Fiscal Council of Romania

Fiscal Council's Opinion on the State Budget Law, the Social Security Budget Law for 2021 and the 2021-2023 Fiscal Strategy

Summary

- The economic shock of the Pandemic is stronger than the one caused by the Great Recession. The Great Lockdown led to a dramatic, double-digit decline in GDP in most European Union (EU) countries in the second quarter of 2020. The third quarter saw a strong recovery in economic activity. For the whole year 2020, the economic decline at EU level is estimated by the EC at about 6.3% of GDP. Also, at EU level, the recovery of economic activity is forecasted at 3.7% in 2021.
- The economic decline caused by the Pandemic in Romania was of 3.9% of GDP, while the GDP growth in 2021 is forecasted by NCSP at 4.3%. Given the uncertainties created by the persistence of the Pandemic, FC advances a range of positive GDP evolution between 4-5% for 2021.
- Measures to support the economy in the year of the Pandemic were constrained by the size of the structural deficit of the public budget, of over 5% of potential GDP in 2019.
- Although fiscal rules were suspended in the EU in 2020 with an extension of the derogation in 2021, a macroeconomic correction was inevitable in Romania to control deficits in the coming years. From this point of view, the construction of the budget for 2021, which targets a cash deficit of 7.16% of GDP, signals a change of the fiscal/budgetary policy. It is true that in the 2021-2022 period the budgetary policy continues to be pro-cyclical in relation to the output gap of the economy (distance from potential GDP), but this situation is inevitable given the need to limit deficits. In the 2021-2024 period, according to MF documents, a correction of deficits is projected (cash, ESA, structural) and another philosophy of building the public budget is implemented with the perspective of public finance sustainability, avoiding major internal and external imbalances.
- The gradual correction of the budget deficit corresponds to a rational attitude, which allows the consolidation of the economic recovery that was initiated at the end of 2020. The gradual correction of the budget deficit was supported by the FC in its analyzes and opinions.

- The relatively small step of reducing the budget deficit according to the European methodology in 2021, justified by the fragility of the economy, must be accelerated starting with 2022, given that the gap towards the 3% ceiling is high.
- Regarding the evolution of the main macroeconomic variables, real GDP is expected to accelerate significantly, over the entire forecasting interval, according to NCSP projections. It outlines a dynamic of macroeconomic variables - relevant for the fiscal-budgetary projection - excessively favorable to fiscal-budgetary consolidation. Hence the need for alternative scenarios as well as back-up measures to help macroeconomic correction, if adverse shocks occur.
- From the point of view of the structural deficit, Romania registered the highest level in the EU even before the occurrence of the COVID-19 pandemic. As a result of fiscal-budgetary developments in 2020, the structural deficit advanced by about 2.5 pp of potential GDP.
- An important factor that has determined the upward evolution of the structural deficit is represented by the strong increase in personnel and social assistance expenditures in recent years. In 2020, a peak was reached in this respect, with personnel and social assistance expenditures representing 94.3% of tax revenues (including social security contributions) and 23.9% of GDP, respectively. This situation is not sustainable as it is located at the level of permanent expenditures.
- The fragility of the public finance position at the end of 2020 is also highlighted by the low level of tax revenues, including social security contributions (25.3% of GDP), and budget revenues (31% of GDP), these values being among the lowest recorded in the EU.
- FC estimates that budget revenues according to the ESA 2010 methodology were lower in 2020 compared to MF estimates by about 0.3 pp of GDP, the deficit FC estimated for the previous year being 9.4% of GDP (compared to 9.1% according to MF). Thus, the starting point of the public finances position, according to the European methodology, from the FC evaluation is different compared to that of MF: -9.4% compared to -9.1% of GDP.
- The budget construction for 2021 envisages a deficit target of 7.16% according to the cash methodology, representing a decrease of 2.63 pp of GDP compared to the level of 2020. The corresponding level of the deficit target for 2021 according to ESA 2010 is 8.23% of GDP, the reduction of the budget deficit in 2021 compared to the estimated level of MF for the previous year being 0.87 pp of GDP.
- It should be noted that the reduction of the cash deficit in 2021 compared to 2020 is significantly supported by two exceptional elements, namely the amounts expected to be collected in 2021 from the budget obligations for 2020 postponed by economic agents and expected amounts from renting in 2021 the 5G frequency bands. These elements justify a significant reduction in the cash deficit in 2021 compared to 2020 - but do not represent structural adjustment measures - while the budget balance according to ESA 2010 improves significantly less than according to the cash methodology.

- The FC does not have major reservations about the proposed level of expenditure aggregates, but considers that the targets, although feasible, involve strict control of expenditures.
- Investment expenditures represented in 2020 the maximum of the last 5 years, with a percentage of 5.1% of GDP and are forecasted to increase further to 5.5% of GDP in 2021, simultaneously with a change in structure in order to increase the share of expenditures related to projects financed from non-reimbursable external funds at about 2.9% compared to 2.0% in 2020.
- FC considers that the budget deficit target for 2021 is feasible, both according to the cash and European methodologies.
- FC appreciates that the eventual materialization of additional revenues should be used to reduce the budget deficit, facilitating the consolidation effort in the coming years.
- FC reiterates that the fiscal consolidation process needs to consider a restructuring of budgetary expenditures, but it is absolutely necessary to increase fiscal revenues in order to strengthen the robustness of the public budget given current acute needs, including in the field of public health and public education, and future pressures from climate change and other unconventional threats. From this perspective, it is worrying that, according to FS, budget revenues are projected to remain at 31% of GDP by the end of 2023.
- The reduction of the budget deficit according to the national methodology in the 2022-2024 period by 4.4 pp of GDP (from 7.2% to 2.9%) is forecasted by MF to be achieved almost exclusively through budget expenditures. Specifically, most of the adjustment is based on a reduction in the share of personnel costs (by 1.9 pp of GDP), goods and services (by 0.8 pp of GDP) and social assistance (by 1.3 pp of GDP).
- In the FC's opinion, an adjustment of 4 pp of GDP of the budget deficit on account of the three categories of expenditures mentioned above is not realistic. The FC considers that an adjustment made only on the expenditure side is very difficult and it is unlikely that the reduction of the budget deficit in this way will exceed 2.5 pp of GDP.
- It is difficult to imagine achieving budgetary consolidation during the 2021-2024 period in the absence of a significant increase in budget revenues. This could come from: improving collection efficiency, broadening the tax base, narrowing exceptions and loopholes that negatively deviate taxes paid by some taxpayers from standard rates, firmly combating tax evasion and unfair tax competition and optimizing tax rates.
- FC appreciates that, assuming insufficiently clear and concrete fiscal-budgetary policies, the risk balance is tilted in the direction of registering substantially higher deficits than those anticipated by the fiscal/budgetary projection for the 2022-2024 period.
- Romania is facing a historic opportunity, with allocations of 31.35 billion euros under the cohesion policy related to the EU multiannual financial framework for the 2021-2027

period, supplemented by 30.4 billion euros (13.7 billion euros in grants and 16.6 billion euros in the form of loans) through the Recovery and Resilience Mechanism (RRM). Romania's chance consists in absorbing these funds as much as possible, leading, on the side of macroeconomic stabilization, to the amplification of the contribution of the investment factor to the increase of potential and real GDP and to the mitigation of the contractionary impact of the macro correction, and on the real economy side to the implementation of structural reforms, directly and indirectly supporting the process of fiscal consolidation in a period of constrained budgetary expenditures for this purpose.

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The Fiscal Council (FC) received in electronic form on February 11th, 2021 from the Ministry of Finance (MF) the addresses no. 462627 and 462628 dated February 10th, 2021, by which it is requested, based on art. 53, para. 2 of the Fiscal-Responsibility Law no. 69/2010 (FRL) republished, to formulate its opinion on the draft Law for the approval of the ceilings for some indicators specified in the fiscal-budgetary framework for 2021, on the 2021-2023 Fiscal Strategy (FS) and the Explanatory note related to it, on the report concerning the macroeconomic situation for 2020 and its projection for the 2022-2024 period, on the draft State Budget Law for 2021, the draft Social Security Budget Law for 2021 and the Explanatory note related to it.

1. General considerations

The economic recovery is taking place in the world; a dynamic of economic recovery has been initiated, even if there are great uncertainties and major differences between sectors. In the EU, the economies will recover overall by about 3.7%, the level of 2019 being expected to be reached in 2022 when the increase would be 3.9% - according to the data from the European Commission's 2021 Winter Forecast.

In Romania, the Government forecasts an increase of 4.3% in 2021, a figure that is achievable, but which depends on the evolution of the pandemic.

Vaccines and mass vaccination are the big news of 2021, as they allow better protection of the population. But the pandemic persists this year as well and there are fears about new strains. It is essential that citizens continue to respect the rules of individual and collective protection.

The economies are in a period of recovery, convalescence and governments and central banks must continue to apply support measures in 2021. However, it must be said that the economies are also in a period of restructuring that will last several years because it also takes into account the impact of new technologies, of the need to take into account climate change.

As stated by EC, ECB, IMF and government officials, the economic recovery is expected to be more visible in the second half of the year. For the Romanian economy, it matters a lot how the main economies in the EU recover, how it is stopped the dismantling of the international economic system based on rules.

Low interest rates in the world help the economic recovery. But these low interest rates do not mean neglecting public deficits and debt, especially in emerging economies that also pay attention to the evolution of the exchange rate and of the external deficits.

In the EU, European funds from the Next Generation EU (NGEU) can make a big difference, help the transformation of economies ("greening" and digitalization, support necessary reforms), preparing them to deal with climate change. NGEU is also a form of debt pooling and a possible macro-stabilization tool at EU level; the proof is that most of the money from the NGEU goes to the most vulnerable economies (Italy, Spain, Portugal, emerging economies, including Romania). It should be noted that "greening" (respecting ecological imperatives and objectives) and digitalization are major objectives of the EU.

For Romania, overcoming the development gap, as well as a transition process to new energy sources are vital, especially taking into account the need for macroeconomic correction (of the public budget) in the 2021-2024 period and for the creation of the premises for entering ERM2, and then for joining the euro area.

The Biden effect can help world trade and strengthen economic relations between Europe and the USA.

2. *The macroeconomic framework underlying the 2021 Budget Law and the 2021-2023 Fiscal Strategy*

The current budgetary framework (both in the Budget Law and in the FS) is based on macroeconomic projections, which, in this exercise, are influenced by the impact of the pandemic. The recovery of the economy, which takes place throughout Europe, is forecasted for 2021 in Romania through a real GDP dynamic of 4.3% and a deflator of 2.8%. The increase in the number of employees across the economy is forecasted at 1.6% and the increase in gross earnings at 4.5%.

Macroeconomic data confirmed the recovery, in the third quarter of the previous year (the last for which there is detailed official data), of a significant part of the large-scale contraction in economic activity suffered in the second quarter of 2020, reducing thus, the annual decline to -6%, from -10.3% previously. This recovery, slightly slower than that which would have corresponded to a full recovery of the previous decline, is due, for the most part, to domestic demand - mainly consumption of households, which shows a revival based on purchases of goods and services, an improvement in the labor market situation and a favorable evolution of real disposable income. Another factor that imprints a positive dynamic on domestic demand is the gross formation of fixed capital - both private (in the construction sector for example) and governmental. The attenuation of the influence of these factors with a positive impact is due to developments related to stock changes, general government consumption and, in particular, the negative contribution of net exports, which maintains its direction, albeit at a slight slowdown. The latter factor - the deficit in net exports of goods and services - acts to worsen the current account deficit (which reached about 11 billion euros for 2020, representing about 5% of GDP, growing year on year by 4.8%); the negative influence of net exports combined with a growing deficit of the primary income balance - resulting from the decrease in the flow of reinvested profits. On the contrary, in the sense of reducing the external deficit, but counterbalancing only partially the factors that determined the accentuation of this deficit, acted the increase of the surplus afferent to the secondary incomes.

The analysis of domestic supply, in the context of detailed GDP data for the third quarter of 2020, shows that, apart from agriculture - which had a negative contribution to the economic recovery, all the other sectors supported the economic recovery - the industry and services sector should be mentioned, net taxes on products, but also the construction sector. Thus, the observed recovery of the economy justifies the favorable dynamics of the projection of the main macroeconomic variables for 2021.

It can also be mentioned that the "flash" data on the GDP dynamics for the fourth quarter of 2020, published by the NIS on February 16th this year, indicates a lower economic contraction in 2020, of only 3.9%, compared to that estimated in the draft budget (4.4%). This data constitutes an element that can strengthen the probability of a higher economic growth in 2021 (than that of +4.3% according to the NCSP estimate), however uncertainties remain regarding the structure of this growth as well as, implicitly, on the permanent or temporary character of it.

The real economic growth, anticipated by NCSP at +4.3% in 2021, is in the median area of a variation range between 4.0-5.0%, considered plausible by FC, which takes into account uncertainties related to the evolution of the pandemic and more favorable data for the fourth quarter of 2020. This level of 4.3% is offset, at the level of nominal GDP dynamics, by the slower projection of the dynamics of overall prices in the economy - reflected by the GDP deflator - which is expected to have an advance of 2.8%. These elements outline, for 2021, the projection of a realistic nominal GDP.

Regarding the labor market - which has a substantial influence on the dynamics of the main categories of fiscal-budgetary revenues - FC considers that the projection of the dynamics of the average number of employees and the average gross monthly earnings show a relatively similar compensation, in terms of salary envelope, to the one at the level of nominal GDP. Thus, the average number of employees is expected to increase by 1.3% in 2021, and gross earnings by 4.5%. The possible faster evolution of the first indicator is offset by a possible slower evolution, in reality, of the second, both evolutions being judged on the basis of the FC's expectations in this respect. These corroborated elements outline a macroeconomic picture for 2021, considered plausible by the FC in the light of recent macroeconomic data and in terms of projections of economic institutions specializing in forecasting.

In the 2022-2024 period, which substantiates the trends and evolutions captured in FS, for the 2021-2023 period, the macroeconomic projections of the National Commission for Strategy and Prognosis (NCSP) reveal, in relation to the forecast for 2021, a more pronounced degree of optimism with regard to the main macroeconomic variables. In what concerns the 2022-2024 period, there are several aspects in the construction of the fiscal-budgetary and macroeconomic forecast that need clarification.

