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Romania's Euro Area accession

Abstract

Eurozone integration is still a target and a challenge for most Eastern European countries, even after twenty years from the accession to the European Union. While financial integration is viewed as an opportunity, there is an ongoing debate about its optimal form. Beyond meeting the Maastricht criteria, with which some countries comply, several critical issues arise: what is the most appropriate type of financial integration within the European Union and whether the development of a Capital Markets Union and a Banking Union can address market fragmentation effectively. Moreover, in the absence of suitable institutional frameworks, are these mechanisms able to overcome asymmetric shocks to accommodate economic convergence and mitigate systemic risks? The Euro Area needs tools like collective deposit insurance schemes (EDIS) and to increase the resources for the Single Resolution Fund (SRF) to address systemic risks more effectively. Economic convergence mechanisms are compulsory to reduce the divergence of NPLs across Member States. The creation of European "safe assets," such as Sovereign Bond-Backed Securities (SBBS), seeks to mitigate the bank-sovereign doom loop.

Keywords: Maastricht criteria, economic reforms, fiscal imbalances, structural weaknesses
JEL Classification: E6

Introduction

In recent years, the Romanian economy has been marked by persistent budget deficits, external imbalances, and structural inefficiencies. These challenges have raised serious concerns among citizens, international creditors, and institutions regarding the country's macroeconomic stability and its capacity to meet the Maastricht criteria for Eurozone accession. In 2024, the fiscal deficit stood at 8.7% of GDP – significantly above the European Union's (EU) permitted threshold of 3%. Simultaneously, the current account deficit is projected to reach 8.3% of GDP, underscoring the severity of the twin deficit problem [European Commission, 2024; Eurostat, 2024]. These imbalances exert pressure on the Romanian leu (RON), undermine investor confidence, and increase borrowing costs, further complicating efforts toward fiscal consolidation.

Given Romania's stated objective of joining the Eurozone, compliance with the Maastricht criteria is of paramount importance. Historically, the country has faced difficulties in meeting core macroeconomic benchmarks, especially those concerning price stability, fiscal discipline, and exchange rate stability. Inflationary pressures and persistently high long-term interest rates have hindered Romania's entry into the Exchange Rate Mechanism II (ERM II), which is a necessary precondition for monetary integration into the Eurozone [European Central Bank, 2024]. Moreover, Romania's financial system exhibits notable vulnerabilities, including a high reliance on external financing and limited credit access for small and medium-sized enterprises (SMEs), which further exacerbate economic instability [World Bank, 2024].

This paper investigates Romania's fiscal and economic challenges within the broader context of European economic integration. It evaluates the country's adherence to the Maastricht criteria over the period 2020–2024, taking into account economic shocks, fiscal policy decisions, and external influences that have shaped its economic trajectory. Additionally, the study addresses Romania's structural shortcomings, such as underdeveloped capital markets, low investment in research and development (R&D), and inefficiencies in the labour market – all of which hinder long-term economic growth and convergence with Eurozone economies [European Investment Bank, 2023].

Between 2020 and 2023, Romania's general government revenue averaged merely 27.8% of GDP, in stark contrast to the EU27 average of 41.5% [Eurostat, 2024]. This considerable fiscal gap reflects the structural limitations of the Romanian tax system, including low revenue productivity, extensive tax evasion, and administrative inefficiencies [Dăianu, 2023]. The introduction of a flat personal income tax rate of 10% in 2018, though intended to simplify taxation and increase competitiveness, has in fact contributed to a decline in overall revenue mobilization [Romanian Ministry of Finance, 2024].

A comparative analysis of fiscal and administrative reforms implemented in neighbouring Central and Eastern European countries, such as Poland, Czechia, Hungary, and Bulgaria, offers valuable insights for potential reform strategies in Romania. These countries have pursued tax system digitalization, improved compliance frameworks, and legislative reforms aimed at enhancing economic resilience and fiscal sustainability [OECD, 2023].

By adopting similar approaches, Romania could strengthen its fiscal architecture, bolster financial stability, and cultivate an environment conducive to sustainable economic development.

