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COMMISSION STAFF WORKING DOCUMENT

Analysis by the Commission services of the budgetary situation in Romania following the adoption of the COUNCIL RECOMMENDATION to Romania of 3 April 2020 with the view to bringing to an end to the situation of an excessive government deficit

Accompanying the document

Recommendation for a

COUNCIL RECOMMENDATION with a view to bringing an end to the situation of an excessive government deficit in Romania

{COM(2021) 530 final}

Analysis by the Commission services of the budgetary situation in Romania following the adoption of the COUNCIL RECOMMENDATION to Romania of 3 April 2020 with the view to bringing to an end to the situation of an excessive government deficit

Accompanying the document

Recommendation for a COUNCIL RECOMMENDATION with a view to bringing an end to the situation of an excessive government deficit in Romania

1. INTRODUCTION

Following a recommendation from the Commission of 4 March 2020 on the basis of an excessive deficit planned in 2019, the Council, on 3 April 2020, decided in accordance with Article 126(6) Treaty of the Functioning of the European Union (Treaty) that an excessive deficit existed in Romania and issued a recommendation to correct the excessive deficit by 2022 at the latest, in accordance with Article 126(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[1].

On 15 September 2020, Romania submitted its report on action taken in response to the Recommendation. That report highlighted the deterioration of the economic and fiscal outlook due to the COVID-19 pandemic.

On 18 November 2020, the Commision presented a Communication on Romania's fiscal situation. In the light of the continued exceptional uncertainty created by the COVID-19 pandemic and its extraordinary macroeconomic and fiscal impact, the Commission considered that no decision on further steps in the Romania's excessive deficit procedure (EDP) could be taken at that juncture. Moreover, the exceptional uncertainty, including for designing a credible path for fiscal policy, did not allow the Commission to put forward a recommendation for a Council recommendation under Article 126(7) of the Treaty at that stage.

This document presents the analysis of Romania's budgetary situation based on the 2020 outturn data, 2021 budget and updated convergence programme and the Commission 2021 spring forecast carried out by the Commission services. In particular, the document examines budgetary developments since the Article 126(7) recommendation of 3 April 2020 and suggests a new adjustment path that would durably bring the general government deficit below the 3% of GDP threshold.

2. MACROECONOMIC DEVELOPMENTS AND OUTLOOK

In 2020, Romania's economy contracted by 3.9% in real terms, with private consumption suffering a sharp decline during the spring lockdown, and external demand shocks and supply chain disruptions hurting exports. The strict lockdown measures introduced in the first half of 2020 to contain the COVID-19 pandemic were particularly damaging for consumer spending, which has been the economy's main growth driver in previous years. Investment, by contrast, made a significant contribution to GDP growth, due to the strong performance of construction activity. A smaller decline in imports than in exports resulted in a further deterioration of the trade balance. This also led to worsening of the current account deficit, albeit only marginally from 4.7% of GDP in 2019 to an estimated 5% of GDP in 2020. The unemployment rate

[1] OJ L 209, 2.8.1997, p.6.

increased from 3.9% in 2019 to 5% in 2020, with government policy measures cushioning the impact of the lockdown on the labour market.

Real GDP growth is forecast by the Commission 2021 spring forecast to rebound to 5.1% in 2021 and then to moderate slightly to 4.9% in 2022. Private consumption is expected to recover as the vaccination roll-out progresses and social distancing measures are gradually lifted. At the same time, robust wage growth is expected to support consumption. The phasing in of projects under Romania's Recovery and Resilience Plan (RRP) is set to lend new impetus to investment growth. The contribution of net exports is expected to remain negative over the forecast horizon, with imports expected to be spurred by the recovery of private consumption as well as by growing investments, while exports are expected to be supported by a recovery in external demand but remain less dynamic than imports. The high current account deficit is expected to decrease only slightly over the forecast horizon on the back of improved primary and secondary income balances. Unemployment is projected to slightly increase in 2021 as the level of employment looks likely to be almost stagnant while the labour force is projected to grow. In 2022, the unemployment rate is expected to decline on the back of a rise in employment.

The growth outlook is subject to balanced risks. On the one hand, a credible medium-term fiscal strategy can help dispel concerns about fiscal sustainability, in particular when combined with ambitious reforms (including those contained in the RRP). This would help address Romania's macroeconomic imbalances, mitigate financial stability risks and contribute to sustainable growth, including by improving the investment climate. On the other hand, uncertainty on public policy-making and delays or inefficiencies in the implementation of the RRP could result in negative confidence effects.

