

4 February 2019

Jean-Claude Juncker, President of the European Commission
Andrus Ansip, Vice-President for the Digital Single Market
Maroš Šefčovič, Vice-President for the Energy Union
Valdis Dombrovskis, Vice-President for Euro and Social Dialogue
Jyrki Katainen, Vice-President for Jobs, Growth, Investments and Competitiveness
Miguel Arias Cañete, Commissioner for Climate Action & Energy
Pierre Moscovici, Commissioner for Economic and Financial Affairs, Taxation and Customs
Margrethe Vestager, Commissioner for Competition

Subject: Emergency Ordinance 114/2018 issued by the Government of Romania and its negative impacts on the economic and business environment

Dear President,
Dear Vice-Presidents,
Dear Commissioners,

I am writing to you on behalf of the Coalition for the Development of Romania (CDR), an umbrella organization bringing together twenty business associations in Romania including the Chambers of Commerce, large employers' confederations, and the associations of local entrepreneurs and foreign investors. The companies CDR represents are responsible for roughly 50% of Romania's GDP.

We would like to bring to your attention the Romanian Government's decision to adopt Emergency Ordinance (EO) no. 114/2018 during the last days of 2018, without consulting the business community and the industries affected and without an impact study. EO 114 has a significant impact on major industries in Romania like banking, telecoms, energy, capital markets, private pension providers, the construction sector and ultimately on the entire economy. We consequently believe the European Commission should be aware, in the first instance, of the expected impact on business in Romania, and that unjustifiable shocks could push these sectors of the economy into deep crises.

The businesses CDR represents are astonished at the antagonistic way the measures were presented and the discourse that accompanied them, which blamed the private sector, especially foreign companies, for the State's inability to collect taxes. The sectors which were accused are among the largest contributors to public budgets, and which also make a significant contribution to the Romanian economy ensuring e.g. energy supplies, telecommunication services, financing or the management of private pensions for millions of citizens. They have been demonized and accused of working against all their customers and the country where they have been doing business for a long time and where they have invested billions of euros.

CDR anticipates that there is a risk that EO 114 could have numerous serious consequences, some of which we list below:

- Businesses and individuals will have increased difficulties in accessing finance in Romania.
- Small and medium sized enterprises will be significantly impacted by the second-round effects of these measures and their sharp adjustments will be felt by the entire economy; this will cause a slowdown in income growth and consumption.
- The real-estate market might be pushed towards an abrupt adjustment.
- There could be increased macroeconomic disequilibria in terms of inflation or higher deficits due to growth being lower than expected.
- The capital market will play an even smaller role in financing the economy.
- There will be a distortion in the functioning of the market instruments at the disposal of the Central Bank.
- The national currency will depreciate against the main foreign currencies.
- The state will find it increasingly difficult to finance the deficit.

In addition to all the above, businesses in Romania are worried about the increased role of the state in the economy, which in some areas goes back on commitments made by Romania in order to join the European Union. The attempt to cap the price of interbank rates through administrative decisions and the impact on energy markets where the liberalization process has been stopped and reversed both in gas and energy are against the principles of the internal market. EO 114 sets extremely high and punitive contributions that telecom and energy companies are required to make towards their regulators, considerably more than what is required for their operational budgets. This also goes against European practice where the various taxes levied by independent regulatory bodies are meant to strictly cover the reasonable costs of the regulator.

CDR believes that the European Commission should give special attention to EO 114 because we believe that it contains provisions which are in conflict with the Romania's EU Accession Treaty, EU Directives and generally with the spirit of EU principles.

This letter is accompanied by an appendix which aims to explain in more detail consequences of EO 114 on the industries impacted. CDR will be happy to hold further discussions or give clarifications of this letter and its appendix.