To address the aforementioned issues, this paper advances a series of policy recommendations focused on four pillars: strengthening fiscal discipline, enhancing financial stability, promoting structural reforms, and increasing resilience to economic shocks. Fiscal consolidation – through more effective revenue collection and prudent expenditure management– will be essential to ensure compliance with EU fiscal rules and mitigate macroeconomic vulnerabilities [IMF, 2024]. In addition, implementing macroprudential measures to reduce dependence on external financing, promoting innovation-led growth, and improving labour market flexibility are imperative steps towards achieving long-term economic stability and successful Eurozone accession.

Through the implementation of comprehensive economic reforms and by drawing lessons from regional peers, Romania can reinforce its macroeconomic resilience, fulfill the Maastricht criteria, and return to a path of sustainable and stable economic development. The findings of this study contribute to the academic and policy discourse on Romania’s economic trajectory and propose a framework for achieving fiscal sustainability and successful integration within the European Monetary Union.

Romania’s outlook on fiscal deficit and budget management

Romania’s excessive fiscal deficit in 2024 is projected to persist into 2025. Forecasts indicate that the deficit will remain above 5% of GDP, with some estimates suggesting it may exceed 6%. This sustained fiscal imbalance undermines the country’s efforts to comply with the Maastricht criteria required for Eurozone accession and significantly increases the risks to macroeconomic stability [Romanian Ministry of Finance, 2024]. Moreover, it presents further obstacles to maintaining investor confidence and ensuring the stability of the national currency. Without substantial fiscal consolidation, Romania faces heightened risks of long-term economic instability.

Among Romania’s key fiscal challenges is the widening current account deficit, projected to reach 8.3% of GDP in 2024 – well above the EU average of 2.9% [Eurostat, 2024]. This twin deficit scenario, combining a fiscal deficit and a current account deficit, is primarily driven by the excessive domestic demand. The growing external deficit places additional pressure on the Romanian leu (RON), which is already vulnerable due to fiscal imbalances. This dynamic undermines further Romania’s economic stability and complicates its prospects for Eurozone integration, as external imbalances limit the effectiveness of monetary policy [IMF, 2024].

Romania's monetary policy is significantly influenced by the policies and regulations of the European Central Bank (ECB), owing to its EU membership and the relatively small scale of its economy. Discrepancies between domestic interest rates and those set by the ECB may lead to destabilizing capital flows, thereby affecting the exchange rate and broader financial stability [European Central Bank, 2024]. The Romanian leu remains susceptible to shifts in fiscal and monetary policy, with a heightened risk of depreciation should investor confidence deteriorate.

In 2024, domestic private credit in Romania stood at 27% of GDP – a substantial decline from over 37% in 2008. This decline suggests that domestic credit no longer plays a central role in stimulating economic growth, which instead has become increasingly reliant on government expenditure and income policies [National Bank of Romania, 2024]. Consequently, small and medium-sized enterprises (SMEs) face major challenges in accessing credit, often resorting to commercial credit over traditional bank financing. This dual financial structure privileges larger enterprises with access to international funding, while SMEs remain exposed to credit shortages, as witnessed during the 2008 financial crisis [OECD, 2024].

To address its unsustainable fiscal deficit, Romania must prioritize fiscal consolidation. Reducing the deficit to below 3% of GDP is essential to comply with EU fiscal rules and ensure long-term economic sustainability. Structural reforms should focus on enhancing revenue collection efficiency and optimizing public expenditure. Rather than pursuing higher tax rates, an emphasis should be placed on improving tax compliance and eliminating unnecessary government spending [European Commission, 2024].

The politically sensitive issue of pension increases and public sector wage growth must be managed prudently within the context of Romania's fiscal constraints. While it is imperative to increase public revenues, pension and wage policies must not exacerbate the fiscal deficit. Striking a balance between social expectations and fiscal discipline is vital to avoid further deterioration of Romania's public finances [Romanian Government, 2024].

Institutional reforms are essential for improving fiscal governance. Measures aimed at increasing administrative efficiency, advancing digitalization, and promoting budget transparency are key to enhancing public sector performance [World Bank, 2024]. Furthermore, addressing corruption and strengthening the capacity of the National Agency for Fiscal Administration (ANAF) are critical for reducing tax evasion and boosting revenue collection [Transparency International, 2024].

Despite the contraction in domestic private credit, Romania remains vulnerable to financial instability due to its reliance on external financing. To mitigate these risks, macroprudential policies (MPPs) must be implemented to regulate credit growth and address vulnerabilities such as exposure to foreign currency-denominated debt. These measures are fundamental to stabilizing the financial system and reducing Romania's external vulnerabilities [IMF, 2024].

