% of GDP, the legal share equivalent in Romania is 3.3 pp lower.

It should be noted that the position at the bottom of the ranking from the perspective of the collection of budget revenues as a share of GDP in recent years is not only the effect of an expansionist fiscal policy, but also of an insufficiently modernized fiscal administration apparatus, the reforms started in this regard being carried out in a slow pace, even with major setbacks, as in the case of the Romanian Administration Modernization Project (RAMP)[109], initiated in 2013 by signing the Loan Agreement between Romania and the World Bank (of 70 million euros), a program similar to the one carried out in Bulgaria in period 2002-2008 with very good results. Unlike our country, which in 2019 decided to abandon the RAMP, in Bulgaria, this program was continued by a set of reforms, which led, under the conditions of much lower tax rates compared to Romania[110], to budget revenues constantly growing,

[109] The objective of the program was to redesign and increase the capacity of the IT system for the administration of a centralized database containing information on all taxpayers in the country. About this program, the FC has written extensively in its previous Reports.

[110] Single tax of 10% and social contribution rates in 2009-2015, of 30.5% compared to 43.4% in Romania, and in 2016-2020, of 32.4% compared to 42.6% (recalculated, considering from 2018 the impact of the transfer of contributions exclusively in the employee's burden on the legal quota).

from 35.7% in 2006 to 39% of GDP in 2021 (for Romania, they decreased from 33.1% in 2006 to 32.8% of GDP).

It can still be appreciated that, in recent years, the simplification and relative efficiency of the administrative apparatus for tax collection at the central level has been achieved, even if at a slow pace and with interruptions, efforts are still needed in this regard at the level of local structures. The process of simplifying the tax system and reducing bureaucracy took place gradually, the recognition of progress being highlighted by the reports of PricewaterhouseCoopers and the World Bank. Thus, the latest report *Paying taxes 2020*[111] (with reference year 2018), ranks Romania, from the perspective of the ease of paying taxes by a medium-sized company, on position 32 out of 189 countries analyzed, up compared to the previous year (position 49/190 countries).

In 2019, NAFA resumed the reform process through the program "Strengthening the capacity of the National Agency for Fiscal Administration to support modernization initiatives", with an initial duration of 2 years, with the objective of introducing electronic public services oriented towards the business environment, in mainly, through the implementation of SAF-T (international standard for electronic data exchange between companies and tax authorities regarding information relevant to tax controls) and the orientation towards digitization of the institution. The SAF-T standard aims to simplify the compliance processes for taxpayers and analysis for NAFA with effects in reducing the VAT gap and digitizing fiscal inspections. Large taxpayers are required to report through the new system starting January 1, 2022, after companies had the option of voluntarily enrolling in the system's testing phase from mid-August 2021.

In 2020, initiatives to introduce blockchain technology in the private and public environment began to be implemented, an example being the project "Connecting Romania through Blockchain" financed by the *Mechanism for the interconnection of Europe regarding blockchain technology in telecommunications*, in the period 2021-2023.

In March 2021 NAFA presented the NAFA Strategy (2021-2024) with three important directions of action (continuation of the partnership with taxpayers, the academic and business environment; the adoption of integrated digital solutions; preventing and combating tax evasion) and the Digital Strategy 2021-2025, a reform package on the use of digitization for the functional areas of tax administration; strengthening the administrative capacity appropriate to the digital transformation process and ensuring the technological framework necessary for the transition to a digital tax administration.

It should be noted that the experience of the advanced OECD countries in the field of digital transformation in tax administrations indicates its advantages, namely[112] the application of new and

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[111] Made with updated data on July 1, 2019, refers to fiscal year 2018, including reforms made during May 2018-May 2019 (see: http://consiliulfiscal.ro/RA%20CF%202019.pdf, pages 115-117). Starting 2021 this report was stopped.

[112] Tax Administration 3.0: The Digital Transformation of Tax Administration, OECD (2020), https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-the-digital-transformation-of-tax-administration.htm

improved treatments for the purpose of tax compliance, the determination of optimal tax treatments and risk assessment, increasing taxpayers' confidence and reducing the risks of tax non-compliance.

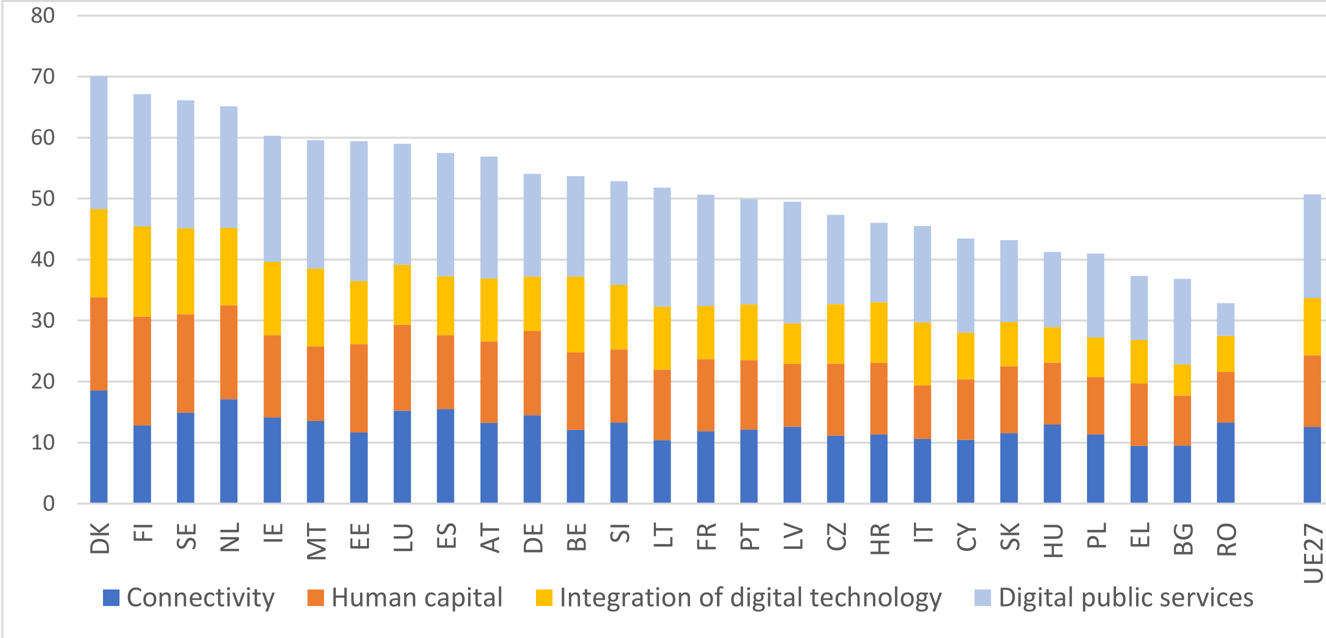
The NAFA reform through digitalization provided for in the NRRP, starts from the recognition that, in order to correct the budget deficit, there is a need for the rapid efficiency of the revenue collection activity and the improvement of the relationship with taxpayers. The reform plan is built on two directions - increasing voluntary compliance by developing digital services (priority digital interaction, through the SPV and by using pre-filled forms, where possible; creating the mechanism for assessing taxpayers' satisfaction in the relationship with NAFA and permanently consulting them) and improving the processes of taxes and fees 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 the corresponding ones of the European Commission and with those of the fiscal administrations from the member states). Moreover, from the perspective of the digital economy and society index (see *Box 2*), according to the EC Report in 2021[113], Romania ranks last among the 27 EU member states, down from the previous year's ranking - 26th place out of 28 states.

Box 2: Digital Economy and Society Index (DESI)
The DESI report monitors global digital performance in the EU, tracking the progress made by member states towards a digital economy and society, being the analysis tool for the evolution of digital competitiveness within the European Semester. From 2021 the DESI composite index has 4 major axes (instead of 5 axes in the period 2014-2020) in line with two policy initiatives with a major impact on digital transformation in the coming years: the Recovery and Resilience Mechanism and the Compass for the Digital Decade. The 4 main axes are: *connectivity*, *human capital*, *digital public services*, *integration of digital technology*, each axis with several sub-components. The DESI 2021 report includes a detailed analysis of digital policies at country level, providing an overview of progress in the digitalization of the economy, identifying sectors that require investment and priority measures, given that good e-government performance is a key element to achieve sustainable development. The areas covered by the Report are: connectivity, digital skills, degree of readiness for the use of 5G networks, electronic exchange of information by enterprises, open data. digital public services, investments in research - development - innovation devoted to information and communication technology (ICT). In addition to previous editions, an indicator that measures the level of support that the adopted ICT technologies have provided to enterprises in taking measures for environmental sustainability and the percentage of enterprises that provide ICT training and use electronic invoicing (the DESI index being recalculated for previous years for all countries) was included. Statistics over the past 7 years show that for countries that have set ambitious targets in line with the *EU's Digital Single Market Strategy* and made targeted investments in this regard, their performance has improved significantly in a relatively short period of time.

