



## **Fiscal Council's Opinion on the First Budget Revision for 2022**

### **Summary**

- This year's budget execution is developing under extremely unfavorable auspices in the European economy, with major implications for the Romanian economy. These are the energy crisis, the disruption of production and supply chains, the quasi-generalized high inflation, the exacerbated effects of climate change, the pandemic and, last but not least, the war in Ukraine.
- These events and phenomena form a combination of adverse shocks that put an extraordinary pressure on the economies of EU member states, on public budgets, and severely affects people's livelihoods.
- Changes in the relative price of energy have distributional consequences between and within economies, implying a major rise in the cost of living.
- The energy transition in the EU is also difficult because the common energy market has important obstacles. Nor is a distinction often made, including in our country, between deregulation and liberalization. This confusion is surprising because modern economies have rules and regulations. The energy market in Romania has an inadequate organization/regulation also through the considerable volume of spot transactions (about 50%, which is no longer found in the EU), through the damaging role of some intermediaries (traders) in the distribution chain.
- The economies of the EU countries present specific features of quasi-war conditions, which materialize in more expensive access to resources, rationing, exhortations addressed to the population and companies to reduce energy consumption, resource mobilization and reorientation towards priority uses through direct intervention, etc.
- Inflation, which has risen to levels not seen for many years, drastically amputates the purchasing power and savings reserves of citizens. High inflation, even if falling, is also forecasted for 2023.
- The tightening of monetary policies in the US and other developed countries, through effects on international financial markets, can cause major trouble in emerging economies that have large internal and, above all, external imbalances.
- Not infrequently, the decisions are for damage limitation, for choosing between options, all with important imperfections. A lucid approach is to try to share the burden of shocks in the society as fairly as possible.

- In a world characterized by a new "cold war" and de-globalization (regionalization of economic and commercial ties), public budgets must be more robust, as must be the budgets of private companies. This target will be increasingly difficult to achieve as demands induced by extraordinary challenges can generate deeper deficits, when public and private debts exceed sustainable levels.
- A particular vulnerability of Romania is the external balance, where this year the current account deficit will exceed 7% of GDP (7% was in 2021), and the degree of coverage by non-generating debt flows will probably be below 50%.
- Romania has been in the excessive deficit procedure since the beginning of 2020. It has to achieve fiscal consolidation in a very unfavorable international environment, when its fiscal revenues (including contributions) are among the lowest in the EU – about 27% of GDP compared to average of about 41% of GDP in the EU. Its tax revenues must increase substantially, a leitmotif of FC documents in recent years.
- The very low level of fiscal/budgetary revenues is unacceptable in relation to Romania's current and future needs. And it is hard to imagine that we could achieve fiscal consolidation through inflation alone. At the same time, there is a need for a more judicious use of public money, a restructuring of the administrative apparatus, and an increase in the efficiency of budget expenditures.
- The latest NCSF forecast – from July 2022 - compared to the previous ones, especially the one that underpins the 2022 budget – from November 15, 2021 - envisages a real economic growth of 3.5%, only slightly more reduced compared to what was the basis of the draft budget – of 4.6 percent. This anticipated dynamic is congruent with recent economic data, especially GDP dynamics in the first quarter of the current year, and although it looks like a negative revision – which, caeteris paribus, reduces nominal GDP dynamics – it is overcompensated by a much higher level of the GDP deflator in the latest forecast compared to the one related to the draft state budget for 2022.
- The dynamics of the national economy is also characterized by the size of rapidly growing external imbalances.
- Looking at this economic picture, there are indicators that seem to show that in the second part of the year the dynamics of the economy will be diminished in relation to the previous one.
- The macroeconomic evolution depends on: (i) maintaining the fiscal adjustment commitments agreed with the European Commission, which guarantee a calendar of reforms, including fiscal/collection (ii) and a substantial volume of financing, under particularly favorable conditions, both through the multiannual European budgetary framework, as well as through the NRRP.
- The budget execution in the first 6 months of 2022 recorded a deficit level of 1.7% of GDP, this being largely influenced by the above-expected dynamics of nominal GDP, which is likely to lead to an important revenue surplus, as well as the additional revenues from the surcharge on electricity and natural gas producers. The nominal GDP level estimated for the year 2022 is about 4.2% higher than the forecast at the

time of drafting the budget, the increase being determined by the revision of the GDP deflator from 5.8% to 12.2%, partially counterbalanced by the downward revision of real GDP dynamics from 4.6% to 3.5%.

- The draft of the first budget revision foresees a substantial nominal increase – unprecedented in the history of the revisions evaluated by the FC from 2010 to present – both in revenues (+31.7 billion lei, representing +7.2%), and in total budget expenditures (+34.9 billion lei, representing +6.8%), the CGB deficit being 3.2 billion lei above the initial target. Expressed as a percentage of GDP, the projected level of the CGB deficit is 5.84% of GDP, identical to that of the initial budget construction, against the background of the nominal GDP projection increase of 55.2 billion lei.
- Essentially, the large-scale review of budget revenues has two main sources:
  - the upward revision of nominal GDP dynamics (on the background of high inflation, the projection of the GDP deflator being increased from 5.8% to 12.2%);
  - the additional receipts from the overtaxing of electricity and natural gas producers.
- On the side of budget revenues, the FC considers as probable the manifestation of a revenue gap compared to the targets assumed in the budget revision project of about 9 billion lei, representing about 0.66% of GDP.
- And on the budget expenditure side, there is a proportional increase, compared to the parameters approved by the draft budget, mainly determined by the addition of social assistance expenses, other transfers and interest. On the budget expenditure side, FC sees an underdimension of 6.2 billion lei, i.e. 0.45% of GDP, assuming that the data sent by the Ministry of Finance regarding the impact of measures in the energy sector is the one estimated by the revision project.

**Analyzing the changes made by the budget revision project at the level of the main aggregates of revenues and expenses, the FC assesses that the plausible budget deficit to be achieved, in the cash methodology, would be around 7% of GDP (compared to 5.84% of GDP in the rectified budget projection) but it must be said that this deficit considers revenues obtained from surcharges of over 12.8 billion lei and total expenses to energy suppliers of approximately 7.4 billion lei (as provided in the budget revision). Postponing some payments to 2023 widens the gap between the cash deficit and the ESA deficit in 2022.**

**If there is an underestimation of the impact of energy offset scheme spending, which is likely, the deficit would inevitably increase considerably. And unfavorable price developments in the markets will put additional pressure on the budget. This under-spending of the energy compensation scheme creates a major risk for the budget and fiscal consolidation.**

**As emphasized in other documents of the Fiscal Council, European resources from NRRP (National Recovery and Resilience Plan) and MFF (Multiannual Financial Framework) represent the only counter-cyclical force that can counteract the contractionary effects of**

**fiscal consolidation. The absorption in a large proportion of these financial resources, both non-reimbursable and reimbursable, is vital for Romania, considering the state of the public budget and the vulnerabilities of the external balance, the extremely unfavorable international environment.**

## **Fiscal Council's Opinion on the First Budget Revision for 2022**

On August 11, 2022, the Ministry of Finance (MF) sent to the Fiscal Council (FC), by address no. 465513/11.08.2022, the Report on the economic and budgetary situation for the first six months of 2022, the draft revision of the general consolidated budget for 2022, the explanatory note and the draft of the Government Emergency Ordinance on the revision of the state budget for 2022, as well as the explanatory note and the draft of the Government Emergency Ordinance for the revision of the social security budget for 2022, requesting, under art. 53, para. (2) of the Fiscal Responsibility Law (no. 69/2010, republished, hereafter referred to as FRL), the opinion of the Fiscal Council.

According to art. 53, para. (4) of the FRL, the Government and the Parliament have the obligation to analyze the opinions and recommendations of the Fiscal Council when they work out the Fiscal Strategy, the annual budgetary laws, as well as other measures determined by the implementation of this law and, respectively, to their appropriation/approval.

The Fiscal Council, through the addresses no. 12 and 13 of August 16, 2022 requested from the Ministry of Finance and from the National Energy Regulatory Authority information regarding the estimation of the impact of the energy compensation and capping schemes<sup>1</sup>, the payments already made, the phasing of these amounts over time, the methodology used to substantiate the estimates/amounts. FC considers that, given the current context in which the issue of energy appears to be particularly important, of the legislation regarding compensation and price capping in this field, including in terms of the fiscal-budgetary impact, such data are essential for a correct, transparent estimate of the magnitude of the budget deficit proposed in the current revision.

### ***1. The general context of the current budgetary revision***

The war in Ukraine has created a very serious situation in Europe, dangerous in every way and throwing the Continent into a new cold war. The reverberations of this war are felt in the global economy.

The Fiscal Council has never had to issue an opinion on budget execution under such unfavorable circumstances in the European economy, with inherently severe implications for the Romanian economy. It is about the energy crisis, which is intertwined with a very complicated transition to green energy, the disruption of production and supply chains, quasi-generalized high inflation, exacerbated effects of climate change (heat, prolonged drought, a water crisis, fires that destroy forests and housing, floods, storms, etc.), the pandemic and, last but not least, the war in Ukraine. These events and phenomena form a combination of

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<sup>1</sup> Legislatively implemented by GEO no. 118/2021 and GEO no. 27/2022 and subsequent normative acts.

adverse shocks that puts an extraordinary pressure on the economies of EU member states, on public budgets, and severely affects people's livelihoods.

The lockdowns amounted to a self-inflicted recession. But the ability of economies to recover with minor frictions has been overestimated. Imbalances between supply and demand, the impact of the energy transition, led to the massive increase in the relative price of energy, to the strong increase in inflation (to levels that have not been recorded in many developed countries in the last four decades).

This change in relative prices has distributional consequences between and within economies, implies a major rise in the cost of living, a deterioration in the quality of life for many citizens.