Inflation control, coupled with measures to address external imbalances, is essential for maintaining currency stability. Persistent fiscal and current account deficits weaken Romania's capacity to contain inflation and manage exchange rate volatility. If left unresolved, these imbalances may trigger a negative feedback loop, further destabilizing the economy [European Central Bank, 2024]. Sound fiscal policies, including efforts to curtail inefficient public spending, are indispensable for securing long-term economic stability and preserving investor confidence.

Assessment of Romania's compliance with the Maastricht criteria (2020–2024)

The Maastricht criteria establish the economic and fiscal prerequisites for European Union (EU) Member States seeking to adopt the euro. These include price stability, sustainable public finances, exchange rate stability, and convergence of long-term interest rates [European Central Bank, 2024].

Price stability

To satisfy the price stability criterion, a country's inflation rate must not exceed by more than 1.5 percentage points the average rate of the three EU Member States with the lowest inflation [ECB, 2024]. Romania's inflation dynamics were strongly influenced by post-pandemic supply chain disruptions, energy price shocks, and the geopolitical consequences of the war in Ukraine.

According to Eurostat [2024], Romania's annual inflation rose from 2.6% in 2020 to a peak of 14.5% in mid-2022, driven primarily by surging energy and food prices. Despite the Central Bank's tightening measures, including a benchmark interest rate hike to 7.00% by late 2023 [National Bank of Romania, 2023], inflation remained elevated at 9.1% in 2023 and declined moderately to an estimated 6.5% in 2024. This consistently exceeded the reference value, preventing compliance. Romanian economist Dăianu [2023] underscores the structural rigidity of prices in non-tradable sectors and the procyclical nature of fiscal policy as key contributors to inflation persistence.

Sustainable public finances

The Maastricht Treaty mandates that the general government deficit should not exceed 3% of GDP, and public debt must remain below 60% of GDP. Romania's fiscal position deteriorated substantially due to pandemic-related spending and structural rigidities in public finance.

The general government deficit reached 9.2% of GDP in 2020, moderated to 5.8% in 2023, but is projected to remain above 5% in 2024 [Ministry of Finance, 2024]. Although public debt rose from 35.3% of GDP in 2019 to 49.3% in 2024, it remains within the Maastricht ceiling. However, persistently high deficits reduce fiscal space and impair the credibility of convergence strategies. Romania's continued reliance on consumption-based growth, coupled with low tax revenue – 27.8% of GDP in 2023 compared to the EU27 average of 41.5% [Eurostat, 2024] – reflects systemic inefficiencies. Dăianu [2022] further argues that the structural deficit must be addressed through tax administration reform and expenditure rationalization.

Exchange rate stability

Membership in the Exchange Rate Mechanism II (ERM II) is a precondition for adopting the euro. Romania has not entered ERM II yet. Nevertheless, the leu (RON) remained relatively stable, fluctuating within ±2% against the euro between 2020 and 2024, primarily due to National Bank interventions and remittance inflows.

Prior accession to ERM II it is important to have an exchange rate anchoring and institutional credibility. Romania's failure to meet this criterion reflects broader institutional vulnerabilities, including political unpredictability and inconsistent fiscal coordination.

Long-term interest rate convergence

Long-term interest rates must not exceed by more than 2 percentage points the average of the three lowest inflation EU countries. Romania's long-term government bond yields ranged from 4.4% in 2020 to an estimated 3.2% in 2024 [Eurostat, 2024]. Despite improvements, these remained above the reference threshold, reflecting investor risk perceptions tied to macroeconomic instability.

The fiscal credibility and policy coherence are key drivers of interest rate convergence. Romania's weak fiscal anchor, limited pension reform, and slow capital market development contributed to elevated risk premia.

Conclusion

Between 2020 and 2024, Romania failed to meet three of the four Maastricht criteria. Persistent inflation, excessive fiscal deficits, and exclusion from ERM II undermine its convergence trajectory. While public debt remained within acceptable bounds, long-term interest rates did not fully converge. Achieving nominal and real convergence will require consistent macroeconomic policies, structural reforms, and improved fiscal governance, as emphasized by Dăianu [2023] and Polanski [2022]. Without credible reforms, euro adoption remains a distant objective.