Thus, with regard to the evolution of the main macroeconomic variables, real GDP is expected to accelerate significantly, over the entire forecast interval, from an increase of +4.3% in 2021 to +5.0% in 2023, and the GDP deflator follows, a similar evolution, from +2.8% in 2021, to +3.0% in 2023. Regarding these forecasted dynamics it is worth mentioning that, although the deflator is in a range that can be considered probable in the FC's view, they are conjugated with real GDP dynamics located in an upper area of a plausible range of variation, which leads, on the whole, to a relatively high nominal GDP growth rate, over the entire period forecasted by NCSP. To this can be added the observation that these rates of evolution are cumulative over the forecast horizon, the level of nominal GDP in 2024 being, for example, the result of all nominal rates in each year of the expected interval. Thus, possible systematic positive spreads of growth rates are mutually reinforcing leading, in the end, to a higher nominal level of GDP, favorable in terms of the dynamics of fiscal-budgetary variables. But, from the point of view of the probabilities of materialization for such a scenario, the consideration of values located in the upper extremity of plausible intervals of variation at annual level, leads to the generation of a cumulative scenario over the 3 years of the projection with a lower probability of materialization, in relation to, for example, the aggregation of the median scenarios from each year. This observation is valid not only at the level of nominal GDP projection, but also at the level of labor market dynamics, as well as the probability of materialization of its projections, being demonstrated by the rapid dynamics of the number of employees in the economy (accelerating, similar to GDP dynamics, from +1.3% in 2021, to +2.4% in 2023) and the significant advance of gross earnings, which also has an intensifying trajectory (from +4.5% in 2021 to +6.7% in 2023). Together, all these elements outline a dynamic of macroeconomic variables - relevant for the fiscal-budgetary projection - excessively favorable both to fiscal revenues and to relatively high nominal GDP levels, which can accommodate, at the level of the ratio of fiscal-budgetary variables in GDP, their generous dynamics; hence the risks regarding the achievement of the fiscal-budgetary consolidation according to the projections from FS. At the same time, there is a need for alternative scenarios as well as back-up measures to help the macroeconomic correction.

Regarding some debatable correlations within the macroeconomic projection, as well as at the level of its interdependence with the fiscal-budgetary one, we can notice the following:

(i) the economic acceleration of the most significant variables for public sector dynamics (nominal GDP, labor market, etc.) is projected to take place against the background of a large fiscal correction, which, regardless of the measurement method (cash methodology, European methodology, through a way of highlighting the structural deficit or cyclically-adjusted deficit) means a significant compression of aggregate demand, in just a few years, determined by the public sector, of about 7 percentage points of GDP (achieved, according to FS, almost entirely on the budgetary expenditure side). This important and necessary fiscal correction does not seem to have a correspondent at the level of macroeconomic dynamics, which continues on a trajectory that thus appears all the more optimistic. Only a very intense absorption of additional European resources could counterbalance, and this only partially, the contractionary impact of the fiscal-budgetary correction. It should be noted that the optimism at the level of macroeconomic variables is not reflected in an increase in the share of budget revenues in GDP, which, until the end of the FS horizon, remains at a level approximately equal to that reached in 2020; tax revenues (including social security contributions) would be 25.8% of GDP in 2024 compared to 25.9% in 2021;

(ii) the economic acceleration in the NCSP projection could be due to a higher absorption of European funds - all the more so as they are considerably increased by those newly allocated to combat the effects of the pandemic and the economic crisis (Next Generation EU). However, it should be noted that the current budget projections, sent to FC for analysis, include only a small increase in the absorption of European funds (of about 1 pp of GDP in 2021, followed by a gradual return to annual pre-pandemic flows). However, this additional absorption, contained in budgetary documents, is not likely to justify a significant acceleration in the main macroeconomic variables. On the other hand, as stated in the FS (pages 22-23), on the inclusion in a budget revision following the approval of the NRRP - by the European Commission in the immediate future - of a significantly higher absorption of European funds - to support economic activity and structural transformations in the economy - this could be the determining factor of the accelerating trajectory of macroeconomic variables already present in the current fiscal-budgetary strategy.

(iii) The large fiscal correction (made on the expenditure side) can mitigate the increase in the current account deficit. But economic growth driven by the absorption of European resources, by an increase in domestic absorption, based more on investment is in contrast to the dynamics of the current account balance of the balance of payments, which adjusts from a deficit of 5.0% of GDP in 2020, to 4.1 and 3.9% of GDP in 2023 and 2024, respectively. This situation is problematic because:

(iii.a) the adjustment of the current account deficit does not correlate with economic growth which accelerates mainly on the part of domestic absorption/domestic demand, in particular as regards gross fixed capital formation as well as the remuneration of employees in the economy. In addition, this economic growth based heavily on domestic absorption, which could be richer in fiscal revenues (a possible effect of economic growth structure), raises additional questions about fiscal revenues, which remain unchanged in relation to GDP over the projection horizon, and/or on the adjustment of the current account of the balance of payments, emphasizing, at the same time, the optimism of the macroeconomic projection;

(iii.b) the situation in 2020, in which a surplus of savings over domestic investment in the private sector (about 5% of GDP), offset an almost double deficit of the public sector, which led to an external deficit of only 5% of GDP, appears to be a phenomenon that cannot be continuously repeated in the projection interval, because the income flows, at the level of the private sector, that would allow such an evolution/accumulation of net savings will be changing within the macroeconomic forecast. Moreover, this surplus of savings which was located both in cash (an increase of almost 2 pp of GDP in 2020 compared to 2019) and in deposits (approximately +4 pp of GDP in the same period) and which, in the context of a relaxations of restrictions, increased confidence in the economy, implicitly increased internal absorption, reflected in both consumption and investment, all stimulated by the evolution of vaccination, will make this previous positive gap (domestic private savings greater than investment) to be gradually reabsorbed - even partially - over the projection horizon. It should be noted that the current projection of NCSP implicitly contains a widening of this gap each year, with additional savings flows greater than investment leading to smaller external imbalances than those in the public sector. This means that, in the NCSP projection, the correction of the external deficit is based on factors that are not transparent from the set of published indicators.

The elements presented above support the FC's assessment of the particularly favorable macroeconomic evolution programmed in the FS and which thus substantiates a symmetrically favorable evolution of the deficits (cash methodology, European methodology, cyclically-adjusted, structural) relative to GDP.

Regarding the fiscal-budgetary correction, FC notes that it is relatively moderate in 2021 (especially adjusting the forecast of deficits with deferred payments, with other temporary measures as well as adjusting for the impact of the economic cycle) and considerably more pronounced in the 2022-2024 period.

This gradual correction corresponds to a rational attitude of the authorities, which thus allows the consolidation of the economic recovery that was initiated at the end of 2020. For the gradual macroeconomic correction, FC pleaded in its analyzes and opinions. The relatively small step of reducing the budget deficit according to the European methodology in 2021, justified by the fragility of the economy, must be accelerated starting with 2022 given that the gap towards the 3% ceiling is high.

However, at the macroeconomic level, the fiscal consolidation as highlighted by the NCSP projections is accompanied by a problematic external deficit trajectory in terms of its determinants as well as in terms of reabsorbing the temporary savings-investment gaps previously generated. These elements make the macroeconomic projection to incorporate, in the FC's view, significant risks even without considering adverse developments at domestic and/or international level.

In conclusion, for the year 2021 the risks to the macroeconomic scenario are considered by the FC to be balanced, but for the rest of the macroeconomic forecast horizon (2022-2024), these risks tilt towards a less favorable scenario in terms of dynamics of the macroeconomic variables. The economic trajectory assumed in FS requires, according to FC, the elaboration of alternative scenarios and the detailing of back-up measures, as well as the clarification of the ambiguities arising from the assumed economic growth relationship - based on domestic demand - and the dynamics of the external balance as well as with regard to the determinants of the anticipated economic acceleration.

3. The excessive deficit procedure and compliance with fiscal rules stipulated by the FRL

Starting with 2020, Romania is subject to the Excessive Deficit Procedure (EDP) as a result of recording a budget deficit of about 4.4% in 2019, significantly above the 3% ceiling set by the Stability and Growth Pact (SGP). The special circumstances of the COVID-19 pandemic and its severe impact led to the activation of the general derogation clause of the SGP by the EC, whereby the fiscal rules of the European budgetary framework were temporarily suspended in 2020, with an extension in 2021.

In November 2020, the EC updated its position on the fiscal situation in Romania, stating that, for the time being, it cannot take any decision on EDP-related measures, including a credible projection for fiscal policy, given the exceptional uncertainty created by the COVID-19 pandemic. Thus, Romania's budgetary situation, including fiscal risks, is to be reassessed in the spring of 2021, based on the results of the 2020 budget execution, the 2021 budget and the EC Spring Forecast.

In the context in which Romania is under the incidence of EDP, the relevant rule on the budget deficit would be represented by the achievement of the target agreed with the EC within the trajectory of reducing the budget deficit to levels below the 3% ceiling. However, the circumstances caused by the COVID-19 pandemic led to a delay in formalizing this trajectory. The programmatic documents elaborated by MF and subject to FC opinion envisage a reduction by 0.87 pp of GDP of the budget deficit according to the ESA 2010 methodology, in the current year compared to the previous one (to -8.3% of GDP), and the return to budget deficits below the 3% of GDP ceiling by 2024.

Other rules that could be subject to FC evaluation in the context of the analysis of the draft budget for 2021 and the Fiscal Strategy for 2021-2023 are the compliance of budget proposals with the ceilings provided in the Law for approving the ceilings of some indicators specified in the fiscal-budgetary framework for 2021. However, considering that the FS for the 2021-2023 period and the Law for approving the ceilings of some indicators specified in the fiscal-budgetary framework for 2021 were elaborated and sent to FC for analysis simultaneously with the draft budget for 2021, verifying compliance with the established ceilings becomes a purely formal step; obviously there are no inconsistencies between the draft budget and the law on ceilings. However, it must be emphasized that, although the present situation can be justified by the provisions of art. 33 (c) of the FRL (according to which the fiscal-budgetary framework can be revised in case of change of Government), this practice has been perpetuated in recent years (FS being published simultaneously with the draft budget and not in July/August, the deadline provided in the FRL). Under these conditions, monitoring *ex-ante* compliance with fiscal rules on ceilings becomes irrelevant, eroding the role that FS should play in guiding fiscal-budgetary policy in the medium term. In the context of the EDP, which involves a credible multi-year budget deficit reduction plan, the elaboration of the FS for 2022-2024 is desirable to be done within the deadline set by the FRL.

4. The fiscal-budgetary framework - context

The budget execution for 2020 according to the cash methodology recorded a deficit of 9.79% of GDP, higher by about 0.7 pp of GDP than the MF estimate of the third budget revision made in November 2020. This development, in line with FC's expectations, was determined by lower budget revenues by about 1.5% of GDP and lower budget expenditures by about 0.9% of GDP compared to MF estimates. On the revenue side, the main aggregates that recorded a negative deviation from estimates were tax revenues (about -0.8% of GDP, including income from social security contributions), non-tax revenues (-0.12% of GDP), amounts received from the EU (about -0.6%, including the amounts not received from EU grants to reimburse expenditure incurred in the fight against the COVID-19 pandemic). On the expenditure side, there was an under-execution at the level of current expenditure (about 1.15% of GDP, of which 0.5% at the level of projects financed from European funds), to which are added payments made in previous years and recovered in 2020 in the amount of 0.17% of GDP, offset by an above-target level of capital expenditure of 0.4% of GDP. It can be appreciated that, on the side of budget expenditures, the budget execution was more favorable than previous estimates in view of the fact that the under-execution was located at the level of permanent expenditures, while the exceeding amounts were found at the level of some categories with discretionary character, respectively capital expenditures.

As the FC anticipated, in its opinion on the third budget revision of 2020, tax revenues were lower than estimated as a result of the facility to defer the payment of obligations to GCB of economic agents for the period between March and October. It should be noted that the facility had an extended applicability, not being limited to companies whose activity was severely affected by the COVID-19 pandemic. The government offered the possibility to stagger the outstanding tax obligations for 12 months by submitting an application until March 31, 2021 (initially until the end of last year), the facility also involving the payment of an interest of about 3.65% per year.

However, the facility of deferring the payment of obligations to GCB of economic agents - beneficial for companies whose activity has been severely affected by the COVID-19 pandemic - induces a high uncertainty of revenue estimates for 2020 and revenue projections for 2021, assuming at the same time a different accounting treatment in the cash methodology compared to ESA 2010. More precisely, the deferred amounts will appear as revenues related to the year 2020 in the ESA 2010 execution, regardless of when they will be settled, while the cash execution will register these amounts only when they are settled. This results in a higher cash deficit in 2020 corresponding to the deferred amounts, the gap reversing (lower cash deficit) in 2021-2022 as these amounts are recovered. Beyond these methodological clarifications, major uncertainties persist regarding the amount of these budgetary obligations deferred to payment by economic agents, all the more so as companies can submit requests for rescheduling until March 31, 2021, so that the amounts will be known more precisely at that time. Currently, according to the information sent to FC by MF, the deferred amounts considered in the ESA 2010 budget execution as revenues for 2020 are in the amount of 9 billion lei, relying on the recovery of 7.3 billion lei in 2021 and respectively of 1.7 billion lei in 2022. It should be mentioned that this estimate is a key element of the fiscal projection, and a subsequent modification of this estimate has the potential to generate relevant differences from current assessments.

The MF estimate for the 2020 budget deficit according to the ESA 2010 methodology is 9.1%, including at revenues the 9 billion lei obligations to GCB deferred to payment by economic agents and 2.2 billion lei additional revenues compared to the cash execution of VAT on account of accelerated VAT refunds made by the state to get "up to date" with refunds (it is estimated that this amount of 2.2 billion lei will be found in the budget revenues from 2021, decreasing only exceptionally the revenues from 2020). <u>FC agrees with the valuation of 2.2 billion lei in terms of accelerated VAT refunds, but, in terms of budgetary obligations deferred to payment by economic agents, its valuation is different, respectively of about 6.2 billion. lei</u>. This assessment is based on the revenues that would have been obtained in 2020 in the absence of this facility given the currently estimated evolution of the relevant macroeconomic bases. As a consequence, the FC estimates that the budget revenues according to the ESA 2010 methodology were lower in 2020 compared to the MF estimates by about 0.3 pp of GDP, <u>the FC deficit estimate for the previous year being 9.4% of GDP (compared to 9.1% in the MF estimate)</u>. Thus, the starting point regarding the position of public finances, according to the European methodology, from the evaluation of FC is different compared to that of MF: -9.4% compared to -9.1% of GDP.

From the point of view of the structural deficit, Romania registered the highest level in the EU (5.09% of potential GDP in 2019, according to MF estimates) even before the COVID-19 pandemic, which limited the Government's maneuvering space in combating its effects. Based on the fiscal-budgetary developments from 2020, the structural deficit advanced to 7.76% according to the MF, so that, although the budget execution for the previous year includes some one-off elements, most of the budget deficit registered in 2020 is of a structural nature and will manifest itself in the future. An important factor that has determined the upward evolution of the structural deficit is the strong increase in personnel and social assistance expenditures in recent years. In 2020, a peak was reached in this respect, with personnel and social assistance expenditures representing 94.3% of tax revenues (including social security contributions) and 23.9% of GDP, respectively. This situation is not sustainable as it is located at the level of permanent expenditures. At the same time, the fragility of the public finance position at the end of 2020 is also highlighted by the low level of tax revenues, including social security contributions (25.3% of GDP), and budget revenues (31% of GDP), these values being among the lowest recorded in the EU.

