



Brussels, 4.3.2020
COM(2020) 91 final

Recommendation for a

COUNCIL RECOMMENDATION

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

{SWD(2020) 53 final}

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) thereof,

Having regard to the recommendation from the Commission;

Whereas:

- (1) According to Article 126 of the Treaty on the Functioning of the European Union (TFEU) Member States are to avoid excessive government deficits.
- (2) The Stability and Growth Pact (SGP) is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.
- (3) On [17 March] 2020, the Council decided, in accordance with Article 126(6) TFEU, that an excessive deficit existed in Romania.
- (4) In accordance with Article 126(7) TFEU and Article 3(4) of Council Regulation (EC) No 1467/97¹, the Council is required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a maximum deadline of six months for effective action to be taken by the Member State concerned to correct the excessive deficit. Furthermore, in a recommendation to correct an excessive deficit the Council should request the achievement of annual budgetary targets which, on the basis of the forecast underpinning the recommendation, are consistent with a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of at least 0.5% of GDP as a benchmark.
- (5) According to the Commission 2020 winter forecast, extended with fiscal variables until 2022, real GDP growth is projected to have stood at 3.9% in 2019. Based on a no-policy-change assumption, real GDP growth is forecast by the Commission to moderate but remain robust at 3.8% in 2020 and at 3.5% in 2021 and 2022. On the one hand, the significant fiscal stimulus implied by current policies would continue giving some impetus to private consumption. On the other hand, a continued widening of the fiscal deficit would erode consumers' and investors' confidence in the sustainability of the economy's growth trajectory. As a result, investment is expected to weaken, as private investors take account of increasing macroeconomic imbalances. The contribution of net exports is expected to remain negative over the forecast horizon, as exports continue to be affected by weak external demand while imports are supported

¹ OJ L 209, 2.8.1997, p. 6.

by private consumption. This in turn would further worsen the already high current account deficit.

- (6) On 10 December 2019 the government adopted and sent to the Parliament its Fiscal-Budgetary Strategy for 2020-22 (the Fiscal Strategy), with a revised general government deficit target of 3.8% of GDP in 2019, above the 3% of GDP reference value. That revision, up from originally planned 2.8% of GDP in 2019, was based on budget execution data for the year to-date. The Fiscal Strategy was promulgated into law on 18 December 2019.
- (7) The Commission 2020 winter forecast, extended with fiscal variables until 2022, projects the general government deficit to remain above the 3% of GDP reference value for the entire forecast period. The Commission projects a general government deficit of 4.0% of GDP in 2019, 4.9% in 2020, 6.9% in 2021 and 7.7% in 2022 under a no policy change assumption. The structural deficit is projected to deteriorate by 1.0% of GDP in 2019, by further 1.9% of GDP in 2021 and by further 0.8% in 2022. The increase in the deficit projected by the Commission is mostly driven by significant pension increases enacted in summer 2019. The higher spending on pensions would contribute 0.9 pp. of GDP to the deficit increase in 2020, 1.7 pp. of GDP in 2021 and 1.1 pp. of GDP in 2022. The doubling of the child allowance, due to enter into force from August 2020, is estimated to have an annualised budgetary cost of 0.6% of GDP. In its Fiscal Strategy, the government projects a general government deficit of 3.6% of GDP in 2020, 3.4% in 2021 and 2.8% in 2022. Based on government estimates, this would lead to a structural adjustment of 0.3% in 2020, 0.2% in 2021 and 0.6% in 2022. The adjustment in the Fiscal Strategy is mostly expenditure based. In particular, the expenditures on compensation of employees, on goods and services and on non-EU-cofinanced capital spending are projected to decrease as a share of GDP. The lower deficit projection in the Fiscal Strategy, compared to the Commission's forecast, stems from more optimistic underlying macroeconomic projections in the Fiscal Strategy and from the fact that the Fiscal Strategy does not take into account the fiscal impact of some enacted measures while the planned moderation of current expenditures is not fully supported by enacted, or credibly announced, measures and could therefore not be taken fully into account in the Commission forecast.
- (8) General government debt in Romania amounted to 34.7% of GDP in 2018. According to the Commission forecast, general government debt is projected to increase to 46.6% of GDP in 2022, thus remaining below the Treaty reference value.
- (9) According to Article 3(4) of Regulation (EC) No 1467/97, the correction of the excessive deficit should be completed in the year following its identification (in this case by 2021), unless there are special circumstances. 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.
- (10) In the present situation, such special circumstances exist in Romania. Correcting the excessive deficit by 2021 would require a too sharp fiscal adjustment and result in a significant output loss. A longer adjustment path, while still requiring substantial annual adjustments, would have a more gradual impact on growth and takes into account the fact that the budgetary year 2020 has already started. Structural reforms pursued in parallel with fiscal consolidation will contribute to ensure a durable correction of the excessive deficit. In light of this and taking into account the economic and fiscal situation in Romania, setting the deadline for the correction of the excessive deficit by 2022 is warranted.

