Council of the
European Union

Brussels, 2 June 2021
(OR. en)

9078/21

ECOFIN 495
UEM 113

COVER NOTE

From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
date of receipt:	2 June 2021
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
No. Cion doc.:	COM(2021) 523 final
Subject:	Recommendation for a COUNCIL RECOMMENDATION delivering a Council opinion on the 2021 Convergence Programme of Romania

Delegations will find attached document COM(2021) 523 final.

Encl.: COM(2021) 523 final

EUROPEAN
COMMISSION

Brussels, 2.6.2021
COM(2021) 523 final

Recommendation for a

COUNCIL RECOMMENDATION

delivering a Council opinion on the 2021 Convergence Programme of Romania

{SWD(2021) 501 final}

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Recommendation for a

COUNCIL RECOMMENDATION

delivering a Council opinion on the 2021 Convergence Programme of Romania

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 9(2) thereof,

Having regard to the Recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

After consulting the Economic and Financial Committee,

Whereas:

(1) On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause[2] of the Stability and Growth Pact.[3] In its Communication, the Commission set out its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the conditions to activate the general escape clause were met. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The general escape clause has granted Member States budgetary flexibility to deal with the crisis. It has facilitated the coordination of budgetary policies in times of severe economic downturn. Its activation allows for a temporary departure from the adjustment path towards the medium-term budgetary objective of each Member State, provided this does not endanger fiscal sustainability in the medium term. On 17 September 2020, in its Annual Sustainable Growth Strategy, the Commission announced that the general escape clause would remain active in 2021.[4]

(2) On 3 April 2020, the Council adopted Decision (EU) 2020/509[5] on the existence of an excessive deficit situation in Romania due to non-compliance with the deficit criterion in 2019. This was based on the updated fiscal targets by the government, while the

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

[2] The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn.

[3] Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, Brussels, 20.3.2020, COM(2020) 123 final.

[4] Communication from the Commission on Annual Sustainable Growth Strategy 2021, Brussels, 17.9.2020, COM(2020) 575 final.

[5] Council Decision (EU) 2020/509 of 3 April 2020 on the existence of an excessive deficit in Romania (OJ L 110, 8.4.2020, p. 58).

subsequent publication of the general government deficit outturn of 4.3% of GDP confirmed the breach. The excess over the 3% of GDP Treaty reference value was the result of a continuous build-up of fiscal imbalances due to an expansionary fiscal policy since 2016, in a period of strong economic growth. On 3 April 2020, the Council also issued a Recommendation[6] with a view to bringing an end to the situation of an excessive government deficit in Romania by 2022 at the latest.

(3) On 20 July 2020, the Council recommended Romania[7] to pursue fiscal policies in line with the Council Recommendation of 3 April 2020, while taking all necessary measures to effectively address the pandemic, sustain the economy and support the ensuing recovery.

(4) Next Generation EU, including the Recovery and Resilience Facility, will ensure a sustainable, inclusive and fair recovery. Regulation (EU) 2021/241 establishing the Recovery and Resilience Facility[8] came into force on 19 February 2021. This Facility will provide financial support for the implementation of reforms and investment, entailing a fiscal impulse financed by the EU. It will contribute to the economic recovery, to the implementation of sustainable and growth-enhancing reforms and investment, notably to promote the green and digital transitions, and it will strengthen the economies' resilience and potential growth. In turn, it will also help public finances to return to more favourable positions in the near term and will contribute to strengthening sustainable public finances, growth and job creation in the medium and long term.

