EUROPEAN
COMMISSION

Brussels, 19.6.2024
COM(2024) 597 final

Recommendation for a

COUNCIL DECISION

establishing that no effective action has been taken by Romania in response to the Council Recommendation of 18 June 2021

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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(8) thereof,

Having regard to the recommendation from the European Commission,

Whereas:

(1) According to Article 126 of the Treaty, Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact 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. The Stability and Growth Pact includes Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure,[1] which was adopted in order to further the prompt correction of excessive general government deficits.

(3) On 3 April 2020, the Council, acting upon a recommendation by the Commission, adopted Decision (EU) 2020/509 under Article 126(6) TFEU on the existence of an excessive deficit situation in Romania due to a planned non-compliance in 2019 with the deficit criterion of the TFEU, and issued a Recommendation under Article 126(7) TFEU with a view to bringing an end to the situation of an excessive government deficit by 2022 at the latest. In light of the deep contraction in economic activity linked to the COVID-19 pandemic, on 18 June 2021 the Council adopted a revised Recommendation under Article 126(7) TFEU to Romania[2].

(4) On 18 June 2021, the Council recommended Romania to put an end to the excessive deficit situation by 2024 at the latest. Specifically, in its 18 June 2021 Recommendation under Article 126(7) TFEU, the Council recommended Romania to reduce its headline deficit to 8.0% of GDP in 2021, 6.2% of GDP in 2022, 4.4% of

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[1] Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 209, 2.8.1997, p. 6).

[2] All documents related to the excessive deficit procedure of Romania can be found at: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/corrective-arm-excessive-deficit-procedure/ongoing-excessive-deficit-procedures/romania_en

GDP in 2023 and 2.9% of GDP in 2024. This was 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. It corresponded 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 Recommendation further stated that Romania should fully implement the measures already adopted for 2021, and to specify and implement the additional measures necessary to achieve the correction of its excessive deficit by 2024. Any windfall gains were to be used to reduce the general government deficit. In its Recommendation, the Council established a deadline of 15 October 2021 for Romania to take effective action and, in accordance with Article 3(4a) of Regulation (EC) No 1467/97, to report on progress made in the implementation of the Recommendation at least every six months until the excessive deficit has been corrected.

(5) On 24 November 2021, the Commission concluded that Romania had taken effective action in response to the 18 June 2021 Recommendation under Article 126(7) TFEU and considered that no additional steps in the excessive deficit procedure were necessary at that point in time. Romania has since been assessed to have complied with the 18 June 2021 Recommendation under Article 126(7) TFEU, due to the fact that the respective headline deficit targets in 2021 and 2022 were achieved. Based on budgetary outcome data validated by Eurostat, Romania's general government deficit decreased from 7.2% of GDP in 2021 to 6.3% of GDP in 2022. The initial estimate for 2022 (notified and validated in the context of the spring 2023 EDP notification) was 6.2% of GDP, in line with the headline deficit target recommended by the Council. The excessive deficit procedure therefore remained in abeyance. However, the structural deficit fell by 1.2 pps. of GDP in 2021 and 0.4 pps. of GDP in 2022, which compares with recommended adjustments of 0.7 pps. and 1.8 pps. of GDP, respectively. The cumulative structural adjustment over 2021-2022 was, therefore, below the recommended one. Moreover, net primary expenditure growth reached 7.4% in 2021 and 15.0% in 2021, well above targets set out in the Council Recommendation.

(6) Since the adoption of the 18 June 2021 Council Recommendation, Romania's economic performance has been broadly in line with the Commission's forecasts. Over 2021-2023, real GDP growth was broadly consistent with projections included in the Commission's Staff Working Document of 2 June 2021, despite macroeconomic shocks that occurred in the meantime (in particular Russia's war of aggression against Ukraine and the ensuing energy shock). The 2023 output gap is estimated to have been less negative than projected in June 2021. Moreover, growth in government revenue has been much faster than projected, mostly due to high inflation but also reflecting the impact of a tax-rich real GDP growth composition. Overall, macroeconomic developments cannot justify the significantly worse fiscal outcomes relative to the June 2021 Council Recommendation, even if GDP growth would likely have been lower with a considerably tighter fiscal policy.

(7) A new assessment of the action taken by Romania to correct the excessive deficit by 2024 in response to the Council Recommendation of 18 June 2021 leads to the following conclusions:

– Based on the budgetary outcome data notified by Romania and validated by Eurostat, Romania's general government deficit increased to 6.6% of GDP in

2023, much higher than the 4.4% of GDP recommended by the Council and planned by Romania in its 2023 Convergence Programme. The main reason for this deviation was that government spending continued to grow at a very high rate, mostly driven by social transfers, interest payments, expenditure in goods and services and capital spending. The 2023 headline deficit was also impacted by the statistical recording of payments of public sector wage increases (0.5% of GDP) following court decisions.

– In 2023, the fiscal effort was much lower than recommended by the Council. Romania's structural balance remained broadly unchanged in 2023 (deteriorating by 0.1% of GDP), well below the target of an improvement by 1.7% of GDP recommended by the Council. Net primary expenditure growth (adjusted for fiscal policy measures on the revenue side) was much higher than recommended in 2023, at close to 12% versus a target of 0.9% recommended by the Council.

– In 2022 and 2023, strong real and nominal GDP growth fuelled a very strong increase in government revenue (20.8% in 2022 and 14.2% in 2023), much larger than was envisioned at the time of the Council Recommendation in June 2021. However, in both years most windfall gains on the revenue side were used to finance additional spending instead of reducing the budget deficit.

– The Commission spring 2024 forecast projects the general government deficit to increase to 6.9% of GDP in 2024. The general government debt-to-GDP ratio is set to increase to 50.9% by the end of 2024, from 48.8% in 2023. As in previous years, the forecast increase of the general government deficit in 2024 reflects high growth in current government expenditure. Spending on public wages is projected to increase strongly, reflecting recent discretionary increases in wages in education, health and the defence sectors. The recalculation of pensions in the context of the pension reform will have a short-term cost in 2024 and 2025 – the reform will however subsequently generate large savings over the medium and long run, assuming the reform is fully implemented.

– In 2024, government revenue growth is expected to outpace nominal GDP growth, reflecting efforts to improve tax collection through digitalisation of the tax system and the impact of a package of revenue-increasing measures adopted in autumn 2023, which is expected to boost government revenue by around 1% of GDP. The package mostly consists of an increase in corporate taxation, in particular for micro-enterprises, an increase in taxation of individuals, coming from a partial removal of preferential tax facilities in the construction and agriculture sectors, the elimination of reduced VAT rates for selected goods and services, an increase in excise duties, and a special tax on the turnover of banks and multinationals.

(8) This leads to the conclusion that the response of Romania to the Council Recommendation of 18 June 2021 has been insufficient. Romania did not reach the headline deficit target in 2023 and is not forecast to put an end to its excessive deficit by 2024. The fiscal effort fell significantly short of what was recommended by the Council, and net primary expenditure grew much faster than recommended.

HAS ADOPTED THIS DECISION:

Article 1

Romania has not taken effective action in response to the Council Recommendation of 18 June 2021.

Article 2

This Decision is addressed to Romania.

Done at Brussels,

For the Council
The President