Comparative reforms in Poland, Czechia, Hungary, and Bulgaria

Digital transformation and modernization of tax systems

Poland has made significant progress in modernizing its tax administration through the introduction of the "Twój e-PIT" (Your e-PIT) platform in 2022. This system has simplified the filing process for individual taxpayers by providing automated, pre-filled personal income tax returns. It has reduced the administrative burden, improved the accuracy of submissions, and lowered operational costs [European Commission, 2022]. Additionally, Poland implemented the Standard Audit File for Tax (SAF-T), which facilitates digital reporting and auditing by tax authorities, thereby enhancing tax transparency and compliance [OECD, 2020].

Czechia launched its digital platform "MOJE daně" (My Taxes) in 2020, enabling real-time tax filing and secure communication between taxpayers and tax authorities. This has improved administrative efficiency and taxpayer compliance substantially [OECD, 2020]. Furthermore, the Electronic Sales Registration (EET) system, introduced in 2016, mandates real-time reporting of business transactions to reduce tax evasion and increase fiscal transparency [Czech Ministry of Finance, 2016].

Hungary has been at the forefront of digital tax reforms in Central and Eastern Europe. It introduced online cash registers and real-time invoicing systems in 2014, directly linking businesses to tax authorities and minimizing VAT fraud [Hungarian Tax and Customs Administration, 2014]. The eSZJA platform for personal income tax filing, implemented in 2015, has streamlined processes and improved taxpayer services further [Hungarian Government, 2015].

Bulgaria has modernized its tax infrastructure through the deployment of electronic fiscal devices (EFDs) since 2015. These are connected to the National Revenue Agency and aim to curb informal economic activities and enhance tax collection efficiency [Bulgaria Ministry of Finance, 2015]. Bulgaria has also enhanced public procurement transparency via the 2015 Public Procurement Act. Its flat tax regime of 10% on corporate and personal income, adopted in 2007 and 2008 respectively, was intended to simplify taxation and attract foreign investment [World Bank, 2023].

Legislative reforms and tax simplification

Czechia transitioned from a progressive personal income tax system to a flat tax rate of 15% in 2008, aimed at simplifying tax calculations and increasing transparency [OECD, 2020]. However, in 2020 it reintroduced progressive taxation for high-income earners, reflecting a shift towards greater income redistribution [Czech Ministry of Finance, 2020].

In 2005 Hungary adopted a flat tax regime with a single 16% rate for both individuals and corporations. This reform was part of broader efforts to streamline tax administration and bolster Hungary's competitiveness within the region [OECD, 2005].

Enhancing compliance and taxpayer services

To curb VAT fraud, Poland implemented the split payment mechanism in 2018, requiring VAT amounts to be transferred into separate, secure accounts. This reform reduced fraud risks and improved VAT compliance [OECD, 2018]. These measures have increased transparency and enhanced taxpayer predictability.

Bulgaria has also strengthened tax compliance by digitizing its VAT registration and return submission processes. Since 2015, these systems have accelerated processing times and improved administrative transparency [Bulgaria Ministry of Finance, 2015].

International cooperation and anti-corruption measures

Czechia improved international tax cooperation through amendments to the Act on International Cooperation in Tax Administration in 2020. These changes incorporated the EU's Mandatory Disclosure Rules (MDR), which aim to counteract aggressive tax planning and avoidance by mandating the reporting of specific cross-border arrangements [Global Tax News, 2020].

Overall, these comparative reforms demonstrate a regional trend towards digitalization, simplification, and increased transparency. The experiences of Poland, Czechia, Hungary, and Bulgaria offer valuable lessons for Romania, which continues to face challenges in tax compliance and administrative efficiency [Dăianu, 2023; OECD, 2024]. Implementing similar modernization strategies could substantially enhance Romania's fiscal capacity and support its long-term macroeconomic stability.