FC reiterates that the fiscal consolidation process needs to consider a restructuring of budget expenditures, but it is absolutely necessary to increase fiscal revenues in order to strengthen the robustness of the public budget given current acute needs, including in the field of public health and public education. future pressures from climate change and other unconventional threats.

From this perspective, it is worrying that, according to FS, budget revenues are projected to remain at 31% of GDP by the end of 2023.

4.1 Objectives and targets of the fiscal-budgetary policy for the 2021-2024 period

The budget construction for 2021 envisages a budget deficit target of 7.16% according to the cash methodology, representing a decrease of 2.63 pp of GDP compared to the estimated level for 2020 (9.79% of GDP). The corresponding level of the budget deficit target for 2021 according to ESA 2010 is 8.23% of GDP, the reduction of the budget deficit in 2021 compared to the estimated level of MF for the previous year being 0.87 pp of GDP. This evolution is compatible, according to MF, with a reduction of the structural deficit by 0.34 pp of potential GDP, from 7.76% to 7.42%.

It should be noted that the reduction of the *cash* deficit in 2021 compared to 2020 is significantly supported by two exceptional elements, namely the amounts expected to be collected in 2021 from the budgetary obligations for 2020 deferred by economic agents (assessed by the MF at 7.3 billion lei, although, as will be shown below, the budget projection does not seem to incorporate a significant part of this estimate) and the expected rental in 2021 of the 5G frequency bands for the next 10 years by the mobile phone operators from which budget revenues of about 2.5 billion lei are expected. These elements justify a significant reduction in the cash deficit in 2021 compared to 2020 - but do not represent structural adjustment measures - while the budget balance according to ESA 2010 improves significantly less than according to the cash methodology.

According to the budget construction for 2021, the reduction of the cash deficit of about 2.6 pp compared to the previous year takes place by increasing budget revenues by approximately 1.7% of GDP and decreasing budget expenditures by 0.9% of GDP. In the structure of budget revenues, more significant increases take place at the level of amounts attracted from the EU (+1.02% of GDP). Fiscal revenues and social security contributions increase by 0.66% of GDP, of which 0.23% represent the amounts related to the rental of 5G frequency bands, and the rest denotes the reversal of the negative effect on budget revenues of the measures for deferred payments/accelerated VAT reimbursement during 2020. In the structure of budget expenditures, more significant reductions occur in the case of personnel (-0.76% of GDP), goods and services (-0.48% of GDP), capital (-0.52% of GDP) and social assistance (-0.51% of GDP) expenditures, while increases take place for projects financed from EU funds (+1.01%) and other transfers (+0.32% of GDP, as a result of an increase in Romania's contribution to the EU budget). In essence, in addition to an anticipated acceleration of revenues and expenditures related to European funds, the budget envisages - considering values expressed as a percentage of GDP -, on the revenue side, a slight increase from the reversal of measures with a temporary negative impact on revenues adopted in 2020, and on the expenditure side a reduction in personnel, goods and services and capital expenditures. Besides, the measures to reduce the categories of expenditures mentioned above can be seen as structural measures to reduce the deficit and are the basis for adjusting the deficit according to the European methodology.

The fiscal-budgetary framework for the 2022-2024 period aims to drive the budget deficit at the end of the period, at a level below the 3% ceiling set by the corrective arm of the Stability and Growth Pact, both according to the cash and European methodologies. Specifically, the deficit according to the national methodology is expected to decrease by 1.32 pp of GDP in 2022, by 1.47 pp of GDP in 2023 and by 1.48 pp of GDP in 2024, respectively, to a level of 2.89% of GDP. The deficit according to the ESA 2010 methodology is expected to decrease by 1.87 pp of GDP in 2022, by 1.68 pp of GDP in 2023 and by 1.78 pp of GDP in 2024, respectively, to a level of 2,9% of GDP. In structural terms, according to the MF, the deficit adjustment in the 2022-2024 period represents 4.03 pp of potential GDP, at the end of 2024 the deviation from the medium-term objective - represented by a structural deficit of 1% of potential GDP – being estimated at 2.39 pp.

4.2 Assessment of the 2021 budget construction

A first observation about the draft budget for 2021 is that it indicates a change in the behavior of the strongly expansionary fiscal-budgetary policy from recent years - which has led to growing budget deficits - signaling a change of direction towards a sustainable trajectory of public finances. For the first time in the last 6 years, the budget balance is projected to improve by a significant amount, but the starting point is a very high level of the budget deficit. Given that NCSP estimates the presence of a recessionary gap in the economy (negative output gap) during the 2021-2022 period, fiscal policy will be pro-cyclical - will have a contractionary effect that will be counteracted by the almost organic recovery of the economy and the increase in investments/absorption of European funds. However, given the position of public finances at the end of 2020, such a conduct is necessary to ensure the sustainability of public finances. Once again, the FC emphasizes the sub-optimality of pre-pandemic fiscal-budgetary policies that stimulated the economy when it was already growing above potential, depleting the fiscal space that could have been used in times of recession, such as the current one.

Getting out of the trap of pro-cyclical policies is difficult and lengthy, major challenges being both the resolution of the current sizeable budgetary imbalance, but also the implementation of prudent fiscal-budgetary policies in the next phase of expansion.

A second observation is aimed at reducing uncertainties about the future trajectory of expenditure aggregates that have a large share in the budget - especially those on social assistance - with the new Government signaling a more predictable policy in this regard. Previously, these expenditures represented a major uncertainty for budget constructions in the coming years, with the potential to contribute further and significantly to the deterioration of the budget balance, which is already characterized by a high imbalance. It is worth noting here the intention to return to a rule of increasing the pension point, to an indexation in relation to the inflation rate and the increase of the real wages.

Budget revenues

Budget revenues according to the national methodology are expected to increase in 2021 compared to 2020 in nominal terms by about 13.1%, their share in GDP being expected to increase by 1.7 pp. The amounts from European funds explain about 1 pp from the increase in the share of budget revenues in GDP, while the growth in tax revenues and social security contributions explains about 0.66 pp. While the amounts from EU funds increase naturally in the context of approaching the time limit for financing under the 2014-2020 financial framework (current projections do not yet include the amounts that will be absorbed through the Recovery and Resilience Mechanism), for the projection of tax revenues and social security contributions a more in-depth assessment is required.

Tax revenues and social security contribution are expected to increase by about 10%, a growth rate higher than that of the nominal GDP (7.3%). There is an increase of 0.4 pp of GDP in VAT revenues and 0.23 pp of GDP in revenues from "Taxes on the use of goods, authorization of the use of goods and conducting activities" (justified by the amounts expected to be collected from renting the 5G frequency bands), the other revenues in this category being characterized by relatively small changes in terms of their share in GDP.

As mentioned in the section on the fiscal-budgetary context, the key element of judging the revenue projection is the assessment of the amount of budgetary obligations deferred from payment by economic operators in 2020 and the extent to which these amounts are recovered in 2021. Also, particularly important are the issues related to the assessment of the impact of the accelerated VAT refund that took place at the level of 2020 and the expected improvement of the collection efficiency on the basis of which NAFA anticipates additional revenues in 2021.

Based on the documents published by the MF related to the draft budget for 2021 and the Fiscal Strategy for 2021-2023 and the additional information submitted to the FC at its request, it resulted that the MF considered the following in its revenue projection: obligations deferred from payment in 2020 amounting to 9 billion lei, of which 7.3 billion lei will be recovered in 2021 and the remaining 1.7 billion lei in 2022; additional amounts at the VAT level in 2021 from the improvement of collection efficiency in the amount of about 2.5 billion lei; amounts that diminished the 2020 execution at the level of VAT revenues as a result of accelerated reimbursements to get "up to date" with them and which no longer negatively affects the budget execution starting with 2021, evaluated at 2.2 billion lei.

The FC's assessment of the supplementary amounts considered in the projection of budget revenues from the sources detailed in the previous paragraph is different from that of the MF, as will be detailed below. Moreover, the FC does not identify in the revenue projection related to the draft budget the consideration of these revenues at the declared nominal value.

More precisely, the current FC assessment regarding the budget obligations deferred from payment is of 6.2 billion lei (3.5 billion lei at the level of social security contributions, 2.3 billion lei at the level of VAT, 0.4 billion lei at the level of income tax). This estimate is based on the comparison between the budget revenues that would have existed last year in the absence of this facility considering the evolution of the relevant macroeconomic bases, and assuming no changes in collection efficiency, and the revenues actually recorded in the budget execution for 2020. Based on the MF hypothesis that the deferred amounts will be recovered in 2020 and 2021, it results that from the 6.2 billion lei estimated by the FC about 5 billion lei could be recovered in 2021 and 1.2 billion lei in 2022. It should be noted that, under the conditions of this hypothesis, the revenues for 2021 would include, on the one hand, the 6.2 billion lei which this year are no longer deferred and reflect taxes related to current economic activity and, on the other hand, the 5 billion lei which is recovered on account of the obligations related to the year 2020 deferred from payment. It should also be emphasized that a hypothesis that involves a lower amount of deferred payment obligations implies lower budget revenues for 2020 according to the ESA 2010 methodology with this difference, which is why the FC estimate for the 2020 budget deficit according to this methodology is about 9.4%.

In what concerns the amounts that diminished the 2020 execution at the level of VAT revenues as a result of accelerated reimbursements to get "up to date" with them, the FC’s valuation is close to that of MF and is mainly based on amounts reimbursed in the first part of 2020 which, in the context of the abrupt decline of the economy, supported the liquidity of economic agents. In addition, the timely repayment of amounts owed by the state to firms is a natural matter, provided that the procedures for verifying the amounts requested for repayment are strictly followed. From the perspective of the revenue projection for 2021, considering that the "up-to-date" refund of VAT will remain the usual practice, and the amounts reimbursed in addition last year were an exceptional element that has no reason to repeat itself, these amounts, evaluated at 2.2 billion lei, will be considered in the VAT revenue forecast for the current year. The difference compared to the situation of budgetary obligations deferred from payment is that in the case of these amounts there is no recovery (in other words, they are taken into account only once).

In connection with the *ex-ante* consideration of additional amounts related to a prospected increase in collection efficiency, the FC has shown on numerous occasions that such an approach is unwise. FC agrees with the *ex-post* inclusion of additional revenues from improved collection in the budget construction, but only after their amount can be assessed with a high degree of confidence and there are sufficient indications of a trend in reducing tax evasion - which would correspond to a permanent character of this income. Moreover, the improvement of collection usually takes place in the context of profound reforms of the tax administration that require legislative changes, as well as significant financial, human and time resources. Taking into account these aspects, FC will not take into account the amounts related to an increase in collection efficiency in its evaluation at the current moment.

Considering the above, <u>the FC's evaluation regarding the projection of budget revenues for 2021 indicates higher fiscal revenues and social security contributions than those considered by the MF in the amount of 5.5 billion lei or 0.45 pp of GDP</u>. In other words, admitting the current NCSP projection regarding the macroeconomic framework, the MF estimate for the 2021 budget revenues appears as conservative, FC appreciating as probable a more favorable evolution of cash revenues. FC does not identify in the MF revenue projection for 2021 the additional amounts envisaged to be collected by NAFA, as well as those related to accelerated VAT refunds at their nominal value, but in a much lower amount. However, these assessments depend fundamentally on the real value of the budgetary obligations deferred from payment by economic agents which are currently characterized by high uncertainty.

Budget expenditures

Budget expenditures according to the national methodology, net of the impact of swap compensation schemes, are projected <u>to increase in 2021 compared to 2020 in nominal terms by about 4.9%, their share in GDP being projected to decrease by 0.9 pp</u>. The main sources of adjustment are personnel (-0.76 pp of GDP), goods and services (-0.48 pp of GDP), social assistance (-0.51 pp of GDP) and capital (-0.52 pp of GDP) expenditures, in the opposite direction acting the influence of projects financed from EU funds (+1.01 pp of GDP, as a result of an increase in the absorption of EU funds), other transfers (+0.32 pp of GDP, as a result of a higher contribution of Romania to the EU) and interest expenditures (+0.12 pp of GDP, due to the increase of the public debt).

<u>In essence, on the expenditure side, the reduction of their share in GDP takes place by freezing public sector wages and giving up holiday vouchers, spending on goods and services associated with the pandemic lower than in 2020, and a replacement of investment expenditures from domestic sources with investments financed from EU funds</u>. It should be emphasized that the main structural measures of fiscal-budgetary policy adopted by the new Government in order to reduce the budget deficit targeted budget expenditures, while the increase in budget revenues

takes place as a result of the expiration of temporary measures related to budgetary obligations deferred from payment.

With regard to social assistance expenditures, the decrease of their share in GDP is mainly attributable to the decrease in labor market support measures financed from the unemployment insurance budget (whose expenditures decrease as a share of GDP by 0.53 pp) and to a lesser extent to the decrease in spending on sick leave (-0.1 pp of GDP, given that outstanding sick leave was paid in 2020). Instead, the main component of this category of expenditure, state pensions, increases its share in GDP by 0.17 pp as a result of the effect propagated throughout 2021 of the increase of the pension point by 14%, operated since September 1, 2020. Also, the share of social assistance expenditures related to the state budget remains relatively constant as a percentage of GDP, the nominal increase of about 2.7 billion lei being mainly explained by the increase in child allowances.

It is worth mentioning that the one-off measures intended to support the economy in the context of the impact of the COVID-19 pandemic included in the draft budget for 2021 are in the amount of 12.88 billion lei, respectively 1.15% of GDP (the amounts recorded in the budget report were reduced by 1.5 billion lei as a result of the budget reduction for the support program for HORECA companies), of which 0.35 pp of GDP are estimated to be reimbursed from EU funds. Therefore, the net impact on the 2021 budget deficit caused by the one-off measures is 0.8% of GDP. Given that in 2020 the support measures amounted, according to the FC's assessment, to about 1.6% of GDP, of which 0.4 were reimbursed from EU funds, it can be seen that the size of these measures for 2021 is smaller, representing a source of adjustment of the budget deficit of about 0.4% of GDP.

Investment expenditure in the proposed budget for 2021 is projected to increase significantly, by 15.7% and 0.4 pp of GDP, respectively, compared to the estimated level of the MF for 2020, exclusively based on the increase in investment expenditure financed by EU funds (+0.9 pp of GDP), while investments financed from domestic sources decrease by 0.5 pp of GDP. Replacing investments financed from internal resources with investments financed through EU funds frees up resources. Investment expenditures represented the highest of the last 5 years in 2020, with a percentage of 5.1% of GDP, and are forecasted to increase to 5.5% of GDP in 2021, simultaneously with a change in their structure in order to increase the share of expenditures with projects financed from non-reimbursable external funds at around 2.9% compared to 2.0% in 2020. Moreover, investment expenditures have the potential to be even higher given that current projections do not yet include amounts absorbed through the Recovery and Resilience Mechanism. The FC appreciates the Government's intention to increase investment expenditures, even under the conditions of initiating the budget consolidation process.

