Romania's National Recovery and Resilience Plan – a Set of Reforms and Investments for the Increase of the Nominal and Real Convergence

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Abstract

The 2020 pandemic has led to economic recession in the European Union, rising unemployment, falling purchasing power among the majority of citizens and has forced national institutions to intervene with many measures that have led to rising budget deficits and public debt.

As of 2021, the Recovery and Resilience Facility has been approved at EU level, to the purpose of economic recovery and increasing the economic resilience of EU Member States.

This paper analyses Romania's fulfilment of the nominal convergence criteria, the evolution of Romania's gross domestic product pre- and post-pandemic, the main measures foreseen in Romania's National Recovery and Resilience Plan to ensure a green, digital transition and economic and social resilience, as well as the funds available to Romania through the NRRP for investments and structural reforms necessary for economic growth and nominal convergence.

Key words: Romania's National Recovery and Resilience Plan, Covid-19 pandemic, Convergence criteria, GDP per capita, Euro are
J.E.L. classification: F15, F36, F43

1. Introduction

The SARS-COV-2 pandemic has led to the collapse of the healthcare system, loss of life, closure of many businesses, increased unemployment and economic recession in all EU Member States. The forced closure of many sectors of activity by national governments in order to stop the spread of the Covid-19 has led to increased state budget expenditure through increased unemployment and financial aid to economic agents whose activity has been affected by the Covid-19 pandemic, as well as a decrease in revenue collected to the state budget. All this has led to rising budget deficits and public debt in all EU Member States at the end of 2020. Many EU Member States outside the euro area have moved further away from meeting the nominal convergence criteria with rising budget deficits.

The pandemic crisis of 2020 has forced the EU institutions to suspend the fiscal rules in the Stability and Growth Pact (SGP) on bringing the budget deficit within the 3% of GDP threshold. Even though Romania was already under the Excessive deficit procedure (EDP) at the end of 2019, this suspension also applied to it, with the obligation to bring the budget deficit (ESA) to 3% of GDP by 2024.

In support of Member States' economies, the European Union launched the Recovery and Resilience Facility (RRF) in early 2021, consisting of financial incentives to be allocated to EU Member States in the form of grants and loans totalling €723.8 billion for investment and reforms in the digital and green sectors. Over time, all of this will lead to reducing or mitigating the future impacts of climate change and strengthening the national economies of EU Member States. The release of funds through the RRF for a given EU Member State will only be made following the European Commission's approval of that country's National Recovery and Resilience Plan (NRRP), which it has submitted in advance.

2. Theoretical background

For a brief presentation of the contents of Romania's National Recovery and Resilience Plan (NRRP), I studied the official document published on the European Commission website and the paper "România – Zona Euro Monitor: O iarnă grea, în multe privințe / Romania - Eurozone Monitor: A hard winter, in many respects" (National Bank of Romania, 2021a), published on the website of the National Bank of Romania.

I documented the Recovery and Resilience Facility and the amounts allocated to Romania through the NRRP from the information provided by the European Commission press releases, on the Commission website, on the Romanian Government website, but also from "The Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility" (Europa.eu, 2021).

The nominal convergence criteria consist of certain economic indicators falling within certain thresholds and refer to price stability, convergence of long-term interest rates, sustainability of public finances and exchange rate stability under the ERM II according to "The Consolidated version of the Treaty on the functioning of the European Union" (Europa.eu, 2012). "Drumul către zona euro: test de rezistență sau probă de viteză? Câteva reflecții pornind de la experiența României și a altor țări din regiune / The road to the euro area: stress test or speed test? Some reflections from Romania's experience and other countries in the region" (Isărescu, M., 2019), "Romania, the euro adoption and the Banking Union" (Isărescu, M., 2014), "România – Zona Euro Monitor: O iarnă grea, în multe privințe / Romania - Eurozone Monitor: A hard winter in many respects" (National Bank of Romania, 2021a) and "România – Zona Euro Monitor: O revenire economică puternică are loc, însâ lupta cu pandemia continuă / Romania - Eurozone Monitor: A strong economic recovery is taking place, but the fight against the pandemic continues" (National Bank of Romania, 2021b) were the main documents underlying the analysis of Romania's nominal and real convergence criteria.