[113] https://digital-strategy.ec.europa.eu/en/policies/desi-romania. The data is for 2020.

In the structure of the 4 major axes of the DESI composite indicator, Romania is ranked last in: digital public services, second to last in terms of human capital (before Bulgaria), antepenultimate in digital technology integration (before Bulgaria and Hungary) and in 10th place in terms of connectivity (*Figure 36*).

Figure 36: DESI composite index for 2021



Source: *EC - Digital Economy and Society Index (DESI) 2021*

Looking at the structure of the *human capital* axis, Romania has a score below the EU27 average for most sub-indices, with two exceptions: the number of IT&C graduates (4th place in the EU) and the number of female IT&C specialists (3rd place).

On the other hand, the shortage of IT&C specialists (sub-index value of 2.3% compared to the EU average of 4.3%) and the very small number of enterprises offering IT&C training (indicative value of 6% compared to the average EU of 20%) limits the country's ability to innovate and take advantage of digital transformation. And from the perspective of at least elementary skills in terms of digital knowledge and software, Romania ranks a little behind, with a value of 10%, well below the EU average of 31%.

Regarding the structure of the *digital public services* axis, Romania constantly presents a low performance compared to the member states, all indicators in this field being well below the EU average. Thus, 16% of Romanian online users actively interact with e-government services, compared to the EU average of 64%, and the score for the pre-filled forms indicator is 6 compared to the EU average of 63. And regarding digital public services for citizens the score is 44 (EU average: 75) and for businesses, 49 (EU average: 84). The report highlights for our country that the lack of interoperability of IT systems in the public administration is a chronic problem, despite the fortuitous advance during the pandemic.

Looking at the *integration of digital technology* by enterprises, a large part of the indicators are far below the EU average: 33% of SMEs have at least a basic level of *digital intensity* (EU average: 60%), 17% of enterprises issue *electronic invoices* (EU average: 32%), 13% use *cloud services* (EU average: 26%) and only 5% of enterprises analyze *large volumes of data*. We rank above the EU average for the *use of artificial intelligence* by businesses (31% compared to the EU average of 25%) and the percentage of *businesses using IT&C for sustainability* (68%, respectively 66% EU average).

Regarding the *connectivity*, Romania is at the EU average for the *broadband coverage indicator* (87%) and *4G coverage* (99.7%). We are above the EU average for the *degree of coverage of fixed very high capacity networks (VHCN)* with 76% (EU average: 59%) and below the EU average for the *global fixed broadband usage rate indicator* which has stagnated at 67% (EU average: 77%), as remote work has been widely used during the pandemic, creating expectations of its increase. The *broadband price indicator* ranks us first in the EU (97 vs. 69, EU average).

From the analysis carried out by the Authority for the Digitization of Romania (ADR) regarding the barriers to the digitization of the public and private environment in Romania[114], it follows that, as far as the public sector is concerned, they are: the lack of an efficient and effective IT architecture; lack of IT systems for central public institutions; the small number of specialists in e-government; and the absence of a coordinated and effective legislative and procedural framework. ADR developed the public policy in the field of e-government, adopted on June 3, 2021, with the main objective of increasing the number and quality of electronic public services in Romania. The policy measures are: (i) the development of digital public services for citizens and businesses; (ii) increasing the capacity of public bodies to operate in an advanced digital environment and to provide mature electronic public services; (iii) strengthening the general digital skills of public sector employees; and (iv) increasing the motivation and specialization levels of IT&C staff in the public sector.

According to NRRP, the reform regarding the development of the government cloud, which aims to modernize the public administration through a series of measures related to digital public services, benefits from an allocated budget of approx. 3 billion euros. Also, the integration of digital technologies is provided with a budget of 1.6 billion euros, for measures related in whole or in part to the digitization of enterprises and the use of advanced technologies.

Achieving the objectives included in the Digital Strategy – improving services, integrated digital solutions, preventing and combating tax evasion, institutional efficiency and transparency, in addition to increasing budget revenues, can also contribute to a much better ranking of Romania from the perspective of the DESI index.

In conclusion, at the level of 2021, the reform resumed in 2019 in order to increase the degree of revenue collection by modernizing and digitizing the tax administration is at an early stage, with unfavorable results from the perspective of budget receipts that place us in the penultimate position in the EU. The situation becomes problematic if we refer not only to the obligation to reduce the budget deficit provided by the EDP in the current conditions of geo-political instability, the war in Ukraine, the energy crisis, etc., as for the challenges related to the transition to a new type of economy, which responds to the issues related to the exodus of human capital, the energy transition and climate changes.

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[114] https://www.adr.gov.ro/wp-content/uploads/2021/04/ADR-Barierele-Digitalizarii-mediului-public-si-privatdin Romania.pdf

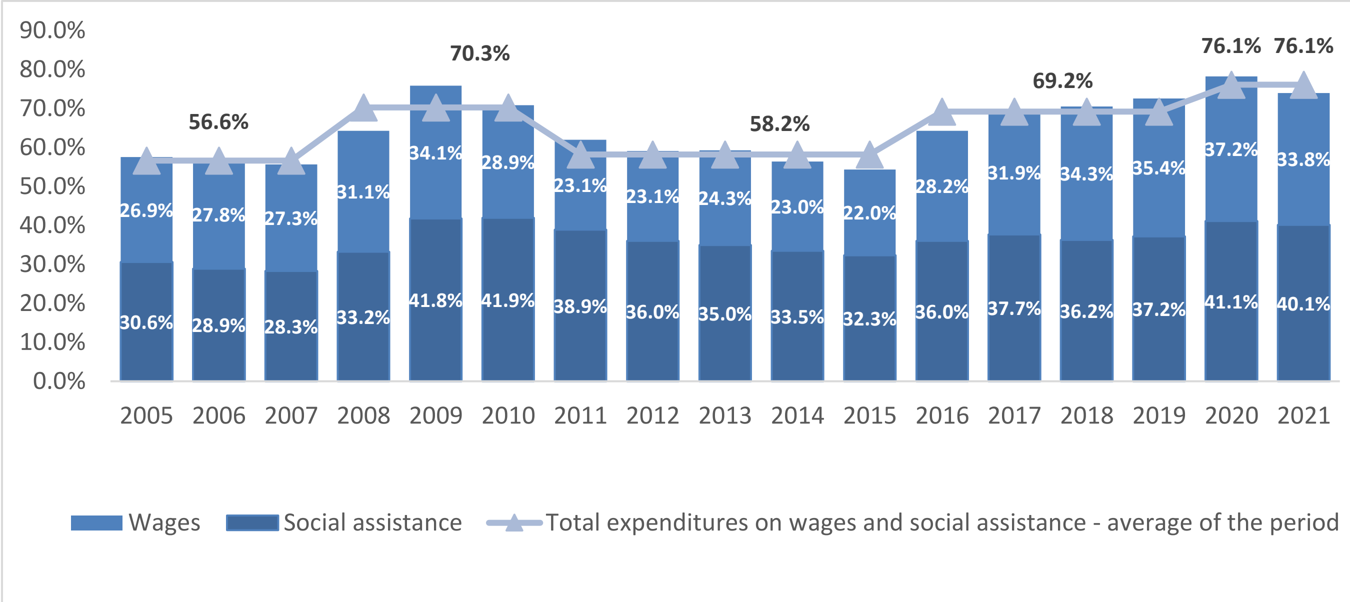
Intense efforts are needed to increase investments in fiscal infrastructure and, especially in digital technology, access to the resources made available to Romania through the Recovery and Resilience Mechanism represents the opportunity through which they can be achieved in the coming years, allowing the capitalization of new innovative economic models to face the challenges in the near future and in the future that derive from the need for the budgetary correction assumed from the Excessive Deficit Procedure, the improvement of financial creditworthiness and the sustainability of public finances.