According to the Commission's estimates, potential GDP growth is projected to have declined from 4.3% in 2019 to 3.2% in 2020 and to slightly increase to 3.3% in 2022. The contribution of capital accumulation is projected to increase and slightly exceed that of total factor productivity, until recently the main contributor to potential GDP growth. At the same time, the contribution of labour is forecast to remain negative, mainly due to the trend decrease in the working age population.

The difference between the actual and potential output, as estimated by the output gap, estimated based on the commonly agreed methodology, is expected to have decreased to -5.3% of potential GDP in 2020, from 1.6% in 2019. It is projected to gradually increase over the forecast horizon and reach -2.1% in 2022. Estimates of the output gap are subject to a particularly high degree of uncertainty at the current juncture, in light of the economic impact of the ongoing COVID-19 pandemic.

3. BUDGETARY DEVELOPMENTS AND OUTLOOK

According to the EDP notification of 19 April 2021[2], validated by Eurostat, the general government deficit in Romania was 9.2% of GDP in 2020, while debt stood at 47.3% of GDP. The Commission 2021 spring forecast projects a general government deficit of 8% of GDP in 2021 and 7.1% of GDP in 2022. The structural deficit, which was around 7.5% of GDP in

[2] Pursuant to Regulation (EC) No 479/2009 as amended by Council Regulation (EU) No 679/2010 and by Commission Regulation (EU) No 220/2014, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Romania can be found at: https://ec.europa.eu/eurostat/web/government-finance-statistics/excessive-deficit-procedure/edp-notification-tables

2020, increased by 2.8 pps of GDP compared to the previous year. It is projected by the Commission to decrease by 0.7 pps of GDP in 2021 and 0.5 pps of GDP in 2022.

The significant budgetary deterioration in 2020 was partly driven by COVID-19 related fiscal measures and the economic downturn. However, the deterioration was also driven by pre-existing expansionary measures. The total cost of COVID-19 related support measures was around 1.6% of GDP in 2020 (see Table 2 below), of which 0.1 pps was financed by European Union (EU) funds. The pandemic-related measures included additional spending on employment support schemes, support to the health sector and some tax incentives. Expansionary measures adopted before the pandemic included increases in social and other expenditure and tax cuts. In particular, expenditure on old-age pensions increased considerably, driven by the full-year effect of a 15% pension increase that came into effect in September 2019 and a further increase of 14% in September 2020. As a result, expenditure on old-age pensions increased by 1.8 pps of GDP in 2020. Social expenditure was also affected by an increase in child allowance by 19% in 2020. On the revenue side, the authorities enacted some tax changes in December 2019, including the reduction of excise duties on fuel and a lowering of social security contributions on part-time workers, with an overall estimated revenue loss of 0.3% of GDP in 2020.

Table 1: Comparison of macroeconomic developments and forecasts

	2020	2021		2022		2023	2024
		COM	CP	COM	CP	CP	CP
Real GDP (% change)	-3,9	5,1	5,0	4,9	4,8	5,0	4,9
Private consumption (% change)	-5,2	6,1	5,1	5,9	4,9	4,9	4,7
Gross fixed capital formation (% change)	6,8	5,8	7,0	7,4	8,8	9,4	8,6
Exports of goods and services (% change)	-9,7	9,8	8,3	8,7	5,7	6,0	5,6
Imports of goods and services (% change)	-5,1	11,4	10,1	10,1	7,2	7,3	6,7
Contributions to real GDP growth:							
- Final domestic demand	-1,3	5,8	5,2	5,9	5,6	5,8	5,5
- Change in inventories	-0,9	0,4	0,9	0,0	0,0	0,0	0,0
- Net exports	-1,6	-1,1	-1,1	-1,0	-0,9	-0,8	-0,7
Output gap[1]	-5,3	-3,6	-3,7	-2,1	-2,5	-1,1	0,2
Employment (% change)	-1,8	0,2	1,1	0,7	0,9	0,6	0,5
Unemployment rate (%)	5,0	5,2	4,8	4,8	4,0	3,5	3,2
Labour productivity (% change)	-2,1	4,9	3,9	4,1	3,8	4,4	4,4
HICP inflation (%)	2,3	2,9	2,6	2,7	2,9	2,6	2,5
GDP deflator (% change)	3,8	3,2	3,2	2,7	3,0	2,9	2,8
Comp. of employees (per head, % change)	7,3	5,8	5,0	6,1	6,1	6,7	6,5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-3,4	-3,2	-2,6	-3,0	-1,8	-1,4	-0,8
General government balance (% of GDP)	-9,2	-8,0	-8,0	-7,1	-6,2	-4,4	-2,9
General government debt (% of GDP)	47,3	49,7	50,8	52,7	52,9	53,3	52,4