The FC does not have major reservations about the proposed level of expenditure aggregates, but considers that the targets, although feasible, involve strict control of expenditures. In the opinion of the FC, risks of overrun exist at the level of expenditures on goods and services that are expected to decrease in nominal terms by 2.2%, considering net amounts of the impact of swap compensation schemes. Even if the reduction of expenditures is justified by the decrease of the direct costs associated with the pandemic compared to 2020, the proposed level, only 3.8% higher than in 2019 - lower dynamics compared to price increases - is an ambitious one. Risks also persist in the category of social security expenditures, despite the freezing of the pension point and special pensions, given that the trend of slight increase in the average pension (regardless of the increase in the pension point) observed in previous years will continue in 2021 (in the case of state pensions, the trend is also explained by the calculation formula which is favorable to those who retire in the current year).

Taking into account the above, the FC considers that the budget deficit target is feasible, both according to the cash and European methodologies, and moreover FC considers that there could be some reserves, amounting to 0.45 pp of GDP according to the national methodology and 0.3 pp of GDP according to the European methodology. These reserves come from the probable recording of higher budget revenues than those forecasted by the MF. The FC considers that the possible materialization of these additional revenues should be used to reduce the budget deficit, easing the consolidation effort in the coming years. From this perspective, the provisions of art. 24 of the FRL according to which "the total expenditures of the general consolidated budget, excluding financial assistance from the EU and other donors, can be supplemented during budgetary revisions only for the payment of the public debt service and for the payment of Romania's contribution to the EU budget" are relevant.

FC emphasizes that these more favorable estimates than those of the MF on the budget balance depend fundamentally on the amount of deferred tax liabilities paid by companies, which is characterized by high uncertainty in itself, as well as the persistence of high uncertainties in the national economy and the European one. This could explain the conservative approach of the MF when drawing up the budget revenue forecast.

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5. The importance of European funds: The National Recovery and Resilience Plan

As stated in the FS for 2021-2023, Romania is facing a historic opportunity, with allocations of 31.35 billion euros under cohesion policy related to the EU's multiannual financial framework for the 2021-2027 period, supplemented by 30.4 billion euros (13.7 billion euros in grants and 16.6 billion euros in the form of loans) through the Recovery and Resilience Mechanism (RRM).

Romania's chance consists in absorbing these funds as much as possible, leading, on the side of macroeconomic stabilization, to the amplification of the contribution of the investment factor to the increase of potential and real GDP and to the attenuation of the contractionary impact of the macro correction, and on the real economy side at the implementation of structural reforms, directly and indirectly supporting the process of fiscal consolidation in a period of constrained budgetary expenditures for this purpose.

Rating agencies consider that the agreement of the Heads of State and Government from December 10, 2020 regarding the multiannual budget for the 2021-2027 period and the *Next Generation EU* instrument - approved by the European Parliament on December 17, 2020 and February 10th, 2021, respectively - will lead, through the implementation of the €1800 billion package, to strong support for the recovery of the Member States' economies in the wake of the 2020 pandemic-induced shock and the achievement of the EU's long-term objectives, which will reflect positively on the sovereign rating of the main countries receiving financial support, primarily those from the Central and South-Eastern Europe, including Romania.

Access to the RRM facility is realized through the National Recovery and Resilience Plan (NRRP), which must be submitted to the European Commission by the end of April 2021, integrated with the National Reform Programme and the Convergence Programme, after which the NRRP will be analyzed and approved on the basis of a complex evaluation grid.

The key principles underlying the development of the NRRP are represented by the priorities set for Member States under the 2020 European Semester (Country Specific Recommendations)[1]. In the case of Romania, the main recommendations refer to the application of a fiscal consolidation strategy to correct the excessive deficit, for the success of which it is important to be supported by comprehensive structural reforms, as well as to promote mature investment projects, both public and private, focused on the green and digital transition[2].

A key aspect of the NRRP's analytical and evaluation framework is the alignment of national objectives with the EU's priorities, respectively a coherent package of public investment and reforms with six pillars: transition to a green economy; digital transformation; economic growth, jobs creation and cohesion; social and territorial cohesion; health and economic, social and institutional resilience; policies for the *Next Generation EU*.

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[1] European Commission, *Annual Sustainable Growth Strategy 2021*, Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank, COM(2020) 575 final, Brussels, 17.9.2020.

[2] European Commission, *Recommendation for a COUNCIL RECOMMENDATION on the 2020 National Reform Programme of Romania and delivering a Council opinion on the 2020 Convergence Programme of Romania*, COM(2020) 523 final, Brussels, 20.5.2020.

For Romania, in addition to the inclusion in the 2021 public budget, at the next budget revision, of the financial flows related to the projects financed from RRM, likely to produce changes of the assumed targets, it is extremely important to finalize as soon as possible the negotiations with the EU concerning programming documents for the 2021-2027 period (Partnership Agreements and Operational Programmes).

The main issue of the investment projects included in the NRRP is to ensure consistency with the reform initiatives, as well as the complementarity of RRM funding with those from other EU policies/programmes/funds/instruments, including the *Just Transition Fund,* harmonization of the implementation schedule and the goals to be achieved, the coordination of all actors involved. Member States can request technical assistance from the European Commission, both in the design phase and during the implementation of the NRRP, which for Romania is an opportunity that it has started to exploit in the field of railway infrastructure.

The stringency of Romania's elaboration of the NRRP in full agreement with the requirements of the European Commission stems from the need of its approval as soon as possible, in order to benefit from the immediate allocation of pre-financing of 13% of the total amount allocated since the middle of this year[3], but also on account of the access mechanism, 70% of the value of grants must be contracted by the end of 2022, and the difference of 30% in 2023. Also, in order to achieve the EU priorities, out of the total amount related to the RRM of €672.5 billion, an allocation of at least 37% investment for the green transition and 20% investment for the digital transformation was established.

From the standpoint of the impact of the European funds from the RRM facility – the grants component – on investments implemented during the 2021-2023 period, the FC estimates that, assuming their absorption **in proportion of 80%, it is significant, being able to contribute to the increase of the share of public investments in GDP by 1-1.5 pp, leading it to record levels of 6.5-7% of GDP.**

Although considered a hypothesis, the previous and current levels of the degree of absorption of European FESI funds by Romanian being relatively low, below 50% during the financial year[4] (subsequently improved in previous years by applying the n+3 rule to 80-90%), the achievement of a high degree of absorption (contracting) of grants from the RRM facility, of at least 80% in the 2021-2023 period, is of utmost importance from the perspective of increasing the annual contribution of Member States to the EU budget by 0.6% of GNI (Gross National Income)[5] to cover

[3] European Commission*, Commission welcomes European Parliament's approval of Recovery and Resilience Facility*, Press Release, Brussels, 10 February 2021.

[4] Ministry of Investment and European Projects, *Absorption stage for programs financed from FESI funds on 29 January 2021.*

[5] The Council of the European Union, COUNCIL DECISION (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom, Official Journal of the European Union L 424/1, 15.12.2020.

the cost of repaying loans borrowed from international capital markets in order to finance the RRM by issuing European Union bonds and assuming the related debt at the EU level[6].

Thus, the allocation for Romania of €13.7 billion grants from the RRM implies an additional contribution of the country to the EU budget of about €1.1 billion annually, which requires the achievement of a high degree of absorption of these grants.

6. The issue of public debt sustainability and budget deficit financing

Although public debt was at a relatively comfortable level of 35.3% of GDP at the end of 2019, it increased to 47.7% of GDP at the end of 2020, according to the MF, amid the high budget deficit (which materialized in a primary deficit estimated by the MF at 7.6% of GDP according to the European methodology), but also as a result of borrowing to pre-finance the resource needs of 2021 and to strengthen the foreign exchange reserve at the disposal of the State Treasury (in the form of a positive stock-flow adjustment of about 2.6 pp of GDP). This evolution of public debt reveals the weaknesses repeatedly identified by the FC in its annual reports, which pointed out that the effects of the expansionary fiscal-budgetary policy, materialized by large primary deficits, were obscured by the favorable macroeconomic situation of previous years, characterized by economic growth and real negative interest rates. The abrupt reversal of the differential between the economic growth rate and the cost of financing, as a result of the effects of the COVID-19 pandemic, has led to a rapid and large-scale increase in public debt in 2020.

According to the 2021-2023 Fiscal Strategy, although a gradual improvement of the primary budget deficit is expected (6.6% of GDP in 2021, 4.8% of GDP in 2022 and 3.2% of GDP in 2023, respectively), public debt is projected on an upward trajectory for the entire forecast horizon. This evolution is caused by the still high levels of the primary deficit which cannot be fully counteracted by the favorable effect of the projected economic growth for the 2021-2023 period. For 2023, a level of public debt of 54.3% of GDP is estimated. Such a level of public debt is not threatening if the necessary gradual macroeconomic correction is achieved. A credible correction is the one that will also give the cost of financing the deficit and refinancing the public debt.

Moreover, unlike developed economies, Romania cannot sustain a high level of public debt given the limited financing capacity in the domestic market, as well as the low level of budget revenues (representing on average 31.7% of GDP over 2021-2023, according to the FS estimates). On the other hand, financing in international markets may increase dependence on non-resident investors, which is associated with an increasing vulnerability to interest and exchange rate

[6] Eurostat, Methodological note. *Draft guidance note on the statistical recording of the recovery and resilience facility*, Directorate - Government Finance Statistics, 17 November 2020.

shocks, as well as a series of uncertainties about the availability of financing in the event of increased risk aversion and/or deterioration of Romania's sovereign rating.

Against this backdrop, restoring public debt to a sustainable trajectory must be a key objective of medium and long-term fiscal-budgetary policy. This need is also supported by the EC report on the sustainability of public debt for 2020[7] which places the risk related to Romania's public debt at a "high" level for all horizons (short, medium and long). Given that the primary deficit is the determining factor for the evolution of public debt during the 2021-2023 period, its return to a sustainable trajectory depends decisively on the success of the fiscal-budgetary consolidation process in the coming years. At the same time, as the level of debt increases, financing costs have a greater influence on its future evolution. In this respect, interest rates in the domestic market have fallen recently, and those at European level have declined over the last decade, and this policy is expected to continue in the medium term, so there are conditions for obtaining reasonable costs for public debt financing. Last but not least, a firm commitment to a credible fiscal-budgetary consolidation plan is a key premise for maintaining the country's rating and investors’ confidence in international markets.

Beyond the impact on the share of public debt in GDP, high levels of budget deficit put a lot of pressure on the financing needs. According to the FC analysis, after reaching a maximum of 149 billion lei (14.3% of GDP) in 2020, it is estimated a gradual reduction of Romania's financing needs amid the fiscal-budgetary consolidation scheduled by the 2021-2023 Fiscal Strategy as follows: 129.7 billion lei (11.6% of GDP) in 2021, 127.8 billion lei (10.6% of GDP) in 2022, respectively 119.6 billion lei (9.2% of GDP) in 2023. Thus, it is estimated that the financing needs of the government sector expressed as a share of GDP will return to pre-pandemic levels (9% of GDP in 2019) only in 2023.

7. *Medium-term fiscal-budgetary perspectives – budget construction beyond the 2021 horizon*

Similarly to the fiscal-budgetary strategies of previous years, the current iteration of the medium-term fiscal-budgetary projection reveals that the authorities are concerned about the first year covered by it, without paying enough attention to the medium-term fiscal-budgetary projections, being manifested the tendency to generate fiscal/budgetary consolidation in the medium term in the absence of a rigorous substantiation of revenues and expenditures and of concrete details on the hypotheses that underline the trajectories of the aggregates of revenues

[7] https://ec.europa.eu/info/sites/info/files/economy-finance/ip143_en.pdf

and expenditures. This asymmetry of attention is all the more important for the necessary, inevitable consolidation, which must take place in the 2021-2024 period.

Hence, the reduction of the budget deficit according to the national methodology in the 2022-2024 period by 4.4 pp of GDP (from 7.2% to 2.9%) is projected to be achieved almost exclusively through budget expenditures. More specifically, most of the adjustment is based on a reduction of the share in GDP for personnel (by 1.9 pp), goods and services (by 0.8 pp) and social assistance (by 1.3 pp) expenditures.

Given that the budgetary aggregates described above are slowly increasing in nominal terms, their share in GDP is declining in the context of a nominal GDP growth in the 2022-2024 period of 25.7% (corresponding to an average annual growth rate of about 8%), on which FC has already expressed reservations, deeming it as too optimistic. Therefore, this is a first source of doubt as to the possibility of such a large adjustment of the abovementioned expenditure aggregates.

Secondly, keeping personnel expenditures constant for the 2021-2024 period is possible either by freezing salaries in the budget sector for this period, or by a combination of a reduction in the number of workers and a moderate increase in salaries. The MF does not specify the hypotheses that substantiate the trajectory of personnel expenditures for that period. From a historical perspective and also taking into account social considerations, such an evolution is unlikely. Admitting keeping constant the salaries in real terms for the 2022-2024 period, and this is difficult to achieve, the size of the adjustment envisaged by the MF in the field of personnel expenditures decreases by 0.5 pp of GDP.

Thirdly, the proposed adjustment for the expenditures on goods and services, materialized in a decrease of their share in GDP by 0.8 pp in the 2022-2024 period, would lead to a level of 4.1% of GDP in the last year of this interval, which would represent an absolute minimum of the 2008-2024 period, well below the average of about 5.5% of GDP in the 2008-2021 period, or below the minimum of 4.7% of GDP related to the same period. FC has reservations about the possibility of materializing such an evolution, even under the conditions of a profound reform of the public procurement system.

With regard to the moderate increase in nominal terms of social assistance expenditures in the 2022-2024 period, this is only possible in the context of implementing a benefit indexation rule similar to the one currently proposed for state pensions (which would involve, according to current forecasts, a cumulative increase of about 12.7% in the 2022-2024 period) and without taking into account additional expenditures that could come, for example, from a correction of inequities that currently characterize state pensions. From a legislative point of view, this indexation rule is provided only for state pensions, not for the other benefits that fall within the scope of social assistance.

In conclusion, according to the FC, a budget deficit adjustment of 4 pp of GDP on account of the above-mentioned three categories of expenditures is not realistic. The FC considers that under the conditions of the adoption of reforms, an adjustment can be made through these categories, but it is difficult and unlikely that the reduction of the budget deficit will exceed 2.5 pp of GDP based exclusively on these sources.

It is difficult to imagine achieving budgetary consolidation in the absence of increased budgetary revenues. This could originate from: improving collection efficiency, broadening the tax base, narrowing exceptions and loopholes that negatively deviate taxes paid by some taxpayers from the standard rates, firmly combating tax evasion and unfair tax competition, as well as optimizing tax rates.

