Fiscal Council of Romania

Fiscal Council's Opinion
on the Draft Law on Certain Fiscal-Budgetary Measures

Summary: A self-inflicted budget crisis!

The very serious budget situation and the risk of a downgrade

- Romania is one of the eight EU member states currently subject to the excessive deficit procedure (EDP), holding the highest budgetary imbalance. It is a positive development that an agreement was reached with the European Commission for the macroeconomic adjustment (of the budget deficit) to be spread over several years, considering the reforms involved and the magnitude of the correction – from over 9% of GDP, taking into account the full impact of the pension recalculation, to below 3% of GDP. In November 2024, the EU Council approved Romania's National medium-term fiscal-structural plan (MTP).

- At the beginning of 2020, Romania was the only EU member state under the excessive deficit procedure, with a structural deficit of around 4.5% of GDP and a large primary deficit.

- Election years cannot justify major imprudence in the management of public finances. The current major budgetary issue, which is also one of balance of payments, as well of credibility, must be addressed in a deteriorating European and international context. The domestic context is also highly tense.

- The budget deficit reached 9.3% of GDP (ESA methodology) (or 8.65% in cash terms) in 2024, the highest in the EU, exceeding even the level recorded during the pandemic year (9.2%). **The deficit deepened primarily due to an increase in permanent expenditures.**

- The budget deficit is accompanied by a current account deficit, which in 2024 exceeded 8% of GDP – the highest in the region – and is financed predominantly through borrowing.

- **In the absence of a credible correction package with upfront measures, the risk of a downgrade is very high.**

- We are forced by circumstances to be procyclical (when the economy slows down), because there have been many mistakes in fiscal policy in recent years (through procyclicality when the economy was recovering after the pandemic and the energy crisis).
- **The public debate is full of confusion, ideological biases, and fundamentalisms. An example is the claim that budget adjustment can only be done on the expenditure side.**
- There is an additional burden from the increase in military expenditures. Reducing tax evasion can help in this regard, considering the VAT collection gap of approximately 30%.
- **The 2025-2026 budget correction package can prevent Romania's sovereign risk downgrade.**

There is no alternative to a severe correction

- **The optimality of the examined correction package is difficult to assess, especially since distributional aspects (including equity) and second-round effects come into play.**
- **The budget correction, which means a reduction in domestic absorption (affecting personal incomes and company revenues), is the price we must pay to ensure public debt sustainability and avoid an even more severe correction.**
- In Romanian society, each social or interest group seeks to minimize its contribution to the adjustment effort. What matters is to avoid deadlocks and social disorder.
- **Even if we consider that the real GDP growth rate could be lower – under the implementation of the fiscal adjustment package –, the evolution of the GDP deflator (and the inflation rate) in the NCSP projection can offset such a trend, given that what matters for the fiscal sector are not the real changes in variables, but the nominal changes (in tax bases).**
- The substantial fiscal adjustment package will have a significant effect in reducing the external imbalance.
- **The analysis of budget execution for the first five months of 2025 is likely to worsen the Fiscal Council's assessment from the time the budget draft was adopted, which projected a cash deficit of around 7.7% of GDP. Thus, in the absence of adopting corrective measures for the budget deficit, the dynamics of the main revenue and expenditure categories in the first part of 2025 are consistent with a cash budget deficit exceeding 8.5% of GDP.**

- **The Fiscal Council considers that adopting a consistent package of measures to correct the budget imbalance is an absolute urgency. In the absence of a credible and firm package, the risk of blocked access to financing and refinancing becomes imminent.**

Review of measures and their impact on the budget deficit

- **This analysis concerns only the draft law on certain fiscal-budgetary measures, published for public transparency on July 3, 2025. In addition to this draft, two more packages targeting public expenditures will follow.**

- **In 2025, the measures provided by the draft law on budget correction could have a positive impact on budget revenues, in a prudent estimate, of about 0.5% of GDP.**

- **The Ministry of Finance estimates the effect of expenditure reduction measures at around 0.1% of GDP in 2025, assuming no reduction in public investments.**

- **In 2026, the positive impact of the measures proposed by the draft law on the revenue side, projected under a no-policy-change scenario, is about 1.75% of GDP. This figure aligns with the recommendation of the EU Council from June 23, 2025, to increase budget revenues by 1.7% of GDP.**

- **In addition to the measures included in this package, considering the commitments assumed under the NRRP (National Recovery and Resilience Plan) and the MTP, it is likely that in 2026 there will also be a revision of the property tax calculation method and the introduction of an environmental tax on means of transport. Both measures would have an additional positive effect on the budget revenue trajectory.**

- **In 2026, the impact of expenditure adjustment measures, projected under a no-policy-change scenario, is about 1.6% of GDP.**

- **In addition to the measures included in this draft law, it is likely that the next two announced government packages will include further measures to improve the efficiency of public sector spending and to prioritize investment projects.** Also, the renegotiation of the NRRP may lead to shifting some projects, currently financed through the loan component of the NRRP, towards the grant component or multiannual European funds. These measures would, in turn, reduce budgetary expenditures.

- **The draft law indicates a budgetary impact of 0.6% of GDP in 2025 and 3.35% of GDP in 2026, creating the premises for reducing the budget deficit below 8% of GDP in 2025 and for meeting the budget deficit target in 2026.**

- **For 2025, the reduction/prioritization of some public investment expenditures (which would be included in the upcoming packages) would bring the budget deficit to around 7.5% of GDP.**

- **The deficit correction measures must be included in the budget revision project and serve as the basis for the new budget deficit trajectory.**

- **The Fiscal Council's analysis considers first-round effects, although there are also second-round effects related to GDP dynamics in connection with the adopted budget deficit correction measures. The second-round effects cannot outweigh the first-round effects and cannot decisively erode the positive impact of these measures on the budget deficit in 2025 and 2026.**

- At the end of May 2025, according to Ministry of Finance data, **the effective absorption rate of Structural and Cohesion Funds from the 2021-2027 Multiannual Financial Framework (excluding advances) was only 5.2%**[1], an extremely low level for the midpoint of the financial exercise, making it difficult to catch up on delays, even though Romania will continue to benefit from the n+3 rule.

- The implementation of the reform and investment measures outlined in the NRRP is facing major difficulties and significant delays, given that all milestones and targets, including related payment requests, must be completed by August 2026. Currently, Romanian authorities are negotiating with the European Commission a revision of the NRRP, aiming for full absorption of non-reimbursable funds, simplification of targets and milestones, maintaining mature projects with a low risk of implementation by August 2026, rescheduling payment requests, with the fourth request planned to be submitted this fall and reimbursed by the end of the year at the latest.

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[1] https://mfinante.gov.ro/static/10/Mfp/buget/sitebuget/BFN2025_05_31.pdf