

Report on the actions undertaken at the request of the Council of the European Union to adjust the budget deficit following the activation of the excessive deficit procedure for Romania

For Romania, 2021 is marked, on the one hand, by the persistence of the COVID-19 crisis, and on the other hand by a favorable macroeconomic environment considering the positive review of economic growth and the approval of the National Recovery and Resilience Plan by the European Commission. According to the Summer Forecast of the National Commission for Strategy and Prognosis, the real GDP growth has been revised to 7% from 4.3%, figure initially used in the initial construction of the general consolidated budget.

In this regard, the budget set for 2021 envisages both the adjustment of the budget deficit and the continuation of the support measures offered in the context of COVID-19 pandemic. Under these circumstances, the budget deficit target adopted in the 2021 Budget Revision is 7.13% of GDP (in cash terms). The budget execution recorded so far does not indicate risks for not meeting the budget deficit target for the end of 2021.

Prudent fiscal policy will continue in the medium term, so that in 2024 the budget deficit will reach below 3% of GDP. The adjustment path assumed through 2021-2024 Convergence Program envisages that the budget deficit (in ESA terms) will not exceed 8% of GDP in 2021, 6.2% of GDP in 2022 and respectively 4.4% of GDP in 2023. In structural terms, the budget deficit target is set to 7.35% of GDP in 2021.

The adjustment of the budget deficit over the medium-term is mainly explained by the significant reduction in the share of budget expenditure in GDP, while the share of tax revenue remains relatively constant. Plus, the positive impact of reforms and investments envisaged in Romania's Recovery and Resilience Plan was not taken into consideration at the moment of accomplishing the Fiscal Strategy for 2021-2023.

According to the Recovery and Resilience Plan, Romania targets fiscal system consolidation and increasing the capacity of revenue collection, with an expected result of at least 3 percentage points (2.5 pps from the tax administration reform and 0.5 pps from the tax framework review) of GDP by 2026.

I. Main economic results in the first part of 2021

During the first half of 2021, the sanitary crisis persisted leading to a prolongation of the state of alert and, on top, with quarantine periods at local level. In the first 6 months, the gross domestic product increased by 7.0%, in real terms, compared to the same period of 2020 (unadjusted series) and by 6.6% (seasonally adjusted data).

On the supply side, we highlight the recovery in industry, which recorded an increase by 10.6% in GVA, leading to a contribution of 1.9 percentage points to GDP's real growth. Constructions have increased moderately, by 4.9%, as a result of a base effect, on one hand, and a surge in prices of construction materials, on the other hand. The service sector recorded a consistent dynamic in GVA of 5.9% which meant a 3.9 percentage points contribution to GDP growth. Within services, entertainment, cultural and recreational activities remained subject to further restrictive measures, especially at the beginning of the analysed period. Under these circumstances, this branch registered a modest increase in GVA, of only 1.2% during the first semester, still without covering the previous year's contraction. Another branch whose activity contracted last year due to the crisis refers to professional, scientific, technical and support services, which turned to positive territory in the first half of this year, with an increase in the GVA of 4.1%, thus supporting the economic growth by 0.3 percentage points. Regarding the branch trade, transport, hotels and restaurants, the return to positive territory is noticeable, after the negative developments in 2020, with an increase of 10.4% in the first semester of 2021 and a contribution of 2.1 percentage points to GDP growth. The Information and communications sector has continued its performance with an increase of 14.4% in the first semester leading to a 1.1 percentage point contribution to real GDP growth.

On the demand side, the economic leap in the first half of 2021 is based on the investment process, which evolved beyond expectations. Gross investments increased by 12.3%, thus contributing by 2.6 percentage points to the economic growth. In the context of the pandemic crisis, when population and companies faced supply chains disruptions, and therefore a change in behavior can be highlighted since the second quarter, namely, a tendency to build up inventories, with a contribution to the growth rate of GDP of 3.0 percentage points in the first semester.