The energy transition in the EU is also hampered because the common energy market has important obstacles: the way electricity tariffs are linked to hydrocarbon quotations, insufficient strategic reserves, dependence on the Russian Federation, poor interconnection in conditions where the member states resort to different energy resources as volume in use, etc. And the regulations in this market are not adequate. Nor is a distinction often made, including in our country, between deregulation and liberalization. This confusion is surprising because modern economies have rules and regulations. The energy market in Romania has an inadequate organization/regulation and through the considerable volume of spot transactions (about 50%, which is no longer found in the EU), through the damaging role of many intermediaries (traders) in the distribution chain.

The adverse shocks mentioned above, by consequence, put a great strain on national budgets. The economies of the EU countries present specific features of quasi-war conditions, which materialize in more expensive access to resources, rationing (not to be confused with rationalization), other administrative reductions in consumption (e.g.: the 15% reduction in consumption of gas in the EU for a period of time), exhortations addressed to the population and companies to reduce energy consumption, mobilization of resources and reorientation towards priority uses through direct intervention (including special state orders), nationalization of some enterprises in strategic sectors (in France and Germany, for example), etc.

Macroeconomic data speaks for itself regarding shocks and economic strain. Inflation, which has risen to levels not seen for many years (in the euro area an average of about 8.9% in June compared to the previous year, in the Baltic countries and in Central and Eastern Europe from about 12 to about 20% in the same month), drastically amputates the purchasing power and savings reserves of the citizens. High inflation, although falling, is also forecasted for 2023. Economic recovery is slowed by the inflationary shock and the effects of the War.

Central banks are tightening monetary policies in the fight against high and persistent inflation, with the danger of inflationary expectations spiraling out of control. The US central bank (Fed) took the key rate into the range of 2.25-2.50%, and the ECB took its rates into

positive territory in nominal terms by increasing by 50 basis points. In Central and Eastern Europe, monetary policy rates were in August at 5.50% in Romania, 6.50% in Poland, 7% in the Czech Republic, 10.75% in Hungary.

The tightening of monetary policies in the US and other developed countries, through effects on international financial markets, can cause major trouble in emerging economies that have large internal and especially large external imbalances. The tightening of monetary policies can generate new financing syncope (sudden stops) on the markets, company failures and even countries in default. Governments seek through targeted programs to mitigate such effects, which however involve increases in budget expenditures.

Not infrequently, the decisions are for damage limitation, for choosing between options, all with important imperfections. A lucid approach is to try to share the burden of shocks in society as fairly as possible. Especially since some companies earn much more not through their own efforts in this turbulent and uncertain period (e.g.: energy producers). Considerable windfall gains can be taxed and used to fuel national budgets, protecting the most vulnerable citizens.

In a world characterized by a new "cold war" and de-globalization (regionalization of economic and trade ties), public budgets must be more robust, as must the budgets of private companies. This target will be increasingly difficult to achieve as demands induced by extraordinary challenges can generate deeper deficits, when public and private debts exceed sustainable levels. A "debt trap" is manifested here, which cannot be eliminated by a high inflation that would favor debtors.

A particular vulnerability of Romania is the external balance, where this year the current account deficit will exceed 7% of GDP (7% was also in 2021), and the degree of coverage through non-generating debt flows will probably be below 50%. In 2021, the structural budget deficit was just over 6% of GDP, which shows the connection between Romania's fiscal issue and the external balance issue.

Romania has been in the excessive deficit procedure since the beginning of 2020. It has to achieve fiscal consolidation in a very unfavorable international environment, when its fiscal revenues (including contributions) are among the lowest in the EU – about 27 percent of GDP compared to average of about 41 percent of GDP in the EU. Its tax revenues must increase substantially, a leitmotif of the FC documents in recent years.

The very low level of fiscal/budgetary revenues is unacceptable in relation to Romania's current and future needs. And it is hard to imagine that we could achieve fiscal consolidation only through inflation. It is also possible to resort to a reduction in public investments, but this way is much suboptimal, with adverse effects in the medium and long term. At the same time, there is a need for a more prudent use of public money, a restructuring of the administrative apparatus, and an increase in the efficiency of budget expenditures.

As other FC documents point out, the only counter-cyclical force that can counteract the contractionary effects of fiscal consolidation are European resources – NRRP (National Recovery and Resilience Plan) and MFF (Multiannual Financial Framework). These resources are vital for Romania considering the state of the public budget and the vulnerabilities of the external balance, the extremely unfavorable international environment.

## **2. The macroeconomic framework underlying the first budget revision in 2022**

The Fiscal Council starts its considerations regarding the first budget revision in 2022, as in previous opinions, from the general economic coordinates of Romania, as well as from the international context.

These considerations are based on the updated forecast – from July 2022 – of the National Commission for Strategy and Forecast (NCSF) and the accompanying note related to this forecast as well as previous forecasts, including the one related to the initial budget for 2022, published by NCSF on November 15, 2021. It is worth noting that all recent forecasts (both by domestic institutions and international ones) start from the important change in the pattern of real economic growth from 2022, revealed by data published by the National Institute of Statistics (NIS) for/related to the first quarter of this year<sup>2</sup>; they shift the center of gravity of economic growth and economic activity to the first part of the year, which implies, in adverse domestic and international economic conditions and in relatively rapid and continuous deterioration, that the second part of the year could register less favorable developments from a macroeconomic point of view and from a fiscal-budgetary perspective. These data, partially supported by the higher frequency indicators<sup>3</sup> published by the NIS in the first part of 2022, follow slower developments in the gross domestic product (GDP) in the last quarter of last year and are, also from this perspective, a shock that has important consequences in any forecast that underpins the likely developments for the year 2022.

In 2021, real GDP increased by 5.9%<sup>4</sup>, the main determinants being, on the one hand, a base effect – located, in particular, at the level of the second quarter of 2021 – and, on the other hand, the positive impact of government fiscal measures, as well as a return of confidence at the level of economic operators, who used their forced savings from the pandemic period (pent-up demand). Household consumption expenditure, on the GDP use side, contributed<sup>5</sup> to the economic recovery, to the greatest extent, with 4.7 bp – 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 bp to GDP growth of 5.9%), together with value added from the information and communications sectors (0.8 bp) as well as industry (1.1 bp),

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<sup>2</sup> Provisional data 1 were published on June 8, 2022, and provisional data 2 on July 8, 2022.

<sup>3</sup> Such as, for example, the indicators regarding the activity in the construction sector, the turnover of companies, trade retail, wage and labor market developments in general, activity in the industry sector (volume, dynamics prices as well as turnover), new orders, unemployment data, economic activity trends in various branches etc.

<sup>4</sup> according to the GDP data in the first quarter of 2022 (provisional data 2), published by the NIS on July 8, 2022, the calculations contributions using the nominal weights of the components in GDP.

<sup>5</sup> contributions to GDP dynamics were calculated by the FC based on NIS data.

to which is added the positive evolution of the added value from agriculture (contribution of 0.4 bp), all led to the rapid recovery of real GDP.

The evolution of real GDP in the first quarter of the current year, highlighted by NIS data, indicates a quarter-on-quarter growth (seasonally adjusted data) of 5.1%, strongly accelerating from -2.9% and +1.0% in Q3 and Q4 2021. This evolution is explained, on the supply side, by the dynamics in the retail and wholesale trade sector, from information and communications. On the demand 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<sup>6</sup>. The data on GDP in the second quarter of the current year ("signal" estimates, not detailed), published by the NIS on August 17, show the continuation of sustained economic growth, but slowing down, with a rate of 2.1% quarter on quarter (from 5.1% in the first quarter).

The latest NCSF forecast – from July 2022 – compared to the previous ones, especially the one that underpins the 2022 budget – from November 15, 2022 – envisages a real economic growth of 3.5%, only slightly lower compared to the one that underpinned the draft budget – of 4.6%. This anticipated dynamic is congruent with the latest economic data, especially GDP dynamics in the first quarter of the current year, and although it looks like a negative revision – which, *caeteris paribus*, reduces nominal GDP dynamics – it is overcompensated by a much higher level of the GDP deflator in the latest forecast compared to the one related to the draft state budget for 2022. This evolution takes place in conditions where, on the one hand, some problems determined by the set of post-pandemic shocks, demand shock – manifested in mainly, by the return of its magnitude – and supply – highlighted by the problems of the supply and production chains and, finally, highlighted by the accelerated increase in prices – and, on the other hand, the war in Ukraine, induced new shocks to supply and production chains, manifested in the prices of energy, fuels, agricultural commodities, various metals and raw materials in the semiconductor industry<sup>7</sup>.

The dynamics of the national economy is also illustrated by the size of the rapidly growing external imbalances – the trade balance deficit, according to the latest data of the NIS, from June 2022, showing a widening of it, in euros, accumulated over the first 6 months of the year compared to the similar period of the last year, with 4.7 billion euros, equivalent to a rate of +44.3%. Similarly, the balance of payments data, published by the NBR on August 12, last year shows an increase in the current account deficit for the cumulative first 6 months of the year

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<sup>6</sup> contributions to GDP dynamics were calculated by the FC based on NIS data, using real weights from the seasonal adjusted series.

<sup>7</sup> 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 was in increased prices for raw materials, which accelerated the dynamics of prices in general, transmitting to the international value added chains, as well as in a further slowdown in economic growth – transmitted, at different speeds, to all the sectors that determined this growth.

compared to the same period last year, by 5 billion euros, equivalent to an increase of 70.7% (the main determinants being the deficit in trade in goods as well as the deficit related to primary income)<sup>8</sup>.