Even if, as shown on many occasions, the FC considers as imprudent to include in the fiscal projection these revenues before their actual materialization, a profound reform of the tax administration that could lead to increased collection efficiency is urgently needed, as there is considerable space for improvements in this direction. The experiences in Poland and Bulgaria prove that it is possible!

Given the above, as well as the extremely favorable nature of the projected growth trajectory on the medium term, the FC considers that, in the event of no changes in current fiscal and budgetary policies, the balance of risks is tilted sharply towards substantially higher deficits than the ones anticipated in the fiscal-budgetary projection for the 2022-2024 period.

Conclusions

- The economic decline caused by the Pandemic in Romania was of 3.9% of GDP, while the GDP growth in 2021 is forecasted by NCSP at 4.3%. Given the uncertainties created by the persistence of the Pandemic, FC advances a range of GDP evolution between 4-5% for 2021.
- The construction of the budget for 2021, which targets a cash deficit of 7.16% of GDP, signals a change of the fiscal/budgetary policy. It is true that in the 2021-2022 period the budgetary policy continues to be pro-cyclical in relation to the output gap of the economy (distance from potential GDP), but this situation is inevitable given the need to limit deficits.
- The gradual correction of the budget deficit corresponds to a rational attitude, which allows the consolidation of the economic recovery that was initiated at the end of 2020. The gradual correction of the budget deficit was supported by the FC in its analyzes and opinions.

- FC considers that the risks to the 2021 macroeconomic scenario are balanced, but for the 2022-2024 macroeconomic forecast, the balance of risks is tilted towards a less favorable scenario in terms of macroeconomic correlations.
- From the point of view of the structural deficit, Romania registered the highest level in the EU even before the occurrence of the COVID-19 pandemic. As a result of fiscal-budgetary developments in 2020, the structural deficit advanced by about 2.5 pp of potential GDP.
- An important factor that has determined the upward evolution of the structural deficit is represented by the strong increase in personnel and social assistance expenditures in recent years. In 2020, a peak was reached in this respect, with personnel and social assistance expenditures representing 94.3% of tax revenues (including social security contributions) and 23.9% of GDP, respectively. This situation is not sustainable as it is located at the level of permanent expenditures.
- The fragility of the public finance position at the end of 2020 is highlighted by the low level of tax revenues, including social security contributions (25.3% of GDP), and budget revenues (31% of GDP), these values being among the lowest recorded in the EU.
- FC estimates that budget revenues according to the ESA 2010 methodology were lower in 2020 compared to MF estimates by about 0.3 pp of GDP, the deficit FC estimated for the previous year being 9.4% of GDP (compared to 9.1% according to MF). Thus, the starting point of the public finances position, according to the European methodology, from the FC evaluation is different compared to that of MF: -9.4% compared to -9.1% of GDP.
- The budget construction for 2021 envisages a deficit target of 7.16% according to the cash methodology, representing a decrease of 2.63 pp of GDP compared to the level of 2020. The corresponding level of the deficit target for 2021 according to ESA 2010 is 8.23% of GDP, the reduction of the budget deficit in 2021 compared to the estimated level of MF for the previous year being of 0.87 pp of GDP.
- The reduction of the cash deficit in 2021 compared to 2020 is significantly supported by two exceptional elements, namely the amounts expected to be collected in 2021 from the 2020 budget obligations postponed by economic agents and the expected rental of the 5G frequency bands in 2021. These elements justify a significant reduction in the cash deficit in 2021 compared to 2020 - but do not represent structural adjustment measures.
- The FC 's evaluation regarding the projection of budget revenues for 2021 shows higher fiscal revenues, including social security contributions, than those considered by the MF, by 5.5 billion lei or 0.45 pp of GDP. However, these assessments depend fundamentally, on the one hand, on the real value of the budgetary obligations deferred from payment by the economic agents, characterized by a high degree of uncertainty, and, on the other hand, on the persistence of great uncertainties in the national and international economy.

- The FC does not have major reservations about the proposed level of expenditure aggregates, but considers that the targets, although feasible, involve strict control of expenditures.
- Investment expenditures represented in 2020 the maximum of the last 5 years, with a percentage of 5.1% of GDP and are forecasted to increase to 5.5% of GDP in 2021, simultaneously with a change in structure in order to increase the share of expenditures related to projects financed from non-reimbursable external funds at about 2.9% compared to 2.0% in 2020.
- FC considers that the budget deficit target for 2021 is feasible, both according to the cash and European methodologies.
- FC appreciates that the eventual materialization of additional revenues should be used to reduce the budget deficit, facilitating the consolidation effort in the coming years.
- FC reiterates that the fiscal consolidation process needs to consider a restructuring of budgetary expenditures, but it is absolutely necessary to increase fiscal revenues in order to strengthen the robustness of the public budget given current acute needs, including in the field of public health and public education, and future pressures from climate change and other unconventional threats. From this perspective, it is worrying that, according to FS, budget revenues are projected to remain at 31% of GDP by the end of 2023.
- The reduction of the budget deficit according to the national methodology in the 2022-2024 period by 4.4 pp of GDP (from 7.2% to 2.9%) is forecasted by MF to be achieved almost exclusively through budget expenditures. Specifically, most of the adjustment is based on a reduction in the share of personnel (by 1.9 pp), goods and services (by 0.8 pp) and social assistance (by 1.3 pp) expenditures in the GDP.
- In the FC's opinion, an adjustment of 4 pp of GDP of the budget deficit on account of the three categories of expenditures mentioned above is not realistic. The FC considers that an adjustment made only on the expenditure side is very difficult and it is unlikely that the reduction of the budget deficit in this way will exceed 2.5 pp of GDP.
- It is difficult to imagine achieving budgetary consolidation during the 2021-2024 period in the absence of a significant increase in budget revenues. This could come from: improving collection efficiency, broadening the tax base, narrowing exceptions and loopholes that negatively deviate taxes paid by some taxpayers from standard rates, firmly combating tax evasion and unfair tax competition and optimizing tax rates.
- Romania is facing a historic opportunity, with allocations of 31.35 billion euros under the cohesion policy related to the EU multiannual financial framework for the 2021-2027 period, supplemented by 30.4 billion euros (13.7 billion euros in grants and 16.6 billion euros in the form of loans) through the Recovery and Resilience Mechanism (RRM).

The opinions and recommendations formulated above by the Fiscal Council were approved by the Chairman of the Fiscal Council, according to the provisions of art. 56, para (2), letter d) of Law no. 69/2010 republished, following their approval by the Council members, through vote, in the meeting of February 17th, 2021.

February 17th, 2021

Chairman of the Fiscal Council

Professor Daniel Dăianu

Annex I – Budget 2021 versus Execution 2020	Execution 2020	Swap Execution 2020	Execution 2020 (without swap)	Initial budget 2021	Swap program 2021	Initial budget 2021 (without swap)	Initial budget 2021 – Execution 2020	Initial budget 2021 – Execution 2020 (without swap)	Initial budget 2021 – Execution 2020 (%)	Initial budget 2021 – Execution 2020 (without swap) (%)	Initial budget 2021 (without swap) (% of GDP)	Execution 2020 (without swap) (% of GDP)	Initial budget 2021 – Execution 2020 (without swap) (% of GDP)
	1	2	3 = 1-2	4	5	6 = 4-5	7 = 4 – 1	8 = 6-3	9 = 7/1	10 = 8/3	11	12	13 = 11-12
TOTAL REVENUE	**322,518.1**	**1,180.9**	**321,337.2**	**364,907.1**	**850.0**	**364,057.1**	**42,389.0**	**42,720.0**	**13.1%**	**13.3%**	**32.6%**	**30.9%**	**1.7**
Current revenue	**288,184.9**	**1,180.9**	**287,004.0**	**316,694.4**	**850.0**	**315,844.4**	**28,509.5**	**28,840.4**	**9.9%**	**10.0%**	**28.3%**	**27.6%**	**0.7**
Tax revenue	**151,279.2**	**628.6**	**150,650.7**	**168,899.1**	**293.0**	**168,606.1**	**17,619.9**	**17,955.4**	**11.6%**	**11.9%**	**15.1%**	**14.5%**	**0.6**
Taxes on profit, wages, income and capital gains	**43,476.1**	**411.1**	**43,065.0**	**47,067.6**	**129.0**	**46,938.6**	**3,591.4**	**3,873.6**	**8.3%**	**9.0%**	**4.2%**	**4.1%**	**0.1**
Corporate income tax	15,988.1	295.8	15,692.2	17,408.8	9.0	17,399.8	1,420.7	1,707.6	8.9%	10.9%	1.6%	1.5%	0.1
Personal income tax	24,333.8	115.3	24,218.5	26,245.2	120.0	26,125.2	1,911.4	1,906.7	7.9%	7.9%	2.3%	2.3%	0.0
Other taxes on income, profit and capital gains	3,154.2	-	3,154.2	3,413.6	-	3,413.6	259.4	259.4	8.2%	8.2%	0.3%	0.3%	0.0
Property tax	**5,935.9**	**-**	**5,935.9**	**6,105.1**	**-**	**6,105.1**	**169.2**	**169.2**	**2.9%**	**2.9%**	**0.5%**	**0.6%**	**0.0**
Taxes on goods and services	**99,824.5**	**157.0**	**99,667.6**	**113,658.8**	**121.0**	**113,537.8**	**13,834.3**	**13,870.2**	**13.9%**	**13.9%**	**10.2%**	**9.6%**	**0.6**
VAT	60,816.9	123.8	60,693.1	69,698.4	84.0	69,614.4	8,881.5	8,921.3	14.6%	14.7%	6.2%	5.8%	0.4
Excise duties	30,715.3	33.1	30,682.1	33,095.6	37.0	33,058.6	2,380.3	2,376.5	7.7%	7.7%	3.0%	2.9%	0.0
Other taxes on goods and services	4,523.2	-	4,523.2	4,214.4	-	4,214.4	-308.8	-308.8	-6.8%	-6.8%	0.4%	0.4%	-0.1
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	3,769.1	-	3,769.1	6,650.3	-	6,650.3	2,881.3	2,881.3	76.4%	76.4%	0.6%	0.4%	0.2
Taxes on foreign trade and international transactions (custom duties)	**1,119.6**	**-**	**1,119.6**	**1,131.9**	**-**	**1,131.9**	**12.3**	**12.3**	**1.1%**	**1.1%**	**0.1%**	**0.1%**	**0.0**
Other tax revenue	**923.2**	**60.5**	**862.7**	**935.8**	**43.0**	**892.8**	**12.6**	**30.1**	**1.4%**	**3.5%**	**0.1%**	**0.1%**	**0.0**
Social security contributions	**112,250.7**	**552.4**	**111,698.3**	**120,825.6**	**557.0**	**120,268.6**	**8,574.9**	**8,570.3**	**7.6%**	**7.7%**	**10.8%**	**10.7%**	**0.0**
Non-tax revenue	**24,655.0**	**-**	**24,655.0**	**26,969.7**		**26,969.7**	**2,314.7**	**2,314.7**	**9.4%**	**9.4%**	**2.4%**	**2.4%**	**0.0**
Capital revenue	**776.0**	**-**	**776.0**	**820.9**	**-**	**820.9**	**44.9**	**44.9**	**5.8%**	**5.8%**	**0.1%**	**0.1%**	**0.0**
Grants	**2.1**	**-**	**2.1**	**8.3**	**-**	**8.3**	**6.2**	**6.2**	**303.5%**	**303.5%**	**0.0%**	**0.0%**	**0.0**
Amounts received from the EU in the account of payments made and prefinancing	**32.9**	**-**	**32.9**	**0.1**	**-**	**0.1**	**-32.8**	**-32.8**	**-99.7%**	**-99.7%**	**0.0%**	**0.0%**	**0.0**
Amounts collected in the single account/in the reallocation process	**0.0**	**-**	**0.0**	**0.0**	**-**	**0.0**	**0.0**	**0.0**	**-**	**-**	**0.0%**	**0.0%**	**0.0**

Other amounts received from the EU for the operational programs funded under the convergence objective	**1,247.0**	**-**	**1,247.0**	**2,679.4**	**-**	**2,679.4**	**1,432.4**	**1,432.4**	**114.9%**	**114.9%**	**0.2%**	**0.1%**	**0.1**
Amounts received from the EU/other donors in the account of payments made and prefinancing for the 2014-2020 financial framework	**32,275.1**	**-**	**32,275.1**	**44,704.0**	**-**	**44,704.0**	**12,429.0**	**12,429.0**	**38.5%**	**38.5%**	**4.0%**	**3.1%**	**0.9**
TOTAL EXPENDITURE	**424,434.8**	**1,180.9**	**423,253.9**	**444,907.1**	**850.0**	**444,057.1**	**20,472.3**	**20,803.2**	**4.8%**	**4.9%**	**39.8%**	**40.7%**	**-0.9**
Current expenditure	**393,039.6**	**1,180.9**	**391,858.7**	**415,035.2**	**-**	**415,035.2**	**21,995.5**	**23,176.5**	**5.6%**	**5.9%**	**37.2%**	**37.6%**	**-0.5**
Personnel	109,978.2	-	109,978.2	109,511.4	-	109,511.4	-466.9	-466.9	-0.4%	-0.4%	9.8%	10.6%	-0.8
Goods and services	57,045.1	417.9	56,627.3	55,382.2	-	55,382.2	-1,662.9	-1,245.1	-2.9%	-2.2%	5.0%	5.4%	-0.5
Interest	14,510.3	-	14,510.3	16,864.5	-	16,864.5	2,354.3	2,354.3	16.2%	16.2%	1.5%	1.4%	0.1
Subsidies	8,140.2	-	8,140.2	6,963.9	-	6,963.9	-1,176.3	-1,176.3	-14.5%	-14.5%	0.6%	0.8%	-0.2
Total transfers	**202,609.0**	**763.1**	**201,845.9**	**224,865.0**	**-**	**224,865.0**	**22,256.0**	**23,019.1**	**11.0%**	**11.4%**	**20.1%**	**19.4%**	**0.7**
Transfers between public administration entities	1,501.0	763.1	737.9	1,975.0	850.0	1,125.0	474.0	387.1	31.6%	52.5%	0.1%	0.1%	0.0
Other transfers	19,065.5	-	19,065.5	24,039.6	-	24,039.6	4,974.1	4,974.1	26.1%	26.1%	2.2%	1.8%	0.3
Projects funded by external grants	269.8	-	269.8	184.7	-	184.7	-85.1	-85.1	-31.6%	-31.6%	0.0%	0.0%	0.0
Social assistance	138,552.9	-	138,552.9	142,939.5	-	142,939.5	4,386.6	4,386.6	3.2%	3.2%	12.8%	13.3%	-0.5
Projects funded by external post-accession grants 2014-2020	34,862.8	-	34,862.8	48,726.8	-	48,726.8	13,864.0	13,864.0	39.8%	39.8%	4.4%	3.3%	1.0
Other expenditure	8,357.0	-	8,357.0	6,999.4	-	6,999.4	-1,357.5	-1,357.5	-16.2%	-16.2%	0.6%	0.8%	-0.2
Reserve funds	**0.0**	**-**	**0.0**	**701.0**	**-**	**701.0**	**701.0**	**701.0**	**-**	**-**	**0.1%**	**0.0%**	**0.1**
Expenditure funded from reimbursable funds	**756.8**	**-**	**756.8**	**747.2**	**-**	**747.2**	**-9.6**	**-9.6**	**-1.3%**	**-1.3%**	**0.1%**	**0.1%**	**0.0**
Capital expenditure	**33,208.0**	**-**	**33,208.0**	**29,872.0**	**-**	**29,872.0**	**-3,336.1**	**-3,336.1**	**-10.0%**	**-10.0%**	**2.7%**	**3.2%**	**-0.5**
Payments made in previous years and recovered in the current year	**-1,812.8**	**-**	**-1,812.8**	**0.0**	**-**	**0.0**	**1,812.8**	**1,812.8**	**-100.0%**	**-100.0%**	**0.0%**	**-0.2%**	**0.2**
EXCEDENT(+) / DEFICIT(-)	**-101,916.7**	**0.0**	**-101,916.7**	**-80,000.0**	**0.0**	**-80,000.0**	**21,916.7**	**21,916.7**	**-21.5%**	**-21.5%**	**-7.2%**	**-9.8%**	**2.6**