3. Research methodology

The analysis of Romania's nominal and real convergence criteria was carried out based on data available in the Eurostat database. The level of the maximum thresholds for the economic indicators of average annual inflation rate and average annual long-term interest rate has been determined by own calculations, in compliance with the Maastricht Treaty conditions.

In this paper I have analyzed the economic evolution of Romania over the period 2019-2021, ante and post pandemic, with the aim of identifying other causes that led to the failure to meet any nominal convergence criteria at the present time, apart from the pandemic crisis in 2020, which affected economically all EU Member States.

Another topic we discussed was Romania's National Recovery and Resilience Plan (NRRP). The funds available under the NRRP can bring more than 2 percent of GDP to Romania's public budget annually (National Bank of Romania, 2021a, p.47), and compliance with the NRRP consists in implementing a set of structural reforms that will implicitly lead, over time, to the sustainable fulfilment of Romania's nominal and real convergence criteria required for Eurozone membership.

4. Findings

4.1. Analysis of Romania's nominal convergence criteria

In order to adopt the European single currency, Romania and any other EU Member State outside the euro area must fulfil the nominal convergence criteria provisioned by the Maastricht Treaty. These convergence criteria consist of the following thresholds for economic indicators: the average annual inflation rate is no more than 1.5 percentage points above that of the three highest performing EU Member States in terms of price stability, the average annual long-term interest rate is no more than 2 percentage points above that of the three highest performing EU Member States in terms of price stability, the general government budget deficit is below 3% of GDP, public debt does not exceed 60% of GDP and the exchange rate of the national currency against the euro is within a fluctuation band of ±15% for a minimum of 2 years.

The exchange rate indicator will not be analysed as Romania has not yet applied for participation in the Exchange Rate Mechanism II (ERM II), which requires the exchange rate of the leu-euro to be within ±15% of a fixed central rate of the national currency against the euro.

Table 1 shows that, in recent years, Romania has managed to meet only one nominal convergence criterion, namely to keep the public debt below 60% of GDP. Indicators for price stability, long-term interest rates and the budget deficit were outside the Maastricht Treaty thresholds as early as 2019, before the start of the Covid-19 pandemic. Therefore, Romania's economic situation in recent years cannot be blamed solely on the pandemic, but also on the economic measures taken by the government in 2018-2019, which led to higher inflation and budget deficit.

The pandemic crisis has led to the suspension and closure of many economic sectors, Romania has had to spend more money on unemployment benefits, and revenues to the state budget have fallen drastically. All this has led to Romania's budget deficit reaching 9.3% of GDP at the end of 2020, with Romania having to borrow to cover this high budget deficit and Romania's public debt increasing from 35.3% of GDP in 2019 to 47.2% of GDP in 2020.

Table no. 1. Romania's fulfilment of the nominal convergence criteria

Indicators/ Year	**2019**	**2020**	**2021**
Inflation Rate (%, annual average)	3.9 criteria: < 1.9	2.3 criteria: < 1	4.1 criteria: < 2.23
Long term interest rates (%, annual average)	4.54 criteria: < 3.47	3.89 criteria: < 2	3.62 criteria: < 2.56
General Budget Deficit* (% in GDP)	4.3 criteria: ≤ 3	9.3 criteria: ≤ 3	7.1 criteria: ≤ 3
Public Debt* (% in GDP)	35.3 criteria: ≤ 60	47.2 criteria: ≤ 60	48.8 criteria: ≤ 60