V.2. Public expenditures – structure and sustainability

The structure of budget expenditures in Romania is characterized by the preponderance of expenditures on salaries and social assistance (pensions, social benefits etc.). Although their relative importance was significantly reduced in the period 2011-2015 as a result of the fiscal consolidation process, with 2015 representing the minimum of the analyzed period, starting from 2016 the reversal of this evolution was recorded (*Figure 37*), the share of expenditure on salaries and social assistance in budget revenues registering a major jump of 9 pp in that year compared to the previous year. In 2019, the upward trend continued, but at a reduced pace, the share of these expenditures in total revenues reaching 72.6%, from 70.5% in 2018. The level recorded in 2020, of 78.3%, represented the maximum of the analyzed period. In 2021, the share of social assistance and salary expenditures in total budget revenues recorded a decrease compared to the previous year, reaching the value of 74%.

This evolution can be explained by the fact that, although these categories of expenditures registered a nominal increase, compared to the previous year, respectively by 2% in the case of personnel expenditures and 10% in the case of social assistance expenditures, budget revenues increased in a more pronounced pace, respectively by 12%. It is noted that the share of salary expenditures in total budget revenues in 2021 (33.8%) exceeds the average of the 2008-2010 period (31.4%), while the share of social assistance expenditures (40.1%) it is placed above the average of the period 2008-2010 (39%), registering a greater difference compared to the average of the years 2011-2015 (35.2%), the expansionist fiscal policy of the last years thus canceling the effect of adjustments to the level of expenditure on salaries and social assistance from the period 2011-2015. Compared to 2020, the ratio of social assistance expenditures in total budget revenues decreased by 0.9 pp, while the share of salary expenditures registered a decrease of 3.4 pp.

Figure 37: The evolution of social assistance and personnel expenditures as a share of total budget revenues (ESA 2010, %)



Source: Eurostat

Note: Given the change in the statistical treatment of special pensions by Eurostat, they are included in income from insurance contributions and in staff costs without an actual collection/payment taking place. Accordingly, in order to avoid double recording, the expenditure on special pensions has been removed from the income from insurance contributions and from personnel expenditure.

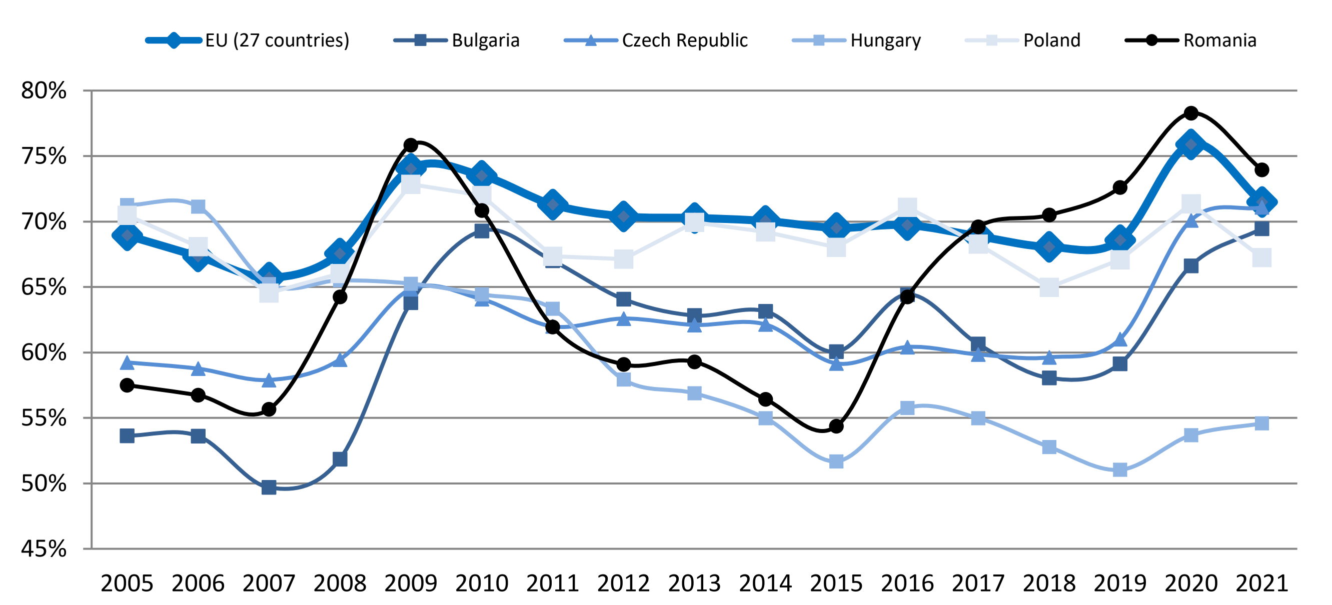
Starting from 2018, the change in the tax regime of salary earnings by transferring contributions from the employer to the employee caused a significant increase in the gross salary, which was equivalent to the increase in the contribution to the social insurance system. These measures, in addition to the reduction of the quota transferred to Pillar II, have contributed to the substantial improvement of the system's self-financing capacity in the last two years. On the other hand, the weight of this category of expenditures in total revenues still remains very high compared to other EU member states. Also, from the point of view of ensuring the medium and long-term sustainability of public finances, it is important that any increases in salary expenditures in the budget sector in the following years should only be done in line with the evolution of economic activity and, in particular, with productivity gains, given that in the 2016-2019 period, a trend of rapid increase in state personnel expenditures can be easily observed, with rates significantly higher than the nominal GDP advance and, above all, compared to the growth rate of total budget revenues from this period.

After a relatively stable evolution compared to budget revenues before 2007, expenditure on salaries and pensions advanced at a rapid pace during 2008-2009[115], with a maximum of 75.8% in 2009, Romania recording in that year the highest large share of expenditure on salaries and social assistance in total budget revenues at the level of CEE countries, even exceeding the EU27 average. After the

[115] Respectively, an average of their weight in total budget revenues of 70%.

implementation of the fiscal consolidation program, their share decreased significantly in the period 2013-2015, being reduced to a lower level than the CEE countries, with the exception of Hungary. However, starting from 2016, Romania reversed this trend, and against the background of aggressive increases in salaries in the budget sector and pensions, in the period 2018-2020, the highest values in the region of expenditures with salaries and social assistance related to budget revenues (70.5% in 2018, 72.6% in 2019 and 78.3% in 2020). In 2021, the share of these expenditures in budget revenues reached 74%, being 2.9 pp above the next ranked country, the Czech Republic, and 19.4 pp above the last ranked country, Hungary. At the same time, this indicator is 2.5 pp above the EU27 average, which reached the level of 71.5% in 2021. Evolution of the share of expenditure on wages and social assistance in total income for CEE countries and the EU27 average in the period 2005-2021 is presented in *Figure 38*.

Figure 38: The share of personnel and social assistance expenditures (including pensions) in total budget revenues in EU27 and CEE between 2005-2021