(5) On 3 March 2021, the Commission adopted a Communication providing further policy orientations to facilitate the coordination of fiscal policies and the preparation of Member States' Stability and Convergence Programmes.[9] That Communication also announced the Commission's view that the decision on the deactivation or continued application of the general escape clause should be taken as an overall assessment of the state of the economy, with the level of economic activity in the EU or euro area compared to pre-crisis levels (end-2019) as key quantitative criterion. On the basis of the Commission's 2021 spring forecast, on 2 June the Commission considered that the conditions to continue to apply the general escape clause in 2022 and to deactivate it as of 2023 were met. Country-specific situations will continue to be taken into account after the deactivation of the general escape clause.[10]

(6) On 5 May 2021, Romania submitted its 2021 Convergence Programme, beyond the deadline established in Article 8 of Regulation (EC) No 1466/97.

(7) In 2020, based on data validated by Eurostat, Romania's general government deficit was 9.2% of GDP, while general government debt increased to 47.3% of GDP. The annual change in the primary budget balance amounted to -3.6% of GDP, including discretionary budgetary measures of 1.5% in support of the economy and the operation

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6 Council Recommendation of 3 April 2020 with a view to bringing an end to the situation of an excessive government deficit in Romania (OJ C 116, 8.4.2020, p. 1).

7 Council Recommendation of 20 July 2020 on the National Reform Programme of Romania and delivering a Council opinion on the 2020 Convergence Programme of Romania (OJ C 282, 26.8.2020, p. 149).

8 OJ L57, 18.2.2021, p.17.

9 Communication from the Commission to the Council on one year since the outbreak of COVID-19: fiscal policy response, Brussels, 3.3.2021, COM(2021) 105 final.

10 Communication from the Commission on Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy, Brussels, 2.6.2021, COM(2021)500 final.

of automatic stabilisers. Romania also provided liquidity support to companies and households (such as guarantees and tax deferrals, which do not have a direct and immediate budgetary impact), estimated at 1.4% of GDP.

(8) The macroeconomic scenario underpinning the budgetary projections is realistic in 2021 and 2022. According to the Convergence Programme real GDP growth is forecast at 5.0% in 2021 and 4.8% in 2022. In both years, domestic demand, with strong consumption and investment growth, is expected to be the main driver. The Commission 2021 spring forecast of Romania's growth is slightly above the one of the Convergence Programme, with 5.1% in 2021 and 4.9% in 2022, also driven by domestic demand.

(9) In its 2021 Convergence Programme, the government plans a decrease in the general government deficit from 9.2% of GDP in 2020 to 8% of GDP in 2021, while the debt ratio is planned to increase to 50.8% of GDP in 2021. According to the programme, the change in the primary budget balance in 2021 compared with the pre-crisis level (2019) is set to amount to 3.3% of GDP, reflecting the discretionary budgetary measures of 1.5% of GDP in support of the economy and the operation of automatic stabilisers. These projections are in line with the Commission's 2021 spring forecast.

(10) In response to the COVID-19 pandemic and related economic downturn, Romania has adopted budgetary measures to strengthen the capacity of its health system, contain the pandemic and provide relief to those individuals and sectors that have been particularly affected. This forceful policy response has cushioned the contraction in GDP, which, in turn, curtailed the increase in government deficit and public debt. The measures taken by Romania in 2020 and 2021 have been in line with the Council Recommendation of 20 July 2020. The discretionary measures adopted by the government in 2020 and 2021 are temporary or matched by offsetting measures. At the same time, there has been a continuous fiscal impact of expansionary measures which were adopted before the pandemic. These measures notably included increases in pensions and other social expenditure and tax cuts.

(11) The 2021 Convergence Programme assumes investment and reforms financed by grants under the Recovery and Resilience Facility amounting to 0.1% of GDP in 2021, 0.6% of GDP in 2022, 1.2% of GDP in 2023, 1.2% of GDP in 2024, 0.9% of GDP in 2025 and 0.9% of GDP in 2026. The programme also assumes loans under the Recovery and Resilience Facility amounting to 2.3% of GDP in 2025 and 2.5% of GDP in 2026. The Commission's spring forecast includes only the grants in its budgetary projections as the loans are assumed in the Convergence Programme to start after the Commission's 2021 spring forecast horizon.