Note: In 2019, the annual average inflation rate of the 3 highest performing EU member states with regards to price stability (Portugal, Greece, Cyprus) is 0.4% (resulting a criterion of 1.9%), and the annual average interest rate in these 3 states is 1.47% (resulting a criterion of 3.47%). In 2020, the annual average inflation rate of the 3 highest performing EU member states with regards to price stability (Estonia, Ireland, Slovenia) is -0.5% (resulting a criterion of 1%), and the annual average interest rate in these 3 states is 0.0% (resulting a criterion of 2%). In 2021, the annual average inflation rate of the 3 highest performing EU member states with regards to price stability (Greece, Malta, Portugal) is 0.73% (resulting a criterion of 2.23%), and the annual average interest rate in these 3 states is 0.56% (resulting a criterion of 2.56%).
* ESA2010 methodology
Source: Eurostat

Although Romania's budget deficit has been below 3% of GDP year after year over the period 2013-2018, it turned out that this nominal convergence criterion was not sustainable, rising to 4.3% of GDP in 2019. Due to this, Romania has been subject to the Excessive deficit procedure (EDP) since 2020.

As the Covid-19 pandemic progressed in Europe, starting with March 2020, the general derogation clause was activated at the European Union level, which led to the suspension of the fiscal rules of the Stability and Growth Pact (SGP) regarding the budget deficit being within the 3% of GDP threshold and allowed EU Member States to move away from fiscal adjustments without being placed under the Excessive deficit procedure. This suspension also applied to Romania, but it is obliged to reduce its budget deficit to below 3% of GDP by the end of 2024. To achieve this, better VAT collection is needed to increase tax revenues and Romania's tax expenditure needs to be kept under control.

The Romanian government will need to reduce its budget deficit every year in order to curb the growth of public debt, which is still below the recommended 60% of GDP.

4.2. Evolution of the Romanian economy pre- and post- the pandemic

The Covid-19 pandemic had a huge impact on the health of the population but also on the world economy. With the outbreak of the Covid-19 pandemic in Europe as well, starting in the second quarter of 2020 the governments of the EU Member States had to impose a series of measures limiting the movement of people and closing many sectors of activity in an attempt to limit the spread of the new virus within each country.

All of this led to economic recession in the European Union, with almost all EU member states except Ireland experiencing declines in their national economies at the end of 2020.

Romania, like other economically developing countries, saw economic growth of 4.2% in 2019, well above the EU average of 1.8% and the Eurozone average of 1.6%. The economic lockdown in 2020 also affected the Romanian economy, with it falling by 3.7% at the end of that year, but not by as much as the economic declines that Eurozone member states experienced.

The pandemic crisis of 2020 has led to travel restrictions in EU Member States, hitting the tourism and hospitality sector hard, as they account for a much smaller share of Romania's GDP than in many Eurozone Member States such as Greece, Italy and Spain.

Table no. 2. Real GDP growth/decrease rate (%)

GEO/ YEAR	**2019**	**2020**	**2021**
Romania	4.2	-3.7	5.9
European Union (27 states)	1.8	-5.9	5.3
Eurozone (19 states)	1.6	-6.4	5.4

Source: Eurostat

During 2021, with knowledge of the virus, the creation of vaccines, providing hospitals with the necessary medicines and equipment, and the provision of the necessary stock of personal protective equipment for citizens, EU Member States lifted many of the restrictions that were imposed in 2020, leading to the reopening of all sectors of activity. All this, as well as the economic support measures adopted by the European Union, led to rapid economic growth in 2021 in all EU Member States. Romania recorded economic growth of 5.9% in 2021, above the Eurozone average of 5.4%.

However, economic forecasts for 2022 are not optimistic, as the war between Russia and Ukraine and the economic measures imposed by the European Union and the US on Russia will also have negative effects on the economies of EU Member States. The post-pandemic economic recovery will also be slowed down by the persistence of disruptions in production chains and the accelerated increase in energy and natural gas prices.