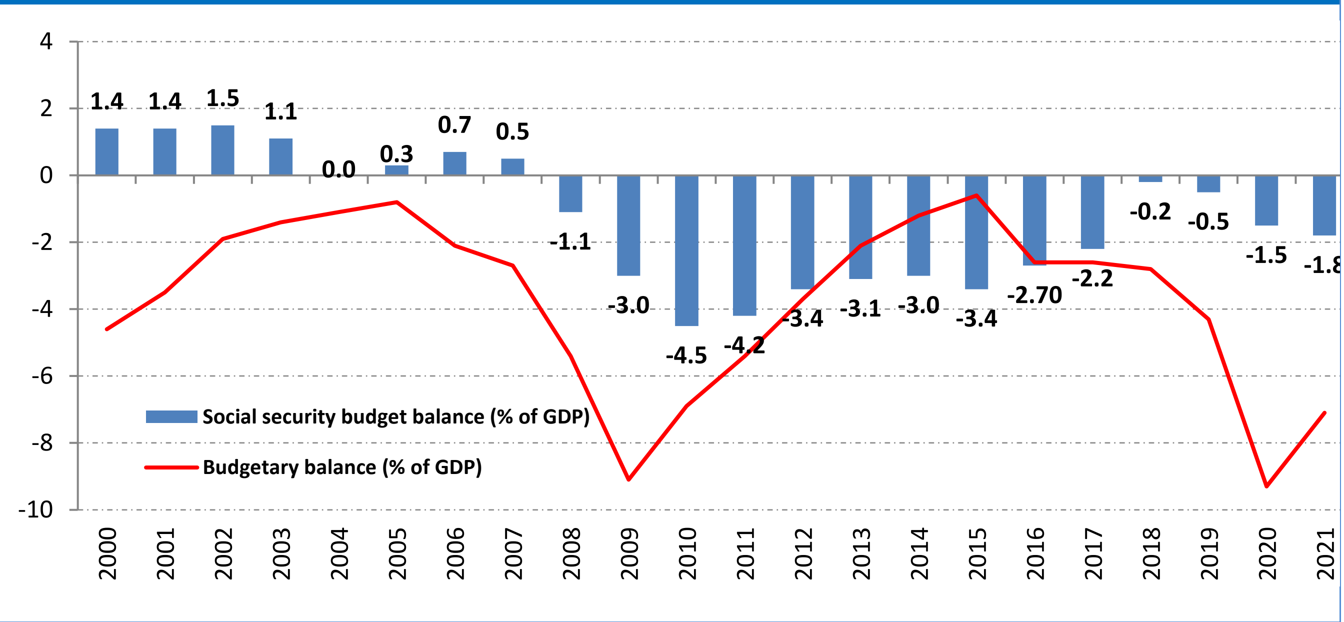


Source: Eurostat

Note: Given the change in the statistical treatment of special pensions by Eurostat, they are included in income from insurance contributions and in staff costs without an actual collection/payment taking place. Accordingly, in order to avoid double recording, the expenditure on special pensions has been removed from the income from insurance contributions and from personnel expenditure.

Regarding the evolution of the social insurance budgets (pensions, unemployment and health), it can be observed that, if in the period 2000-2007, they were characterized by a relatively equable balance or even a surplus, after 2008 they went into deficit, and even had come to represent an important component of the total deficit, respectively between 65% and 85% between 2010-2017. In 2019, the deficit of the social insurance systems represented 14% of the total budget deficit, after in 2018, it was considerably reduced as a result of the fiscal measures to reset taxation embodied in the increase of taxation through insurance contributions (reaching 7% of the total budget deficit). In 2020, it increased by 2 pp compared to 2019, representing 16% of the total budget deficit. The growing trend of the deficit of social insurance systems was also manifested in 2021, when it reached the value of 1.8% of GDP, representing 25% of the budget deficit. It should be noted that, although the budget balance corrected by 2.2 pp of GDP in ESA terms, the balance of social security budgets worsened by 0.3 pp of GDP, which may signal a systemic problem for Romania.

Figure 39: Social security budget balance (pensions, unemployment and health) and total budget balance (ESA 2010, % of GDP)



Source: Eurostat

Note: Data according to ESA 2010 - the differences from the figures in the reports for the years 2010-2015 are due to the transition from ESA 95 to ESA 2010 methodology.

Compared to the previous year, investment expenditures decreased in 2021 by approximately 0.4 pp, reaching the level of 4.2% of GDP[116]. Thus, it was the first year in the last four in which this expenditure aggregate decreased as a percentage of GDP compared to the previous year. Compared to 2015[117], public investment spending as a percentage of GDP is 19.2% lower, i.e. by 1 pp. From the perspective of allocations with this destination as a percentage of GDP, in 2021, Romania was ranked 9 in the EU27 (down one position from 2020) and in the middle of the ranking among CEE countries, ahead of Bulgaria and Poland, but behind Hungary and the Czech Republic.

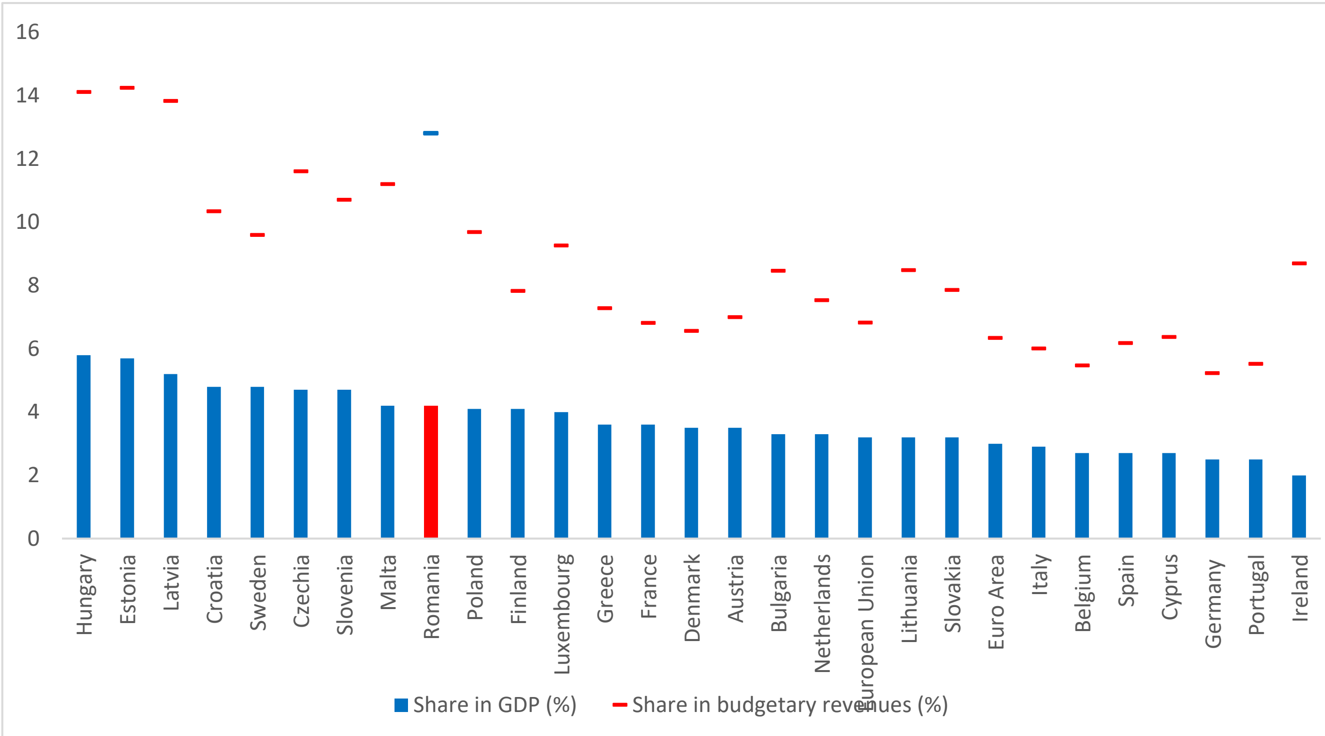
Relative to budget revenues, public investment expenditures were 1.3 pp lower compared to the previous year, and 1.8 pp lower compared to 2015, remaining well below the pre-crisis level. In the context marked by price increases for raw materials and Romania's development needs, it is expected

[116] However, the contractionary effect that the Pandemic had on GDP in 2020 and its growth in 2021 must be taken into account.

[117] 2015 was the first year after 2008 in which public investment spending was on the rise as a percentage of GDP compared to the previous year, given that this year represented the deadline for the attraction of European funds related to the financial year 2007-2013.

that the allocation for this budgetary aggregate will also be supported by the attraction of the amounts specified in the National Recovery and Resilience Plan.

Figure 40: The share of investment expenditures in GDP and in total budget revenues (2009-2021 average)



Source: Eurostat

VI. 2022 – Macroeconomic and fiscal perspectives

VI.1. Macroeconomic framework

In 2021, Romania's economy had an economic growth in real terms of approximately 6%, both on the basis of the basic effect represented by the 3.9% contraction in 2020, and due to the return of consumer and investor confidence in the economy, marked by the mobilization, to consumption and investments, of part of the savings made during the pandemic period. Factors that contributed to the rapid economic dynamics in 2021 were relaxed fiscal and monetary policies, as well as the return of investments and more optimistic expectations. However, this generalized return of demand has also led to the highlighting of dysfunctions within the supply and production chains, one of the results being a rapid increase in the prices of those raw materials, and, at the same time, the pandemic wave - of lesser magnitude - from the fall of 2021 left its mark on economic growth – by a short-lived tempering of its magnitude.