Source: MF, FC's calculations

Annex II – The evolution of budgetary aggregates in the 2021-2022 period	**FS projection 2021 (mil. lei)**	**FS projection 2022 (mil. lei)**	**FS projection 2022 – FS projection 2021 (mil. lei)**	**FS projection 2022 – FS projection 2021 (%)**	**FS projection 2021 (% of GDP)**	**FS projection 2022 (% of GDP)**	**FS projection 2022 – FS projection 2021 (% of GDP)**
	1	**2**	**3=2-1**	**4=3/1**	**5**	**6**	**7=6-5**
TOTAL REVENUE	**364,907.1**	**378,157.5**	**13,250.4**	**3.6%**	**32.7%**	**31.4%**	**-1.3**
Current revenue	**316,694.4**	**335,700.2**	**19,005.8**	**6.0%**	**28.4%**	**27.9%**	**-0.5**
Tax revenue	**168,899.1**	**176,977.4**	**8,078.3**	**4.8%**	**15.1%**	**14.7%**	**-0.4**
Taxes on profit, wages, income and capital gains	**47,067.6**	**49,956.9**	**2,889.3**	**6.1%**	**4.2%**	**4.1%**	**-0.1**
Corporate income tax	17,408.8	17,787.9	379.1	2.2%	1.6%	1.5%	-0.1
Personal income tax	26,245.2	28,488.6	2,243.4	8.5%	2.4%	2.4%	0.0
Other taxes on income, profit and capital gains	3,413.6	3,680.4	266.8	7.8%	0.3%	0.3%	0.0
Property tax	**6,105.1**	**6,558.2**	**453.1**	**7.4%**	**0.5%**	**0.5%**	**0.0**
Taxes on goods and services	**113,658.8**	**118,253.8**	**4,595.0**	**4.0%**	**10.2%**	**9.8%**	**-0.4**
VAT	69,698.4	74,120.7	4,422.2	6.3%	6.2%	6.2%	-0.1
Excise duties	33,095.6	35,573.2	2,477.6	7.5%	3.0%	3.0%	0.0
Other taxes on goods and services	4,214.4	4,345.1	130.7	3.1%	0.4%	0.4%	0.0
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	6,650.3	4,214.9	-2,435.5	-36.6%	0.6%	0.4%	-0.2
Taxes on foreign trade and international transactions (custom duties)	**1,131.9**	**1,141.1**	**9.3**	**0.8%**	**0.1%**	**0.1%**	**0.0**
Other tax revenue	**935.8**	**1,067.4**	**131.6**	**14.1%**	**0.1%**	**0.1%**	**0.0**
Social security contributions	**120,825.6**	**130,595.2**	**9,769.6**	**8.1%**	**10.8%**	**10.8%**	**0.0**
Non-tax revenue	**26,969.7**	**28,127.5**	**1,157.9**	**4.3%**	**2.4%**	**2.3%**	**-0.1**
Capital revenue	**820.9**	**884.3**	**63.4**	**7.7%**	**0.1%**	**0.1%**	**0.0**
Grants	**8.3**	**1.2**	**-7.1**	**-85.2%**	**0.0%**	**0.0%**	**0.0**
Amounts received from the EU in the account of payments made and prefinancing	**0.1**	**0.0**	**-0.1**	**-100.0%**	**0.0%**	**0.0%**	**0.0**
Financial operations	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.0**

Amounts collected in the single account/in the reallocation process	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.0**
Other amounts received from the EU for the operational programs funded under the convergence objective	**2,679.4**	**0.0**	**-2,679.4**	**0.0%**	**0.2%**	**0.0%**	**-0.2**
Amounts received from the EU/other donors in the account of payments made and prefinancing for the 2014-2020 financial framework	**44,704.0**	**41,571.8**	**-3,132.2**	**-7.0%**	**4.0%**	**3.5%**	**-0.6**
TOTAL EXPENDITURE	**444,907.1**	**448,533.1**	**3,626.0**	**0.8%**	**39.8%**	**37.2%**	**-2.6**
Current expenditure	**415,035.2**	**411,534.4**	**-3,500.8**	**-0.8%**	**37.2%**	**34.2%**	**-3.0**
Personnel	109,511.4	109,514.0	2.7	0.0%	9.8%	9.1%	-0.7
Goods and services	55,382.2	55,555.0	172.8	0.3%	5.0%	4.6%	-0.3
Interest	16,864.5	17,992.8	1,128.3	6.7%	1.5%	1.5%	0.0
Subsidies	6,963.9	7,810.7	846.8	12.2%	0.6%	0.6%	0.0
Total transfers	**224,865.0**	**219,705.2**	**-5,159.8**	**-2.3%**	**20.1%**	**18.2%**	**-1.9**
Transfers between public administration entities	1,975.0	2,027.7	52.7	2.7%	0.2%	0.2%	0.0
Other transfers	24,039.6	20,856.6	-3,183.0	-13.2%	2.2%	1.7%	-0.4
Projects funded by external grants	184.7	40.3	-144.4	-78.2%	0.0%	0.0%	0.0
Social assistance	142,939.5	147,904.0	4,964.5	3.5%	12.8%	12.3%	-0.5
Projects funded by external post-accession grants 2014-2020	48,726.8	42,418.9	-6,308.0	-12.9%	4.4%	3.5%	-0.8
Other expenditure	6,999.4	6,457.7	-541.7	-7.7%	0.6%	0.5%	-0.1
Reserve funds	**701.0**	**100.0**	**-601.0**	**-85.7%**	**0.1%**	**0.0%**	**-0.1**
Expenditure funded from reimbursable funds	**747.2**	**856.6**	**109.4**	**14.6%**	**0.1%**	**0.1%**	**0.0**
Capital expenditure	**29,872.0**	**36,998.8**	**7,126.8**	**23.9%**	**2.7%**	**3.1%**	**0.4**
Financial operations	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.0**
Payments made in previous years and recovered in the current year	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.0**
EXCEDENT(+) / DEFICIT(-)	**-80,000.0**	**-70,375.6**	**9,624.4**	**-12.0%**	**-7.2%**	**-5.8%**	**1.3**

Source: MF, FC's calculations

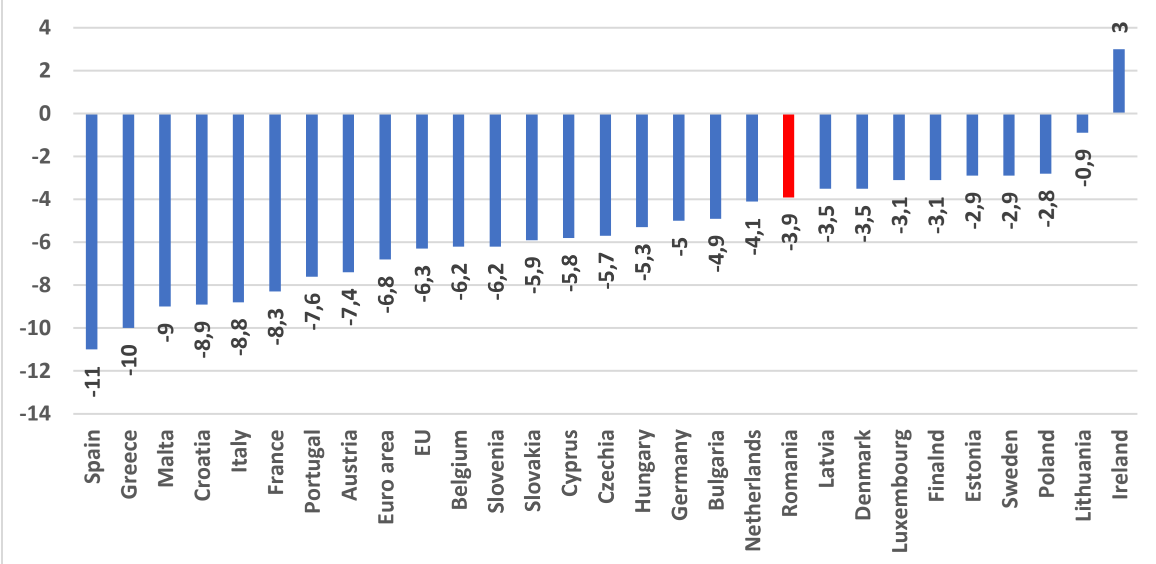
Annex III - The evolution of budgetary aggregates in the 2022-2023 period	FS projection 2022 (mil. lei)	FS projection 2023 (mil. lei)	FS projection 2023 – FS projection 2022 (mil. lei)	FS projection 2023 – FS projection 2022 (%)	FS projection 2022 (% of GDP)	FS projection 2023 (% of GDP)	FS projection 2023 – FS projection 2022 (% of GDP)
	1	2	3=2-1	4=3/1	5	6	7=6-5
TOTAL REVENUE	**378,157.5**	**402,976.3**	**24,818.8**	**6.6%**	**31.4%**	**31.0%**	**-0.4**
Current revenue	**335,700.2**	**364,230.6**	**28,530.5**	**8.5%**	**27.9%**	**28.0%**	**0.1**
Tax revenue	**176,977.4**	**191,069.6**	**14,092.3**	**8.0%**	**14.7%**	**14.7%**	**0.0**
Taxes on profit, wages, income and capital gains	**49,956.9**	**54,124.8**	**4,167.9**	**8.3%**	**4.1%**	**4.2%**	**0.0**
Corporate income tax	17,787.9	19,226.7	1,438.8	8.1%	1.5%	1.5%	**0.0**
Personal income tax	28,488.6	30,920.3	2,431.8	8.5%	2.4%	2.4%	**0.0**
Other taxes on income, profit and capital gains	3,680.4	3,977.8	297.4	8.1%	0.3%	0.3%	**0.0**
Property tax	**6,558.2**	**7,058.3**	**500.1**	**7.6%**	**0.5%**	**0.5%**	**0.0**
Taxes on goods and services	**118,253.8**	**127,593.1**	**9,339.3**	**7.9%**	**9.8%**	**9.8%**	**0.0**
VAT	74,120.7	80,115.8	5,995.1	8.1%	6.2%	6.2%	**0.0**
Excise duties	35,573.2	38,446.2	2,873.0	8.1%	3.0%	3.0%	**0.0**
Other taxes on goods and services	4,345.1	4,480.1	134.9	3.1%	0.4%	0.3%	**0.0**
Taxes on the use of goods, on authorizing the use of goods and on carrying activities	4,214.9	4,551.1	336.2	8.0%	0.4%	0.3%	**0.0**
Taxes on foreign trade and international transactions (custom duties)	**1,141.1**	**1,150.4**	**9.3**	**0.8%**	**0.1%**	**0.1%**	**0.0**
Other tax revenue	**1,067.4**	**1,143.1**	**75.7**	**7.1%**	**0.1%**	**0.1%**	**0.0**
Social security contributions	**130,595.2**	**142,278.5**	**11,683.3**	**8.9%**	**10.8%**	**10.9%**	**0.1**
Non-tax revenue	**28,127.5**	**30,882.4**	**2,754.9**	**9.8%**	**2.3%**	**2.4%**	**0.0**
Capital revenue	**884.3**	**954.8**	**70.5**	**8.0%**	**0.1%**	**0.1%**	**0.0**
Grants	**1.2**	**1.3**	**0.0**	**3.8%**	**0.0%**	**0.0%**	**0.0**
Amounts received from the EU in the account of payments made and prefinancing	**0.0**	**0.0**	**0.0**	**-**	**0.0%**	**0.0%**	**0.0**
Financial operations	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.0**

Amounts collected in the single account/in the reallocation process	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.0**
Other amounts received from the EU for the operational programs funded under the convergence objective	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.0**
Amounts received from the EU/other donors in the account of payments made and prefinancing for the 2014-2020 financial framework	**41,571.8**	**37,789.6**	**-3,782.2**	**-9.1%**	**3.5%**	**2.9%**	**-0.5**
TOTAL EXPENDITURE	**448,533.1**	**459,916.8**	**11,383.6**	**2.5%**	**37.2%**	**35.3%**	**-1.9**
Current expenditure	**411,534.4**	**421,545.3**	**10,011.0**	**2.4%**	**34.2%**	**32.4%**	**-1.8**
Personnel	109,514.0	110,065.6	551.6	0.5%	9.1%	8.5%	**-0.6**
Goods and services	55,555.0	56,612.9	1,057.9	1.9%	4.6%	4.3%	**-0.3**
Interest	17,992.8	18,947.9	955.0	5.3%	1.5%	1.5%	**0.0**
Subsidies	7,810.7	7,921.6	110.9	1.4%	0.6%	0.6%	**0.0**
Total transfers	**219,705.2**	**226,955.2**	**7,250.0**	**3.3%**	**18.2%**	**17.4%**	**-0.8**
Transfers between public administration entities	2,027.7	2,112.9	85.2	4.2%	0.2%	0.2%	**0.0**
Other transfers	20,856.6	21,564.6	708.0	3.4%	1.7%	1.7%	**-0.1**
Projects funded by external grants	40.3	37.5	-2.8	-6.9%	0.0%	0.0%	**0.0**
Social assistance	147,904.0	155,826.7	7,922.7	5.4%	12.3%	12.0%	**-0.3**
Projects funded by external post-accession grants 2014-2020	42,418.9	40,695.9	-1,723.0	-4.1%	3.5%	3.1%	**-0.4**
Other expenditure	6,457.7	6,717.5	259.8	4.0%	0.5%	0.5%	**0.0**
Reserve funds	**100.0**	**100.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.0**
Expenditure funded from reimbursable funds	**856.6**	**942.2**	**85.6**	**10.0%**	**0.1%**	**0.1%**	**0.0**
Capital expenditure	**36,998.8**	**38,371.4**	**1,372.6**	**3.7%**	**3.1%**	**2.9%**	**-0.1**
Financial operations	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.0**
Payments made in previous years and recovered in the current year	**0.0**	**0.0**	**0.0**	**0.0%**	**0.0%**	**0.0%**	**0.0**
EXCEDENT(+) / DEFICIT(-)	**-70,375.6**	**-56,940.4**	**13,435.2**	**-19.1%**	**-5.8%**	**-4.4%**	**1.5**