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source: Commission 2021 spring forecast (COM); 2021 Convergence Programme of Romania (CP)

The projected improvement in the headline deficit in 2021 is mainly due to postponement of increases in pensions and public sector wages, additional cuts to some bonuses and other remunerations, and the partial expiration of COVID-19 related emergency measures (see Table 2). Additional emergency expenditure for the purchase of vaccines and support to companies is set to be offset by the lower cost of measures to support employment and wages. EU funds are also expected to cover part of costs of the emergency measures in 2021. The fiscal position is also forecast to benefit from higher revenues thanks to the economic recovery. The positive impact of an improved macroeconomic environment on the headline fiscal deficit is shown by the relatively small improvement of the structural deficit. This is also the case for 2022, when the economic recovery is expected to play a key role in further reducing the headline government deficit. In 2022, the remaining emergency support measures are expected to end, the suspension of increases in public sector wages is set to continue, while pensions are planned to increase by around 5%, following the standard indexation rule.

On 5 May 2021, the government adopted the convergence programme for the period 2021-2024. The programme confirms the government fiscal target, originally set out in the medium-term fiscal strategy adopted on 2 March 2021, for a deficit below 3% of GDP by 2024. It presents the following deficit targets (in ESA terms): 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 government estimates, this would lead to a structural balance improvement of 0.6 pps of GDP in 2021, 0.0 pps of GDP in 2022, 1.4 pps of GDP in 2023 and 1.2 pps of GDP in 2024.

The planned adjustment consists mainly of expenditure measures. At the end of the projection period in 2024, general government expenditure is projected at 37.2% of GDP, down by 5.2 pps compared to 2020, but still above the 2019 ratio of 36.2% of GDP and the average of 35% of GDP of the five years before the crisis. Expenditure control (reductions of expenditure as a percentage of GDP) is envisaged in particular for public sector wages (down by 1.4 pps between 2022 and 2024) and social transfers (down by 0.9 pps between 2022 and 2024). Government gross fixed capital formation is projected to increase from 5% of GDP in 2021 to 5.3% in 2023 and 2024. The general government revenue-to-GDP ratio is projected to improve by 1.2 pps between 2020 and 2024, from 33.1% to 34.3% of GDP. All revenue categories are estimated to remain broadly constant as a percentage of GDP except transfers from the European Union, due to projected transfers from the EU funds and the Recovery and Resilience Facility (Facility).

General government debt stood at 35.3% of GDP at end-2019 and 47.3% of GDP at end-2020. According to the Commission 2021 spring forecast, it is projected to increase to 49.7% of GDP at end-2021, 52.7% of GDP at end-2022 and 59.5% of GDP at end-2024, [3] thus approaching for the first time the 60% of GDP Treaty reference value in the absence of additional corrective measures than those already enacted or as yet credibly announced.

The analysis of medium to long-term debt sustainability confirms that risks to sustainability are high in the medium term. According to a baseline 10-year projection, the general government debt-to-GDP ratio would continue increasing over the projection period and reach a level close to 90% of GDP. Risks to debt sustainability are driven by large fiscal deficits, costs of ageing, and vulnerability of the debt path to macro-fiscal shocks. The latter is also visible from the significant probability of debt being higher in 2025 than 2020, according to a stochastic extension of the baseline projection. Pension increases legislated in summer 2019,

[3] This figure is based on an update of the Debt Sustainability Monitor 2020, notably reflecting the latest Commission 2021 spring forecast.

and for the time being postponed until the end of 2022, are the predominant source of the debt sustainability risks. The debt structure, with a high share of foreign denominated debt and a significant share of debt held by non-residents further adds to debt sustainability risks, although interventions by the National Bank of Romania on the secondary market have helped keep government borrowing costs at favourable levels in 2020. Moreover, there are risks linked to contingent liabilities stemming from state guarantees (of 1.4% of GDP) granted to firms and the self-employed during the COVID-19 crisis. Gross financing needs are projected to increase. Conversely, reforms and investments under Next Generation EU if effectively implemented, are expected to have a positive impact on GDP growth in the coming years, thereby contributing to debt sustainability.