The set of demand shocks - manifested mainly by its large recovery - and supply shocks - highlighted by supply and production chain problems and, finally, highlighted by accelerated price growth - led to a marked macroeconomic picture of great uncertainties regarding the future evolution of economies. Added to these developments in 2021, in the first part of 2022, is the war in Ukraine, which induced new shocks on the supply and production chains, manifested in the prices of energy, fuels, basic agricultural products, various metals and raw materials in semiconductor industry. In addition, the war tested the resilience of economies, their ability to adapt to a new shock of great magnitude, which comes to accentuate already existing problems in most economies. The effect of all these developments consisted in increased prices for raw materials, which accelerated price dynamics in general, being transmitted through international value-added chains, as well as a further slowdown in economic growth - transmitted, at different speeds, to all sectors what was causing this growth.

At the level of the world economy, the latest forecast of the International Monetary Fund (IMF)[118] assesses that the gross domestic product will grow by 3.6% in real terms during 2022, a trend found, but in a significant slowdown both in relation to the previous year, when the real advance of savings was 6.1%, as and slowing from the previous projection of 4.4% - the main negative factor being the war in Ukraine and its economic consequences - especially on prices. The country structure of this IMF forecast shows different degrees of resilience of economies, but also marked by different economic structures, unequal dependencies on global supply and production chains, and economic policies with varying degrees of reactivity and efficiency. Similar to previous forecasts, this too shows slower economic growth in developed countries of 3.3% (down from the previous January 2022 forecast of 3.9%), located mainly in the US and only to a lesser extent in the EU (growth of 2.9% and 2.8% in the euro area), as well

[118] World Economic Outlook – April 2022, https://www.imf.org/en/Publications/WEO/Issues/2022/04/19/world-economic-outlook-april-2022.

as faster economic growth of 3.8% (from 4.8% in the previous forecast) in 2022, in the emerging economies, among which the developing economies in Asia stand out (with 5.4%; especially India and ASEAN-5 having more dynamic economic growth forecasts) but also the countries producing raw materials (especially energy, fuels) from the Middle East and Central Asia (4.6% estimated economic growth). Russia makes a discordant note in this forecast, the sanctions - mainly economic - imposed by the international community, but also the fiscal-budgetary costs of the war that has started will lead to the contraction of the real gross domestic product by approximately 8.5%.

For the year 2023, the IMF anticipates a growth rate of real GDP similar to that estimated for the current year - of 3.6% - with a different and divergent distribution, however, with developed countries showing slower GDP progress compared to 2022, from 2.4%, and the emerging ones a change in real GDP of 4.4% - accelerating. The IMF's 2023 forecast anticipates an economic growth of 2.5% in the European Union and only slightly lower in the Eurozone, of 2.3% - the countries of Central and Eastern Europe will grow faster, despite the geographical proximity to countries involved in the war. It should be noted, however, that the latest IMF assessments note a significant and increasing probability of worse developments in the global economy compared to the baseline scenarios.

The latest forecast of the European Commission – the summer forecast for 2022[119] published in July this year - estimates an increase in real GDP of 2.7% at EU27 level[120] and 2.6% at the level of the euro area (from a growth of 5.4% and 5.3% respectively in 2021), with a moderation of the growth rate in 2023 to only 1.5% in the EU27 and 1.4% at the level of the euro area. Compared to the EC's spring forecast - published during May this year. - economic growth in the last forecast is, in 2022, similar at the EU level and 0.1 pp lower in the euro zone, and for 2023 the forecast is lower by 0.8 pp for the EU27 and by 0.9 pp for the euro zone. The economic scenario and the assumptions underlying it show similarities with those of other similar institutions as well as with the previous forecast, but, at the same time, it represents a materialization of almost the majority of the risks presented in the spring forecast (such as the unfavorable evolution of the energy markets, conditions more restrictive financial policies, a steeper deceleration of the US economy, a larger and faster negative effect on the Chinese economy of severe anti-pandemic measures, etc.).

Given the current very high level of uncertainty, the necessary but also common assumptions with the previous projections, behind the anticipated dynamics, are: (i) a recovery process of the European economies after the temporary negative shock from the beginning of 2022 – determined, in mainly, from the problems of the supply and production chains as well as the short-lived recrudescence of the Omicron variant of the SAR-COV-2 virus, (ii) the continued improvement of the pandemic situation - which allows a much more dynamic evolution of the service sector mainly, (iii) an improving labor market, active economic policies – especially with regard to the Next Generation EU (NGEU) program – with a driving effect on investment, the accumulation of high pandemic-forced savings that can finance

[119] European Economic Forecast, Summer 2022, https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/economic-forecasts/summer-2022-economic-forecast-russias-war-worsens-outlook_en, 14 July 2022

[120] Excluding the United Kingdom.

household consumption and financing conditions still favorable (for example real interest rates remain strongly negative, typical of a period of fine repression really).

The favorable hypotheses of the forecast and mentioned above are, however, severely affected by Russia's invasion of Ukraine; these new, negative factors modify the magnitude and timing of the effect of the previously listed elements. Among these can be distinguished: (iv) a significant impact of the war, but uncertain in magnitude, depending decisively on the duration of the conflict; the negative shocks being generated by the evolution of raw material prices [121] – also taking into account the high dependence of the EU27 on the import of fossil fuels from Russia -, (v) the impact generated by the quasi-stopping of trade flows at the eastern border of the EU27 (with Ukraine, Belarus and Russia) which boosts the world demand for products and services community - in reduction as well, but also the costs of the influx of refugees from the war zone (fiscal costs, labor market integration costs from the host EU countries).

The risks to the real GDP evolution, as anticipated by the EC forecast, start from the already high level of uncertainty induced by the war in Ukraine and are determined by (i) a different evolution of the geopolitical situation and its reverberations on the markets of raw materials - especially energy – and the volume of trade and economic growth worldwide, (ii) a strong stagflationary effect of import prices, both directly and indirectly through second-round effects, of gearing the rest of the prices in the economy as well as the expectations that would could attract a much faster than anticipated tightening of monetary policies and thus a tightening of financing conditions, (iii) a more unfavorable evolution of COVID-19 than anticipated in the baseline scenario, (iv) a faster deceleration of economic growth in China with the pandemic evolution as the main determinant – which risks exacerbating blockages in the supply and production chains, (v) a more favorable impact of investments from the NGEU funds, with cross-sector and country effects, and (vi) a negative effect of the very high uncertainty both on investments and on the confidence of companies and households - all the more accentuated in a climate of slowing economic growth – although possibly mitigated by the use of forced austerity from the pandemic period. Overall, the European Commission considers that the current balance of risks is inclined towards more adverse scenarios than the base one.

Regarding the economic growth forecasts for the EU27 member states, for 2022 the EC estimates, in the summer forecast, faster growth rates for countries such as Portugal (6.5%), Slovenia (5.4%), Ireland (5.3%), Malta (4.9%), Spain and Greece (4.0%). The lowest GDP dynamics are expected to be recorded in countries such as Germany (1.4%), Estonia (1.6%), Finland (1.8%) and Lithuania and Slovakia (with 1.9%). The projection shows that the degree of dispersion of GDP per inhabitant in European countries could increase, in the context of both different starting points and uneven developments, which would widen the gap between countries and regions within the projection horizon. For 2023, the speed of economic growth is anticipated to decrease in most European countries (with an aggregate dynamic of

[121] Mainly energy, but there are also significant negative effects in terms of agricultural raw materials (and considering that Ukraine and Russia are important producers of fertilizers but also large producers of grains and other technical plants) as well as some rare metals and gases – used in the semiconductor industry.

