EUROPEAN
COMMISSION

Brussels, 24.11.2021
COM(2021) 915 final

COMMUNICATION FROM THE COMMISSION

Assessment of action taken by Romania

in response to the Council Recommendation of 18 June 2021 with a view to bringing an end to the situation of an excessive government deficit in Romania

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1. INTRODUCTION

On 18 June 2021, the Council adopted a recommendation under Article 126(7) of the Treaty on the Functioning of the European Union (TFEU), with a view to bringing an end to the situation of an excessive government deficit in Romania by 2024 at the latest.

Romania was recommended to reduce the general government deficit to 8.0% of GDP in 2021, 6.2% of GDP in 2022, 4.4% of GDP in 2023, and 2.9% of GDP in 2024. Based on the Commission 2021 spring forecast underpinning the Council recommendation, this was considered consistent with an annual structural adjustment of 0.7% of GDP in 2021, 1.8% of GDP in 2022, 1.7% of GDP in 2023, and 1.5% of GDP in 2024, and with a nominal growth rate of net primary government expenditure of 3.4% in 2021, 1.3% in 2022, 0.9% in 2023 and 0.0% in 2024.[1] The Council recommended that Romania fully implement the measures already adopted for 2021 and specify and implement the additional measures that are necessary to achieve the correction of the excessive deficit by 2024. The Council also recommended that Romania use any windfall gains to reduce the general government deficit and that budgetary consolidation measures secure a sustainable correction in a growth-friendly manner. Furthermore, the Council recommended that Romania ensure the full and effective application of the national fiscal framework and to support the fiscal consolidation with comprehensive reforms.

In accordance with Article 3(4a) of Council Regulation (EC) No 1467/97, the Council established the deadline of 15 October 2021 for Romania to report in detail on action taken in response to the Council recommendation. Romania submitted its report on 14 October 2021.

The Commission has examined the budgetary strategy of Romania based on the information included in the report on action taken in order to assess whether the Member State has complied with the Council recommendation of 18 June 2021.

Box 1: Methodology For Assessing Effective Action

According to Regulation (EC) No 1467/97 and the Code of Conduct,[2] a Member State should be considered to have taken effective action if it has acted in compliance with either the Council

[1] Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

[2] "Revised Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes", available at: https://data.consilium.europa.eu/doc/document/ST-9344-2017-INIT/en/pdf

recommendation under Article 126(7) of the TFEU or the Council decision to give notice under Article 126(9). On 29 November 2016, the Economic and Financial Committee adopted its Opinion entitled "Improving the assessment of effective action in the context of the excessive deficit procedure – a specification of the methodology", which was endorsed by the ECOFIN Council on 6 December 2016.[3] This Opinion sets out an EDP decision tree for assessing whether effective action has been taken.

If the Member State concerned is compliant with the headline deficit target and the underlying improvement in the structural balance, the procedure is held in abeyance. If the Member States fails or is at risk of failing to meet the headline deficit target or the required improvement in the structural balance, or both, a careful analysis of the reasons of the shortfall will be undertaken.[4] The careful analysis is, therefore, a centrepiece in the assessment of effective action.

The careful analysis first uses the expenditure benchmark to assess fiscal effort. All in all, the aim of the careful analysis is to provide an adequate estimation of the extent of policy actions, to evaluate whether the Member State concerned has delivered on its policy commitments as set in the EDP recommendation. If the expenditure benchmark is met, meaning that it shows an effort equal to or above what was recommended, there is a presumption that the Member State concerned has delivered on its policy commitments. If the expenditure benchmark is not met, there is a presumption the Member State has not delivered on its policy commitments.

The Commission uses qualitative economic judgement in making its final assessment where relevant, in particular of the outcome of the expenditure benchmark, as part of the careful analysis which the Commission uses to determine whether the Member State concerned has delivered or not on its policy commitments. In other words, the careful analysis evaluates whether the Member State concerned has put in place enough actions to comply with the EDP recommendation. In sum, any conclusion needs to take into consideration the quantitative information from the expenditure benchmark together with other considerations − mostly of qualitative nature − that do not emerge from the benchmark itself. These considerations are typically related to the reasons that have caused the non-fulfilment of the expenditure benchmark and are directly linked to fiscal developments.

If the careful analysis concludes that the Member State concerned has delivered on its policy commitments, the assessment will conclude that effective action has been taken, with a possibility to extend the deadline, even if the headline deficit target has not been met. If the careful analysis concludes that policy commitments have not been delivered and that the headline deficit target is not met, the assessment will conclude on non-effective action and the procedure should be stepped up including by setting a new correction path (and possibly deadline) as appropriate.