Table 2: Measures affecting budgetary projections

	ESA coding	Budgetary impact, % of GDP (change compared to the previous year)		
		2020	**2021**	**2022**
Discounts for the advance payment of corporate income taxes	D.5: Current taxes on income, wealth, etc.	-0,10	0,10	0,00
Employment support measures	D.3: Subsidies	0,76	-0,53	-0,15
Risk incentive (bonuses) for staff at the front line of the fight of the pandemic	D.1: Compensation of employees	0,03	-0,02	-0,01
Other bonuses awarded in the public administration during the pandemic	D.1: Compensation of employees	0,14	-0,04	-0,09
Purchase of medical material for COVID-19 treatments	P.2: Intermediate consumption	0,40	-0,23	-0,14
Purchase of medical equipment, mobile hospitals and other capital expenditure in health	P.51: Gross fixed capital formation	0,08	-0,03	-0,04
Information technology equipment -mobile IT and tablets with access to the internet for students	P.51: Gross fixed capital formation	0,01	0,00	-0,01
Purchase of anti-COVID-19 vaccine and operation of vaccination centres	P.2: Intermediate consumption	0,00	0,12	-0,11
State aid scheme in the form of grant for the establishment of state guaranteed facilities for loans granted to enterprises by credit institutions	D.3: Subsidies	0,01	0,05	-0,05
Investment grants to companies affected by the COVID-19 pandemic (financed by Competitiveness Operational Programme 2014-2020)	D.3: Subsidies	0,09	0,31	-0,36
Financial support to tourism enterprises, accommodation facilities, restaurants and tourism agencies affected in the context of the COVID-19 pandemic as well as on fiscal measures (commitment appropriations)	D.3: Subsidies	0,00	0,22	-0,20
Provisions related to guarantees issued in 2020 for COVID-19 measures (mainly related to SME Invest Romania)	D99p: Other capital transfers	0,01	0,00	-0,01
Sub-total (1)		1,63	-0,25	-1,17
of which from EU funds (2)		*0,09*	*0,31*	*-0,36*
Impact on budget deficit (3)=(1)-(2)		1,54	-0,56	-0,81

Source: Convergence Programme of Romania, 2021

The Commission forecast and the convergence programme projections include the same assumption on the allocation of non-repayable financial support (grants) and loans under the

Facility. Romania is expected to benefit from substantial grants (6.3% of 2019 GDP) and loans (6.8% of 2019 GNI) under the Facility over the period 2021-2026. The government intends to make use of the entire amount of grants and loans during that implementation period. Table 3 below presents the allocation of grants and loans based on information from Romania's convergence programme and additional updated information from the Romanian authorities. According to this allocation, Facility-financed spending, which is expected to start in 2021, is set to be of sizable magnitude starting from 2022, thereby provide a significant fiscal impulse to the Romanian economy. Romania's RRP was not yet assessed and approved by the time of the publication of this staff working document and grant and loan allocations are still provisional.

Table 3: Recovery and Resilience Fund projected allocation of grants and loans financed expenditure

Grants	2021	2022	2023	2024	2025	2026	TOTAL
RON billion	1,4	7,5	16,0	17,9	13,4	13,4	69,6
EUR billion	0,3	1,5	3,3	3,7	2,7	2,7	14,2
% of annual GPD	*0,1%*	*0,6%*	*1,2%*	*1,3%*	*0,9%*	*0,9%*	
% of total	2%	11%	23%	26%	19%	19%	100%
% of total (cumulative)	2%	13%	36%	61%	81%	100%	

Loans	2021	2022	2023	2024	2025	2026	TOTAL
RON billion	0,0	4,9	9,8	9,8	24,5	24,0	73,0
EUR billion	0,0	1,0	2,0	2,0	5,0	4,9	14,9
% of annual GPD	*0,0%*	*0,4%*	*0,7%*	*0,7%*	*1,7%*	*1,6%*	
% of total	0%	7%	13%	13%	34%	33%	100%
% of total (cumulative)	0%	7%	20%	34%	67%	100%	

Source: Convergence Programme of Romania, 2021 and Ministry of Investments and European Projects