Romania's potential economic growth will also be slowed down by a shortage of human resources, due to a continued out-migration of labour to northern and western European EU countries, and by the under-utilisation of the labour resources available on the Romanian labour market.

As for Romania's real convergence indicator, represented by real GDP per capita calculated at purchasing power parity (PPP) and compared to the European Union average, it has increased year on year. In 2019, Romania's GDP per capita PPS was 69.2% of the EU average (27 countries), rising to 71.9% in 2020 and 72.9% in 2021.

The pandemic crisis has hit the economies of the strong European Union countries hardest, narrowing the gap between their economies and those of Eastern European countries.

If the level of GDP per capita in PPP of 76% of the EU average that Lithuania recorded in the last year before adopting the euro on 1 January 2015 is anything to go by, Romania would also be ready to join the euro area. Unlike Lithuania, Romania is a country with a much larger population and territorial area and should focus on reducing the very large economic gap that exists between the Bucharest-Ilfov region and the rest of the country's seven regions. In addition to this problem, Romania will have to meet the nominal convergence criteria in a sustainable and durable manner, an objective it has failed to achieve in recent years.

4.3. Romania's National Recovery and Resilience Plan (NRRP)

In order to revive the economies of the EU Member States affected by the Covid-19 pandemic, the Recovery and Resilience Facility (RRF) came into force at EU level in February 2021. The RRF has a total of €723.8 billion (at current 2021 prices) to be distributed to EU Member States in the form of loans and grants.

In order to benefit from the sources of funding under the RRF, each EU Member State has submitted to the European Commission (EC) its own National Recovery and Resilience Plan (NRRP), which contains the reforms and investments to be undertaken until the end of 2023, with the release of funds for a given state only after the European Commission has approved its NRRP.

Following the approval of the NRRP, a first instalment of the EU funds related to the RRF will be allocated to the state in question, but the allocation of the next instalments will depend on the economic performance of the country, on the state of implementation of the reforms and investments that have been undertaken through its own NRRP. If the EC considers that a Member State has not adequately met the targets associated with a milestone and progress in implementing projects is not as expected, it will make only a partial payment and the remainder of the tranche payment will be suspended. That Member State will have six months from the date of the submission of the European Commission's observations to take the necessary measures to achieve the milestones and not to lose the remaining payment.

Unlike the Multiannual Financial Framework, payments under the NRRP are linked to the successful achievement of the objectives set out in the plan.

The aim of the NRRP is to reform national economies, through measures aimed at reducing climate change, and to digitize many sectors of activity in order to increase the competitiveness and resilience of national economies. Through the NRRP, additional resources can be attracted to develop Member States' economies and boost reforms in many areas of activity, leading to economic growth and rising living standards.

NRRPs differ from country to country, Romania's NRRP aims to reduce the economic and social development gap between the various regions of the country, between large and small cities, between urban and rural areas, by improving road and rail infrastructure, education and poor health systems. In short, the NRRP is a series of reforms and investments that Romania will have to undertake to strengthen the Romanian economy and reduce macroeconomic imbalances over time.

On 27 September 2021, Romania's National Recovery and Resilience Plan (NRRP) was approved by the European Commission. The assessment of the NRRP was based on the criteria set out in the Recovery and Resilience Facility (RRF) Regulation, analysing whether the reforms and investments included in the NRRP aim at green and digital transition, job creation, economic growth and economic and social resilience of Romania.

According to the European Commission's press release of 27 September 2021 (European Commission, 2020), following the approval of the NRRP, Romania will be able to receive grants worth €14.2 billion and loans worth €14.9 billion from the European Union. The loans to be granted through the RRF are much more advantageous than those on international markets, as they have lower costs (interest) and longer repayment terms. Romania should be able to attract and use these loans from the EU and stop borrowing from international markets, so as to keep the country's debt level below 60% of GDP. These amounts would be sufficient to implement many of the reforms Romania needs, the only question mark would be whether they can be attracted and used properly. We know that loans through the RRF will be granted to each EU Member State gradually, as projects are financed, and in Romania's case this means that most of them will be accessed sometime after 2024.