A positive signal is given by the recovery of the private consumption, which increased by 6.3% in the first half and had a contribution of 4.0 percentage points to the economic growth (with a noticeable pick-up of 11.8% in the second quarter). By contrast, the government consumption decreased by 1.1%.

On the whole economy, domestic demand increased by 8.9% in the first half of 2021 compared to the corresponding period of 2020 contributing by 9.4 percentage points to GDP growth, but it was offset by the external demand which had a negative contribution of 2.4 percentage points. Exports of goods and services increased by 17.5%, while the

rhythm of the imports of goods and services was higher (20.8%).

During March-June 2021, **industrial production** has recorded 2-digit increases (in annual terms), the highest in April 2021, given the fact that April 2020 was the first month strongly affected by the pandemic. Regarding the developments in the first 7 months of 2021, the industrial production has increased by 14%, fueled by the recovery in the manufacturing sector (15.3%), with an increase exceeding 30% in manufacture of motor vehicles (31.7%) one of the most important exporting sectors which was impacted by the crisis of semiconductors. Important increases have been recorded also in manufacture of electrical equipment (28.1%), machinery and equipment (25%) and other transport equipment (20.8%).

During the first 7 months, **the volume of construction works** increased by 4.4%, fueled by the positive developments in the new construction works (12.7%). The other two components, namely capital repair works and maintenance and current repair works, decreased of 14.3% and 9%, also due to a pronounced base effect. By type of construction, residential component has supported the sector's growth, with an increase of 28%, while the construction of non-residential buildings has decreased by 3.6%, on the back of a lower interest in office construction due to the persistence of the teleworking activity during 2021. As regards the civil engineering, a decrease of 1.6% was registered as compared to the corresponding period of the previous year.

The volume of the retail trade increased by 12.4% in the first 8 months of 2021, with positive contributions from all the components, as follows: sales of non-food goods (18.7%), fuel retail trade (13.0%) and food goods (5.6%). In the structure of non-food goods, the most consistent increase was registered for textile, clothing and footwear sales (48.3%) in line with the evolution of the industrial production, followed by other non-food products (23.0%) and furniture, lightening and electric equipment (18.5%). Consumer's behavior has continued to be oriented towards online purchases, with an increase of 15% during the first 8 months of 2021.

The **services rendered to the population**, sector hardly affected by the crisis, have recovered, the volume of the turnover increasing by 37.6% during the first 7 months. The evolution was mainly fueled by the pickup in hotels and restaurant activities (41.2%) but also hairdressing and other beautifying activities (51.3%), and gambling and other activities (38.1%). The upward trend in the activity of tourism agencies in the latest months brought them in the positive territory, increasing by 13.2% in the first 7 months as compared to the corresponding period of 2020.

Services rendered to enterprises grew by 16.4% in nominal terms, in the first 7 months of 2021, with strong increases (in annual terms) especially during April-June. Except for the air transport, which is still recovering from the low levels in the context of the pandemic (-3.8%), the other branches had positive developments.

International trade intensified, once the economic activities gradually resumed, the

restrictions on movement were lifted and the supply chains recovered. Thus, in the first 8 months of the current year, the exports of goods reached EUR 48.2 billion, 24.4% higher compared to the corresponding period in 2020; the deliveries towards external markets returned to a positive dynamic starting March 2021. The purchase of goods on the international markets returned to positive dynamics, once the economic sectors resumed their activity and the inventories began to decrease. During the first 8 months of 2021, the imported goods were 24.9% higher than the value registered in the same period of the previous year. Therefore, Romania's trade balance registered a FOB-CIF deficit of EUR14.6 billion in this interval, 26.8% higher than during the corresponding period in 2020.

The gross average salary earnings on the whole economy was of RON 5,698 in January - July 2021, 7.6% higher than the one registered in the corresponding period of 2020. The **net** average salary earnings increased by 7.6%, amounting RON 3,492.