4. POLICY DEVELOPMENTS SINCE THE EDP RECOMMENDATION

The Article 126(7) recommendation to Romania of 3 April 2020 was prepared in the context of a very different macroeconomic environment. It was based on the Commission 2020 winter forecast extended with fiscal variables until 2022 (baseline scenario). Thus, the impact of the COVID-19 pandemic was not taken into account. An analysis of Romania's budgetary decisions in response to the Council Recommendation has to take into account the deterioration of the macroeconomic outlook and the impact of the emergency fiscal measures to deal with the pandemic and its economic and social consequences, as well as any other measures or actions by the authorities. Real GDP growth in 2020 was 7.7 pps lower than in the baseline scenario underlying the Article 126(7) recommendation of 3 April 2020. The deterioration of the structural balance, which was projected in the baseline scenario at around 1 pp. of GDP in 2020, turned out to be 2.8 pps of GDP. The headline deficit was projected to increase by 0.9 pps of GDP in 2020 while it in fact it increased by 4.6 pps. Table 4 summarises the main differences of the key macroeconomic and budgetary variables under the Commission's 2020 winter forecast extended to 2022 with fiscal variables, the recommended adjustment path of April 2020 and the Commission 2021 spring forecast.

On 15 September 2020, the Romanian authorities sent a report on action taken in response to the Article 126(7) recommendation. That report highlighted the deterioration of the economic and fiscal outlook due to the pandemic. It presented the fiscal targets and measures from the draft 2020 budget amendment of August 2020 but no details on the medium-term fiscal targets nor on measures by the government, as the Romanian authorities had not yet presented the 2021 draft budget nor the 2021-2023 fiscal strategy. The amended 2020 fiscal targets incorporated the measures that the government had taken in order to address the consequences of the COVID-19 outbreak on the health system and the economy, with a net impact on the deficit of around 1.5% of GDP (Table 2).

Table 4: Comparison of key macroeconomic and budgetary variables under the Commission's forecasts and the recommended adjustment path in the Council recommendation of 3 April 2020

Commission 2020 winter forecast (extended) – baseline scenario		2019	2020	2021	2022
Real GDP growth	%	3,9	3,8	3,5	3,5
Headline general government balance	% of GDP	-4	-4,9	-6,9	-7,7
Structural balance	% of GDP	-3,9	-4,9	-6,8	-7,6
Change in structural balance	% of GDP	-1,1	-1	-1,9	-0,8
Net expenditure growth corrected for one-offs (nominal)	%	13,2	12,9	13,7	10,3
Output gap	%	0,1	0	-0,3	-0,5

April 2020 Article 126(7) Recommendation		2019	2020	2021	2022
Real GDP growth	%	3,9	3,3	2,4	2,7
Headline general government balance	% of GDP	-4	-3,6	-3,4	-2,8
Structural balance	% of GDP	-3,9	-3,4	-2,7	-1,8
Change in structural balance	% of GDP	-1,1	0,5	0,8	0,8
Net expenditure growth corrected for one-offs (nominal)	%	13,2	8,2	5,5	5,5
Output gap	%	0,1	-0,6	-1,9	-2,8

Commission 2021 spring forecast		2019	2020	2021	2022
Real GDP growth	%	4,1	-3,9	5,1	4,9
Headline general government balance	% of GDP	-4,4	-9,2	-8,0	-7,1
Structural balance	% of GDP	-4,7	-7,5	-6,9	-6,4
Change in structural balance	% of GDP	-1,6	-2,8	0,7	0,5
Net expenditure growth corrected for one-offs (nominal)	%	14,0	16,2	3,4	5,5
Output gap	%	1,6	-5,3	-3,6	-2,1

Through its August 2020 budget amendment, the government attempted to limit the fiscal deterioration in 2020 owed to pre-existing measures and initiatives, by limiting the planned increases in social expenditures and in public sector wages. More precisely, the government limited the increase in old-age pensions from September 2020 to 14%, instead of the originally planned increase of 40%. The government also proposed to phase in the doubling of the child allowance. Rather than an immediate doubling in February 2020, it enacted an increase by 19% as of August 2020, followed by increases twice a year until the doubling is reached by July 2022. The government also postponed the wage increases of education staff from September 2020 to September 2021.[4] The estimated fiscal impact of those measures was around 1.3% of GDP in 2020.

