Foreign
Investors
Council

A LONG-TERM VISION FOR A PROSPEROUS COUNTRY

April 2024

Romania is in a complex environment marked by several macroeconomic imbalances: the twin deficits—budget and current account, the structural problem of demography—the difference between the active and retired population, the need for a qualified and healthy workforce, but also the climate transition that introduces additional costs and requires the reorganization of important economic sectors. A strategic approach is necessary in order to ensure the maintaining of the budget deficit ceiling for the coming years, but also a recovery of the economy based on sustainable pillars.

Considering the four types of elections scheduled for 2024, this year may represent a turning point for Romania. The geostrategic position, the EU and NATO membership, the evolution regarding the Schengen Area and the prospects of joining the OECD represent important competitive advantages for Romania. Broad consultation between political parties, business and civil society is needed to outline a common vision and set the guidelines for the development of the economy and society.

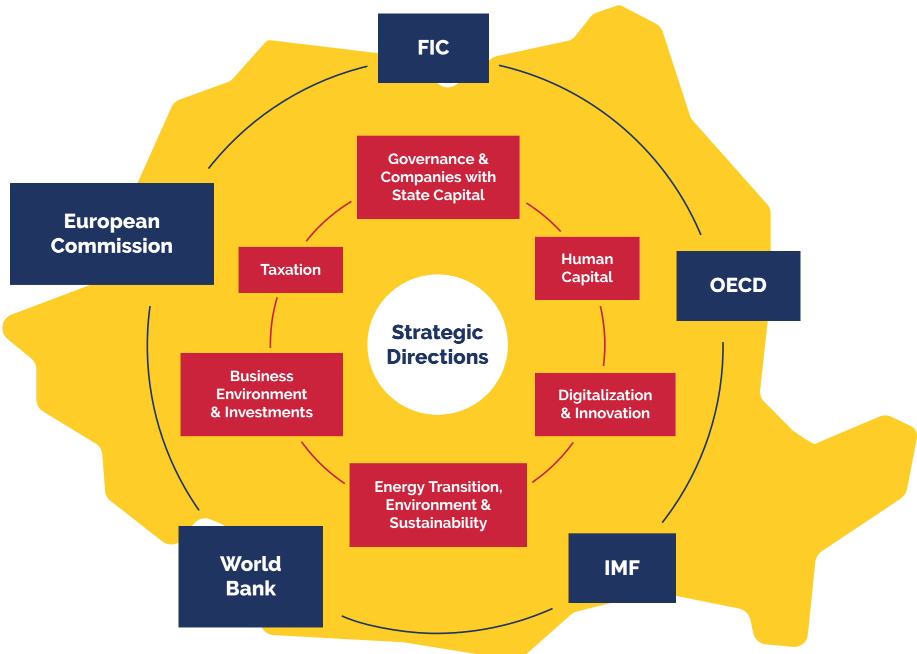
In the medium term Romania continues to have access to European funding that has the huge potential to contribute mightily to the country's development, but in the long term EU countries will have to rely more and more on their own funding for public investment projects, and also to encourage private investments. Furthermore, the state budget's limited resources need to be utilized more rationally, i.e. to finance projects that generate income for public authorities either through financial instruments and/or through a combination of financial instruments and grants, based on a careful analysis of the business plans for these projects. This approach should be properly reflected in relevant policies, strategies and especially in funding programs where the use of financial instruments is still very limited.

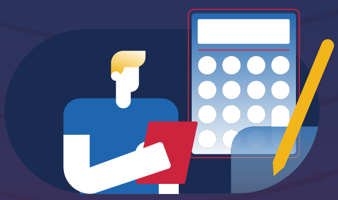
Foreign direct investment also contributes significantly to economic development, both in terms of capital, but also the technological advance and know-how they bring to the production and service chains in which they are present. A friendly investment climate is based on consultation with the business environment and a clear, fair, predictable, and stable legislative framework. Also, the macroeconomic framework, fiscal system, market size, public services, education and skills, level of de-bureaucratization and digitalization of public administration, technology and infrastructure are equally important for investors when deciding a destination for their projects. All these elements lead not only to a more developed economic environment, but also to the well-being of citizens.

The **Foreign Investors Council (FIC)** analyzes the key areas for the economy from a strategic perspective, in the medium-long term, in line with good practices from other countries, but updated to Romania's specificities. In this sense, we carried out several projects and analyzes - Va Urma, the White Book, the Study on foreign direct investments - with the aim of identifying the current blockages, opportunities and challenges that Romania has, but also the measures that could accelerate economic development and the country's competitiveness in the region. At the same time, we analyzed the recommendations and reports of international institutions for Romania (Organization for Economic Cooperation and Development - OECD, World Bank, European Commission, International Monetary Fund - IMF), but also the targets and reforms assumed under the National Recovery and Resilience Program (NRRP) – the table in the annex.