It must be emphasised that if the intermediate headline deficit target has been met, the procedure will not be stepped up even if the policy commitments have not been delivered. However, it should be stressed that where the absence of a stepping-up of the procedure is taken based on in-year data, should the (notified) ex post data show that the intermediate headline deficit target was eventually not met, the EDP can still be stepped up.

[3] See Annex 4 of the Code of Conduct.

[4] The Code of Conduct on the SGP states in this respect that: *"In case the observed budget balance proves to be lower than recommended or if the improvement of the cyclically-adjusted balance net of one-off and other temporary measures falls significantly short of the adjustment underlying the target, a careful analysis of the reasons of the shortfall will be made"*.

2. ASSESSMENT OF ACTION TAKEN BY ROMANIA

2.1. Measures included in the report on action taken and updated budgetary projections

Since 5 October 2021, Romania has had a caretaker government with limited competences. Therefore, the report on action taken submitted by Romania on 14 October 2021 focuses on measures adopted with the aim of ensuring compliance with the intermediate budgetary target for 2021. The report also recalls the budgetary targets from the May 2021 Convergence programme for the period 2021-2024, and confirms the commitment therein to bring the deficit below 3% of GDP by 2024, without presenting any new fiscal policy measures for 2022-2024, which would be necessary to ensure compliance with the respective budgetary targets.

The general government deficit for the period January-August 2021 stood at 3.4% of GDP in cash terms, lower by 1.8 pps. of GDP compared to the same period last year. According to the report the deficit in cash terms for 2021 is expected to be around 7.1% of GDP (RON 83.8 bn), instead of 7.2% of GDP (RON 80 bn) originally planned in the 2021 budget. This cash deficit would correspond to an ESA deficit of around 8% of GDP, in line with the budgetary target for 2021 in the EDP recommendation.[5]

With respect to 2021, no changes to the tax system are reported, except for slight increases in the level of excise duty on tobacco starting on 1 January 2021, with a budgetary impact close to 0.1% of GDP. Concerning general government expenditure, the report lists the following measures implemented throughout 2021[6]:

- maintainance of gross wages in the public sector, including bonuses, allowances and premiums (insofar as the staff hold the same position and work under the same conditions) at the level granted for December 2020;
- maintainance of the pension point (the value used to convert the points accumulated throughout years based on earnings into regular pension payments) at RON 1 442 from September 2020; return, as of 2022, to the existing transparent mechanism for establishing the value of the pension point consisting of raising the pension point, starting 1 January of each year, by the average annual inflation rate, to which is added at most 50% of the increase in the realised real average gross wages, as approved by Government Emergency Ordinance (GEO) no. 8/2021;
- maintainance of the food allowance at the level set for 2020;
- non-awarding of prizes and holiday allowance provided by Law no. 153/2017;
- compensation of overtime work for public sector employees with free time only;

[5] Compared to the initial budget, the 2021 general government revenue increased by RON 17.6 billion and the general government expenditure increased by RON 21.4 billion in cash terms. The September budget revision contains allocations to support the health sector (0.38 % of GDP) taking into account the additional expenditure created by the COVID-19 pandemic and further investment projects at central and local level (plus 0.6% of GDP),

[6] The effective action report does not quantify the budgetary effect of each of the measures listed.

- extension of the use of holiday vouchers issued in 2019 and 2020 until the end of 2021 and suspension of the issuance of holiday vouchers for 2021 by public authorities and institutions;
- increase of the minimum gross salary by 3.1% as compared to December 2020, at RON 2 300 per month, starting 13 January 2021;
- increase of the state allowance for children by 16% compared to the value in December 2020, starting January 2021, and by further 14% from 1 January 2022 and establishment, from 2023, of a transparent indexation mechanism by GEO no. 56/2021;
- reduction of the tariffs offered to students for means of transport.

According to the report, measures aimed at strengthening tax collection will continue during the rest of 2021, also in the context of the Operational Revenue Recovery Plan and National Agency for Fiscal Administration (NAFA) Strategy 2021-2024 and the Recovery and Resilience Plan (RRP). The measures aim at supporting tax compliance by improving business processes and services to taxpayers, digitalising NAFA, and preventing tax evasion. The authorities expect that these reforms will increase the revenue-to-GDP ratio by 2.5 percentage points by 2026 as compared to the 2019 value of the ratio.

In 2021, the government maintained the measures to support households and businesses introduced in 2020, including state guarantees, financing programmes, the easing of some tax obligations, grants to support employment and to preserve the link between employers and employees in case of temporary interruption of activity due to the COVID-19 pandemic, the purchase and administration of COVID-19 vaccines, expenditure for purchasing of medical equipment and to cover the extra cost for public health personnel, and IT equipment for students. The budget revision adopted in September 2021 contains additional allocations to support the health sector and further investment projects at central and local levels. According to the report, the impact of temporary measures related to the COVID-19 pandemic as part of the 2021 budget, including the September revision, amounts to RON 7.33 billion (0.6% of GDP). The report does not include the measures to support households and enterprises against energy price increases, which were adopted on 16 September 2021 (see section 2.2), and which will have effect for 5 months starting on 1 November 2021.