The average number of employees (calculated as arithmetic mean of the monthly staff headcount) was of 4,953.7 thousand individuals in the first 7 months of 2021, 0.3% higher than in the same period of 2020.

Registered unemployment at national level, starting March 2021, followed a descending trend, despite the effects of the COVID-19 pandemic manifestation. The support measures adopted by the Government of Romania, especially those referring to technical unemployment, allowed the staff to remain employed, even though, in some cases, the activity of the companies was affected. At the end of August 2021, the number of registered unemployed decreased to 256.1 thousand persons (0.6 thousand persons lower than in February 2020) with a rate of 2.93% registered unemployment (2.95% in February 2020), according to the ANOFM's statistical data.

Consumer prices have stepped in an inflationary process since the beginning of the current year, reaching a maximum level of 5.25% in annual terms in August. By components, non-food goods have a more pronounced increase (7.92%), driven mainly by the sharp rise in energy prices, but also by a significant increase in international quotations of raw materials.

As regards the risks associated to the forecast, we mention the lack of predictability of the international economic environment for the last part of this year, in a context dominated by the 4th wave of pandemic. It is worth highlighting the factors influencing the European economy, EA and especially Germany (Romania's main trading partner) whose evolution is reflected in the aggregate demand through exports, especially through national industrial production. The supply chains disruptions with unfavorable impact on car industry can also be mentioned.

In a context of high economic growth, even if the export of goods is expected to recover from the last year's decline the trade balance deficit is estimated to widen, thus influencing the current account evolution.

On the other side, an internal risk may come from price increases for commodity, agri-food products and from substantial increase for gas and electric energy prices, setting a supplementary pressure on domestic production competitiveness and on inflation.

Taking into account the economic developments during the first half of 2021 GDP is expected to reach 7% real growth.

II. Fiscal policy in 2021

The prudent fiscal policy established at the construction of the initial budget is maintained throughout the year 2021, including within the budget revision.

In this regard, we mention that from general government revenue perspective, no changes to the tax system are planned, except for slight increases in the level of excise duty on tobacco (according to the schedule of gradual increase of the level of excise duties provided in the Fiscal Code). From general government expenditure perspective, the measures used in the initial budget construction and maintained during the year, including at the budget revision, are:

- maintaining the gross wages in the public sector at the level granted for December 2020
- maintaining the pension point at RON 1,442
- maintaining the bonuses, allowances, compensations and premiums at the level granted for December 2020, as far as the staff hold the same position and work under the same conditions
- maintaining the amount of the food allowance at the level set for 2020
- non-awarding of prizes and holiday allowance provided by the Law no. 153/2017
- compensation for overtime work for employees of public sector only with free time
- extending the use of holiday vouchers issued in 2019 and 2020 until the end of 2021 and suspending the issuance of holiday vouchers for 2021 by public authorities and institutions
- raising the minimum gross salary by 3.1% compared to December 2020, at RON 2300 per month, starting January 13, 2021

- raising the state allowance by 16% compared to the value in December 2020, starting with January 2021, by 14% from January 1st, 2022 and establishing a transparent indexation mechanism by GEO no. 56/2021 according to which the allowance will be indexed annually with the average annual inflation rate known in the current year for the previous calendar year, communicated by the National Institute of Statistics
- changing the tariffs offered to students for means of transport.

Also, a transparent mechanism for establishing the value of the pension point was approved by GEO no. 8/2021. It consists in raising the pension point, starting with January 1st of each year, by the average annual inflation rate, to which is added at most 50% of the real increase of the achieved average gross wage, final indicators, known in the current year, for the previous calendar year, communicated by the National Institute of Statistics.

Measures aimed at improving the level of general government revenue collection envisaged by the National Agency of Fiscal Administration (NAFA) continue in 2021.