(12) To assess the overall fiscal stance at the current juncture, the sizeable transfers from the EU budget (such as those from the Recovery and Resilience Facility) should be included in the relevant expenditure aggregate.

Therefore, the fiscal stance is then measured by the change in primary expenditure (net of discretionary revenue measures and excluding crisis-related temporary emergency measures) including expenditure financed by grants under the Recovery and Resilience Facility and other EU funds.

Going beyond the overall fiscal stance, the analysis also aims at assessing whether national fiscal policy is prudent and its composition is conducive to a sustainable recovery consistent with the green and digital transitions. For that reason, particular attention is paid to the evolution of nationally financed primary current expenditure and investment.

(13) In its 2021 Convergence Programme, Romania's general government deficit is planned to decrease to 6.2% of GDP in 2022, mainly due to a discontinuation of the temporary support measures adopted in 2020 and 2021. The general government debt ratio is planned to increase to 52.9% of GDP in 2022. These projections are more favourable than the Commission's 2021 spring forecast.

Based on the Commision's forecast, the overall fiscal stance as defined above – also including the impact on aggregate demand in 2022 from investment financed by both the national and the EU budgets, notably the Recovery and Resilience Facility – is estimated at -0.5% of GDP[11]. The positive contribution of the expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to increase by 0.4 percentage points of GDP. Nationally financed investment is projected to provide an expansionary contribution of 0.1 percentage points of GDP.[12] Nationally financed primary current expenditure (net of discretionary revenue measures) is projected to provide a neutral contribution.

(14) According to the programme's medium-term budgetary plans, the general government deficit is planned to decrease from 4.4% in 2023, to 2.9% of GDP in 2024. The general government deficit is planned to no longer exceed 3% of GDP in 2024.

Based on the programme, the overall fiscal stance – also including the impact on aggregate demand from investment financed by both the national and the EU budgets, notably the Recovery and Resilience Facility – is estimated at 0.6% of GDP in 2023 and 2024 on average. The positive contribution of the expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to increase by 0.2 percentage points of GDP. Nationally financed investment is projected to provide a contractionary contribution of 0.1 percentage points of GDP.[13] Nationally financed primary current expenditure (net of discretionary revenue measures) is projected to provide a contractionary contribution of 0.8 percentage points of GDP.

The current estimate of the 10-year average nominal potential growth is 5¾%.[14] 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 potential growth.

(15) The general government debt ratio is planned to increase from 53.3% of GDP in 2023 and decrease to 52.4% of GDP in 2024. In light of the particularly fast-increasing debt path in the medium term, mainly due to the large deficit forecasted in 2022 and unfavourable financing conditions compared with other EU countries, Romania is considered to face high fiscal sustainability risks over the medium term, as per the latest debt sustainability analysis.[15]

(16) On 2 June 2021, the Commission recommended a Council recommendation for the correction of Romania's excessive deficit by 2024. According to that recommendation, Romania should reach a headline general government deficit target of 8.0% of GDP in

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11 A negative sign of the indicator corresponds to an excess of the primary expenditure growth compared with medium-term economic growth, which indicates an expansionary fiscal policy.

12 Other nationally financed capital expenditure is projected to provide a neutral contribution.

13 Other nationally financed capital expenditure is projected to provide a neutral contribution.

14 Estimated by the Commission, following the commonly agreed methodology.

15 See Commission Staff Working Document – Statistical Annex providing background data relevant for the assessment of the 2021 Stability and Convergence Programmes.

2021, 6.2% of GDP in 2022, 4.4% of GDP in 2023, and 2.9% of GDP in 2024, which 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. This corresponds to 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.

The Council has assessed the 2021 Convergence Programme and the follow-up by Romania to the Council Recommendation of 20 July 2020.

HEREBY RECOMMENDS ROMANIA TO:

1. Pursue fiscal policies in line with the Council Recommendation under Article 126(7) of the Treaty of [XX June 2021].

Done at Brussels,

For the Council
The President