Looking at this economic framework, there are indicators that seem to show that in the second part of the year the dynamics of the economy will be diminished in relation to the previous one. Thus (i) the volume of retail trade figures shows a reduced and decelerating growth in June, (ii) the index of real wage earnings contracted by 2.4% in June compared to last year – for the 3rd month in a row, at an accelerating pace, (iii) the evolution of industrial production in June 2022, accelerated its decline, regardless of the methodology used, (iv) new manufacturing orders in June 2022 decreased in nominal terms compared to the previous month, thus continuing its decline from the annual maximum reached in March – the one that justifies the cumulative positive evolution over the first 6 months of the year, (v) the situation in agriculture – marked in some sub-sectors by prolonged drought, such as (vi) the dynamics particularly high and persistent industrial production prices in June 2022, which overall stands at approximately +48% (which constitutes a strong negative supply shock. All these are some arguments that support the assessment regarding the temperation of economic activity in what is left of the current year.

These developments in economic activity are, in addition, marked by important internal and external risks: (i) the tightening of monetary policies domestically and internationally (and very pronounced regionally) may lead to both negative influences of tighter monetary conditions and difficulties in accessing funds – taking into account the external imbalances of the Romanian economy which are mainly determined by fiscal policy<sup>9</sup> – through sources of financing of lower volume, more expensive and more selective in terms of risk, all the more the effect of import prices in most of the world's economies is strongly stagflationary, (ii) the consequences of additional problems on the energy and fuel market (which may even stop deliveries from countries involved in the war), which may affect the main European trading partners of the Romanian economy, and thus can influence internal dynamics, (iii) a possible crisis in the real estate/financial sector and finally economic in the large Asian economies, which, considering the share in global trade but also the financing provided to other economies, can cause a sudden, extensive braking of the world economy, with profound consequences for the Romanian economy as well, (iv) the sharp increase in global geopolitical tensions, not only as a result of the war started by Russia in Ukraine.

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<sup>8</sup> And all the more worrisome as the financing of this deficit is done to a smaller and smaller extent through non-debt generating flows (these being considered to be the balance of the capital account as well as, from the financial account, only "shares in the capital"), for the first 6 cumulative months of this year, their share being only 40% in the total current account deficit (5 billion euros out of 12.3 billion euros), compared to 60% in the similar period of 2021 (4.3 billion euros out of 7.2 billion euros).

<sup>9</sup> Considering that in 2021 the ESA2010 fiscal deficit is approximately equal to the current account deficit of the payments – both around 7% of GDP (fiscal deficit of 7.1% of GDP and external of 7% of GDP).

This type of economic evolution, marked by rapid dynamics in the first part of the year, and a likely slower evolution in the second, presents risks as follows: (i) the increase in GDP, especially in sectors that, under normal conditions, are rich in taxes and fees, such as internal absorption, especially private consumption, can be constituted in a period with additional tax revenues, which are not permanent, being located in the first half of the year and which could be followed in the second part of the year, from an evolution of tax revenues closer to normal, which would make a part of the additional revenues on which the rectified budget is based not materialize, (ii) in the conditions where the current excess demand does not seem to have a significant magnitude, a slower dynamic can bring the transition to the opposite position – of a demand deficit – which makes the structural adjustment of the fiscal imbalance difficult (and which thus underlines the importance of achieving a significant, sustainable, structural, as firm as possible fiscal consolidation), (iii) a reduction in the growth rate of the economy would reduce in relative terms its attractiveness for external financing at a critical moment for it – internal and external imbalances being relatively high and persistent.

Regarding the inflation forecast and the GDP deflator, the latest NCSF forecast significantly revises the dynamics for 2022, to +12.9% for CPI inflation (end of period) and +12.2% for the deflator, from 4.7% and, respectively, 5.8% in the forecast that underpinned the draft state budget for 2022. This means an increase in nominal GDP, in 2022, of 16.1% compared to only 10.7% in the initial draft budget, a significant increase of approximately 5.5 bp. It should also be noted that the NBR, in the Inflation Report for August 2022, considers a slightly higher level of inflation in the current year, of 13.9%, substantiated by an adjusted CORE2 inflation index of approximately 11.4%. From the evolution of inflation, approximately half of the inflation shock is determined by exogenous shocks (at the level of administered prices, those of electricity, gas, fruits, vegetables, egg prices, fuels, tobacco and alcohol).

In the evolution of inflation, the two compensation and capping schemes for electricity and natural gas prices (GO 118/2021 and GEO 27/2022 and subsequent normative acts) are of great importance, which reduced the incidence of sharp increases in the prices of these products on the whole CPI. The effect of this legislation – to calm inflation – is anticipated to dissipate in April 2023, and, with all the positive shock on prices from that moment, the inflection point is anticipated by the NBR to be recorded during the third quarter of 2022 (close to the current level of inflation, of approximately 15% – July 2022), from which point the speed of price growth is forecast to decrease considerably. This fact, positive from the point of view of economic stability, can, however, act from a fiscal-budgetary point of view in the same sense as a slower real economic evolution in the second part of the year.

The corroboration of this information makes the elements of risk on fiscal consolidation – knowing that inflation is observationally equivalent to a structural adjustment of the fiscal-budgetary deficit – all the more relevant and the need to reduce the deficit, through firm, sustainable measures, all the more more acute. Moreover, the possible stagflationary shock felt by the economy – which leads to the slowdown of economic growth combined with the

mitigation of the inflationary shock in the medium time horizon, acutely raises the issue of the future economic and fiscal-budgetary evolution, especially considering the adjustment constraints assumed by the MF for the years to come – and which will no longer benefit from the help given by a rapid increase in nominal GDP.

The labor market – important through the related macroeconomic bases, payroll tax, social contributions, some elements of expenses such as unemployment benefits and social transfers, all with a significant impact on the value of the deficit – is forecast by the NCSF to record an increase in the average number of employees by 1.4% (from 2% in the forecast that underpinned the budget for the current year) and an increase in average gross salary earnings of 10.4% (compared to 8.7% previously). The unemployment rate remains close to the previous values, being 5.4% – the BIM unemployment rate and 2.5% – the unemployment rate registered at the end of the year (from 5.1% and 2.9%, respectively, in the macroeconomic projection related to the initial budget). These coordinates indicate a plausible projection of labor market aggregates.

The corroboration of economic information and data with the dynamics of the relevant macroeconomic variables projected by the NCSF and for the budget revision leads to the conclusion of a plausible trajectory of these aggregates for the year 2022. It is even possible a slightly faster evolution of the prices/GDP deflator but also of the real economic growth which through the cumulative effect it could lead, in the assumption of a normal economic evolution, to a substantially higher nominal GDP than the NCSF forecast. However, in the light of the risks identified for the course of economic activity in the last part of the year, the macroeconomic forecast appears as prudent, appropriate to the domestic and international economic context marked by great uncertainty.

However, the macroeconomic evolution depends on: (i) maintaining the fiscal adjustment commitments agreed with the European Commission, which guarantee a calendar of reforms (including fiscal/collection) and a substantial volume of financing, under particularly favorable conditions, both through the European multi-annual budgetary framework as well as through the NRRP, (ii) reaching the targets conditions the access to the international capital markets<sup>10</sup>, also emphasizing the issue of public debt sustainability in the broader context of ensuring the financing of Romania's total external debt (public and private), (iii) achieving a substitution between investment projects with full national financing and those financed by European projects appears to be particularly important both from the perspective of ensuring a smaller deficit, financing flows for the external imbalance and the positive effect on economic development.

Failure to achieve fiscal-budgetary targets and a different evolution from a macroeconomic point of view can lead to an area of precarious balancing of the economy, which does not

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<sup>10</sup> Critical to deficit and debt financing and refinancing; in this respect there is a relative improvement, reflected by the slight decrease in both the yields on Romanian government securities and the related risk premium/CDS.

ensure the stability sought through fiscal consolidation<sup>11</sup> and the rest of economic policies, even culminating in non-linear evolutions of economic-financial indicators. This important risk must guide and discipline public policy in the sense of respecting the commitments assumed, in the interest of achieving the national macroeconomic objectives.

### **3. Updated coordinates of budget revenues and expenditures**

The analysis of the revision project starts, as a first point of reference, from the initial budget construction that envisaged a deficit target of 5.84% of GDP, according to the cash methodology. In its opinion on the draft budget, based on the macroeconomic framework projected at that time and a prudent approach to revenues and expenses, the FC assessed the cash budget deficit at around 7% of GDP. In this sense, the FC had identified an over-dimensioning of excise revenues, as well as the need for additional allocations at the level of interest expenses and those with social assistance, stressing also that the inclusion in the proposed level for expenses with goods and services calls for a rigorous control of them. At the same time, the CF considered that it is not prudent to include ex-ante in the revenue projections additional amounts counting on increasing the efficiency of collection/reducing tax evasion.

The budget execution in the first 6 months of 2022 recorded a deficit level of 1.7% of GDP, this being largely influenced by the dynamics above expectations of nominal GDP, which is likely to lead to an important revenue surplus, as well as the additional receipts from the overtaxing of electricity and natural gas producers, in the context of the manifestation of a gap in the execution of the expenses associated with GEO 118/2021 and GEO 27/2022 and subsequent normative acts regarding compensation schemes for the consumption of electricity and natural gas. The nominal GDP level estimated for the year 2022 is about 4.2% higher than the forecast at the time of drafting the budget, the increase being determined by the revision of the GDP deflator from 5.8% to 12.2%, partially counterbalanced by the downward revision of real GDP dynamics from 4.6% to 3.5%.

In this context, the draft of the first budget revision provides for a substantial nominal increase – unprecedented in the history of the revisions evaluated by the FC from 2010 to the present<sup>12</sup> – both in revenues (+31.7 billion lei, representing +7.2%), and of total budget expenditures (+34.9 billion lei, representing +6.8%), the CGB deficit being 3.2 billion lei above the initial target. Expressed as a percentage of GDP, the estimated level of the CGB deficit is 5.84% of GDP, similar to that of the initial budget construction, against the background of the nominal GDP projection increase of 55.2 billion lei. The first budget revision also includes an increase by 159 million lei of the chain compensation scheme for swap-type arrears to CGB, with a symmetrical impact on revenues and expenses (and therefore neutral on the budget

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<sup>11</sup> This area of precarious balance would equate to an unstable equilibrium, as such a state is encountered in the specialized literature.