In this regard, we present the main recommendations of FIC for medium and long-term measures for the sustainable development of Romania, and also the correlations with the proposals of the World Bank, the IMF, the European Commission, the OECD and with the milestones in the NRRP, in order to have a complete perspective of the strategic directions that Romania must analyze, prioritize, implement and adjust according to the characteristics of our country.

We highlight that all the mentioned organizations recommend the transparency and predictability of the legislative process, public-private partnerships, reducing the use of governmental emergency ordinances as a legislative instrument and following up the commitments of systematization of policy impact assessments.





I. Taxation

Common measures (FIC, World Bank, IMF, European Commission, OECD, NRRP):

- Reducing the budget deficit by streamlining budget processes, increasing the collection and share of revenues to the state budget (including in the long term).
- Combating tax evasion/fraud and reducing the VAT gap.
- Digitalization and modernization of ANAF (integrated risk management and modernization of systems).
- Tax system reform and a credible plan for fiscal consolidation.
- Gradual withdrawal of tax incentives/fiscal facilities.
- Pension reform (increasing the retirement age, limiting the possibilities of early retirement, eliminating special pensions).

Additional measures:

- NRRP includes the adjustment of social insurance contributions (CAS, CASS, CAM), and the business environment supports their capping. At the same time, the OECD draws attention to the high level of social contributions.
- A form of progressive taxation with a focus on reducing the tax burden on low wages is recommended by the World Bank, the OECD and the IMF. This measure is recommended to be implemented over an extended period of time. The business environment draws attention to the fact that the topic of progressive tax versus flat tax should be broader and not limited to income tax rates.
- First, it should target total taxation (income tax and social security contributions) as a percentage of gross salary. In 2021, total taxation was 37.2% while the EU average was 31.9% and the OECD average 34.5%. According to the latest data published by Eurostat, Romania is the 5th country in the EU, at the same level as Austria, in terms of the size of the tax burden on salaries.
- Secondly, without an analysis of the structure of the economy, it is possible that the introduction of this tax will not increase the budget revenues, but could have other effects: labor force migration, underdeclared incomes (in the envelope), etc.
- Third, in the absence of a comprehensive structural reform of ANAF, the application and control of a progressive system will be very difficult to manage. Progressive taxation,

often present in highly developed economies, can only produce the predominantly positive effects expected if its provisions consider the economic and fiscal maturity of the adopting states. In this regard, countries such as Poland and the Czech Republic, which are gradually returning to progressive taxation, have also introduced a series of compensatory measures, deductibility.

- The World Bank and the IMF recommend the reform of public salaries, including the cancellation of vacancies and predictability in the allocation of budgetary resources for salaries and pensions.
- The OECD also recommends increasing the VAT base by uniformly applying a standard rate.

FIC documents: White Book, Study of taxes paid by FIC members, Analysis of income taxation in Romania, Romania in the OECD

Other reports that were the basis for the development of this section: OECD Economic Survey (March 2024 edition), World Bank Report on the fiscal system in Romania (March 2023 edition), World Bank Report - Updated Systematic Country Diagnosis (June 2023 edition), IMF Country Report (September 2023 edition)

//. Human Capital

Common measures
(FIC, World Bank, IMF, European Commission, OECD, NRRP):

- Measures to reduce inequalities (minorities, women, vulnerable people, disadvantaged areas) and increase social inclusion.
- Analysis of expenditure in the health and education sectors (efficiency, effectiveness).
- Development of open educational resources.
- Programs to improve skills, including in the workplace.
- Digitalization of the healthcare system and the creation of competence development centers for staff in the public healthcare system.
- Modernization of healthcare infrastructure in the medium and long term.

Additional measures:

- FIC considers that there needs to be a gradual increase in the percentage of GDP allocated to healthcare, in order to reduce the gap between Romania and other EU countries in terms of the healthcare financing. New alternative solutions for healthcare financing should be identified, with a focus on private contributions, European funds in the future programming period, as well as public-private partnerships.
- FIC recommends better training, continuing medical education, implementation of modern management systems, which will lead to increased performance of medical professionals. Decentralization of the public healthcare system will also lead to more entrepreneurial management of each medical institution and higher staff retention rates.
- The main areas that should be addressed to manage the labor shortage in the economy, including through measures such as labor import, are, according to the FIC, the following: staff training, future skills development, but also labor retention. There is also a need to develop a medium/long-term strategy in order to adapt the education system to the new model of economic growth in line with the digital and energy transition.
- FIC and IMF recommend implementing more options for childcare, so that mothers can return to work more quickly.
- FIC and IMF recommend measures to to enhance the flexibility of the labour regulatory framework (part-time).