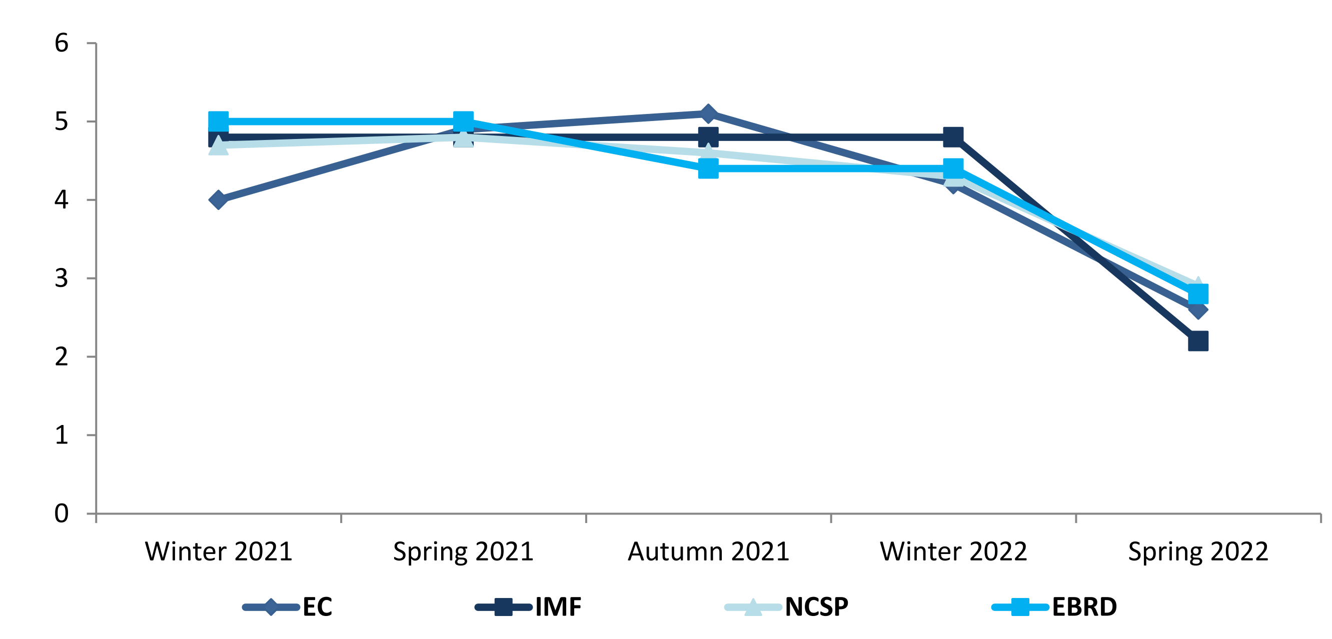
1.5%, lower by 1.2 pp compared to the previous year), especially in Portugal (moderation of growth of 4.6 pp), Slovenia (-4.4 pp), Poland (-3.7 pp), there being exceptions, with real GDP forecast to accelerate in 2023 compared to 2022, in Slovakia (+0.8 pp), Lithuania (+0.6 pp) and Estonia (+0.3 pp). The EC's estimates of economic growth in 2022 must be judged against very high uncertainties.

For the year 2022, from the perspective of the evolution of inflation at the EU27 level, expressed by the harmonized index of consumer prices (HICP), it is estimated, in accordance with the usual macroeconomic relations, that it will be placed at very high values, of 8.3% for EU27 and 7.6% at the level of the eurozone, both in relation to the inflation level of the previous year (2.9% in the EU27 and 2.6% in the eurozone), and in relation to the inflation target of the eurozone but also with the specific targets of each of its non-member countries. It is worth noting that in the current forecast the emerging countries located inside the euro zone but, especially, those outside it, the more so as they are closer to the eastern border of the EU27, have HIPC levels higher than the other countries - the differences coming from both from a stronger impact of the war on prices within them, as well as from different economic policies. From the perspective of HICP inflation, the biggest difference between the EU27 countries is, in the forecasts for the current year, between the anticipated inflation in Estonia and Lithuania (17%) and Latvia (15.5%) and that projected for Malta (5.6%), France (5.9%) and Finland (with 6.4%).

From the perspective of the pace of economic growth for Romania, the EC anticipates in the summer forecast an advance of 3.9% in 2022 – above the IMF forecast of +2.2% – followed by a deceleration of the pace to +2.9% the following year (+3.4% in the IMF projection). The determining factors of the upward trajectory of GDP in the next two years are expected to be private consumption and gross fixed capital formation, the advance of investments being also supported by the anticipated absorption of the funds allocated by the EC both through the multiannual financial framework and through the NRRP. Net exports are anticipated to have a negative contribution to economic growth and will cause a further widening of the current account deficit of the Balance of Payments, with all the estimated positive influence of European funds and allocations within the NGEU, against the background of an unfavorable external climate represented, mainly by a reduced external demand, with a more significant effect on exports than imports. On the one hand, high inflation is forecast to reduce the purchasing power of households, and on the other hand, government measures are anticipated to contribute to a moderate increase in domestic demand. The increase in interest rates and the effect of uncertainty may be overcompensated by the evolution of investments from European resources (multiannual budget and NRRP). Economic developments are dependent on the negative influences of the armed conflict in Ukraine - which essentially depend on the duration and consequences of the war - on the evolution of global trade. A positive impact could be the relocation of some investments/production capacities from Russia and Ukraine, as well as the integration into the labor market of a part of the refugees from Ukraine.

For the year 2022, the initial forecasts of the EC, IMF and EBRD aimed at an economic growth above Romania's potential, which would accentuate the excess of domestic demand. The major change in these projections occurs following the outbreak of the war in Ukraine, with economic growth being reduced from around 4.5% to something close to 2.5%. The outbreak of the war re-fractured supply and production chains, which were already dysfunctional, and increased the pressure to increase the prices of raw materials - energy, food, for some metals - increasing, at the same time, the uncertainty regarding future developments.

Figure 41: 2022 economic growth forecasts for Romania



Source: EC, IMF, NCSP, EBRD

The effect on the Romanian economy is estimated to be significant, despite a lower index of vulnerability[122], driven by weak trade and supply/production ties with the warring states, and a near non-existent financial exposure to the financial systems of Ukraine and Russia. The data on the GDP evolution in the first quarter of 2022 indicate a growth of almost 6.6% of the economy (the first quarter of 2022 compared to the similar quarter of last year), which could be a factor for the upward revision of the estimated economic growth, assuming a normal development in the rest of 2022. On the other hand, global financing conditions are deteriorating rapidly, mainly due to tightening of monetary policies in the main jurisdictions in response to the recrudescence of inflation. This could lead to a reduction in financing volumes, an increase in risk premiums and interest rates, amid increased risk aversion among investors, all with an amplified impact in the case of emerging countries.

In the conditions of twin deficits (current account deficit of the balance of payments and fiscal deficit) close to the level of 7% of GDP in 2021, Romania's economy is particularly vulnerable to changes in the financiers' attitude reflected by the financial markets. The complex interaction between these positive shocks - a positive inertia still existing in the Romanian economy - with the negative ones - represented by the consequences of the war in Ukraine on raw materials markets, as well as the predictable worsening of financing conditions towards the end of the current year - greatly increase the associated uncertainty forecasts. Regarding the evolution of nominal GDP, its value forecast for 2022 will mark a

[122] See box I.2.2 of the European Commission's 2022 Spring Forecast.

substantial increase compared to last year, the upward revision of real economic growth - as a result of the very good data from Q1 2022 - being augmented by a much more alert evolution of prices in the economy - measured by means of the GDP deflator.

According to the Inflation Report, published by the NBR in May 2022, the annual CPI inflation rate [123] will reach the level of 12.5% at the end of 2022, with a peak of 14.2% at the end of June this year, then falling, during 2023, to the value of 6.7%. The acceleration of the CPI in 2022 is largely due to exogenous factors – which the central bank cannot influence – especially the prices of energy goods (electricity and natural gas), fuels, fruits, vegetables, eggs, alcohol and tobacco. The reduction in the forecast inflation rate from 2023 is due to a significant base effect, interrupted in April 2023 by the expiry of support measures aimed at mitigating the energy price shock – embodied in price capping and price compensation schemes. Gradual tightening of monetary policy[124], which responds to the 2nd round, gearing effects, of energy product and fuel inflation, also contributes to the reduction of the inflationary imbalance at the horizon of 2023. The adjusted CORE2 inflation projection for 2022 reflects these developments – in particular the transmission of exogenous price dynamics to the other prices in the economy - reaching a level of 10.9% at the end of the year. The moderation of core inflation to only 4.8% towards the end of 2023 reflects "a gradual easing of pressures from production costs under the assumption of the stabilization and, subsequently, the downward correction of agri-food prices and, respectively, the medium-term easing of energy markets" as well as a resorption of the GDP deviation combined with "a moderation in import prices".