After the December 2020 parliamentary elections, the new government put forward an ambitious fiscal consolidation target to bring the deficit below 3% of GDP by 2024, starting from 2021. This target was included in the medium-term fiscal strategy of the government accompanying the 2021 budget adopted by the Parliament on 2 March 2021. The government adopted several measures to achieve the 2021 target. Measures enacted in 2021 include lower expenditure ceilings for line ministries, a freeze in public sector wages and social benefits, cuts in some of the additional remunerations in the public sector, such as overtime payments and vouchers, and a postponement of all pension increases. Moreover, in 2021, the authorities expect a partial withdrawal of COVID-19 emergency measures, while the improved economic outlook is expected to have a positive impact on tax receipts. For 2022, there will be no increases in public sector wages, while pensions are expected to increase with the existing indexation system (inflation plus 50% of the increase in average real wage). This indexation is expected to lead to an estimated increase of pension expenditure of around 5%, which is below the projected increase of nominal GDP. The remaining COVID-19 measures (with a budgetary impact of close to 1% of GDP in 2021) are set to expire in 2022. The government has not yet presented a full, detailed list of fiscal policy measures to support the planned adjustment in 2022-2024 period.

5. PROPOSED ADJUSTMENT PATH

According to the Commission 2021 spring forecast, Romania is not projected to correct its excessive deficit by the deadline of 2022 established in the Council recommendation of 3 April 2020. Despite the reversal of some of the pre-existing expenditure-increasing measures in the 2020 budget amendment of August 2020 and the 2021 budget adopted in March 2021, the excessive deficit is not expected to be corrected in 2022. This is partly due to the severe economic downturn, which has led to a significant deviation from the economic assumptions on which the Council Article 126(7) recommendation of 3 April 2020 was based. In such a context, the recommended adjustment path of 3 April 2020 does no longer provide a relevant basis for fiscal policy guidance and for the assessment of the action taken by the government in response to the recommendation to bring to an end its excessive deficit.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact due to the severe economic downturn in the European Union as a whole.[5] On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. According to the last sentence of Article 3(5) of Regulation (EC) No 1467/97, the Council may decide, on a recommendation from the Commission, to adopt a revised recommendation under Article 126(7) of the Treaty in the event of a severe economic downturn in the Union as a whole, provided that this does not endanger fiscal sustainability in the medium term. The new recommendation needs also to take into account the changed economic and fiscal situation, including the budgetary performance in 2020, the adopted 2021 budget and the new budgetary strategy put in place by the government.

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4 According to a previous decision of the Romanian authorities, wages of educational staff would have increased as of 1 September 2021 in order to reach the level provided for in the unified wage grade for 2022. The impact of this increase was estimated at 0.05% of GDP in 2020.

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Under Article 3(4) of Regulation (EC) No 1467/97, the correction of the excessive deficit is to be completed in the year following its identification unless there are special circumstances. Moreover, the adjustment path should be determined in line with Regulation (EC) No 1467/97, taking into account the economic and fiscal position of the Member State. In the present situation, such special circumstances exist in Romania. However, extending the deadline for the correction of the excessive deficit by only one year as compared to the Article 126(7) recommendation of 3 April 2020, namely setting an EDP deadline of 2023, would require a very sharp fiscal adjustment, thus risking compromising the recovery after the COVID-19 pandemic. A longer adjustment path, while still requiring substantial annual adjustments, would imply a more gradual effort and strike a good balance between fiscal consolidaton and supporting the economic recovery. It would also take into account that the budgetary year 2021 has already started and includes an adjustment effort by the government despite the ongoing pandemic. Reforms, including those that improve the management of public finances would be instrumental in ensuring a durable correction of the excessive deficit. In light of these considerations, and consistent with the fiscal policy orientations set out in the Commision Communication of 3 March 2021, setting a deadline to correct the excessive deficit by 2024 is justified.