The report submitted by Romania on 14 October mentions that the further reduction of the deficit planned over the medium term will occur mainly on the expenditure side, while tax revenues as a share of GDP will remain relatively constant, not yet taking into account the impact of reforms and investments contained in Romania's RRP. However, the report does not specify any further details of the consolidation strategy for 2022 and beyond.

Related to this, it should be noted that the medium-term fiscal strategy for 2022-2025, which, according to the national fiscal rules, the government has to prepare and adopt in August, is still pending.

2.2. Assessment of action taken

The Commission 2021 autumn forecast projects a headline deficit of 8.0% of GDP in 2021, which is in line with the deficit target in the Council recommendation (see Table 2). This projection takes into account all measures mentioned in the report on action taken (see Section 2.1), in particular the consolidation measures adopted at the beginning of the year, i.e.

the wage and pension freezes and cuts to some bonuses and other remunerations, as well as the budget revision of September 2021, and the measures to support households and enterprises against energy price increases adopted on 16 September 2021. Revenues are forecast to be higher than expected in Spring, mainly as a result of higher-than-expected nominal GDP growth. The positive impact on the deficit of higher revenues is, however, projected to be offset by higher-than–planned expenditures on most public expenditure items. The Commission forecast also takes into account the RRP-financed expenditure and revenue based on the plan approved by the Council on 29 October 2021 (see Table 1).[7]

Table 1: Recovery and Resilience Facility financed expenditure

Grants	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**TOTAL**
RON billion	1,0	11,6	15,0	16,2	15,7	10,0	69,6
EUR billion	0,2	2,4	3,1	3,3	3,2	2,0	14,2
% of annual GDP	*0,09%*	*0,90%*	*1,07%*	*1,08%*	*0,98%*	*0,60%*	
% of total	1%	17%	22%	23%	23%	14%	100%
% of total (cumulative)	1%	18%	40%	63%	86%	100%	

Loans	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**TOTAL**
RON billion	0,7	10,0	16,5	18,2	15,7	11,9	73,0
EUR billion	0,1	2,0	3,4	3,7	3,2	2,4	14,9
% of annual GDP	*0,06%*	*0,78%*	*1,17%*	*1,21%*	*0,98%*	*0,71%*	
% of total	1%	14%	23%	25%	22%	16%	100%
% of total (cumulative)	1%	15%	37%	62%	84%	100%	

According to the Commission 2021 autumn forecast, the adjustment in the structural balance for 2021 is 0.4 pps, below the recommended 0.7 pps. As per the methodology for assessing effective action (see Box 1), this warrants a careful analysis based on the evolution of net expenditure growth.

In 2021, net expenditure growth (adjusted for one-offs) is projected at 5.9% in the Commission 2021 autumn forecast, above the recommended 3.4%. Therefore, the deviation of net expenditure growth from the recommendation goes in the same direction as the deviation of the adjustment in the structural balance, although with a larger magnitude (0.9% of GDP in the case of net expenditure growth compared to 0.3% of GDP in the case of the structural balance). The difference can be partly explained by revenue windfalls in 2021, which improve the structural balance but do not affect the expenditure benchmark.[8] Despite the aforementioned consolidation measures implemented by the Romanian government, slippages

[7] The 2021 Autumn forecast includes the impact of annual expenditure financed by RRF grants (non-repayable financial support) and loans and the corresponding revenue from grants on an accrual basis (i.e. based on the planned implementation of projects as described in the Council Implementing Decision and the costs described in the accompanying documents of the Romania's RRP). Although RRF grants are deficit neutral, the impact of loans is not. The main differences with the RRF figures underlying the EDP recommendation are that the profile of both grants and loans is more frontloaded, and that the forecast of the nominal GDP is higher, making the RRF figures as a share in GDP slightly lower.

[8] According to the Commission 2021 autumn forecast, the additional revenues stemming from higher nominal GDP growth rate amounts to 0.2 pps.

in most public expenditure items drive the deviation in net expenditure growth in 2021, including personnel expenditure, purchase of goods and services and social assistance expenditure. More than half of these slippages can be attributed to higher expenditure related to COVID-19 (mainly in the health sector) and measures to cope with significant increases in energy prices, while the rest can be associated with inadequate control of spending.