<sup>12</sup> Far exceeding the first budget revision in 2021 which provided an increase in revenues by 17.6 billion lei and in expenditures by 21.4 billion lei.

deficit), a more faithful illustration of the position of public finances requiring the exclusion of this element from the analysis. Eliminating the impact of the swap type schemes, the budget revenues projected in the first revision increase by approximately 31.6 billion lei, and the budget expenses by 34.8 billion lei.

In essence, the large-scale review of budget revenues has two main sources:

- the upward revision of nominal GDP dynamics (on the background of high inflation, the projection of the GDP deflator being increased from 5.8% to 12.2%);
- the additional receipts from the overtaking of electricity and natural gas producers.

Added to these are some smaller increases in budget revenues as a result of the fiscal measures adopted by GO 16/2022, as well as the expected effect of the measures to improve the collection of fees and taxes (with a target set by the Ministry of Finance at 3.5 billion lei). In relation to the ex-ante consideration of additional amounts based on the increase in collection efficiency/reduction of tax evasion, the FC has shown on numerous occasions that such an approach is not prudent. The FC agrees with the ex-post inclusion of additional revenues from improved collection in the budget construction, but only after their amount has been measured with a high degree of certainty.

By category of budget revenues, positive revisions to the levels projected in the initial budget (net of the impact of swap schemes) occur in the vast majority of them, as follows:

- *Tax revenues*: +21.2 billion lei, the main changes being found at the level of the following components:
  - *Corporate income tax*: +4 billion lei. The revision of this budget aggregate envisages increasing the projection for nominal GDP dynamics from +10.7% (at the time of drafting the budget) to +16.2%. The budget execution for the first semester indicates a 27.5% increase in profit tax receipts compared to the same period of the previous year, and the new target in the rectification project foresees a 27.7% increase compared to the 2021 budget execution. Thus, reaching the proposed target for income tax receipts requires maintaining their growth rate in the second half of the year as well. This hypothesis is problematic given the high degree of uncertainty of possible macroeconomic developments, especially against the background of the prolongation or even escalation of the armed conflict on the territory of Ukraine.
  - *Personal income tax*: +1.7 billion lei. The revision takes into account the modification of the forecast that was the basis for the elaboration of the initial budget regarding the relevant macroeconomic aggregates, respectively for the average number of employees from +2% to +1.4% and for the average gross salary gain from +8.7% to +10.4% (the overall effect being a projected increase in the dynamics of the wage bill in the economy from +10.9% to +11.9%), as

well as the impact of the income tax measures adopted by GO 16/2022, assessed by the Ministry of Finance at +0.3 billion lei for the year 2022. At the same time, the revision performed appears to be compatible with the budget execution from the first semester of this aggregate, which recorded a degree of fulfillment of the new target in proportion to 51.1%.

- *Other taxes on income, profit and capital gains*: +0.13 billion lei.
- *Property taxes*: -0.4 billion lei.
- *VAT*: +5.1 billion lei. The main factors that could justify the increase in the projection of VAT receipts are represented by the revision of the forecast for the relevant macroeconomic base (the final consumption of households, excluding self-consumption and the peasant market) from +10.9% to +13.3%, respectively by the target of 1 billion lei set by the Ministry of Finance to improve VAT collection. However, these elements are not sufficient to justify the revision performed. Considering the budget execution in the first semester (which recorded an average of monthly VAT receipts of 7.6 billion lei), reaching the new projected level for this budgetary aggregate would mean that the monthly average of receipts would increase to 8.6 billion lei (+13.7%), not being highlighted the factors that would determine such an evolution. Under these conditions, and taking into account that the ex-ante inclusion of additional amounts based on the increase in collection efficiency is not compatible with the principle of fiscal responsibility (art. 4 of the FRL), the FC assesses as probable the manifestation of a revenue gap of around 5 billion lei at the level of VAT receipts.
- *Excise duties*: -1.9 billion lei, confirming the evaluation of the FC from the time of drafting the budget, which indicates an over-dimensioning of this budgetary aggregate. However, even the new projected level appears oversized compared to the first semester execution which recorded a degree of achievement of the revised target of only 45.7%. Thus, the receipts from excise duties in the first semester increased by only 0.7% compared to the similar period of the previous year, and the new target provided in the rectification project would imply a significant acceleration of receipts to a level of 5.7% higher than the one recorded in the budget execution of 2021. Taking into account the impact of the increase in tobacco and alcohol excise taxes, assessed by the MF at +0.5 billion lei for 2022, and not taking into account the target of 1 billion lei provided by the MF for the improvement collection of excise duties, the FC assesses as probable the manifestation of a revenue gap of about 2.5 billion lei at the level of this budgetary aggregate.
- *Other taxes and general taxes on goods and services*: +11.1 billion lei. The increase in the projection for this category of income appears to be compatible with the evolution of receipts from the tax on additional income obtained as a

result of the deregulation of prices in the natural gas sector, respectively from the tax applied to the additional income made by electricity producers.

- *Tax on the use of goods, authorization to use goods or on conducting activities*: +0.7 billion lei. The new projection incorporates the increase in revenues from gambling taxes and the maintenance of estimates for the collection in 2022 of revenues related to the exploitation of radio frequencies in the new European harmonized frequency bands for 5G land mobile broadband systems. It should be noted that the realization of revenues from the sale of 5G licenses depends on the successful completion of the auction, but a potential non-realization of them will affect to a small extent the budget execution according to the European methodology (according to which the revenues associated with the rental of frequency bands are distributed over the entire duration of the contracts).
  - *Foreign trade tax (customs duties)*: +0.4 billion lei.
  - *Other taxes and fiscal fees*: +0.3 billion lei.
- *Social security contributions*: +1.6 billion lei. Similar to the receipts from the income tax, the receipts from social security contributions have as a relevant macroeconomic basis the wage bill in the economy, whose dynamics have been revised from +10.9% to +11.9%. Other factors influencing receipts from insurance contributions are represented by the change in the method of calculating social contributions for individual part-time employment contracts by GO 16/2022 (with an impact assessed by the Ministry of Finance at +0.4 billion lei for the year 2022), respectively by the decrease in payments from legal entities for non-employed persons with disabilities (-0.3 billion lei). The new level proposed by the revision project, however, appears oversized in relation to the execution in the first semester, which recorded a degree of fulfillment of the revised target of only 48.3%. Thus, receipts from insurance contributions in the first semester increased by 9.7% compared to the similar period of the previous year, and the new target provided in the revision project implies an increase by 11.1% compared to the budget execution of 2021. Having in view of the slower dynamics of insurance contributions in the first half of the year, and without taking into account the target of 1 billion lei provided by the Ministry of Finance for the improvement of collection, the FC assesses as probable the manifestation of a revenue gap of about 1.5 billion lei at the level of this budgetary aggregate.
- *Non-tax revenues*: +7.2 billion lei. The revision of the projection for this category incorporates the upward evolution of oil royalties (on the back of rising oil and natural gas prices) and dividends for the financial year 2019 and 2020 made by CEC BANK. On the other hand, a negative impact (-0.7 billion lei) is exerted by fuel compensation to support the granting of price reductions for gasoline and diesel. The execution of the first semester of non-tax revenues indicates a significant increase in receipts by 62.7% compared to the same period of the previous year, this increase being recognized by

the revision operated by the revision project. FC estimates that the new revenue target is achievable if non-tax revenues will continue to evolve similar to the budget executions of previous years.

- *Capital revenues*: +0.4 billion lei.
- *Amounts received from the EU/other donors on account of payments made and pre-financing related to the 2014-2020 financial framework*: +1 billion lei. The upward revision occurs as a result of the increase of the sums transiting the consolidated general budget intended for the pre-financing of projects of the non-governmental sector in the event of the temporary unavailability of European funds, based on art. 10 of GEO no. 40/2015 (about +4 billion lei), this increase being largely counterbalanced by the decrease in the amounts related to the European funds for agriculture (-2 billion lei) and the amounts from structural and cohesion funds (-1 billion lei) . The first two categories, which were not included in the cash budget execution before 2016, represent European funds whose recipient is the private sector with a symmetrical impact on revenues and expenses, these only passing through the general consolidated budget. Considering the relatively high gap between the execution for the first 6 months and the revised target of revenues from European funds (degree of achievement of about 31%), the FC notes some risks regarding the materialization of the projection for this budget aggregate, even if traditionally the absorption of Europeans funds accelerates strongly at the end of the year. Similarly, it is worth noting that of the total amounts related to the non-refundable financial assistance allocated for NRRP (revised target of 8.9 billion lei), only 5.1 million lei were recorded in the first semester.

Summing up, on the budgetary revenue side, the FC assesses as probable the manifestation of a revenue gap compared to the targets assumed in the budget revision project of about 9 billion lei, representing about 0.66% of GDP.

And on the budget expenses side, there is a proportional increase, compared to the parameters approved by the budget draft, mainly determined by the addition of social assistance expenses, other transfers and interest. The upward revision of previous estimates (amounts net of the impact of swap schemes) occurs in almost all major expenditure categories, as follows:

- *Personnel expenditures*: +2.8 billion lei. Of this amount, 1.6 billion lei represents the addition of personnel expenditures to the state budget, mainly for the payment of salary rights established by court decisions and administrative acts, respectively for the granting of salary increases in education, while 1.2 billion lei represents the addition of personnel expenditures to the centralized general budget of administrative-territorial units. Considering the fact that the increase in the envelope of personnel expenses is not negligible, a strict control of them is necessary, falling within the ceiling assumed in the revision project carrying risks.