Table 5 – Forecast of key macroeconomic and budgetary variables under the baseline scenario[6]

Commission baseline scenario with Facility		2020	2021	2022	2023	2024
Real GDP growth	%	-3,9	5,1	4,9	4,5	3,8
Headline general government balance	% of GDP	-9,2	-8,0	-7,1	-6,8	-6,8
Structural balance	% of GDP	-7,5	-6,9	-6,4	-6,5	-6,9
Change in structural balance	% of GDP	-2,8	0,7	0,5	-0,1	-0,4
Net expenditure growth corrected for one-offs (nominal)	%	16,2	3,4	5,5	6,5	5,7
Fiscal stance (including EU-financed expenditure, excluding crisis-related temporary measures)	*% of GDP*	*-2,2*	*0,5*	*-0,5*	*-0,1*	*0,2*
Output gap	%	-5,3	-3,6	-2,1	-1,4	-0,7

The proposed EDP scenario is based on the Commission 2021 spring forecast, extended until 2024 and taking into account the expected Facility allocation of grants and loans. Table 6 summarises the key macroeconomic and budgetary variables under the EDP scenario, in which the excessive deficit is corrected by 2024. The recommended fiscal effort is assumed to impact real GDP growth with a multiplier of 0.7. That multiplier also reflects the growth impact that the Commission assumes for the fiscal stimulus from the in the baseline scenario. In line with the assumptions used in the Commission 2021 spring forecast and the Romanian convergence programme, the measures financed from the Facility are assumed to create new investment of an equal amount in 2021 and 2022, i.e. to be fully additional to what the public investment would be in the absence of the Facility (or additionality of 100%). As of 2023, the

6 The table also presents an indicator of the overall fiscal stance. The overall fiscal stance is measured by comparing the change in primary expenditure (net of discretionary revenue measures but including changes in expenditure financed by the RRF and other non-repayable financial support from the European Union) to the 10-year average potential growth rate. However, this estimate does not include the impact of the reforms that are part of the Recovery and Resilience Plan and can boost Romania's economic potential growth. A negative sign of the indicator (e.g. in 2020) corresponds to an excess of the primary expenditure growth compared with medium-term economic growth, which indicates an expansionary fiscal policy. By contrast, a positive sign points to a contractionary fiscal policy.

Facility average additionality assumption is 60%, as it is assumed that the Facility, notably Facility loans, will partly finance projects that would have been financed from other sources. The potential GDP remains the same in baseline and EDP scenarios.

In the proposed EDP scenario, Romania's headline general government deficit is set to decrease 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, in line with the government's own targets. This, based on the Commission forecast, is consistent 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.[7] Such growth rates of net primary government expenditure will be the primary indicator used to assess the fiscal effort if a careful analysis is needed. The corresponding annual adjustment in the structural balance is 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.

Table 6 – Forecast of key macroeconomic and budgetary variables under the EDP scenario

Revised Article 126(7) recommendation		2020	2021	2022	2023	2024
Real GDP growth	%	-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
Fiscal stance (including EU-financed expenditure, excluding crisis-related temporary measures)	*% of GDP*	*-2,2*	*0,5*	*1,0*	*1,8*	*2,0*
Output gap	%	-5,3	-3,6	-3,5	-3,3	-3,2

To assess the potential impact of overall fiscal policy on output, at the current juncture, the sizeable payments from the budget of the European Union, such as those from the Facility and other EU funds, should be duly considered. Indeed, as discussed above, Romania will receive substantial grants under the Facility in the coming years. On this basis, the overall fiscal stance under the recommended adjustment path, is estimated at 0.5% of GDP in 2021, 1% of GDP in 2022, 1.8% of GDP in 2023 and 2% of GDP in 2024.[8] While this points to an overall contractionary stance in the years of the EDP adjustment, this contractionary stance would be substantially larger in the absence of Facility grants. In other words, investments and reforms supported by the Facility provide an opportunity for Romania to improve its underlying fiscal position in the medium term while still supporting growth and job creation. This highlights the significant positive impact that the Facility and other EU funds are expected to have on the Romanian economy in the coming years.

[7] 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.

[8] See footnote 5.

6. Conclusion

The convergence programme adopted by the Romanian authorities on 5 May 2021 sets a general government deficit target of 2.9% of GDP by 2024, down from 9.2% of GDP in 2020, with the fiscal adjustment set to start in 2021. The Commission analysis suggests that a correction of the excessive deficit by 2024 in the current economic context is warranted in order to strike a good balance between ensuring fiscal sustainability and supporting the recovery. A sustainable fiscal adjustment needs to be based on structural measures and on structural reforms that will improve budgetary outcomes on a permanent basis.

A credible and sustainable adjustment path to correct the excessive deficit would require Romania to reach a headline general government deficit of 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. This, based on the Commission forecast, is consistent 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. Such growth rates of net primary government expenditure will be the primary indicator used to assess the fiscal effort if a careful analysis is needed. The corresponding annual fiscal adjustment in the structural balance is 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.