Table 2: Romania's fiscal adjustment path

		2020	2021	2022	2023	2024
June 2021 Article 126(7) recommendation						
GDP growth rate	% y/y	-3.9	5.1	3.4	3.2	2.9
Headline general government balance	% of GDP	-9.2	-8.0	-6.2	-4.4	-2.9
Structural balance	% of GDP	-7.5	-6.9	-5.0	-3.3	-1.9
Change in structural balance	% of GDP	-2.8	0.7	1.8	1.7	1.5
Net expenditure growth corrected for one-offs (nominal)	%	16.2	3.4	1.3	0.9	0.0
Commission 2021 autumn forecast[9]						
GDP growth rate	% y/y	-3.9	7.0	5.1	5.2	4.5
Headline general government balance	% of GDP	-9.4	-8.0	-6.9	-6.3	-6.8
Structural balance	% of GDP	-7.5	-7.1	-6.4	-6.1	-7.1
Change in structural balance	% of GDP	-2.8	0.4	0.7	0.3	-0.9
Net expenditure growth corrected for one-offs (nominal)	%	16.2	5.9	5.1	7.1	11.7

According to the Commission 2021 autumn forecast, extended until 2024, the deficit is expected to amount to 6.9% of GDP in 2022. It is then expected to fall to 6.3% of GDP in 2023 and widen to 6.8% of GDP in 2024. In the absence of measures for 2022 (and beyond), these projections are made under the usual no-policy change assumption. The projected improvement in the headline deficit in 2022 is driven by improved revenues (mostly on account of strong growth, supporting government revenues from taxes and social contributions), fiscal-structural measures contained in the RRP (i.e., the tax administration reform and the tax framework review), and the phase-out of emergency measures. The projections of the headline deficit for 2021 and 2022 also take into account the measures to support households and enterprises against energy price increases, which are expected to cost in total about 0.2% of GDP over the two years.

The projected 2022 deficit in the Commission 2021 autumn forecast is 0.7 pps above the headline deficit target recommended by the Council, while the adjustment in the structural balance is forecast to be 0.7 pps in 2022, against the recommended 1.8 pps. As provided in the methodology for assessing effective action (see Box 1), this situation calls for a careful analysis of the expenditure benchmark.

While acknowledging the no-policy-change nature of these projections, the net expenditure growth target for 2022 is not expected to be met, and there are expected to be further deviations in 2023 and 2024 (see Table 2). The deviation of net expenditure growth from its

[9] The Commission 2021 autumn forecast does not include projections for 2024. Figures for 2024 in this table are extrapolated from the Commission autumn forecast under the usual no-policy change assumption.

targets is consistent with the deviation of the structural balance in 2022. The slight projected improvement in 2022 for both indicators, mainly due to the discontinuing of part of the COVID-19 measures, is not enough to meet the targets for that year, as no consolidation measures are included in the EDP report. The lack of such measures is the main driver also for the targets not being met in the outer years, in spite of the higher projected GDP growth over the entire EDP period, compared to the Commission 2021 spring forecast.

Since June 2021, there have been no substantial actions to ensure the full and effective application of the national fiscal framework. In particular, as mentioned above, the update of the medium term fiscal strategy, due in August, has not been published yet.

The Romanian RRP includes fiscal-structural measures. The reform of the tax administration, which is set to strengthen tax collection, was taken into account in the Commission 2021 autumn forecast and thus in the assessment of action taken by Romania. The plan also includes a review of the tax framework with the objective to gradually phase out excessive tax incentives and exemptions, and to expand green taxation. Furthermore, the plan includes the introduction of systematic spending reviews, which increase the efficiency of public spending, and a reform of the pension system to make it more stable and improve its fiscal sustainability.

3. CONCLUSIONS

On 14 October 2021, Romania reported on the action taken in response to the June 2021 Article 126(7) recommendation. The authorities have confirmed their commitment to ensuring a correction of the excessive deficit as required by the Council. However, given the caretaker nature of the government, the report on action taken contains only the measures adopted with the aim of delivering compliance with the 2021 intermediate deficit target.

According to the Commission 2021 autumn forecast, the headline deficit is expected to amount to 8.0% of GDP in 2021, in line with the recommended target, while the fiscal effort is expected to fall short of the requirements. At the same time, the targets for 2022-2024 are currently not projected to be met on a no-policy-change basis, indicating the need for a medium-term consolidation strategy and corresponding corrective measures. On the basis of the projected achievement of the required headline deficit target in 2021, the excessive deficit procedure should be kept in abeyance at this stage.

The Commission expects the Romanian government, when formed, to present a budget for 2022 and a medium-term fiscal strategy in line with the June 2021 Council recommendation as a matter of urgency. The Commission will re-examine compliance with the requirements set out in the Council recommendation on the basis of the information in the budget and the medium-term fiscal strategy.