Source: MF, FC's calculations

Annex IV

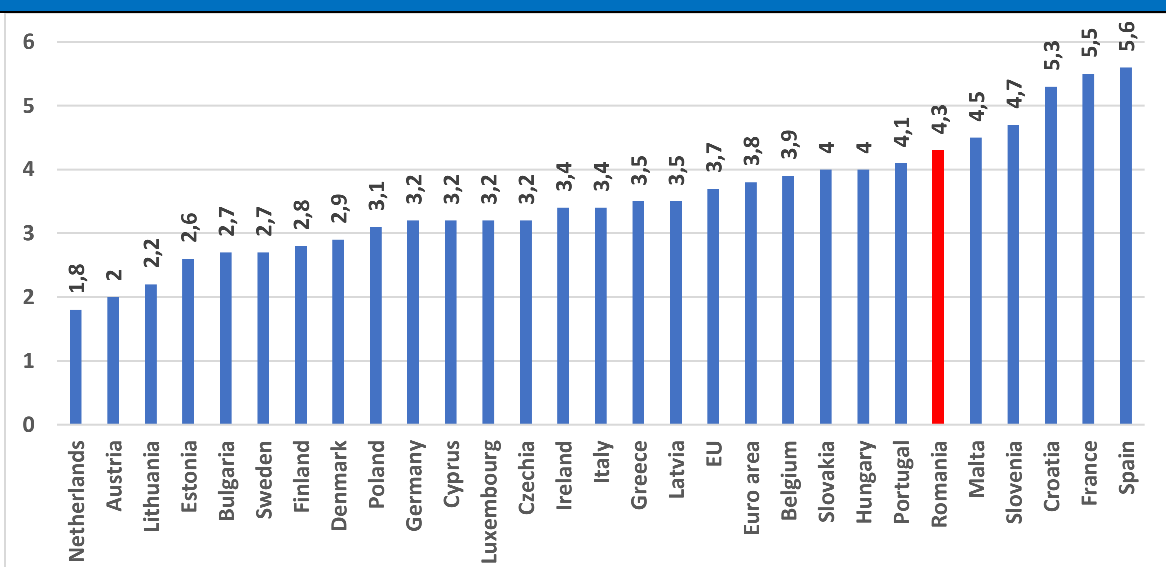
Figure 1: Real GDP dynamics of EU Member States in 2020 (%)



Source: EC, NIS

Note: In the case of Romania, real GDP dynamics is given by the most recent NIS estimates

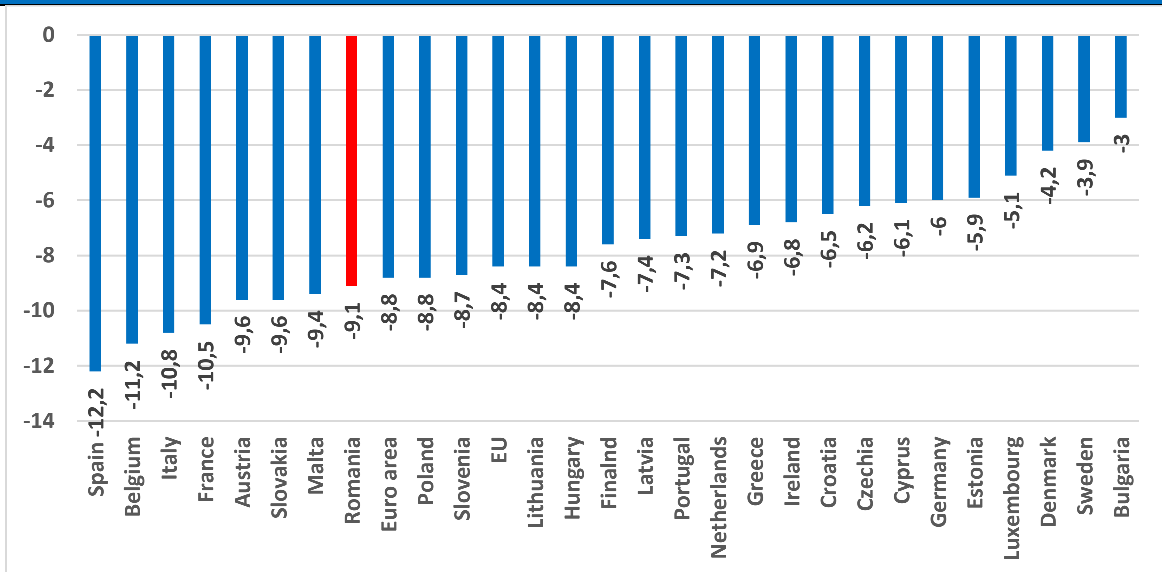
Figure 2: Estimated real GDP dynamics of EU Member States for 2021 (%)



Source: EC, NCSP

Note: In the case of Romania, real GDP dynamics is given by the NCSP estimate which underlies the budget draft for 2021

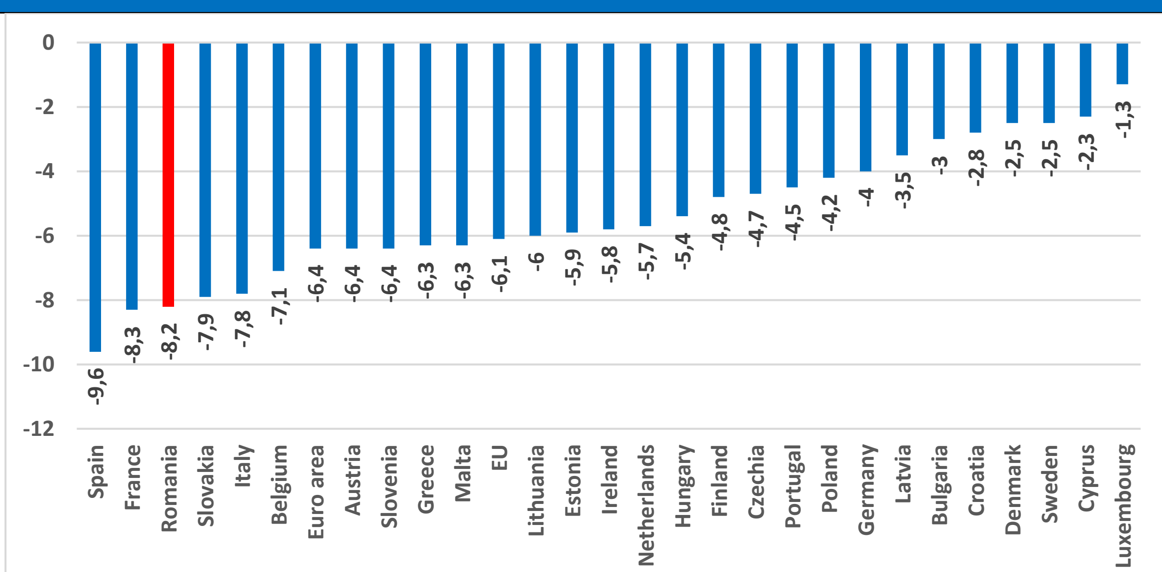
Figure 3: Budget balance of EU Member States in 2020 (% of GDP, ESA 2010)



Source: Ameco, MF

Note: In the case of Romania, the budget balance is given by the MF estimate

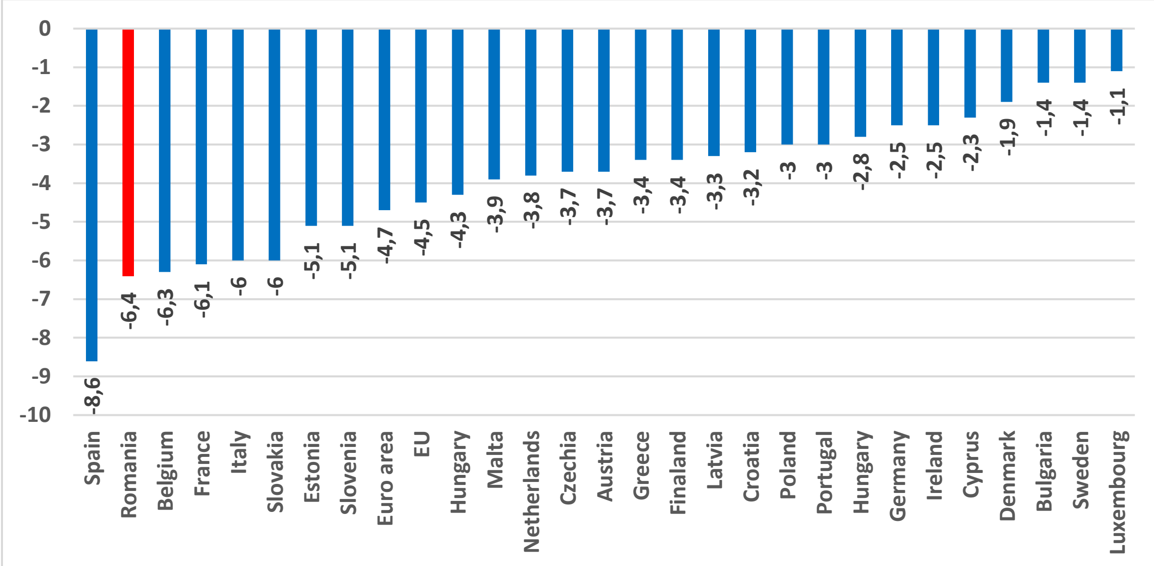
Figure 4: Estimated budget balance of EU Member States for 2021 (% of GDP, ESA 2010)



Source: Ameco, MF

Note: In the case of Romania, the budget balance is given by the MF estimate

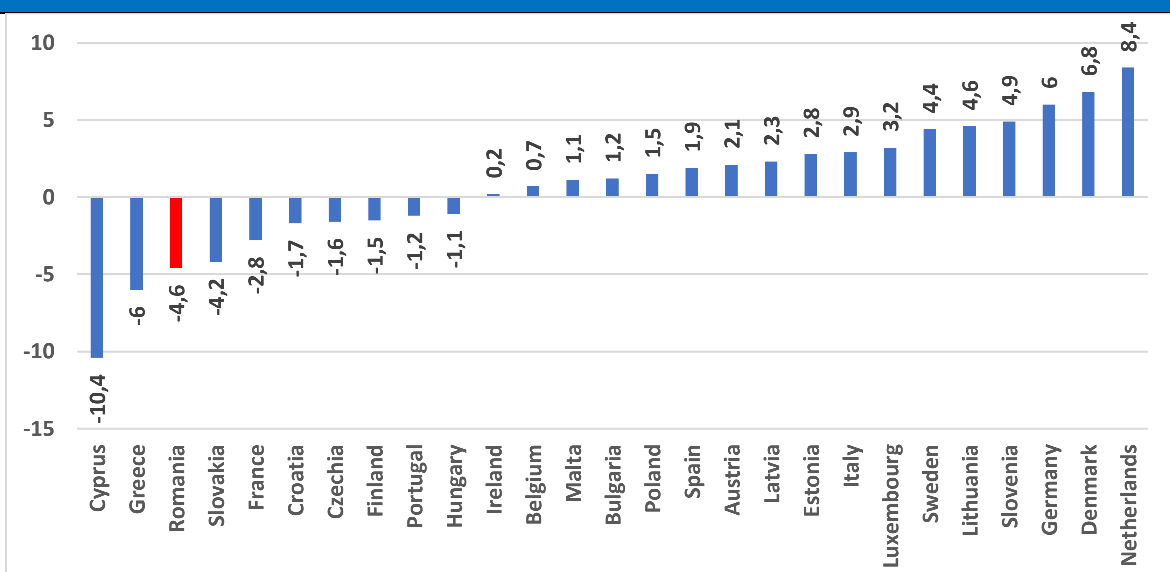
Figure 5: Estimated budget balance of EU Member States for 2022 (% of GDP, ESA 2010)



Source: Ameco, MF

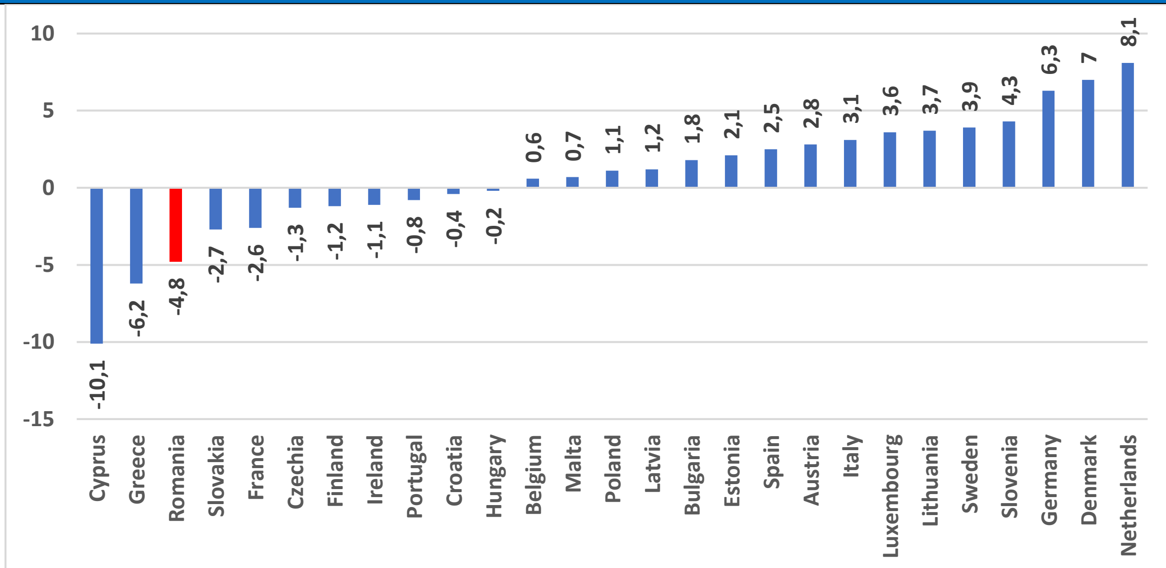
Note: In the case of Romania, the budget balance is given by the MF estimate