- (11) A credible and sustainable adjustment path under this deadline would require Romania to reach a headline general government deficit target of 3.6% of GDP in 2020, 3.4% of GDP in 2021 and 2.8% of GDP in 2022 which, based on the Commission forecast, is consistent with a nominal growth rate of net primary government expenditure² of 8.2% in 2020, 5.5% in 2021 and 5.5% in 2022. Such growth rate of net 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 of 0.5% of GDP in 2020, 0.8% of GDP in 2021 and 0.8% of GDP in 2022. Based on the current forecast, those targets still allow for annual increases in real net expenditure. Achieving the targets will likely require reconsidering the large legislated pension increases and other recent measures which drive the sharp deterioration of the deficit in the baseline scenario.
- (12) Budgetary consolidation measures should secure a lasting correction, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy.
- (13) Since 2016, Romania has systematically and repeatedly derogated from fiscal rules enshrined in the national fiscal framework, thereby rendering them largely ineffective. It is crucial that, in the future, Romania ensure the full application of the national fiscal framework.
- (14) In the medium and long term, risks to sound public finances appear high, driven by high fiscal deficits and costs of aging. The pension increases, enacted in summer 2019 and scheduled to enter into force over 2019-2021, play a large part in those risks. This confirms the urgent need to fully restore the long-term sustainability of public finances,

HAS ADOPTED THIS RECOMMENDATION:

- (1) Romania should put an end to the present excessive deficit situation by 2022 at the latest.
- (2) Romania should reach a headline general government deficit target of 3.6% of GDP in 2020, 3.4% of GDP in 2021 and 2.8% of GDP in 2022 which is consistent with a nominal growth rate of net primary government expenditure of 8.2% in 2020, 5.5% in 2021 and 5.5% in 2022, corresponding to an annual structural adjustment of 0.5% of GDP in 2020, 0.8% of GDP in 2021 and 0.8% of GDP in 2022.
- (3) Romania should specify and rigorously implement the measures that are necessary to achieve the correction of its excessive deficit by 2022. Budgetary consolidation measures should secure a lasting correction in a growth-friendly manner. Romania should use any windfall gains for deficit reduction.
- (4) The Council establishes the deadline of 15 September 2020 for Romania to take effective action and, in accordance with Article 3(4a) of Regulation (EC) No 1467/97, to report in detail the consolidation strategy that is envisaged to achieve the targets. Thereafter the Romanian authorities should report on progress made in the

² 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.

implementation of these recommendations at least every six months until the excessive deficit has been corrected.

Furthermore, the Romanian authorities should ensure the full application of its national fiscal framework. To ensure the success of the fiscal consolidation strategy, it will be also important to back the fiscal consolidation by comprehensive structural reforms, in line with the Council recommendations addressed to Romania in the context of the European Semester and in particular those related to the Macroeconomic Imbalance Procedure.

This Recommendation is addressed to Romania.

Done at Brussels,

*For the Council
The President*