Yours sincerely,

Ramona Jurubiță
Coordinator

APPENDIX

Banking sector

The tax on banking assets which is disproportionate vis-à-vis the size of the Romanian banking sector and its linking with ROBOR is unjustified and seriously calls into question Romania's status as a market economy. ROBOR is determined mainly by inflation, budget deficits, and government policies and not by banks. Even if the tax would be unconnected to ROBOR, its current level (1.2% per year) is much higher than any other similar tax in Europe. The tax base is intended to be the full amount of banking assets including cash, mandatory reserves with the central bank and government bonds, something which does not apply in any other EU member state, nor, to the best of our knowledge anywhere else in the world. Moreover, the inclusion of government bonds also distorts the level playing field for local banks holding government debt versus non-residents or other categories of resident investors. The level of the tax is triple the average profitability of assets in the Romanian banking sector in the past 10 years which was 0.44%. Other countries that have introduced similar taxes did it to cover the expenses incurred to save their financial sector during the crisis of 2008, which is not the case in Romania where banks brought in over 4 billion euro in capital during the crisis in order to strengthen their position. In essence, such a tax should be designed to reduce risks in the banking sector as its imposition can have drastic consequences: a larger cash economy, lower investments and higher costs for Government borrowing. The Hungarian Government, for example, had to significantly reduce the level of a similar tax in order to cope with its aftermath.

According to calculations made by the National Bank of Romania, in the worst-case scenario, 27 banks including all those considered systemically important banks would not have sufficient own funds to cover all the global capital requirements imposed by European legislation. The 27 banks will have to ask their shareholders in 2020 for additional capital injections of at least several billion euros. The central bank has recommended that the impact analysis of this tax should also include the possible costs the authorities would have to shoulder in order to save the banks from bankruptcy. Romania has the lowest degree of financial intermediation in the EU (26.4%), the lowest number of small and medium sized companies per 1000 inhabitants (43), the lowest digitalization level and as a consequence the highest need for financing resources (loans) in the Union. Bearing this in mind and also the fact that the effects of this tax will swallow any profits from the banking system, Romanian banks will be unable to muster sufficient resources to invest in developing financial infrastructure and education in order for Romania to reduce the existing gap with other EU Member States.

Pillar II pension system

From the impact analysis of the Financial Supervisory Authority in Romania it is quite clear that the new capital requirements for pension fund managers are completely unreasonable, without any justification having been given of the risk that would have to be covered by these supplementary funds. The seven pension fund administrators will have to raise their capital in 2019 by approximately 800 million Euro. This is 11 times more than the current requirements and double all the gross commissions cashed by administrators in the 11 years of Pillar II's existence in Romania. The Government has not provided any justification for imposing such stringent capital requirements in parallel with a reduction of up to 70 % in the permissible level for the administration fees.

In very simple language, administrators will have to bring in an extra 800 million euros, in a situation where lower commissions – which were already low compared with the EU average - will no longer allow them to make profits. This is an unwritten invitation for these companies to leave Romania with consequences which are hard to quantify, but could amount to a de facto nationalization of the entire system. *"The high level of minimum capital, coupled with the short-term compliance (related to the amount of input needed), may discourage the management of privately managed pension funds, with the risk that some administrators may not be able to obtain the necessary resources and be forced to withdraw"* are the words used by ASF to describe the situation. The Bucharest Stock Exchange will receive a serious blow and the objective of increasing the financing of the Romanian economy through the capital market will be impossible to achieve in the medium and long term. Finally, eliminating this mechanism for domestic savings will lead to higher financing and refinancing costs for public debt and a higher dependency on external funding which is by nature more volatile. This comes on top of demographic trends (aging and emigration) which will have massive impact on public budgets and the welfare of Romanians.

Telecommunications sector

In the telecommunications sector, the Government decided to raise the supervisory tariff from 0.4% to 3% of turnover, a tax which is excessive and unjustified and goes against the European regulatory framework. This will become a burden for the entire industry and for all fixed and mobile internet users, as well as fixed and mobile telephony and television services and will practically freeze the development of communication networks and services. EU legislation stipulates that these kinds of contributions should strictly cover the operating expenses of the regulator and not translate into an extra tax burden for the sector.

The thresholds set by EO 114 for bidding for bandwidth appear to be so high that they will discourage any significant investment in the future. The price for spectrum is very high and random and with no real connection to its value, in direct contradiction with EU regulatory principles. Romania has high internet speeds, which gives it a global competitive advantage, but this performance can only be maintained by constant investment. In the context in which the digitalization of the economy and public administration should be national priorities for Romania (mentioned even in the context of the presidency of the Council of the European Union), it is incomprehensible why the Government has opted for a punitive and discouraging tax regime in this area.