Figure 6: Current account balance of EU Member States in 2020 (% of GDP)



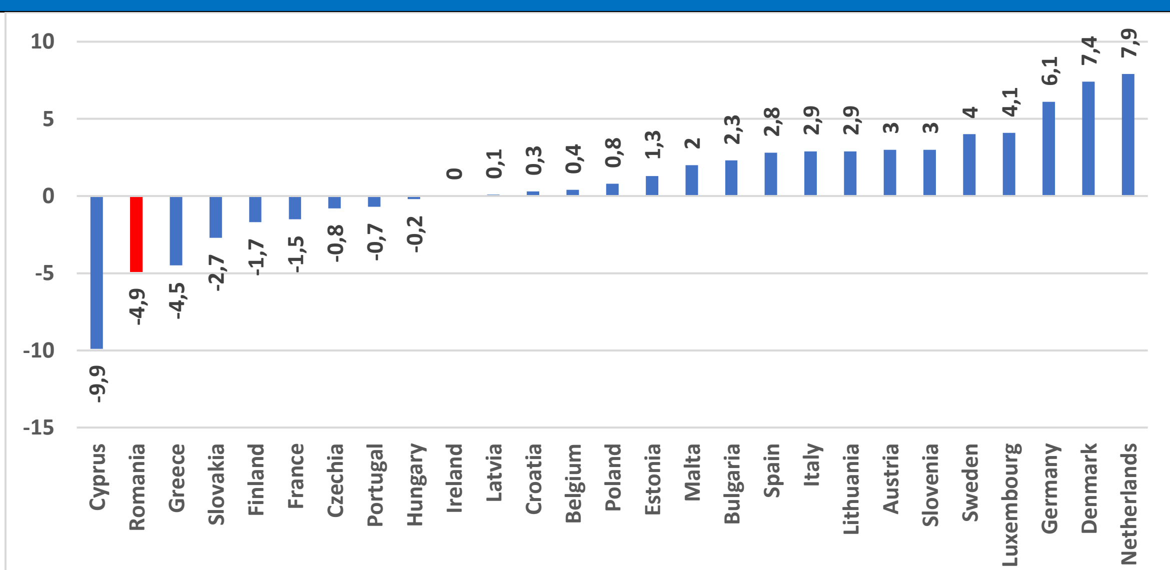
Source: Ameco

Figure 7: Estimated current account balance of EU Member States for 2021 (% of GDP)



Source: Ameco

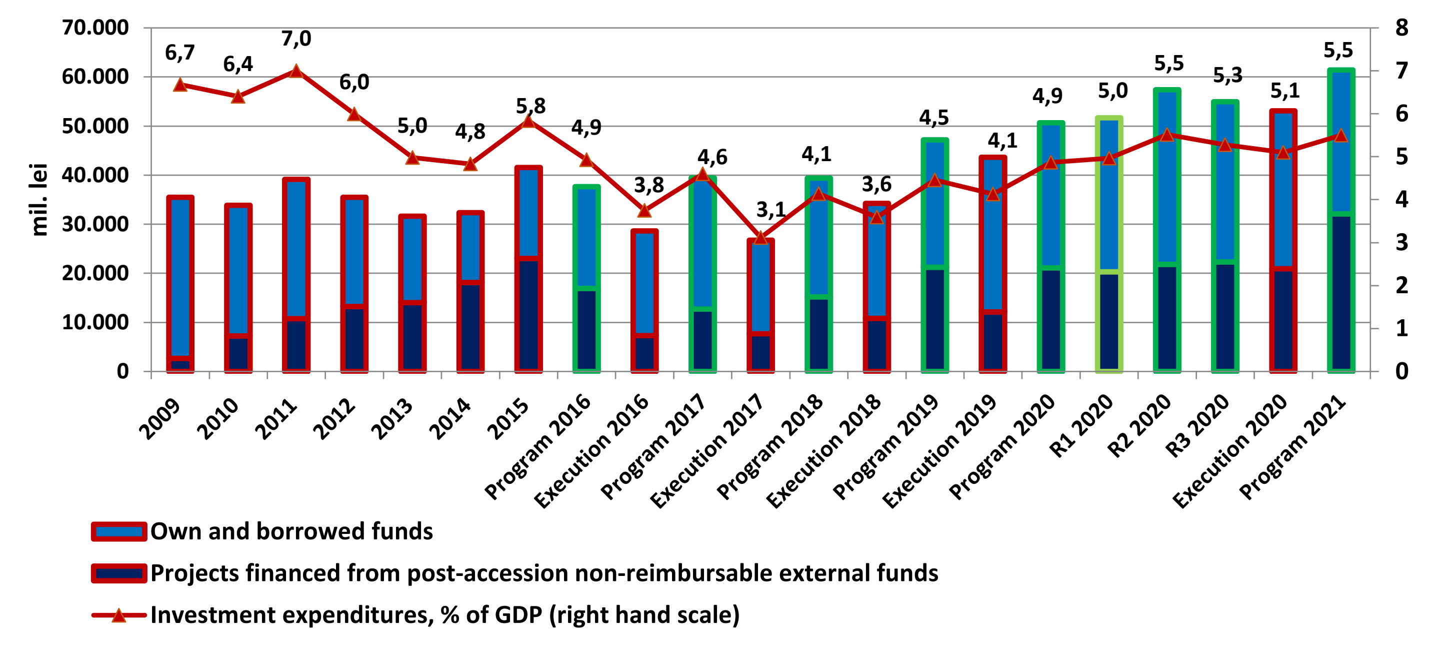
Figure 8: Estimated current account balance of EU Member States for 2022 (% of GDP)



Source: Ameco

Annex V

Figure 9: The evolution of public investment expenditures between 2009-2021 – planned level vs. realized (mil. lei)



Source: MF, FC's calculations

EU FUNDS	Execution 2020 (mil. lei)			Projection 2021 (mil. lei)			Projection 2022 (mil. lei)		
	Structural	Agriculture	Amounts according to art. 10 letter a) of GEO no. 40/2015	Structural	Agriculture	Amounts according to art. 10 letter a) of GEO no. 40/2015	Structural	Agriculture	Amounts according to art. 10 letter a) of GEO no. 40/2015
EU funds inflows	15,145.3	17,129.8	1,040.8	23,266.7	21,437.3	1,200.0	22,964.1	18,607.7	1,963.0
EU funds expenditure	24,515.3	17,129.8	1,040.8	34,704.2	21,437.3	1,200.0	36,383.1	18,607.7	1,963.0
National cofinancing and ineligible expenses	9,370.0	0.0	0.0	11,437.5	0.0	0.0	13,419.1	0.0	0.0

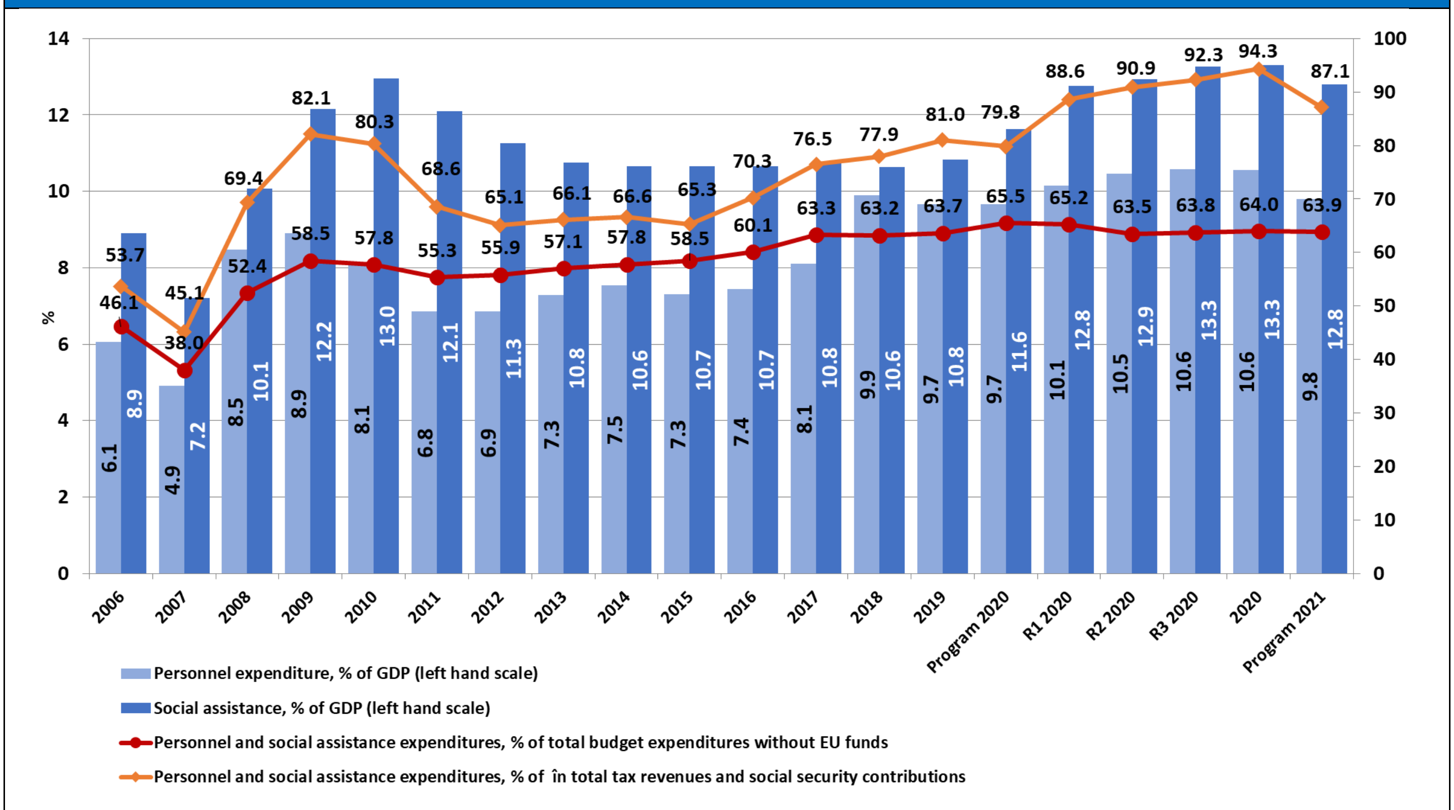
Source: MF, FC's calculations

EU FUNDS - continuation -	Projection 2023 (mil. lei)			Projection 2024 (mil. lei)		
	Structural	Agriculture	Amounts according to art. 10 letter a) of GEO no. 40/2015	Structural	Agriculture	Amounts according to art. 10 letter a) of GEO no. 40/2015
EU funds inflows	18,636.0	18,743.6	2,239.6	19,190.2	18,535.5	2,049.7
EU funds expenditure	30,027.0	18,743.6	2,239.6	30,514.8	18,535.5	2,049.7
National cofinancing and ineligible expenses	11,391.0	0.0	0.0	11,324.5	0.0	0.0

Source: MF, FC's calculations

Annex VI

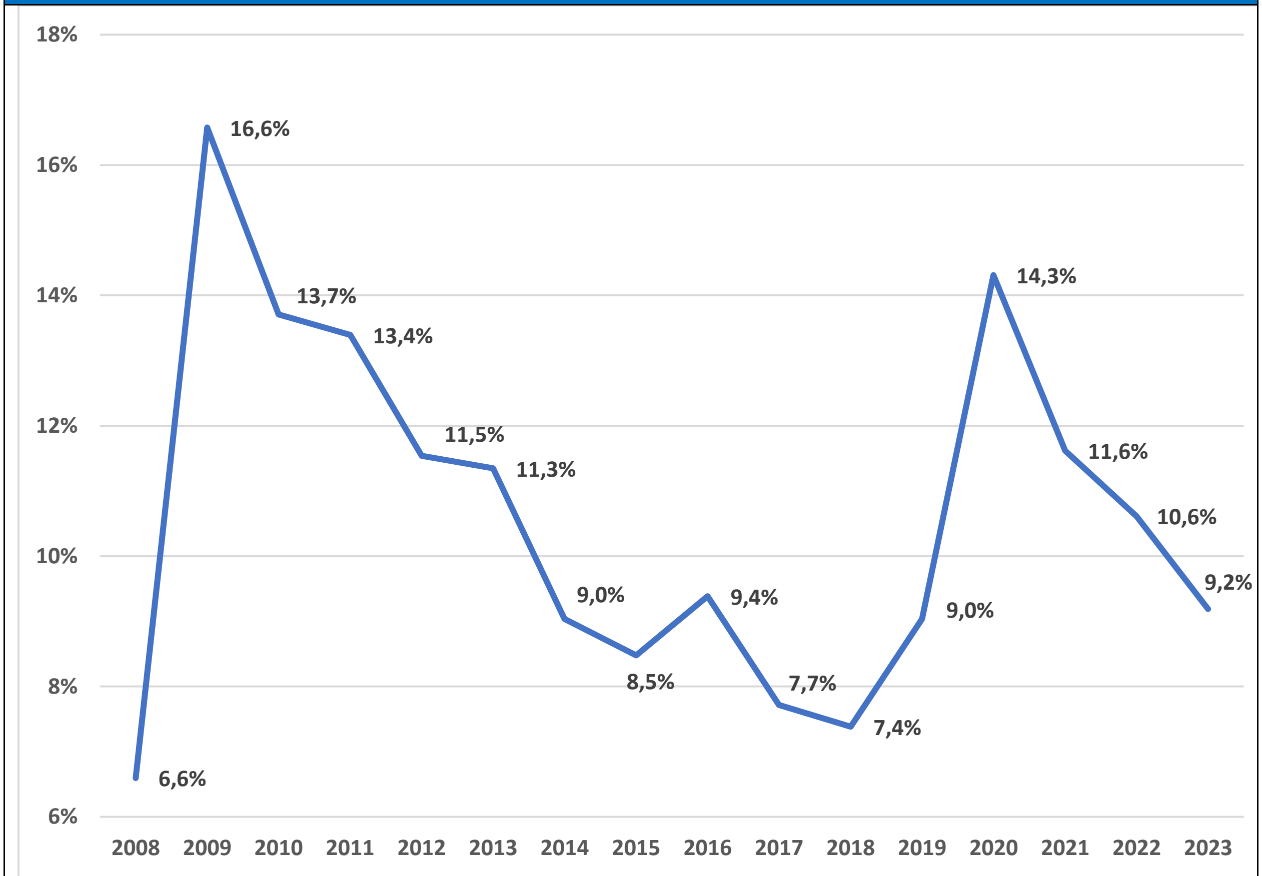
Figure 10: The evolution of personnel and social assistance expenditures between 2006-2021



Source: MF, FC's calculations

Annex VII

Figure 11: The evolution of Romania's financing needs between 2008-2020 and projections for the 2021-2023 period (% of GDP)



Source: MF