- The OECD and the World Bank pay special attention to education, especially for disadvantaged environments and support measures for disadvantaged schools, investment in IT equipment for schools, increasing access to quality early education and care, especially in rural, poor and marginalized areas, and improving the quality of education in primary and secondary schools at risk of dropping out. FIC also considers all these measures necessary for the proper preparation of the future workforce and for reducing the economic gap between the regions of Romania.
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- The OECD also recommends increasing the VAT base by uniformly applying a standard rate.

FIC documents: White Book, Va Urma, White paper regarding the financing of the healthcare system, Romania in the OECD

Other reports that formed the basis of this section: OECD Economic Survey (March 2024 edition), World Bank Report - Updated Systematic Country Diagnosis (June 2023 edition) , IMF Country Report (September 2023 edition)

///. Energy Transition, Environment & Sustainability

Common measures
(FIC, World Bank, IMF, European Commission, OECD, NRRP):

- Additional renewable energy capacity.
- Strengthening the electricity storage capacity.
- Investments in energy efficiency in industry.
- Measures to ensure the energy efficiency of buildings.
- Accelerating the decision-making process regarding the use of European funds available for the modernization of the energy sector.
- Harmonization of strategic documents for the environment, energy and sustainable development.
- Improving the waste management system.
- Measures to achieve climate neutrality.

Additional measures:

- FIC suggests tracking certain elements for the energy transition: security of supply - natural gas and electricity, production and consumption of sustainable energy, the socio-economic dimension of the energy transition, prosumers, public financing instruments. Develop a credible plan to accelerate the use of renewables in the hard-to-decarbonize sectors, especially the heating and cooling sector. Accelerating the process of national and regional retraining to balance the potential reduction of labour demand among activities with high greenhouse gas emissions. To be underlined that all the above mentioned institutions recommend targeted support schemes limited to vulnerable consumers and free market conditions.
- FIC proposes addressing the following aspects of the waste management system: the achievement of waste management objectives and the allocation of responsibility to the actors involved in the waste management chain, transparency and traceability, the acceptance of waste for recycling and the termination of waste status, the development of infrastructure and the unification of reporting systems, funds for environmental projects.

- FIC considers necessary for the authorities to fully support the decarbonisation of the economy through all means, including co-financing. Effective and transparent planning as well as an enabling legislative framework is recommended in this regard, including on how to achieve the various mandatory EU objectives, on how to prepare and adapt the country to the new implementation technologies (CCUS, Biomethane, batteries / flexibility assets, hydrogen etc.) would foster innovation and knowledge sharing and enable the most cost-effective solutions to be found in all economic sectors, but also in the public sector.
- According to the FIC & ASE study - FDI seems to play a more consistent role in promoting sustainability in CEE economies than in the entire EU region. Thus, they can lead to investments in renewable energy projects, transfer of technology and know-how that can stimulate the development and adoption of renewable energy in the medium and long term.
- The OECD and the IMF raise the topic relating to carbon taxation (including for certain sectors – transport, construction) and the elimination of fossil fuel subsidies and the introduction of excise duties. The business environment believes that any new taxes or adjustments must be discussed with all interested parties and analyzed according to the economic and competitive context of Romania. In this regard, we consider necessary to setup a working group with experts from the Government, OECD, IMF and private companies in order to identify the best measures to ensure the energy transition. A tailored approach should consider national specificities of the energy market and natural resources.

FIC documents: White Book, Va Urma, Study on FDI , Document on waste management, Study on the Romanian Energy Market Analysis with a focus on Gas and Power, Romania in the OECD

Other reports that formed the basis of this section: OECD Economic Survey (March 2024 edition), IMF Country Report (September 2023 edition)

IV. Business Environment & Investments

Common measures (OECD, World Bank, FIC):

- Removing regulatory constraints that prevent the economic growth of productive firms and streamlining administrative procedures.
- Developing a strategic and coordinated approach to promote financial inclusion, financial literacy, capital market development and making the financial sector more environmentally friendly.
- Improving the design and implementation of policies promoting technological uptake, technology transfer, digitalization and modernization of firms' capacities.
- Increase the scale and effectiveness of research and innovation spending and strengthen the innovation ecosystem.