Fiscal performance and revenue efficiency in Romania: comparison with non-euro countries of Eastern Europe

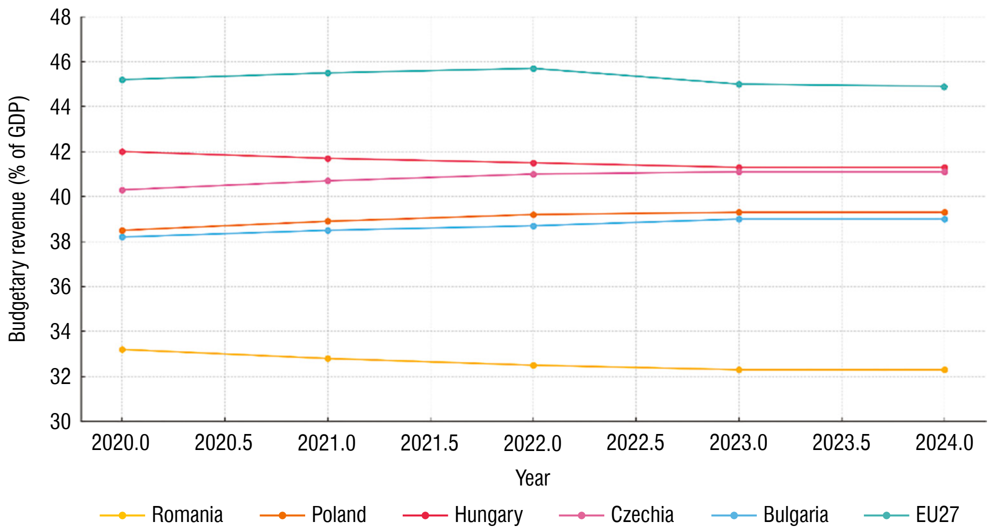
The analysis of Romania's fiscal performance between 2020 and 2024 reveals a structural deficit in both the level of public revenues and the efficiency of revenue collection compared to other Central and Eastern European (CEE) countries and the EU27 average. These deficits pose major risks to Romania's macroeconomic stability and its Eurozone accession trajectory.

Budgetary and fiscal revenues as a share of GDP

Data from Eurostat [2023] and OECD [2023] confirm that Romania records persistently the lowest ratio of budgetary and fiscal revenues to GDP among its regional peers. In 2023, Romania's tax-to-GDP ratio was only 27.0%, significantly below the EU27 average of 40.0%. Likewise, budgetary revenues (which include taxes, contributions, and other current revenues) stagnated around 32.3% of GDP, compared to 45.0% in the EU27.

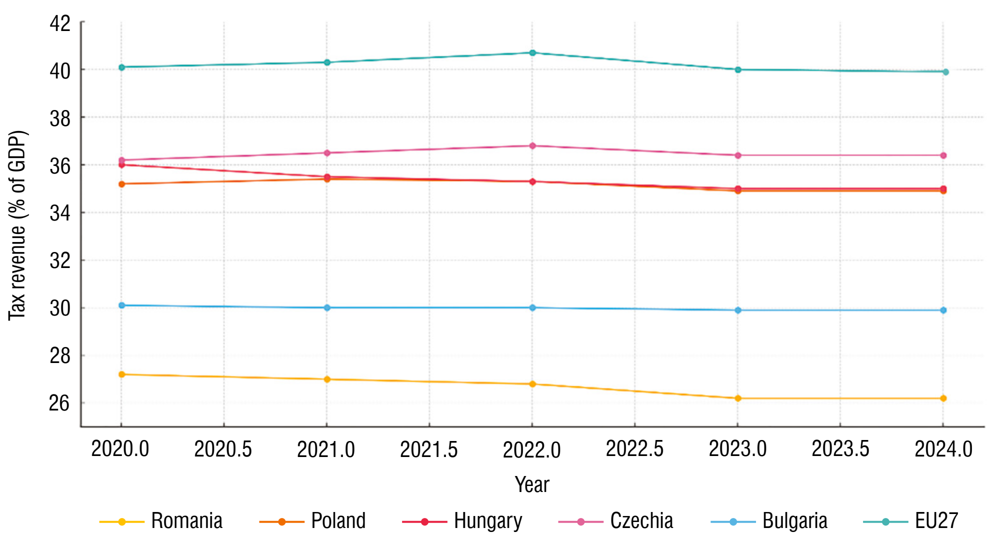
This chronic underperformance supports the argument by Tanzi and Zee [2000], who emphasized that weak institutional capacity, low tax morale, and pervasive informality contribute to revenue inefficiency in transition economies. Moreover, Alesina and Perotti [1996] demonstrated that persistently low tax revenues constrain the government's capacity to implement countercyclical fiscal policies, leaving the economy more vulnerable to shocks.