The strategic objectives of NAFA aim at permanent improvement of general government revenue collection on the entire flow of fiscal administration activities, but also at firmly combat tax evasion. Under these circumstances and in order to streamline the general government revenue collection, the Operational Revenue Recovery Plan and NAFA Strategy 2021-2024 were adopted. These documents contain concrete measures whose implementation has been initiated since 2020. The measures are:

- supporting voluntary compliance by achieving a new and innovative design of business processes and services in interaction with taxpayers
- integrated digital solutions – transforming NAFA into a high-performance and intelligent organization with integrated digital solutions, that makes maximum use of the available data and information
- preventing and combating tax evasion in order to maintain a fair economic environment by implementing new tools for tax authorities:
 - ✓ **connecting cash registers to IT infrastructure of NAFA** started on March 31, 2021 and is scheduled to run in stages until November 2021; 242,404 cash registers are, already, connected
 - ✓ the project aimed at introducing **the electronic invoice** was started:
 - the legal framework was adopted on November 4, 2021
 - the IT system was developed for the transmission and storage by electronic means of invoices issued by economic operators in relation to public institutions (Business-to-Government relationship)
 - the system is to be extended to relations between economic operators (Business-to-Business relationship)

- ✓ **desk-audit** implementation by developing the fiscal control component aimed at document verification; approximately 5000 verifications have been carried out this year
- ✓ **SAF-T** implementation:
 - the voluntary testing phase has been started in August and it represents a form of assistance for taxpayers to verify their own reporting systems
 - the legal form was adopted on August 30, 2021 and it regulates the obligation to submit "Standard File of Fiscal Control (SAF-T)" at primary level
 - the system becomes mandatory with taxpayers starting with January 1st, 2022.

Support measures for population and business environment continue in 2021, by:

- SME Invest (the total ceiling of guarantees is worth RON 15 billion, of which RON 1 billion is allocated to the AGRO IMM Invest program) with new financing components: SME Equipment leasing and equipment; SME Factor (total ceiling of guarantees of RON 1 billion); The program "State aid for financing investment projects"; The program "Transfers under state aid schemes representing amounts returned to excise duty for diesel fuel"; 56% of the total ceiling allocated for 2021 was used by September 2021
- the granting of a non-reimbursable aid for economic operators in the tourism sector in 2021 to cover part of the loss of turnover related to the period in which their activity was affected by the first wave of the COVID-19 pandemic
- regulation of the fact that the request for reimbursement through the returns with negative amount of value added tax with reimbursement option, submitted within the legal term of submission, to be followed by the tax inspection, until January 31, 2022
- the establishment of measures for granting some tax facilities for taxpayers who have outstanding debt on March 31, 2020 (individuals, legal entities, individuals carrying out economic activities or self-employed, entities without legal personality, public institutions, etc.), respectively for the cancellation of the debt accessories under the conditions of payment of fiscal obligations; the request for cancellation of the debt accessories can be submitted until January 31, 2022
- the conditions for accessing the restructuring of fiscal obligations become more flexible, by adopting provisions to regulate: including in the scope of fiscal obligations for which the restructuring of outstanding fiscal obligations can be granted until December 31, 2020, extending the deadline for submitting notifications of intention to benefit from the restructuring of fiscal obligations until

September 30, 2021; the request for fiscal obligation restructuring can be submitted until January 31, 2022

- regulation of a simplified procedure for granting payment rescheduling for a maximum of 12 months, for the fiscal obligations whose payment deadline is met after the declaration of urgency until the date of issuance of the fiscal attestation certificate (if certain conditions are met); the application for granting the rescheduling can be submitted permanently, starting with October 1st, 2021
- granting allowances until December 31, 2021 for employers' employees during the period of temporary interruption of activity, in whole or in part, in the context of increasing the incidence of SARS-CoV-2 spread and of the measures for diminishing the impact of the type of risk provided by the Government decisions for prolonging the alert state on the Romanian territory; employee benefits are set to 75% of the basic salary corresponding to the occupied job and are supported from unemployment insurance budget, but no more than 75% of the average gross earnings provided by the Law on state social insurance budget no. 16/2021, with subsequent amendments and completions
- granting paid days off to parents (under certain conditions) for the entire period in which it is decided to limit or suspend teaching activities that involve physical presence of children in schools, during the alert state and after it ends, but not later than completion of the courses of 2021-2022 school year, without including holidays; the allowance for each day off granted is set to 75% of the basic salary corresponding to a working day, but not more than the daily correspondent of 75% of the average gross salary used in the construction of state social insurance budget.