- *Goods and services*: +2.8 billion lei, mainly as a result of supplementing the amounts related to the budget of the Single National Social Health Insurance Fund (+2 billion lei) and the general centralized budget of the administrative-territorial units (+1,5 billion lei), partially counterbalanced by the reduction of the ceiling for expenditure on goods and services at the level of the state budget (-0.5 billion lei). Under the new conditions, the budget envelope of this aggregate is placed at a level of 69.8 billion lei, 9.1% above the nominal level from 2021 (the growth rate from 2021 compared to 2020 being 12.3%). At the same time, in the first semester of 2022, this category of expenses registered a growth rate of 16.4% compared to the same period last year. The FC has already noted in its opinion on the draft budget that the inclusion in the initial ceiling for this category of expenses involves challenges given that this budgetary aggregate has proven difficult to control in the past. Moreover, considering the execution in the first semester, the revision performed appears to be insufficient, FC estimating that an additional need of around 3 billion lei is likely.
- *Interest*: +4.4 billion lei. The important addition of this category of expenses occurs against the background of the increase in public debt and the interest rates at which new loans are contracted and highlights the fact that the initial ceiling was undersized, an aspect noted by the FC in its opinion on the draft budget.
- *Subsidies*: +2.9 billion lei, mainly for the financing of the electricity and natural gas price compensation/ceiling scheme (+2.5 billion lei).
- *Transfers between public administration units*: +0.5 billion lei.
- *Other transfers*: +6 billion lei. In the main, the amounts related to green certificates with a special purpose (+1.7 billion lei), allocations to the Environment Fund (+1.5 billion lei), transfers to enterprises under state aid schemes (+1.1 billion lei), Romania's contribution to the EU budget (+0.8 billion lei) and transfers to the National Investment Company (+0.7 billion lei).
- *Social assistance*: +10.9 billion lei. The substantial increase in social assistance expenses is mainly due to the addition of allocations for medical leave settlement (+2.5 billion lei), the granting of a one-off support in July for pensions of less than or equal to 2,000 lei (+2.3 billion lei), supplementing the amounts for compensating electricity and natural gas prices (+1.5 billion lei), respectively supplementing the amounts for the payment of state military pensions (+0.4 billion lei). At the same time, the extensive upward revision also highlights the fact that the initial ceiling was significantly undersized, an aspect noted by the FC in its opinion on the draft budget. Moreover, considering the budget execution for the first semester of 2022, the FC considers it possible to materialize an additional requirement of around 3 billion lei.

- *Projects with financing from non-refundable external funds post-accession 2014-2020: +1.9 billion lei.* This increase occurs mainly due to the upward revision of the sums transiting the general consolidated budget intended for the pre-financing of projects of the non-governmental sector in the event of the temporary unavailability of European funds, based on art. 10 of GEO no. 40/2015 (about +4 billion lei), this increase being partially counterbalanced by the decrease in the amounts related to the European funds for agriculture (-2 billion lei) and the amounts from structural and cohesion funds (-0.1 billion lei).
- *Other expenses: +0.6 billion lei.*
- *Projects financed from the amounts representing the non-refundable financial assistance related to NRRP: +0.1 billion lei.*
- *Projects financed from the amounts related to the loan component of the NRRP: +1 billion lei.*
- *Reserve funds: +1 billion lei.* The amounts will later be distributed by budget categories according to the actual needs.
- *Capital expenditures: +0.6 billion lei.* The increase in the amounts allocated to this category of expenses is mainly found at the level of the state budget, respectively of the administrative-territorial units.

*Total public investment expenditures*, from internal and external sources, are increased in the planning by 3.2 billion lei (+3.7%) compared to the level provided for in the draft budget (maintaining at the level of 6.7% of GDP in the context of the upward revision of the nominal GDP projection), with the main sources being the increase in capital expenditures, investment transfers and the related amounts of NRRP by about 1.1 billion lei each. Following this increase, the programmed level of investment expenses is 37.8% higher (+25.1 billion lei) compared to the level in the execution related to 2021.

According to the Report on the economic and budgetary situation for the first 6 months of 2022, the execution of investment expenses recorded a level of approximately 21 billion lei in the first semester, given that the programmed level of this aggregate for the entire year, according to the draft revision, is 91.7 billion lei (resulting in a completion rate of almost 23%). Thus, similar to previous years, the tendency to concentrate investment expenses in the last months of the year is maintained, raising questions about the efficiency of the budget programming process, both from the point of view of the way investment projects are managed, and from the point of view of establishing the criteria for making investments in accordance with their importance and usefulness.

Under these conditions, on the budget expenditure side, FC sees an underdimension of 6.2 billion lei, i.e. 0.45% of GDP, assuming that the data sent by the Ministry of Finance regarding the impact of measures in the energy sector is the one estimated by the revision project.

**In summary, analyzing the changes made by the budget revision project at the level of the main aggregates of revenues and expenditures, the FC estimates that the plausible budget deficit to be achieved, in the cash methodology, would be around 7% of GDP (compared to 5, 84% of GDP in the rectified budget projection) but it must be said that this deficit considers revenues obtained from surcharges of over 12.8 billion lei and total expenses to energy suppliers of approximately 7.4 billion lei (as provided for in the rectification). The postponement of some payments for the year 2023 increases the difference between the cash deficit and the ESA deficit in 2022.**

**If there is an under-dimensioning of the impact of the expenditure on the energy compensation scheme, which is very likely<sup>13</sup>, the deficit would inevitably increase considerably<sup>14</sup>. And unfavorable price developments in the markets will put additional pressure on the budget. This under-spending of the energy compensation scheme creates a major risk for the budget and fiscal consolidation.**

#### ***4. The importance of European funds: The National Recovery and Resilience Plan***

In an extremely complicated international context, at high levels of uncertainty and instability under the influence of multiple economic, energy, fiscal, monetary, social crises, with an amplified impact by geopolitical tensions on a global scale and, especially in space of the war in Ukraine, European funds represent a financial resource of crucial importance for Romania.

For the period 2021-2027, Romania benefits from the European Union's allocations amounting to almost 80 billion euros<sup>15</sup> (31.5 billion euros from the cohesion policy and about 20 billion euros from the Common Agricultural Policy related to the CFM 2021-2027, adding to these 12.2 billion euros in grants and 15 billion euros in the form of loans, through the Recovery and Resilience Mechanism – RRM). Capitalizing on this exceptional opportunity depending on concerted efforts at the central and local level it would help macroeconomic

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<sup>13</sup> Caeteris paribus, i.e. under the conditions in which the provisions of GEO 27/2022 and the subsequent legislation remain operational.

<sup>14</sup> For example, if it is considered that the explanatory memorandum of GEO 27/2022, which stipulated that the budgetary impact of the compensation scheme is null, compensating with the additional revenues obtained from the surcharge, is in valid continuation, it would result that an additional expenditure of approximately 5.4 billion lei is needed, which would bring the deficit – considered by the FC to be plausible, this year –, incorporating this correction, to approximately 7.4% of GDP.

<sup>15</sup> It should be emphasized that, until 2023 inclusive, Romania also benefits from European funds related to the financial year 2014- 2020 exercise, in the case of OP-cohesion funds, the effective absorption rate at the end of July 2022 being around 50% (12 billion euro reimbursements from the EC, against the 24 billion euro allocations). Given the pre-financing received from the EC and the amounts requested for reimbursement an acceleration of the effective absorption is expected in the last months of this year, respectively until the end of period n+3.  
<https://mfe.gov.ro/stadiul-absorbției-fondurilor-ue/>

stabilization, increase investments, and on the side of the real economy, the implementation of structural reforms.

The recent conclusion of the Romania – European Union Partnership Agreement for the period 2021-2027<sup>16</sup> will allow the start of this financial year<sup>17</sup>, MIPE committing to launch all major calls for projects by the end of 2023, in correlation with the absorption targets, respectively with the amounts that must be requested to the European Commission for reimbursement, to prevent possible blockages that may occur in implementation, with an impact on absorption and the risk of disengagement. By the end of August this year, in order to accelerate the implementation of the projects, all the Management Authorities for the Operational Programs through which Romania attracts the funds allocated for the 2021-2027 programming period will upload all the necessary documents, including the operational procedures, into the electronic communication system with the services of the European Commission and the protocol framework<sup>18</sup>.

Regarding the NRRP, according to the data on the budget execution on June 30, 2022, the amounts related to the non-refundable financial assistance spent (grant component) were at a low level of 5.9 million lei, as were the expenses related to projects financed from the loan component (5 million lei). In addition to the delays in the operationalization of the organizational structures necessary to initiate the implementation of the NRRP, respectively in the conclusion of financing contracts with the beneficiaries, the main explanation for the low rate of absorption of funds from the NRRP in mid-2022 lies in the fact that most of the benchmarks and targets established, both for Q4/2021, as well as for Q1 and Q2/2022, focused on the component of reforms (mainly institutional and legislative, methodologies, procedures, operational arrangements) without significant budgetary implications, expecting that the absorption rate of these funds will sensitive increase in the second part of the year<sup>19</sup>.

A recent report by the European Commission on the balance sheet of the implementation of the Recovery and Resilience Mechanism 18 months after its creation (February 2021) revealed that this mechanism has become the fundamental tool in the operationalization of the medium and long-term strategies of the European Union, the National Recovery and

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<sup>16</sup> 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, Brussels, 25 July 2022.

<sup>17</sup> As of mid-August 2022, only 18 EU Member States had concluded Partnership Agreements 2021-2027. [https://ec.europa.eu/info/publications/partnership-agreements-eu-funds-2021-2027\\_en](https://ec.europa.eu/info/publications/partnership-agreements-eu-funds-2021-2027_en)

<sup>18</sup> <https://mfe.gov.ro/obiectiv-major-indraznet-asumat-de-ministerul-investitiilor-si-proiectelor-europene-pentru-perioada-de-programare-2021-2027-majoritatea-apelurilor-de-proiecte-sa-fie-lansate-public-pana-la-sfarsitul/>

<sup>19</sup> It should be noted that, according to the statements of MIPE officials, all milestones with a completion date in Q4/2021 (for which was submitted Payment request no. 1), but also in Q1 and Q2/2022 were fulfilled according to the assumed calendar.