Figure 1. Budgetary revenue as % of GDP (2020–2024)



Source: own elaboration based on the data from European Commission Data on Taxation Trends database (DG TAXUD) and OECD Consumption Tax Trends supplement.

Figure 2. Tax revenue as % of GDP (2020–2024)



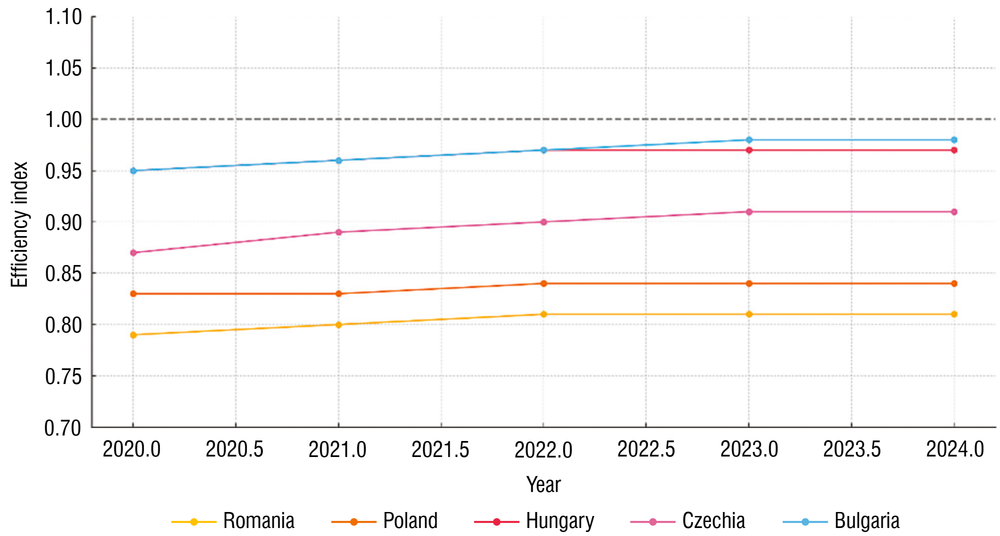
Source: own elaboration based on the data from European Commission Data on Taxation Trends database (DG TAXUD) and OECD Consumption Tax Trends supplement.

Efficiency of tax instruments: consumption, labour, and capital

Consumption tax efficiency

The VAT efficiency index (implicit rate/statutory rate) in Romania remained around 0.81 throughout 2020–2024, below countries such as Hungary (0.97) and Bulgaria (0.98). This implies continued losses due to tax evasion, exemptions, and compliance gaps, despite the presence of a unified VAT rate of 19%. According to Keen [2013], such discrepancies signal a "policy gap" and "compliance gap" that erode VAT's potential as a stable revenue source.

Figure 3. Efficiency index – consumption tax (VAT) (2020–2024)

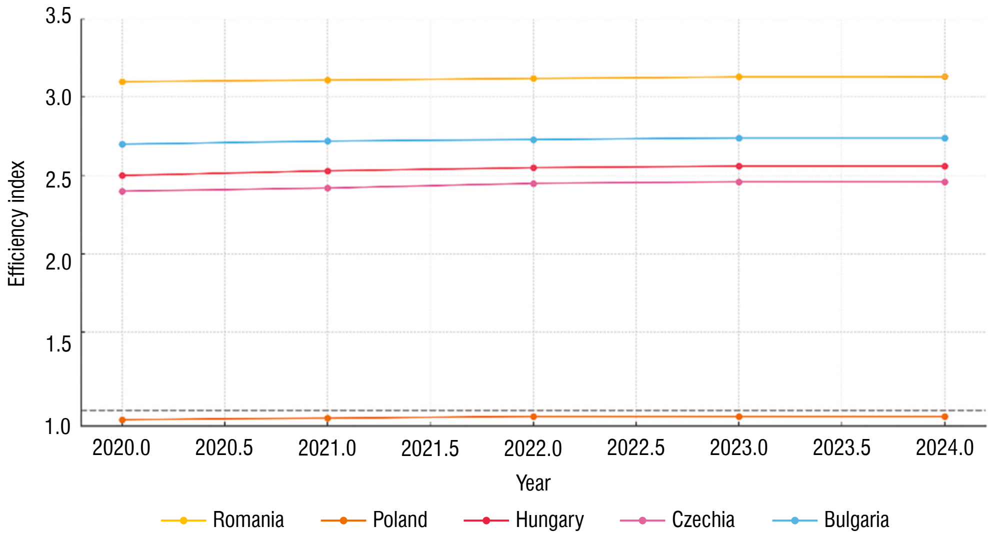


Source: own elaboration based on the data from European Commission Data on Taxation Trends database (DG TAXUD) and OECD Consumption Tax Trends supplement.