The latest statistical data published by the National Institute of Statistics (NIS), respectively those for the first quarter of 2022, indicate a quarter-on-quarter increase (seasonally adjusted data) of 5.2%, accelerating from -2.9 % and +1.0% in Q3 and Q4 2021. This evolution is explained, on the training side, by the dynamics of the retail and wholesale trade sector, information and communications, agriculture and industry. On the use side, the strong dynamics in the first quarter of the year have their determinations in household consumption and gross fixed capital formation, these being partially offset by a negative influence of net export and collective consumption of public administrations. The dynamics of the economy, with consumption as the main determinant, but also partly investments, is also confirmed by the rapid increase in the deficit (in euros) in Romania's international trade with goods (+41.4% in the first 4 cumulative months of 2022 compared to the similar interval in 2021), by the 84% increase in the current account deficit of the Balance of Payments for the first 4 months accumulated from 2022 compared to the first 4 months of 2021, by the relative preservation of the purchasing power of wages in April 2022 (real wage earnings reducing , year on year, by 2.1%) and the positive dynamics of trade turnover, as well as positive developments in sectors such as industry, construction, tourism

[123] Calculated according to the national methodology. It is different from the HICP inflation rate, calculated according to the European methodology.

[124] This achieving 6 increases in the monetary policy interest rate, from a level of 1.25% at the beginning of 2021, to 3.75% in May 2022, as well as returning the interest corridor to its normal amplitude of plus/minus 1 pp around the monetary policy interest rate.

that can be corroborated with positive trends in the evolution of future economic activity estimated by managers from manufacturing, construction, retail and services.

In the opinion issued in the case of the draft budget for 2022 and the fiscal-budgetary strategy 2022-2024, the Fiscal Council considered that high inflation could weigh on future real growth – despite the favorable short-term fiscal effect. The forecast on which the budget is based regarding the GDP deflator has a high level of uncertainty, and could register, FC estimates, additional increases determined by price developments within the production and supply chains. Overall, FC assessed, "the nominal GDP forecast, which includes both the real dynamics of the economy and the dynamics of all prices - reflected by the GDP deflator -, appears to be marked by a slight optimism in the sense of forecasting a higher level of this indicator, which leads to favorable effects in relation to the fiscal consolidation process - both through the higher forecasted revenues and the higher deficit reporting base". The latest information shows that, for the year 2022, the Government's economic growth forecast of 4.6% in the initial draft budget, 4.3% in the NCSP's winter forecast (published on February 11 of this year), and 2 .9% in the spring forecast (published on April 28, 2012) could be significantly revised in the context of very high uncertainty – in both directions. The GDP deflator forecast in 2022, which was 5.8% in the NCSP autumn forecast, was successively increased to 6.1% (in the 2022 winter forecast) and then to 9.2% in the spring forecast. The risks to the evolution of this indicator can be considered to be inclined towards higher values.

Under the conditions mentioned above, even if actual growth were to remain at the anticipated level[125], in the event of a much faster evolution of the deflator, nominal GDP growth for 2022 could appear to be underestimated, even in the updated NCSP projection from April this year, which, in the conditions of a more alert dynamic of the economy and its reflection in the volume of fees and taxes, could lead to the registration of higher fiscal/budgetary revenues. With the revision of the projections for 2022, they have, according to the FC, a higher degree of plausibility.

And for the following years the combined forecast of real economic growth and deflator dynamics proposed by the NCSP remain, despite a deceleration compared to 2022, and relatively high values of the indicators, relatively plausible. These assessments start from a course without sudden changes in the economy, which do not and cannot take into account the rapid, large-scale developments, determined by the changing geopolitical context, by the change in financing conditions, by events that affect the flows of European funds and those related NRRP. In addition, even in the absence of these shocks, the updated NCSP forecast could benefit from more transparency regarding the determinants of economic growth in the future (including by clarifying the assumed coordinates regarding the attraction of NRRP related funds) and, implicitly, the internal saving correlations - detailed external balance by public - private sector, connected with the evolution of financing conditions.

[125] Despite the favorable shock represented by the data for the first quarter of 2022, which makes an upward revision of the economic growth for the whole year very likely.

VI.2. Fiscal framework

The 2021 budget execution recorded a GCB deficit of 6.8% of GDP (according to the national methodology), respectively of 7.1% of GDP (according to the ESA 2010 methodology), given that the budget at the beginning of the year had foreseen a deficit target of 7.2% of GDP according to the national methodology, respectively of 8.2% of GDP according to the ESA 2010 methodology. The results seem favorable in relation to the initial planning, but it should be noted that the corrections carried out during 2021 recorded a large upward revision of revenues against the background of the recovery beyond expectations of taxes deferred for payment by economic agents in the previous year and the favorable revision of the macroeconomic framework. However, the achievement of these additional revenues did not lead to a wider reduction of the budget deficit in relation to the initial target, the revenue surplus being fully allocated for increases in the expenditure aggregates and even additional increases in budget expenditures being operated.

The FC emphasized in its opinions and analyzes that the corrections made in 2021 complicated the budget consolidation process, given that part of the revenue surplus was temporary (representing deferred payment obligations from 2020), and another part was due to the dynamics favorable cyclical conditions of the economy, this revenue surplus financing to an important extent increases in permanent budget expenditures, which accentuates the risks related to the sustainability of the fiscal position of the public sector.

Romania is in a very difficult fiscal situation, characterized by an insufficient level of budget revenues (approximately 33% of GDP compared to an average of approximately 47% of GDP in the EU), the lowest level of fiscal revenues in the EU with the exception of Ireland (about 27% of GDP in Romania compared to the average of about 41% in the EU), and a high size of the structural deficit (6.3% of potential GDP in 2021) as well as the external deficit (current account deficit) of 7% of GDP in 2021).

In this context, the draft budget for 2022 had in mind a budget deficit target of 5.9% of GDP, according to the national methodology, representing a decrease of 0.9 pp compared to the level registered in the previous year. The deficit target, according to the ESA 2010 methodology, was 6.2% of GDP, which represents a reduction of 0.9 pp compared to the level recorded in 2021. The planned decrease in the deficit is expected to be achieved partially through the increase in budget revenues (mainly by increasing the efficiency of collection/reducing tax evasion, the revenues obtained from this source being estimated at 10.7 billion lei) and partly by freezing the majority of salaries in the public sector, respectively by lower growth rates than the nominal GDP dynamics for expenditure on goods and services, social assistance and other transfers. In its Opinion on the draft budget for 2022 and the SFB 2022-2024, the FC noted the following main aspects:

- The development of the fiscal-budgetary programming documents took place in a complicated internal and external context marked by the onset of a new pandemic wave with the Omicron variant, the energy price shock, the impact of climate change and policies to combat them, as well as of strong and rising inflation. In this context, of overlapping crises, to which the outbreak of the war in Ukraine was later added, the economies are operating under siege, which calls for resource mobilization, prioritization, solidarity, and responsibility;

- The budget consolidation process cannot be achieved simultaneously with the provision of a critical mass of essential public goods, only by restricting budget expenditures. On the contrary, taking into account that public health and education are chronically under-funded, a military and geopolitical context that calls for increased defense and security spending, the impact of climate change that requires state intervention in times of emergency, the significant increase in budget revenues is an urgent need, a priority in economic policy;

- In this sense, it is necessary to eliminate exemptions and loopholes from the current legislation, as well as increase the efficiency of collection by discouraging tax optimization and reducing evasion. On the other hand, it must be taken into account that such measures have a significant distributional impact, so their implementation would face economic, social and political difficulties;

- A too slow fiscal-budgetary consolidation increases the risks to the non-problematic financing of external and internal imbalances, as well as in terms of financing conditions. Achieving this in a climate of contractionary policies is much more difficult. That is precisely why the use of the financing made available by the EU, which should replace as much as possible the use of own budgetary resources, is essential for a favorable trajectory of the Romanian economy;

- NRRP, together with the resources available through the MFF, can be a vital tool for facilitating fiscal-budgetary consolidation, by supporting a higher level of economic activity than that induced by a negative fiscal impulse and the tightening of monetary policy - to avoid entering a zone of precarious balance or even instability of the economy;

- By virtue of the principle of prudence, FC had reservations in considering the additional amounts resulting from the desired improvement of collection efficiency. Beyond these reserves, the assessment of the revenue projections contained in the draft budget led to a lower amount of budget receipts by about 1.5 billion lei. Thus, the FC assessed as probable the manifestation of a revenue gap compared to the targets assumed in the budget draft of about 12.2 billion lei, representing about 0.9% of GDP;

- On the expenditure side, the FC assessed as likely an additional need for budget allocations of 1.9 billion lei for social assistance expenses and at least 2 billion lei for interest expenses. Cumulatively, these represent an under-budgeting of spending by at least 0.3% of GDP;

- Taking into account the assessment of the revenue and expenditure projections, the FC assessed that the budget drawn up for 2022 is compatible with a deficit of around 7% of GDP, according to the national methodology, equivalent to 7.5% of GDP according to the ESA 2010 methodology. Although the draft budget targets a deficit of only 5.8% of GDP (national methodology) the FC assessed that there are not enough budgetary adjustment measures to lead to the achievement of this target.