<https://mfe.gov.ro/mipe-in-calitea-de-coordonator-national-al-pnrr-a-solicitat-ministerelor-implicate-o-analiza-privind-progresele-in-iffellierea-jaloanelor-si-targets-from-pnrr-related-to-the-end-of-September>

Resilience Plans of Member States making important progress in achieving the investment and reform agenda, supporting the acceleration of the digital and green transition<sup>20</sup>.

In view of unprecedented geopolitical events that have adverse effects on the EU economy, faced with a new crisis generated by Russia's invasion of Ukraine, the European Commission launched the REPowerEU plan with the objective of transforming the EU's energy system and eliminating dependence on fossil fuel imports from Russia until 2030<sup>21</sup>.

In this context, the European Commission invited the Member States to add to their recovery and resilience plans a distinct chapter including new actions leading to directing investments and reforms to achieve the objectives of REPowerEU, namely for energy saving, clean energy production and diversification energy supply sources<sup>22</sup>.

It has been estimated that the realization of this plan requires additional investments at the EU level of around 210 billion euros until 2027, the main recommended source of financing, in the case of member states that have not resorted (fully or partially) to the loan facility related to the RRM, being the part unused portion of this component of the RRM, namely 225 billion euros, to which are added RRM grants financed from the revenues obtained through the trading of ETS emission certificates – currently held in the reserve for market stability – which represents 20 billion euros. Consequently, we appreciate that Romania can comply with this requirement by applying for new grants, in relatively easier terms compared to the other member states, at least due to its lower degree of dependence on energy imports, respectively by harmonizing reforms and investment projects with the financial resources from NRRP and MFF 2021-2027 related to the green transition.

As emphasized in other documents of the Fiscal Council, European resources from NRRP (National Recovery and Resilience Plan) and MFF (Multiannual Financial Framework) represent the only counter-cyclical force that can counteract the contractionary effects of fiscal consolidation. The absorption in a large proportion of these financial resources, both non-reimbursable and reimbursable, is vital for Romania considering the state of the public budget and the vulnerabilities of the external balance, the extremely unfavorable international environment.

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<sup>20</sup> European Commission (2022). Review report on the implementation of the Recovery and Resilience Facility. Report from the Commission to the European Parliament and the Council, COM(2022) 383 final, Brussels, 29.7.2022.

<sup>21</sup> European Commission (2022). REPowerEU Plan, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, COM (2022) 230 final, 18.5.2022, Brussels

<sup>22</sup> European Commission (2022). Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulation 2021/1060, 2021/2115, 2003/87/EC and Decision 2015/1814, COM(2022) 231 final 2022/0164 (COD), Brussels, 18.5.2022

## **5. Compliance with fiscal rules**

The project of the first budgetary revision for the year 2022 provides for the modification of the ceilings in nominal terms of some of the indicators specified in the fiscal-budgetary framework for the year 2022, established by Law no. 312/2021, as follows:

- the nominal ceiling of the GCB deficit is increased by 3.2 billion lei to the level of 80.2 billion lei.
- the nominal ceiling of the GCB's total expenses, excluding financial assistance from the European Union and other donors, is increased by 33.8 billion lei, up to the level of 491.8 billion lei.
- the nominal ceiling of GCB's personnel expenditures is increased by 2.8 billion lei, up to the level of 118.2 billion lei.

As for the primary deficit of the GCB, it remained within the limit provided for by Law no. 312/2021, based on the upward revision of interest expenses (+4.4 billion lei) compared to the level provided for in the draft budget. Also, the indicators expressed as a share in GDP have remained within the limits provided by Law no. 312/2021 (5.8% of GDP in the case of the GCB deficit, respectively 8.8% of GDP in the case of GCB personnel expenditures), as a result of the increase in the nominal GDP projection by 55.2 billion lei compared to the estimate from the budget project.

The Government ordinance draft on the rectification of the state budget for 2022 stipulates the necessary exemptions from the fiscal rules established by the FRL and redefines the ceilings of the budget aggregates in accordance with the levels provided for in the rectification proposal.

## **Conclusions**

- This year's budget execution is developing under extremely unfavorable auspices in the European economy, with major implications for the Romanian economy. It is about the energy crisis, the disruption of production and supply chains, the quasi-generalized high inflation, the exacerbated effects of climate change, the pandemic and, last but not least, the war in Ukraine.
- These events and phenomena form a combination of adverse shocks that puts an extraordinary pressure on the economies of EU member states, on public budgets, and severely affects people's livelihoods.
- The change in the relative price of energy has distributional consequences between and within economies, implying a major rise in the cost of living.

- The energy transition in the EU is also difficult because the common energy market has important obstacles. Nor is a distinction often made, including in our country, between deregulation and liberalization.
- The economies of EU countries present specific features of quasi-war conditions, which materialize in more expensive access to resources, rationing, exhortations addressed to the population and companies to reduce energy consumption, mobilization of resources and reorientation towards priority uses through direct intervention, etc.
- Inflation, which has risen to levels not seen for many years, drastically amputates the purchasing power and savings reserves of citizens. High inflation, even if falling, is also forecast for 2023.
- The tightening of monetary policies in the US and other developed countries, through effects on international financial markets, can cause major trouble in emerging economies that have large internal and, above all, external imbalances.
- Not infrequently, the decisions are for damage limitation, for choosing between options, all with important imperfections. A lucid approach is to try to share the burden of shocks in society as fairly as possible.
- In a world characterized by a new "cold war" and de-globalization (regionalization of economic and commercial ties), public budgets must be more robust, as must be the budgets of private companies. This target will be increasingly difficult to achieve as demands induced by extraordinary challenges can generate deeper deficits, when public and private debts exceed sustainable levels.
- A particular vulnerability of Romania is the external balance, where this year the current account deficit will exceed 7% of GDP (7% was also in 2021), and the degree of coverage by non-generating debt flows will probably be below 50%.
- Romania has been in the excessive deficit procedure since the beginning of 2020. It has to achieve fiscal consolidation in a very unfavorable international environment, when its fiscal revenues (including contributions) are among the lowest in the EU – about 27% of GDP compared to average of about 41% of GDP in the EU. Its tax revenues must increase substantially, a leitmotif of FC documents in recent years.
- The very low level of fiscal/budgetary revenues is unacceptable in relation to Romania's current and future needs. And it is hard to imagine that we could achieve fiscal consolidation through inflation alone. At the same time, there is a need for a more judicious use of public money, a restructuring of the administrative apparatus, and an increase in the efficiency of budget expenditures.
- The latest NCSF forecast – from July 2022 – compared to the previous ones, especially the one that underpins the 2022 budget – from November 15, 2021 – envisages a real economic growth of 3.5%, only slightly more reduced compared to the one that underpinned the draft budget – of 4.6%. This anticipated dynamic is congruent with the latest economic data, especially GDP dynamics in the first quarter of the current year, and although it looks like a negative revision – which, caeteris paribus, reduces

nominal GDP dynamics – it is overcompensated by a much higher level of the deflator GDP in the latest forecast compared to the one related to the draft state budget for 2022.

- The dynamics of the national economy is also illustrated by the size of the rapidly growing external imbalances.
- Looking at this economic framework, there are indicators that seem to show that in the second part of the year the dynamics of the economy will be diminished in relation to the previous one.
- The budget execution in the first 6 months of 2022 recorded a deficit level of 1.7% of GDP, this being largely influenced by the above-expected dynamics of nominal GDP, which is likely to lead to an important revenue surplus, as well as the additional revenues from the surcharge on electricity and natural gas producers. The nominal GDP level estimated for the year 2022 is about 4.2% higher than the forecast at the time of drafting the budget, the increase being determined by the revision of the GDP deflator from 5.8% to 12.2%, partially counterbalanced by the downward revision of real GDP dynamics from 4.6% to 3.5%.
- The draft of the first budget revision foresees a substantial nominal increase – unprecedented in the history of the revisions evaluated by the FC from 2010 to the present – both in revenues (+31.7 billion lei, representing +7.2%), and in total budget expenditures (+34.9 billion lei, representing +6.8%), the GCB deficit being 3.2 billion lei above the initial target. Expressed as a percentage of GDP, the projected level of the GCB deficit is 5.84% of GDP, identical to that of the initial budget construction, against the background of the nominal GDP projection increase of 55.2 billion lei.
- Essentially, the large-scale review of budget revenues has two main sources:
  - the upward revision of nominal GDP dynamics (on the background of high inflation, the projection of the GDP deflator being increased from 5.8% to 12.2%);
  - the additional receipts from the overtaking of electricity and natural gas producers.
- On the side of budget revenues, FC considers as probable the manifestation of a revenue gap compared to the targets assumed in the budget revision project of about 9 billion lei, representing about 0.66% of GDP.
- And on the budget expenditure side, there is a proportional increase, compared to the parameters approved by the draft budget, mainly determined by the addition of social assistance expenditures, other transfers and interest. On the budget expenditure side, FC sees an under-dimensioning of 6.2 billion lei, i.e. 0.45% of GDP.
- Analyzing the changes made by the budget revision project at the level of the main aggregates of revenues and expenditures, the FC assesses that the plausible budget deficit to be reached, in the cash methodology, would be approx. 7% of GDP (compared to 5.84% of GDP in the rectified budget projection), but it must be said that this deficit considers revenues obtained from surcharges of over 12.8 billion lei and

total expenses to energy suppliers of approximately 7.4 billion lei (as provided in the amendment).