The Financing Agreement between the European Commission and Romania, covering the grant component, signed on 26 November 2021, provides for the allocation of €14.2 billion in grants to Romania, of which €10.2 billion for commitments until the end of 2022 and the remaining €4 billion to be available for commitments to be made during 2023. Loan applications will have to be submitted by the end of 2023.

For 2021, Romania has received two instalments under the NRRP totalling €3.78 billion in pre-financing, as follows: on 2 December 2021 the European Commission paid Romania a pre-financing of €1.85 billion under the grant component and on 13 January 2022 it transferred €1.94 billion in the form of a loan to Romania's accounts.

According to Romania's NRRP, most of the financial resources will be allocated to climate objectives, with a share of 41%, followed by those for ensuring the digital transition at 21%, and the rest will be for ensuring economic and social resilience. Below are briefly presented the main measures foreseen in Romania's NRRP (European Commission, 2021b).

The main measures to ensure the green transition foreseen in Romania's NRRP are:

- modernisation of railway infrastructure, largely through the purchase of zero-emission rolling stock (electrified railways) - €3.9 billion allocated;
- seismic strengthening of buildings and their energy improvement through renovation - €2.7 billion of available funds;
- improving urban infrastructure for green and safe transport - €1.8 billion;
- environmental protection measures (reforestation, species protection and other biodiversity measures) - €1.1 billion available;
- implementation of renewable energy sources and phasing out of coal and lignite based energy production - €855 million allocated.

Key measures to ensure the digital transition in Romania aim to:

- digitisation of public administration in areas such as public procurement, public service management and skills development, employment and social protection, justice and environment - €1.5 billion allocated;
- digitisation of education by upgrading equipment and improving the digital skills of teachers - €881 million;
- digitisation of health, including the development of a national integrated health information system - €470 million available.

Ensuring economic and social resilience in Romania includes:

- strengthening public administration, mainly by reinforcing the effectiveness of the judiciary and the fight against corruption;
- fiscal sustainability through a strengthened budgetary framework, limiting budgetary expenditure through tighter control, reforming the pension system and changing the tax system;
- digitisation of social protection systems, implementation of minimum income inclusion reform and improvement of employment;
- strengthening the health system by investing in hospital infrastructure.

Romania's NRRP contains 107 projects (investments), 64 reforms and 507 milestones and targets. According to the Regulation 241/2021 on the implementation of the RRF, milestones refer to the qualitative achievements of the reforms and investments in the NRRP and targets refer to the quantitative ones, with a deadline of 31 August 2026.

The main problems Romania will face in meeting the NRRP objectives relate to the low capacity and quality of Romanian institutions to properly manage such a project, the risk of not meeting several NRRP targets and milestones on time, which will lead to the suspension of payments from the European Commission.

It is estimated that attracting all funds through the NRRP, cumulatively over the 6 years, will amount to about 12% of Romania's GDP (National Bank of Romania, 2021a, p.12).

5. Conclusions

In addition to the current problems, such as halting accelerated price increases and reducing budget and trade deficits, Romania will also have to face new global challenges in the coming years, such as climate change, which is causing a number of medical as well as economic problems, especially in the agricultural sector, and the ageing of the population, which will put even greater pressure on public pension and social assistance systems. This is why Romania will have to implement all the measures undertaken in its own NRRP to reform the administrative, education, health and pension systems and to obtain the necessary funds to finance the digital and green sectors.

Romania needs to absorb most of the funding available through the NRRP and the Multiannual Financial Framework (MFF) to be able to cope with the pandemic crisis that has not yet gone away, the accelerating rise in energy prices and more recently the crisis of the war in Ukraine, which has started to have economic repercussions on other European countries as well.

Attracting and correctly using all European funds available will help reduce the economic gap between Romania and the other EU Member States.

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