Labour tax efficiency

Romania exhibits an abnormally high labour efficiency index (above 3.1), caused by the coexistence of a low statutory personal income tax (PIT) rate of 10% and high social contributions. While this may suggest a strong collection mechanism, it also reveals distortions in the tax structure. Bird and Zolt [2005] caution that over-reliance on social contributions without adequate PIT progression may compromise equity and labour market incentives.

Figure 4. Efficiency index – labour tax (PIT + contributions) (2020–2024)

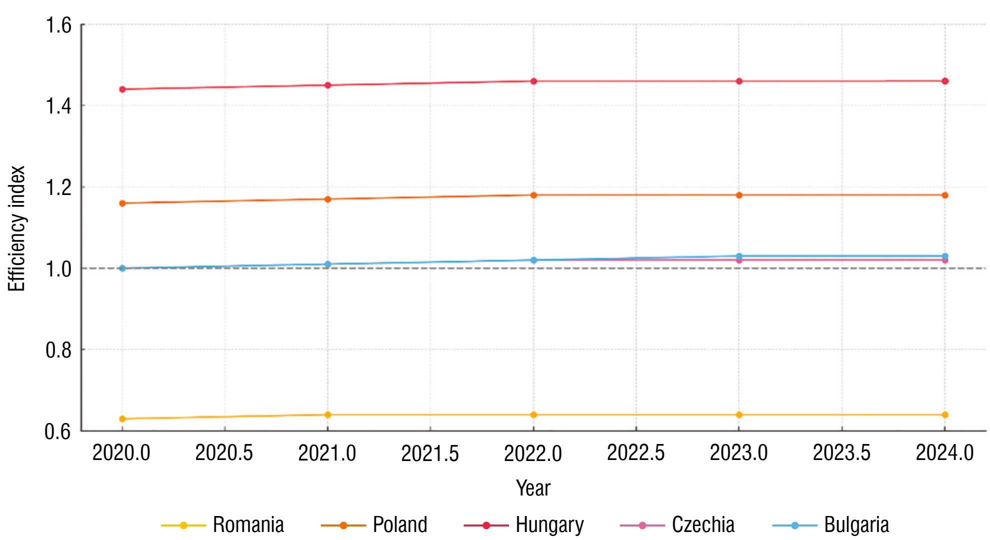


Source: own elaboration based on the data from European Commission Data on Taxation Trends database (DG TAXUD) and OECD Consumption Tax Trends supplement

Capital tax efficiency

With a flat corporate income tax (CIT) rate of 16%, Romania's capital tax efficiency remains modest (0.64), compared to Hungary (1.46) or Poland (1.18). The discrepancy reflects profit-shifting practices, generous deductions, and weak enforcement. De Mooij and Devereux [2011] argue that in small open economies, statutory CIT rates are less relevant than the effective tax burden, which in Romania remains poorly captured and administered.

Figure 5. Efficiency index – capital tax (CIT) (2020–2024)



Source: own elaboration based on the from European Commission Data on Taxation Trends database (DG TAXUD) and OECD Consumption Tax Trends supplement.

Structural fiscal and external imbalances

Romania's budget deficit reached 8.7% of GDP in 2024, well above the Maastricht threshold (3%). Simultaneously, the current account deficit reached 8.3% of GDP, raising concerns over external sustainability. According to Blanchard and Giavazzi [2002], persistent twin deficits are a symptom of weak competitiveness and insufficient national saving, particularly in economies preparing for EMU accession.

Such imbalances undermine investor confidence and expose the Romanian leu (RON) to depreciation pressures. As shown in ECB (2023), unsustainable fiscal paths erode central bank credibility and complicate monetary policy transmission.