- Postponing some payments to 2023 widens the gap between the cash deficit and the ESA deficit in 2022.
- If there is a significant under-dimensioning of the impact of energy compensation scheme spending, which is highly likely, the deficit would inevitably increase considerably. And unfavorable price developments in the markets will put additional pressure on the budget.
- This undersizing of energy compensation scheme spending creates a major risk for the budget and fiscal consolidation.
- As emphasized in other documents of the Fiscal Council, European resources from NRRP (National Recovery and Resilience Plan) and MFF (Multiannual Financial Framework) represent the only counter-cyclical force that can counteract the contractionary effects of fiscal consolidation. The absorption in a large proportion of these financial resources, both non-reimbursable and reimbursable, is vital for Romania, considering the state of the public budget and the vulnerabilities of the external balance, the extremely unfavorable international environment.

The opinions and recommendations formulated above by the FC were approved by the Chairman of the Fiscal Council, according to the provisions of art. 56, para (2), letter d) of Law no. 69/2010 republished, following their approval by the Council members, through vote, in the meeting of August 17, 2022.

August 17, 2022

Chairman of the Fiscal Council

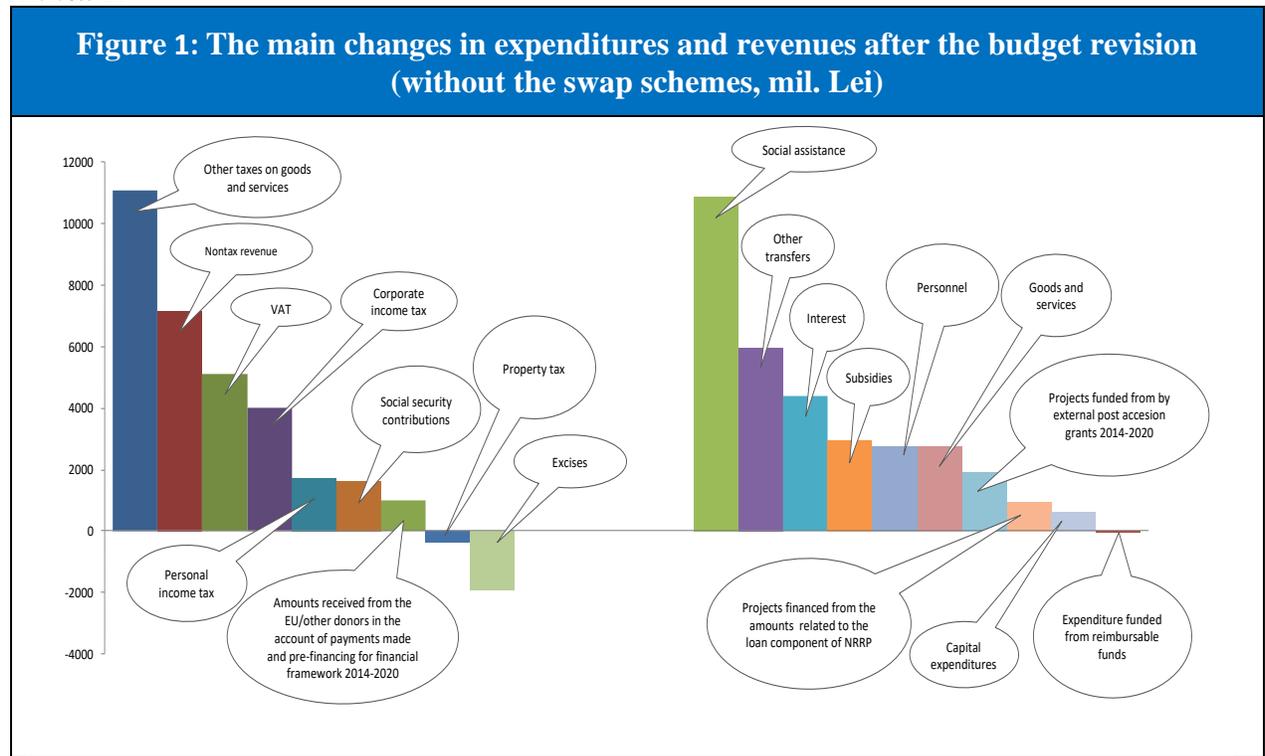
Professor Daniel Dăianu

ANNEX I - Budget revision vs. Initial budget	Initial budget 2022	Swap program 2022	Initial Budget 2022	First Budget Revision (R1) 2022	Swap program R1	First Budget Revision 2022	R1 - Initial Budget 2022	R1 - Initial Budget 2022	R1 2022/Budget Execution 2021
			Without swap		Without swap		With swap	Without swap	With swap
	1	2	3=1-2	4	5	6=4-5	7=4-1	8=6-3	9
<b>TOTAL REVENUE</b>	<b>439.985,9</b>	<b>850,0</b>	<b>439.135,9</b>	<b>471.735,6</b>	<b>1.009,0</b>	<b>470.726,6</b>	<b>31.749,7</b>	<b>31.590,7</b>	<b>24,3%</b>
<b>Current revenue</b>	<b>380.118,5</b>	<b>850,0</b>	<b>379.268,5</b>	<b>410.304,9</b>	<b>1.009,0</b>	<b>409.295,9</b>	<b>30.186,4</b>	<b>30.027,4</b>	<b>20,8%</b>
<b>Tax revenue</b>	<b>210.917,4</b>	<b>250,0</b>	<b>210.667,4</b>	<b>232.406,0</b>	<b>509,0</b>	<b>231.897,0</b>	<b>21.488,6</b>	<b>21.229,6</b>	<b>24,9%</b>
<b>Taxes on profit, wages, income and capital gains</b>	<b>57.603,1</b>	<b>129,0</b>	<b>57.474,1</b>	<b>63.357,8</b>	<b>0,0</b>	<b>63.357,8</b>	<b>5.754,7</b>	<b>5.883,7</b>	<b>21,6%</b>
Corporate income tax	21.581,8	9,0	21.572,8	25.591,2	0,0	25.591,2	4.009,3	4.018,3	27,7%
Personal income tax	31.498,9	120,0	31.378,9	33.118,5	0,0	33.118,5	1.619,6	1.739,6	18,2%
Other taxes on income, profit and capital gains	4.522,4	0,0	4.522,4	4.648,1	0,0	4.648,1	125,7	125,7	14,6%
<b>Property tax</b>	<b>7.467,7</b>	<b>0,0</b>	<b>7.467,7</b>	<b>7.085,8</b>	<b>0,0</b>	<b>7.085,8</b>	<b>-381,9</b>	<b>-381,9</b>	<b>8,2%</b>
<b>Taxes on goods and services</b>	<b>143.059,4</b>	<b>121,0</b>	<b>142.938,4</b>	<b>158.464,9</b>	<b>509,0</b>	<b>157.955,9</b>	<b>15.405,5</b>	<b>15.017,5</b>	<b>27,0%</b>
VAT	91.692,5	84,0	91.608,5	97.233,9	509,0	96.724,9	5.541,4	5.116,4	22,5%
Excises	38.416,8	37,0	38.379,8	36.445,9	0,0	36.445,9	-1.970,9	-1.933,9	5,7%
Other taxes on goods and services	5.088,1	0,0	5.088,1	16.195,5	0,0	16.195,5	11.107,4	11.107,4	195,4%
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	7.862,0	0,0	7.862,0	8.589,6	0,0	8.589,6	727,5	727,5	56,7%
<b>Taxes on foreign trade and international transactions (customs duty)</b>	<b>1.678,1</b>	<b>0,0</b>	<b>1.678,1</b>	<b>2.125,1</b>	<b>0,0</b>	<b>2.125,1</b>	<b>447,0</b>	<b>447,0</b>	<b>39,2%</b>
<b>Other tax revenue</b>	<b>1.109,1</b>	<b>0,0</b>	<b>1.109,1</b>	<b>1.372,4</b>	<b>0,0</b>	<b>1.372,4</b>	<b>263,3</b>	<b>263,3</b>	<b>23,4%</b>
<b>Social security contributions</b>	<b>140.088,5</b>	<b>557,0</b>	<b>139.531,5</b>	<b>141.660,7</b>	<b>500,0</b>	<b>141.160,7</b>	<b>1.572,2</b>	<b>1.629,2</b>	<b>11,1%</b>
<b>Nontax revenue</b>	<b>29.112,6</b>	<b>43,0</b>	<b>29.069,6</b>	<b>36.238,2</b>	<b>0,0</b>	<b>36.238,2</b>	<b>7.125,6</b>	<b>7.168,6</b>	<b>38,6%</b>
<b>Capital revenue</b>	<b>867,9</b>	<b>0,0</b>	<b>867,9</b>	<b>1.306,6</b>	<b>0,0</b>	<b>1.306,6</b>	<b>438,8</b>	<b>438,8</b>	<b>-11,3%</b>
<b>Grants</b>	<b>8,7</b>	<b>0,0</b>	<b>8,7</b>	<b>37,4</b>	<b>0,0</b>	<b>37,4</b>	<b>28,8</b>	<b>28,8</b>	<b>1058,8%</b>
<b>Amounts received from the EU for payments made and prefinancing</b>	<b>5.000,1</b>	<b>0,0</b>	<b>5.000,1</b>	<b>5.014,2</b>	<b>0,0</b>	<b>5.014,2</b>	<b>14,2</b>	<b>14,2</b>	<b>22038,7%</b>
<b>Other amounts received from the EU for operational Programmes funded under the convergence objective</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>-100,0%</b>