Telecommunications infrastructure is the basis and the catalyst for the development of other sectors and the potential for an advanced digital economy is jeopardized by EO 114. Furthermore, there are contradictory provisions in the text which serve only to overburden an already complicated bureaucratic regime of authorization for the communications sector. These provisions will effectively block investments needed for the building and maintaining of high-speed internet infrastructure. In addition, the objectives of the Digital Agenda for Europe for access to broadband communications services by 2020, as well as the implementation of the " Action Plan: 5G for Europe" on the coordinated introduction of 5G services in the European Union, including Romania, is put in real danger.

Energy sector

In the energy sector the situation is equally worrisome. It is a sector where, again, investment needs are very high and the Romanian state does not have enough resources to make them all happen in the next few decades. The decapitalization of the energy sector will serve only to slow investments even more. The efforts undertaken so far to liberalize and deregulate the gas and electricity markets represented good progress, though significant deficiencies in the functioning of wholesale markets still needed to be addressed. However EO 114 does not solve these issues.

EO 114 fixes the gas wholesale price in Romania at 68 lei / MWh (below comparable international market-based prices) introduces sales obligations for gas producers in relation to the residential market, provides for the regulatory authority ANRE to determine how much market participants should purchase from domestic producers and how much from foreign producers, and it levies a 2% turnover contribution, payable to ANRE. These measures represent significant government intervention into the Romanian energy market, and seriously impede the development of the wholesale market, which allowed national and international producers, suppliers, importers and traders to compete in supplying Romanian consumers. These terms de-facto re-introduce a centralized planned economy for supplies to Romanian consumers. They strongly conflict with the EU single market principles of free trade and free movement of goods.

The capping of prices and supply obligations dis-incentivize investments in gas production, because producers will not be able to sell at prices reflecting international energy commodity prices. Over time, this will reduce gas production in Romania and related economic activity and employment. This would make Romania more dependent on imports of gas from external sources. EO 114 also discriminates against Romanian producers in favor of foreign producers, who can freely sell to Romanian buyers. EO 114 wipes out progress made in reforming the Romanian gas market to make it more competitive: the fixed prices and 2% ANRE contribution can be expected to stop activities of traders who typically operate with small margins. Consequently, a development of liquidity in the centralized markets in Romania (which was a key justification for the centralized market obligation) is unlikely. Regulating gas prices at wholesale level below comparable prices in neighboring markets and setting a gas basket could also constitute a state aid measure, especially in the case of the non-residential sector. Finally, these measures will lead to lower revenues to the state budget and potentially additional losses due to the reduction of investments, lower gas production, loss of jobs and the corresponding indirect and induced negative economic impact.

In this context, a contribution to the regulator applied on turnover in an industry which to a large extent works with large volumes and small margins can only jeopardize profitability to the point of severely reducing capital spending. The ill-thought out way in which EO 114 was written and the increase in fines creates significant exposures to market participants in cases of non-compliance and thus places the energy sector in deadlock; market transactions in electricity and gas have already showed signs of slowdown with visible effects. EO 114 also incentivizes market participants to buy gas from Romanian producers at the fixed (low) prices and then export this gas and thus one can anticipate – if not prevented by further detailed legislation or regulation - an increase in exports of natural gas from Romania, which would be likely followed by substantial imports at a higher price to cover the needs of domestic consumption. The unintended effects of this ordinance will be that supplies available to Romanian consumers will be reduced, especially at times of high demand in the winter, which is the opposite of what policy makers intend. Furthermore, while the

terms of EO 114 seem to aim to limit the capped prices and sales obligation until February 2022, it will be difficult to transition from a centralized planned/regulated market back to a competitive market framework.

In the electricity sector, the return to the regulation of electricity prices for household consumers, just one year after liberalization, creates an uncertain situation for consumers (about 2 million) who opted for the free market. By granting preferential prices to regulated market customers, those customers on the free market will be disadvantaged in terms of pricing and they will likely consider a return to regulated prices. In recent years, suppliers have invested heavily in developing the competitive market, relying on the timetable of liberalization and the explicit intention of creating a free market. By the regulation of a market sector, the effective operation of the competitive sector on a level playing field is negatively affected by price distortion, taking into account the withdrawal from the competitive market of a quantity of electricity to be sold at regulated prices/tariffs. Any cost associated with the sale of electricity on the regulated sector not recognized by ANRE or acknowledged late will be transferred to the competitive sector, thus creating a subsidy of the regulated sector by the competitive one. Overnight, this market - the result of the work that has been done together with the authorities in Romania over many years – has been jeopardized, with negative consequences for investments.