The first budget rectification of 2021, approved through Government Emergency Ordinance no. 97/2021 on the rectification of the State budget for year 2021 and Government Emergency Ordinance no. 98/2021 for the rectification of the social insurance budget for 2021, was based on:

- ✓ The need to correlate budget planning with the forecasted developments of macroeconomic indicators in the first months of 2021. In this respect, the National Commission for Strategy and Prognosis estimates a real GDP growth of 7% for 2021, compared to 4.3%, figure considered for the initial budget.
- ✓ The need to ensure in the budget the amounts that correspond to the implementation of the measures taken for the purpose of preventing the spread of the virus and mitigating the negative effects thereof.

The 2021 budget deficit (in cash terms) target was only marginally changed at the First Budget Revision at 7.13% of GDP, compared to 7.16% of GDP at the time of approving the budget for 2021. Under these circumstances, there is a 2.51 percentage points of GDP budget consolidation compared to 2020.

The general government revenue-to-GDP ratio is set to 32.6% and the general government expenditure-to-GDP ratio is set to 39.7%. 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.

Compared to the initial budget for 2021, the advance of general government revenue is mainly due some increase in VAT, social contributions, excise duties and EU funds.

This advance is influenced by:

- the recovery of economic indicators in 2021
- the positive evolution of the receipts to the general consolidated budget
- the partial recovery of the state budget revenue related to the declared fiscal obligations that were deferred to payment in 2020, by the effect of law.

The 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), but also to ensure the necessary amounts for the active measures taken by the Government during the alert period.

Investment increased by RON 6.6 billion, thus reaching RON 69.7 billion (5.9% of GDP), by RON 16.5 billion more than in 2020.

Likewise, the **impact of the temporary measures** included in the 2021 budget, including this revision, determined by the effects of the COVID-19 pandemic amounts RON 7.33 billion (0.62 % of GDP). The main temporary measures that have been considered are the following:

- RON 2.134 billion – amounts required for the purchase of COVID-19 vaccines and the necessary materials, as well as the measures to stimulate vaccination
- RON 2.22 billion – amounts needed for active measures to combat the effects of the COVID-19 pandemic
- RON 1.18 billion – grant to the company “Oltenia Energy Complex” S.A. for the purchase of green certificates
- RON 1 billion – state aid schemes for HORECA

- RON 95 million – temporary measure for public information campaign.

III. Budget execution for the first 8 months of 2021

General government budget recorded a **deficit of RON 39.36 billion (3.35% of GDP)** in the first eight months of 2021, amounting to a consolidation of 1.84 pp compared to the same period of 2020.

This positive development was determined by: (i) the increase of general government revenue by 1.42 percentage points of GDP (y.o.y), mainly influenced by the advance of VAT revenues and European funds; (ii) reduction of general government expenditure by 0.42 percentage points of GDP (y.o.y), as a result of the decrease in the share of wage expenditure to GDP.

The reduction in the budget deficit for the first eight months of the current year, compared to the same period last year, is explained, on the revenue side, by (i) lower revenue in the corresponding period of last year (base effect) - as a result of measures to support taxpayers (postponement of payment terms, bonuses and exemptions), (ii) recovery of economic indicators, respectively (iii) partial recovery of certain categories of income (VAT, insurance contributions, income tax and profit).