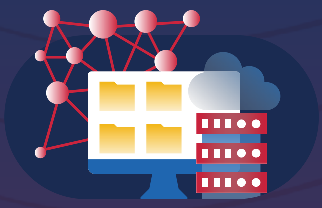
Additional measures:

- First, stimulating foreign direct investment with added value, high-tech and intensive use of knowledge in priority sectors where Romania can create competitive advantages and advance in the value chain, with a high productivity per worker. This requires selective tax incentives, co-financing for research, development, and innovation, simplified administrative procedures and modernization of ICT infrastructure.
- Secondly, the positioning of Romania as a center for ecologically sustainable foreign direct investment in areas such as renewable energy, green mobility, or the circular economy. In this regard, there is great market potential at local and regional level. It is, therefore, imperative to adopt comprehensive and competitive legislation and regulations covering carbon pricing, pollution control, environmental product standards, fair competition in energy markets, etc. - to reduce risks and ensure stable returns throughout the life cycle of these projects.
- Thirdly, improving the absorption of public funds and the efficiency of their management. Therefore, the continuation and, in particular, the implementation of reforms in the area of governance and fiscal consolidation, together with electronic governance solutions and transparency measures are essential to demonstrate Romania's commitment to a sustainable development.

- Fourth, the development of human capital. Romania still benefits from cost advantages but higher value-added activities require advanced skills. Therefore, education and training systems need to be modernised to meet investors' expectations, while also facilitating technology transfer.
- Fifth, promoting Romania's unique capabilities abroad by consistently promoting FDI and exports. Efforts should target those European countries which are important regional investors, to raise awareness about the specialized skills of Romania and the favorable conditions for establishing export-oriented operations.
- Finally, monitor the impact of EU-wide regulations and policies on location decisions and cross-border investments, while learning from regional best practices to make timely use of emerging FDI opportunities.
- In conclusion, Romania must define and implement a coordinated strategy that mobilises all responsible public and private actors to transform the high FDI flows into sustainable growth, competitiveness, and convergence with the EU. Attracting quality FDI starts with specific incentives, but is fundamentally dependent on internal capacities and integrated policies that enhance competitiveness.
- FIC believes that the efficiency of the foreign investment agency can be maximized if it reports to a supervisory board that includes representatives from all relevant institutions in attracting foreign investments (Ministry of Finance, Ministry of Economy, Ministry of Foreign Affairs, Presidential Administration) and even representatives of embassies and the private sector that could bring more responsibility, efficiency and promote the image of Romania as a destination for investments. The direct reporting to the prime minister and the existence of a supervisory board with multi-institutional representation would be a signal that the entire government is oriented towards performance and reforms in the direction of attracting FDI, and it is not only a consequence of the effort of a small unit or representatives of the private sector. Collaboration with private investors: association with the main investor groups (foreign and domestic) in Romania, so as to facilitate the links between foreign and private Romanian companies and, further, with universities, local and central public authorities. This can also contribute to the reduction of Romania's trade balance deficit.
- FIC recommends providing the minimum tools available for each municipality in Romania - sector presentations, opportunities, industrial base, potential suppliers and the dynamics of the economy in recent years (for example, groups of relevant indicators: labour, supply chain, taxation and incentives, crime, tax and legal issues, macroeconomics).
- FIC recommends the strategic use of sectoral state aid schemes, focusing on a selection of areas that (i) are locally competitive and/or (ii) have high potential to bring great added value to the economy - growth on value chain added to R&D, Design, After-service segments.

FIC documents: White Book, Va Urma, The FIC Study on Foreign Direct Investment, Romania in the OECD

Other reports that were the basis for the preparation of this section: OECD Economic Survey (March 2024 edition), World Bank Report – Updated Systematic Country Diagnosis (June 2023 edition), Recommendation for a Council Recommendation on the 2023 National Reform Programme of Romania and delivering a Council opinion on the 2023 Convergence Programme of Romania



V. Digitalization & Innovation

Common measures (NRRP, European Commission, World Bank, FIC):

- Digital transition and investing in digital transformation and infrastructure

Additional measures:

- FIC and the World Bank recommend promoting and adopting new technology in both the public and private sectors, as well as digitalising the interaction between business and central and local governments.
- FIC and the World Bank encourage the promotion of measures to improve digital literacy among the population. Also, incorporating digital tools into companies' business activities to prepare for the transition to industry 4.0.
- FIC supports the stimulation of the absorption of technology/innovation, the creation of dedicated industrial parks for „smart factories" and cooperation with the CEE states with the aim of sharing best practices used in the field of digitalization.

FIC documents: White Book, Va Urma, Romania in the OECD

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VI. Governance & State-owned Companies

Common measures (FIC, OECD, IMF, World Bank):

- Anti-inflationary measures - monetary policy makers should remain focused on reducing inflation.
- Ensuring that the enhanced rules on corporate governance of state-owned companies are properly implemented and monitored.
- Improving the management and monitoring of state-owned entities.
- Updating policies to eradicate corruption, developing and implementing a new strategy for the justice sector.
- Improving administrative capacity (in particular local public administration).

Additional measures:

- FIC and the World Bank recommend promoting and adopting new technology in both the public and private sectors, as well as digitalising the interaction between business and central and local governments.
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