Comparative fiscal reforms in the region

Poland, Hungary, Czechia, and Bulgaria have implemented substantial tax administration reforms, including digitalization (e.g., e-invoicing in Poland), risk-based audits, and centralized compliance platforms. These measures contributed to increased collection efficiency and fiscal resilience. As the OECD [2023] notes, digital tax reforms enhance both transparency and efficiency, especially in middle-income economies.

Romania lags in these dimensions, and thus could benefit significantly from emulating successful regional practices.

Structural challenges and Eurozone accession

Romania's productivity and innovation gap, low R&D investment, and rigid labour market prevent the economy from achieving real convergence. As Eichengreen [1998] argued, nominal convergence (Maastricht criteria) must be accompanied by real convergence to avoid asymmetric shocks in a monetary union.

Furthermore, the postponement of Romania's euro adoption to 2027 underscores institutional and policy weaknesses. The absence of strong automatic stabilizers and limited labour market flexibility increase exposure to external shocks – concerns also raised by Draghi [2022] in discussing the incomplete architecture of the Eurozone.

Policy recommendations

Strengthening fiscal discipline

Improving revenue collection and controlling expenditure are foundational to achieving fiscal consolidation. Romania's tax-to-GDP ratio remains below the EU average [Eurostat, 2024], reflecting inefficiencies in revenue administration and widespread tax evasion [Darvas, 2021]. According to Alesina and Perotti [1996], credible fiscal frameworks reduce sovereign risk premiums and promote macroeconomic stability. Romania should emulate best practices in digital tax reporting, as adopted successfully in Hungary through real-time invoicing [OECD, 2020].

Enhancing financial stability

Romania's financial system is vulnerable due to its reliance on external financing and the dominance of foreign-owned banks [ECB, 2023]. Macroprudential policies, such as stricter loan-to-value (LTV) ratios and capital buffers, are critical for resilience. Draghi [2022] emphasizes that building counter-cyclical buffers in good times helps withstand asymmetric shocks. Romania's high share of FX-denominated private debt also necessitates interventions similar to Poland's de-euroization efforts [OECD, 2023].

Promoting structural reforms

Low productivity and weak capital markets continue to limit Romania's economic convergence with the Eurozone [EIB, 2023]. Blanchard and Summers [2019] argue that post-crisis economies need supply-side reforms, especially in innovation, education, and labour mobility. Investment in R&D is just 0.5% of GDP, well below the EU average [European Commission, 2023]. Romania should replicate Czechia's targeted tax incentives for digitalization and innovation [Czech Ministry of Finance, 2020].

Improving shock resilience

Joining the Eurozone reduces monetary autonomy, making fiscal stabilizers vital. Verdun [2022] underlines the importance of national automatic stabilizers and EU-level risk-sharing mechanisms. Romania lacks robust unemployment insurance and suffers from rigid labour markets. According to Buti and Carnot [2018], a Eurozone-wide unemployment reinsurance mechanism would complement national efforts and mitigate asymmetric shocks, especially during downturns.

Summary

Romania's path to its Eurozone membership depends not only on meeting the Maastricht convergence criteria, but also on addressing entrenched fiscal inefficiencies, low institutional capacity, and structural competitiveness gaps. The comparative analysis of fiscal performance indicators from 2020 to 2024 highlights a persistent underperformance in revenue mobilization and tax efficiency, particularly in labour and capital taxation, despite favourable statutory rates. This underperformance reflects deeper issues of tax evasion, weak compliance, and insufficient administrative modernization, as discussed by Darvas [2021] and the European Commission [2023].

As Polanski [2021] argues, nominal convergence without real convergence exposes economies to long-term instability within the monetary union. Similarly, Dăianu [2022] warns that premature euro adoption without correcting macroeconomic imbalances and enhancing shock-absorbing capacities would amplify vulnerabilities rather than reduce them. Romania's reliance on external financing, limited fiscal buffers, and low innovation investment point to the urgent need for robust structural and institutional reform.

To move forward credibly, Romanian policymakers must not only fulfill the Maastricht criteria on paper, but also address the qualitative dimensions of convergence. This includes strengthening fiscal discipline, reinforcing financial stability, improving tax collection efficiency, and advancing inclusive, productivity-driven growth. Only through a coherent reform agenda aligned with the European Union's fiscal and institutional standards can Romania ensure a smooth and sustainable integration into the Eurozone.

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