A significant part of the budget deficit recorded in the first 8 months of 2021 (RON 15.85 billion, respectively 1.3% of GDP) is due to **the exceptional payments generated by the COVID-19 epidemic amounting to RON 9.77 billion and the increase of investment expenditure by RON 6.08 billion** compared to the same period of the previous year.

The general government revenue amounted to RON 240.81 billion in the first eight months of 2021, 19.6% above the level collected in the same period last year. The general government revenue-to-GDP ratio increased by 1.4 percentage points (y.o.y.). The most significant nominal increases compared to the same period of 2020 regard VAT (+ 41.2%), social contributions (+ 13.7%) and European funds (+ 30.8%). The evolution of VAT revenues was influenced by last year's reduced base (when the VAT payment deadline was postponed), the partial recovery of deferred VAT in 2020, and the recovery of the relevant macroeconomic base. The evolution of social insurance contributions was influenced both by the reduced revenue from the comparable period of 2020 and the partial recovery of deferred contributions in the previous year.

The general government expenditure amounted to RON 280.16 billion and increased in nominal terms by 9.4% compared to the same period of the previous year.

The personnel expenditure amounted to RON 73.95 billion, up by 2.6% compared to the same period of last year. The personnel expenditure represents 6.3% of GDP, 0.5

percentage points lower than in the same period last year. Out of the total of personnel expenditure:

- RON 71.73 million - represent the payments for the risk stimulus granted for COVID-19
- RON 1,763.41 million - represent other personnel expenditure, including bonuses granted to the medical and auxiliary staff involved in the activities with the patients diagnosed with COVID-19.

Goods and services expenditure reached RON 37.38 billion, up by 8.7% compared to the same period last year. An increase is reflected in the state budget, by 27.3% compared to the same period of the previous year, as well as in the budget of the Single National Health Insurance Fund, by 8.9%. Out of these, RON 4.84 billion represent payments for medicines, sanitary materials, reagents and other products necessary for the diagnosis and treatment of patients infected with SARS-CoV-2, as well as the payment for vaccines against COVID -19.

Social assistance expenditure reached RON 99.5 billion, increasing by 9.2% compared to the same period of the previous year. The evolution of social assistance expenditure was mainly influenced by:

- raising the pension point, by RON 177, from RON 1,265 to RON 1,442, from September 1st, 2020,
- raising the guaranteed social allowance for pensioners from RON 704 to RON 800, starting September 1st, 2020
- raising the state allowance for children by 16% as compared to the previous year level starting with January 1st, 2021.

At the same time, the payments related to the **exceptional measures**, taken in the social and economic field, to reduce the negative effects generated by the COVID-19 pandemic were continued in 2021. Thus, until the end of August, RON 1,580.35 million were paid on active measures, as follows:

- RON 606.8 million for the allowances granted during the period of temporary suspension of the individual employment contract at the initiative of the employer
- RON 190.71 million for allowances granted for other professionals and for persons who have concluded individual labor agreements and interrupted their activity as a result of the effects of SARS-CoV-2
- RON 353.38 million for amounts granted to employers for the reimbursement of a part of the gross salary for employees kept in employment after the temporary suspension

- RON 54.51 million for amounts granted to employers for the employment of certain categories of persons
- RON 374.95 million for allowances granted during the temporary reduction of the activity for professionals as well as for the persons who have concluded individual labor agreements based on Law no. 1/2005.

Also, the settlements of the social health insurance indemnities for medical leave have continued in order to reduce the stock of related outstanding payments, so that at the end of August the payments were RON 2,755.1 million.

Investment, which include capital expenditures, as well as those related to development programs financed from internal and external sources, amounted to RON 30.19 billion, increasing by 25.2% compared to the value for the same period of the previous year (RON 24.11 billion). There is also a more pronounced increase in projects financed from external post-accession non-reimbursable funds, representing 54.27% of total investment of the first eight months of 2021.