Capital market

The stock market suffered significant losses immediately after the announcement of EO 114 and then in the following weeks. CDR considers that this fall in the stock indices was unequivocally determined by the unexpected announcement of all these measures. This increased volatility will affect investor confidence just as the Bucharest Stock Exchange has made significant efforts to move from frontier to emerging market, which could bring significant investments to Romania. The funds which invest in emerging markets manage assets which are 130 times larger than the ones which invest in frontier markets, and for the time being they cannot invest in Romania.

The hit taken by pension funds and banks is already visible and it has affected the local investor base which is needed to support IPOs and sustainable liquidity for the stock market. This impact will continue if pension funds have to pull out of the market. If these measures stay as they are now, the Romanian Stock Exchange will remain significantly underdeveloped compared with peers in the region. In addition to the impact on the local investor base, the consequences for energy and telecoms are even worse. Together with the banking sector, these are the main constituents of the benchmark indices of the local capital market, BET. Any impairment of the sectors in which the companies included in the index work is reflected in the price of the shares of these companies, reduces their profitability and affects medium and long-term liquidity. In addition, all this reduces the chances of new listings of Romanian private companies on the stock exchange, contrary to the European objective of reducing dependence on bank credit. We believe that the fall in stock market indices as a result of this EO has dramatically affected investors' confidence and thus decreased attractiveness will remove any chance of Romania being promoted to the position of an emerging market despite all the efforts made over the past four years.

Construction sector

The construction sector is also negatively impacted by the lack of clarity of EO 114 both in terms of legal formulations and also in relation to the objectives the government has for this sector. It is not very clear who will benefit from the fiscal incentives in the ordinance and the way the legislation is drafted will have an impact both on companies in other sectors which have a small amount of construction activity but also on personnel in the construction sector who are not directly involved in construction but who handle various support activities.

In general, contractors with significant turnovers (i.e. bigger than 1 million euro), which have predictable financial behaviour, and are attractive from a banking point of view have their turnover generated from several activities, not only from construction. As a result, their economic sustainability and development potential is higher, in comparison with the companies which concentrate solely on one single type of activity. A higher level of turnover increase the competitiveness of Romanian contractors in large tenders in the public sector, due to increased bankability and capability to provide financial guaranties up to the required level for large infrastructure works. Setting an 80% turnover threshold for qualifying for the incentives provided for in EO 114 will encourage these companies to divide into smaller entities, with smaller turnovers, diminishing their competitive capabilities from the bankability point of view, for large infrastructure works.

The 80% turnover threshold is also a very volatile limit, which needs to be demonstrated monthly to the fiscal authorities, in order to highlight the legitimate implementation of EO 114 within the company's operations; this will generate a high volume of bureaucratic work and increased costs, with an increased risk of wrong interpretation/implementation resulting in penalties for the company.

Conclusion

CDR does not understand who benefits from the withdrawal of private pension fund managers from Romania, from the loss of profitability of the banking sector, from the weakening of the local capital market or from stopping major investments that could have taken place in the communications and energy sectors. All these measures come in a context in which the Romanian economy seems to have reached the peak of economic growth of this cycle and is about to enter a more moderate growth period. Worse, there are several signs that the forecasts for the European economy are quite cautious in the immediate future and we know for a fact that if the most important trading partner sneezes, Romania will catch a cold. There are also concerns over the sustainability of public finances, especially since these measures came at the end of the year and seem hastily designed to bring funds to a state budget that is barely managing to cope with all the public spending increases of recent years. All these represent significant risks to Romania's economy and their accumulation does not bode well for the business environment, for the population or for public finances. Sound macroeconomic numbers, obtained with great efforts after the restructuring of 2011-2015, together with solid global and European economies, acted as a shield against some of the less well thought through measures the Government has adopted in these past few years and which have created certain imbalances in the private sector. This time, the provisions of EO 114 bring massive structural changes which may have a devastating impact on the whole economy with implications for each citizen. CDR wishes to sound the alarm that this arbitrary way of making decisions will have seriously negative effects as the clouds gather in the global economy.