Amounts received from the EU/other donors in the account of payments made and pre-financing for financial framework 2014-2020	45.113,4	0,0	45.113,4	46.133,4	0,0	46.133,4	1.020,0	1.020,0	21,0%
Amounts related to the non-reimbursable financial assistance allocated to NRRP	8.877,4	0,0	8.877,4	8.939,1	0,0	8.939,1	61,6	61,6	0,0%
<b>TOTAL EXPENDITURE</b>	<b>516.968,9</b>	<b>850,0</b>	<b>516.118,9</b>	<b>551.889,7</b>	<b>1.009,0</b>	<b>550.880,7</b>	<b>34.920,7</b>	<b>34.761,7</b>	<b>20,1%</b>
Current expenditure	478.247,5	850,0	477.397,5	512.028,6	500,0	511.528,6	33.781,1	34.131,1	19,8%
Personnel	115.407,0	0,0	115.407,0	118.198,4	0,0	118.198,4	2.791,4	2.791,4	5,6%
Goods and services	66.573,8	0,0	66.573,8	69.845,8	500,0	69.345,8	3.272,0	2.772,0	9,1%
Interest	19.938,2	0,0	19.938,2	24.325,3	0,0	24.325,3	4.387,2	4.387,2	35,3%
Subsidies	12.646,5	0,0	12.646,5	15.589,1	0,0	15.589,1	2.942,6	2.942,6	80,3%
Total Transfers	261.763,3	850,0	260.913,3	282.014,9	0,0	282.014,9	20.251,7	21.101,7	25,8%
Transfers for public entities	2.583,3	850,0	1.733,3	2.243,3	0,0	2.243,3	-340,0	510,0	37,0%
Other transfers	24.308,7	0,0	24.308,7	30.301,1	0,0	30.301,1	5.992,3	5.992,3	19,1%
Projects funded by external post accession grants	5.204,1	0,0	5.204,1	5.329,1	0,0	5.329,1	125,1	125,1	2708,3%
Social assistance	160.401,0	0,0	160.401,0	171.288,6	0,0	171.288,6	10.887,6	10.887,6	16,3%
Projects funded by external post accession grants 2014-2020	50.577,4	0,0	50.577,4	52.480,0	0,0	52.480,0	1.902,6	1.902,6	26,8%
Other expenditure	8.127,8	0,0	8.127,8	8.738,4	0,0	8.738,4	610,5	610,5	5,0%
Projects with financing from the amounts representing the non-reimbursable financial assistance related to NRRP	10.238,8	0,0	10.238,8	10.341,5	0,0	10.341,5	102,7	102,7	0,0%
Projects financed from the amounts related to the loan component of NRRP	322,0	0,0	322,0	1.292,9	0,0	1.292,9	970,9	970,9	0,0%
Reserve funds	1.249,0	0,0	1.249,0	1.447,2	0,0	1.447,2	198,2	198,2	-
Expenditure funded from reimbursable funds	669,8	0,0	669,8	607,9	0,0	607,9	-61,9	-61,9	-11,2%
Capital expenditures	38.721,4	0,0	38.721,4	39.861,1	509,0	39.352,1	1.139,7	630,7	17,8%
<b>SURPLUS (+) / DEFICIT (-)</b>	<b>-76.983,0</b>	<b>0,0</b>	<b>-76.983,0</b>	<b>-80.154,0</b>	<b>0,0</b>	<b>-80.154,0</b>	<b>-3.171,0</b>	<b>-3.171,0</b>	<b>0,2%</b>

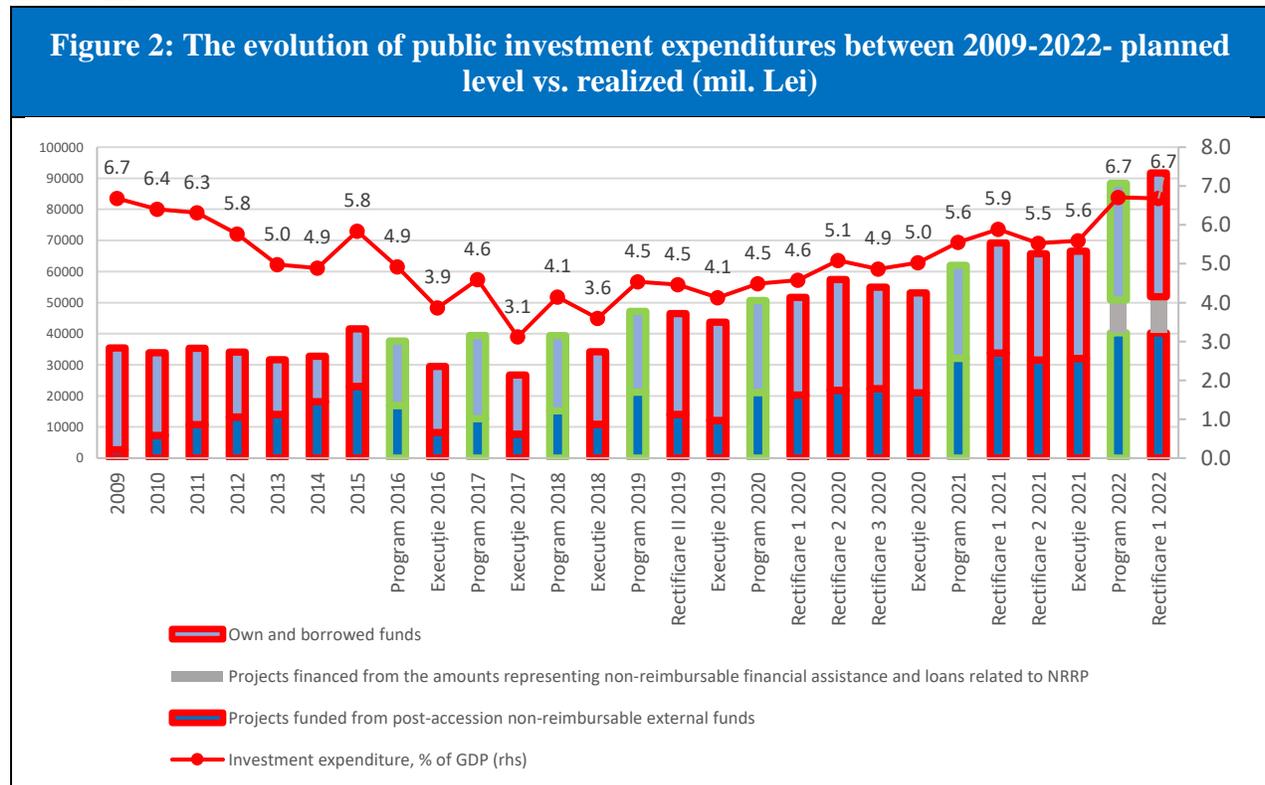
Source: MF, FC's calculations

**Annex II**



Source: MF, FC's calculations

**Annex III**



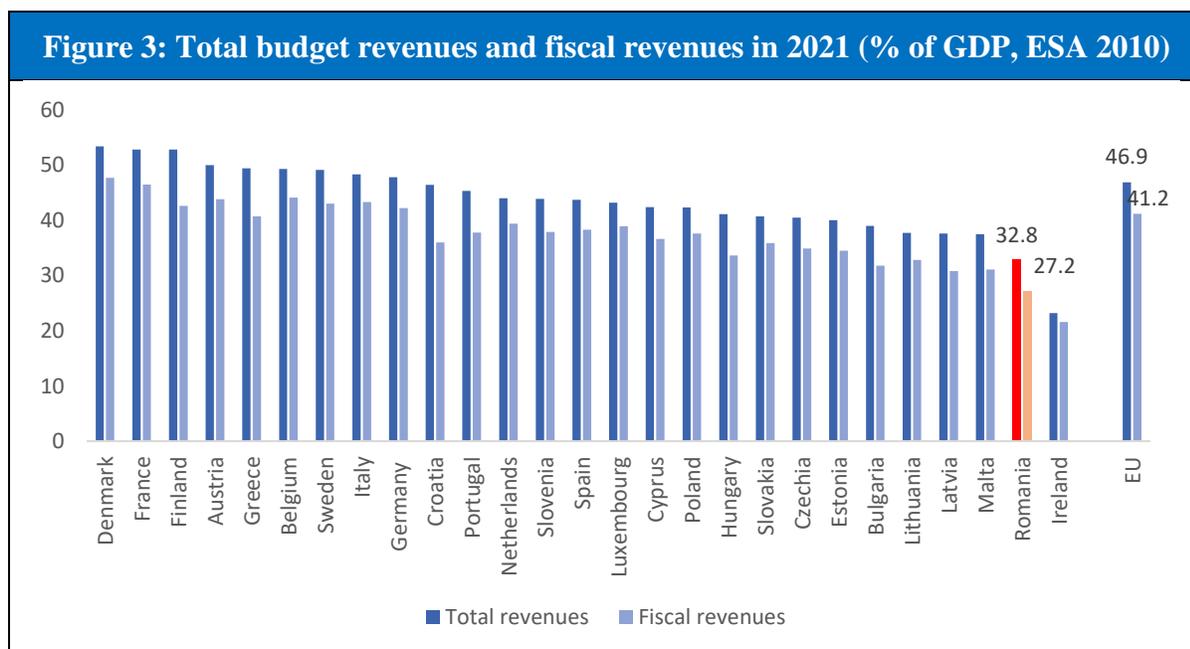
Source: MF, FC's calculations

## Annex IV

EU funds	Initial schedule 2022 (mil lei)			Updated schedule 2022 (mil.lei)			R I 2022 (mil.lei)		
	Structural	Agriculture	Amounts according to art. 10 letter a) of GEO nr. 40/2015	Structural	Agriculture	Amounts according to art. 10 letter a) of GEO nr. 40/2015	Structural	Agriculture	Amounts according to art. 10 letter a) of GEO nr. 40/2015
EU funds inflows	24.252,2	18.255,3	2.605,9	24.764,0	16.292,7	4.272,0	23.285,0	16.292,7	6.555,7
EU funds expenditure	37.596,7	18.255,3	2.605,9	37.804,4	16.292,7	4.272,0	37.051,9	16.292,7	6.555,7
National cofinancing and ineligible expenses	13.344,5	0,0	0,0	13.040,4	0,0	0,0	13.766,9	0,0	0,0

Source: MF, FC's calculations

## Annex V



Source: Eurostat; Fiscal revenues include social security contributions