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COMMISSION OPINION

on the existence of an excessive deficit in Romania

Application of Article 104(5) of the Treaty establishing the European Community

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THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

1. Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States, with more room for manoeuvre for those Member States that have achieved sustainable public finance positions and improved their competitive positions. It also called for structural reforms that support demand and promote resilience in the short term, while paying special attention to actions in the four priority areas of the Lisbon strategy. Finally, several countries have taken measures to stabilise the financial sector, some of which impact on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.
2. The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation, and thereby ensuring long-term sustainability of public finances.

LEGAL BACKGROUND

3. Article 104 of the Treaty lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 “on speeding up and clarifying the implementation of the excessive deficit procedure”¹, which is part of the Stability and Growth Pact.

¹ OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on the “Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes”, endorsed by the ECOFIN Council of 11 October 2005, available at: http://ec.europa.eu/economy_finance/other_pages/other_pages12638_en.htm.

4. According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).
5. Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to “take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State”.
6. On the basis of the data notified by the Romania authorities in April 2009², subsequently validated by Eurostat³, and taking into account the Commission services’ spring 2009 forecast, the Commission adopted a report under Article 104(3) for Romania on 13 May 2009⁴.
7. Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee formulated an opinion on the Commission report on 28 May 2009.
8. Article 104(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. In order to reach a conclusion on whether an excessive deficit exists or may occur, the Commission considers that account should be taken of: (i) the conclusions of its report under Article 104(3) and (ii) the opinion of the Economic and Financial Committee on this report. On the basis of these elements, the Commission has established a number of considerations for Romania.

CONSIDERATIONS CONCERNING ROMANIA

9. On 12 June 2008, the Commission addressed to Romania a Recommendation providing a policy advice⁵ on the economic and budgetary policy in Romania. It recommended the country to: i) take urgent action to implement a binding medium-term fiscal framework; ii) implement rigorously the policy invitations of the Council issued on 12 February 2008 on the updated convergence programme of Romania for the period 2007 to 2010 so as to ensure that the general government deficit does not

² According to Council Regulation (EC) No 3605/93, 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:
http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables.

³ Eurostat news release No 56/2009 of 22 April 2009.

⁴ All EDP-related documents for Romania can be found at the following website:

⁴ http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

⁵ Commission Recommendation of 12 June 2008, providing a policy advice on the economic and budgetary policy in Romania.

breach the 3% of GDP reference value and to help contain external imbalances and iii) accelerate structural reforms so as to increase Romania's growth potential and strengthening its external competitiveness.

10. Despite the Commission policy advice issued in June 2008, the budgetary slippages heightened in the remaining part of the year. Three quarters of the 2008 deficit in cash terms were created in the second half of 2008. Consequently, in 2008, the deficit outturn was more than twice the official target, mostly due to weak budgetary management with frequent ad-hoc budgetary amendments, use of overly optimistic revenue projections to increase expenditure and shifting capital to current spending. This was compounded by a sudden drop in revenues at the end of the year because of the economic slowdown.
11. In view of the large domestic and external imbalances and the adverse effect of the global financial turmoil on the economic and financial situation in Romania, the authorities requested multilateral financial assistance in March 2009⁶. The multilateral financial assistance is conditional on the implementation by the Romanian authorities of a comprehensive economic policy programme. In particular, fiscal consolidation is a cornerstone of the adjustment programme. A gradual expenditure-driven reduction of the fiscal deficit to 5.1% of GDP in 2009, 4.1% of GDP in 2010 and below 3% of GDP in 2011 is envisaged. In addition, measures are foreseen to improve the budgetary strategy and process, notably the adoption and implementation of a binding medium-term fiscal framework, establishing limits on budget revisions during the year, including fiscal rules and the creation of a fiscal council to provide independent and expert scrutiny. Moreover, in order to improve budgetary predictability and transparency, measures also aim at restructuring the public compensation system, including by unifying and simplifying the pay scales and reforming the bonus system. To help improve the long-term sustainability of public finances, the further reform of key parameters of the pension system is foreseen.
12. According to the April 2009 EDP notification by the Romanian authorities, subsequently validated by Eurostat, the general government deficit in Romania reached 5.4% of GDP in 2008, thus exceeding the 3% of GDP reference value. The Commission report under Article 104(3) considered that the deficit was not close to the 3% of GDP reference value and that the excess over the reference value cannot be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it does not result from an unusual event or from a severe economic downturn in 2008 in the sense of the Treaty and the Stability and Growth Pact. Despite growth slowing down in the final quarter of the year, overall GDP growth in 2008 accelerated to a rate of 7.1%, from 6% in 2007 and significantly above the rate of potential growth. Furthermore, the excess over the reference value cannot be considered temporary. According to the Commission services' spring 2009 forecast the general government deficit is expected to reach 5.1% of GDP in 2009 and 5.6% in 2010, a projection that is based on a contraction in GDP of 4.0% in 2009

⁶ The total multilateral financial assistance amounts to up to EUR 20 billion over the period to the first quarter of 2011. The EU provides a medium-term loan of up to EUR 5 billion. in conjunction with EUR 12.95 billion from the International Monetary Fund. Additional multilateral support of EUR 2 billion will be provided by the World Bank (1 billion), the European Investment Bank and the European Bank of Reconstruction and Development (1 billion together) on top of their general lending activities.

and 0% growth in 2010 and takes into account measures for the current year in the budget for 2009 approved in February 2009 and the additional measures adopted by the government in April 2009. The deficit criterion in the Treaty is therefore not fulfilled.

13. General government gross debt remains well below the 60% of GDP reference value and stood at 13.6% of GDP in 2008. Nevertheless, according to the Commission services' spring 2009 forecast, the debt-to-GDP ratio is expected to increase significantly to 18¼% in 2009 and 22¾% in 2010.
14. In line with the provisions in the Stability and Growth Pact, the Commission in its report gave due consideration to systemic pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar. While the implementation of these reforms leads to a temporary deterioration of the budgetary position, the long-term sustainability of public finances clearly improves. Based on the estimates of the Romanian authorities, the net costs of this reform amount to 0.2% of GDP in 2008, 0.3% in 2009, 0.4% in 2010 and 0.4% in 2011. According to the Stability and Growth Pact, these can be taken into account on a linear degressive basis for a transitory period and only in case where the deficit remains close to the reference value, which is not the case of Romania. In any event, the government deficit adjusted for the pension reform cost in 2008 would be well above 3% of GDP.
15. In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report "relevant factors". According to the Stability and Growth Pact, these can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of Romania, the double condition is not met. Considered on their own merit, the relevant factors in the current case on balance present a mixed picture.
16. The opinion of the Economic and Financial Committee in accordance with Article 104(4) of the Treaty is consistent with the assessment in the Commission report under Article 104(3).

CONCLUSION

17. The monitoring of the budgetary situation in Romania and, in particular, the examination of the compliance with the criteria laid down in Article 104(2) has led the Commission to prepare a report in accordance with Article 104(3) of the Treaty. The Commission, having taken into account its report and the opinion of the Economic and Financial Committee, is of the opinion that an excessive deficit exists in Romania.