However, it should be noted that, after the preparation of the draft budget, a series of measures were adopted with an impact on the budget aggregates and, implicitly, on the deficit, among which: support measures to protect the population and the economy by capping the prices of electricity and natural gas (with an estimated impact of around 14.5 billion lei by the end of 2022, the impact on the budget deficit being significantly lower as a result of the additional taxes applied to the energy sector, such as the 80% tax for the additional income made by energy producers electricity); the "Support for Romania" program, which includes measures to support the economy and social measures to protect the population in a total amount of 17.3 billion lei, of which 9 billion lei are financed from European funds; granting salary increases for employees in the Ministries of Health, Culture, Transport, Sports and for employees who manage European funds.

Nevertheless, the most recent estimates of the Ministry of Finance, according to the Convergence Program 2022-2025, maintain the budget deficit target, in the European methodology, at 6.2% of GDP, without presenting sufficient adjustment measures that allow the achievement of this target, especially considering the spending increases adopted after the drafting of the draft budget. Moreover, the EC 2022 Spring Forecast has a projection that places the deficit for the current year at a significantly higher level, of 7.5% of GDP, similar to the estimates of the FC in its Opinion on the draft budget. And the IMF's assessments are close to those of the EC. The gap between the EC and MF projections for 2023 is even larger (1.9 pp), with the MF anticipating an accelerated decline in the ESA deficit to 4.4% of GDP, while the EC forecast is 6.3% of GDP. Regarding the structural budget balance, the Ministry of Finance predicts a structural adjustment step of 1 pp of potential GDP in 2022, respectively of 1.6 pp of potential GDP in 2023. On the other hand, the EC estimates for 2022 a deepening by 0.2 pp of the structural budget deficit, followed by an adjustment of 1.1 pp of potential GDP in 2023.

The adjustment of the budget deficit in the medium term (2023-2025 period) is determined, according to the projections of the Convergence Program, by the reduction of the share of budget expenditures in GDP by 1.7 pp, combined with the increase in the share of budget revenues by 1.6 pp. In this sense, FC drew attention in its Opinion on the draft budget and in subsequent analyses [126] that, given the complicated international context and the overlap of crises facing both Romania and the EU, a combination of macroeconomic measures is needed to try to avoid entering recession, which implies the gradual but firm implementation of the process of budgetary consolidation and a massive absorption of European funds (the only one with an anti-cyclical character).

FC emphasizes that macroeconomic adjustment, fiscal consolidation, need a significant increase in fiscal revenues, which are at an inadmissibly low level in relation to Romania's needs and compared to EU benchmarks. In this sense, it is necessary to remove exemptions and loopholes from the current legislation, as well as to increase the efficiency of collection by discouraging tax optimization and reducing evasion. It should be borne in mind that such measures have a significant distributional impact,

[126] „Budget consolidation and higher fiscal revenues – A vital need for Romania's stability and economic security", study carried out by a working group under the coordination of the Fiscal Council (http://www.fiscalcouncil.ro/Analiza_sistem_fiscal%20EN%2031%20mai.pdf).

so their implementation may face difficulties, with the opposition of some interest groups. And yet, the overall interest of the economy, of society, must receive and prevail.

The budget execution in the first 6 months of the current year recorded a deficit of 1.7% of GDP, largely influenced by nominal GDP dynamics, by the evolution of budget revenues. Considering the newly adopted or announced fiscal-budgetary policy measures, FC considers that the budget deficit target for 2022 is difficult to achieve, it being more likely to place the deficit according to the national methodology in the range of 6.3-6.8% of GDP and that according to the European methodology in the range of 6.6-6.9%. Thus, the FC favorably revised its estimates regarding the budget deficit for the current year compared to those at the time of the opinion on the draft budget. This revision is mainly attributable to the significant increase in the projection of nominal GDP for the current year which is likely to lead to important additional revenues.

There is a need for firm fiscal/budgetary consolidation measures in the coming period, which will allow Romania to maintain access to financing (internal and external) at costs that do not overwhelm the public budget. These measures can be applied through the prism of a gradual macroeconomic correction, which should take into account the very complicated international context, the strengthening of monetary policies in the world, the unfortunate implications of the war in Ukraine. European resources (NRRP and MFF) are a vital lever, the only one with counter-cyclical action in current conditions; they can drive structural reforms, help the energy transition and improve the competitiveness of the domestic economy.

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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 government – 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 result of contractual terms' violations.

Automatic disengagement – part of the budget 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 – features of the tax and transfer systems that tend to offset fluctuations in economic activity. Examples are unemployment compensation and progressive taxation rates.

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

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

Budget balance – indicator computed as the difference between overall budget revenues and expenditures.

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

Budgetary policy – financial policy of the state regarding public 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.

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 Unique Fund for Health Insurance.

Cohesion Fund (CF) – 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.

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 state government and local governments, 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 – is a fiscal policy behavior 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 of a country are greater than exports of goods, services and transfers of that country; in this case, that country becomes a net debtor to the rest of the world.

Cyclical adjustment of budgetary revenues – elimination of the budgetary revenue's component dependent on the demand excess/deficit (economic expansion/contraction), eliminating trend deviations; the level of cyclically adjusted budgetary 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 (CABB) – the general government balance net of the cyclical component. CABB is a measure of the fundamental trend in the budget balance.

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

Disinflation – process of reducing inflation.

Economic classification – expenditure classification based on their economic nature and effect.

ESA 2010 methodology (*European System of National and Regional Accounts*) – The European System of National and Regional Accounts is an accounting reporting framework used internationally for a systematic and detailed description of an economy (of a region, a country or group of countries), or its components and its relations 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 replaces 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 committed themselves to take measures to encourage competitiveness, employment and consolidation of public finances.

European Agricultural Guarantee Fund (EAGF) – European funds for implementation of support measures for farmers.

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

European semester – additional tool for preventive surveillance of economic and fiscal policies of the Member States; 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 (ESF) – Structural Fund for Social Policy of the European Union, which supports employment measures for labor 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 (EDP) – the corrective arm of the Stability and Growth Pact (SGP) 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 (ERM 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 – special consumption tax applied to domestic and imported products, borne by consumers and included in the sale price of some specific commodities.

Expansionary fiscal policy – is a fiscal policy behavior that has an accelerating effect in 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 – the price one pays 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 on assets or liabilities of a country and 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 would be 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 addressing 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 as instrument.

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.

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.

Functional classification – expenditure classification based on their destination in order to assess public funds allocations.

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

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 labor and with other administrative procedures.

Medium Term Objective (MTO) – 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) 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/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 – a component of revenues or expenditures that has a temporary nature.

Output gap – an indicator that measures the difference between the actual GDP of an economy and potential GDP. It is also acknowledged as GDP deviation.

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

Pillar 2 of the pension system – name given to the private pension system; has a compulsory character for employees below the age 35 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 of economy determined by technology and demographic factors that affect the labor, etc.

Primary balance of the General Consolidated Budget – the difference between 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 behavior that does not fulfill its stabilizing role of the economic cycle but rather contributes to amplifying cyclical fluctuations and inflationary pressures from excess demand.

Proxy – a variable which 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 degree of openness, the share of the commerce with Member States, economic structure.

Real GDP – represents the value of final goods and services produced in an economy in a given period, adjusted with 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.

Restrictive monetary policy –monetary policy behavior 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 was 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 will be able to make purchases (drawings) from the General Resources Account (GRA) up to a specified amount and during a specified period of time, usually one to two years, provided that the member observes 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 deducting from the cyclically adjusted budget balance the temporary elements (one-offs).

Structural budget deficit – the budget deficit that would be recorded if GDP was at its potential level; it's 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.

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.

Taxes – compulsory and non-refundable levy charged by a government with the purpose of financing public goods and services.

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.