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COMMISSION OF THE EUROPEAN COMMUNITIES

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Recommendation for a

COUNCIL RECOMMENDATION TO ROMANIA

with a view to bringing an end to the situation of an excessive government deficit

COUNCIL RECOMMENDATION TO ROMANIA

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof;

Having regard to the recommendation from the Commission;

Whereas:

- (1) According to Article 104 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.
- (3) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. It 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.
- (4) The Council has decided on [7 July 2009], in accordance with Article 104(6), that an excessive deficit exists in Romania.
- (5) In accordance with Article 104(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure¹ (which is part of the Stability and Growth Pact), the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member State concerned to correct the excessive deficit as well as a deadline for the correction of the excessive deficit, which should be completed in the year following its identification unless there are special circumstances, and request the achievement of a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of 0.5% of GDP as a benchmark. In deciding whether special

¹ OJ L 209, 2.8.1997, p. 6.

circumstances exist, “relevant factors” as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be taken into account.

- (6) Special circumstances, which are relevant for the greater flexibility in the application of the EDP introduced with the 2005 reform of the Stability and Growth Pact, are deemed to exist in the case of Romania. In particular, 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 2009 from the EU and other international lenders². According to the Commission services' spring 2009 forecast growth is projected to contract by 4% in 2009 compared with significant positive growth of 7.1% in 2008. While the economic adjustment programme agreed to by the Romanian authorities in the framework of the multilateral financial assistance could limit the fall and a recovery is expected for 2010 (with growth expected at around zero), risks are mostly on the downside, reflecting uncertainty about the speed with which financial markets will stabilise and the depth of the global economic downturn. The existence of special circumstances authorises the Council to allow the correction of the excessive deficit in a medium-term framework.
- (7) Bearing in mind the need to act promptly to address the fiscal situation in Romania, and in accordance with the path for deficit reduction as specified in the June 2009 convergence programme – on which the Council gave its opinion on [7 July 2009] – correcting the excessive deficit by 2011 is appropriate.
- (8) During the first half of 2008, the degree of restrictiveness of monetary policy increased significantly, amid successive policy rate hikes up to 10.25% in July, following excess domestic demand, currency weakening and adverse supply shocks. Since the beginning of 2009, the central bank maintained a prudent monetary policy stance and has cut the policy rate by a cumulative 75bps since February 2009 in two steps, following the reduction of demand pressures and easing inflationary pressures.
- (9) The June 2009 convergence programme envisages a reduction of the government deficit to below 3% of GDP reference value by 2011, in line with the fiscal targets agreed in the framework of the medium-term financial assistance. The reduction would start in 2009 as the deficit is targeted to decrease from 5.4% of GDP in 2008 to 5.1% of GDP in 2009 due to consolidation measures undertaken in the 2009 budget adopted in February 2009 and additional measures taken in a rectified budget approved by the government in April 2009. According to the convergence programme the deficit will be reduced to 4.1% of GDP in 2010 and to below 3% in 2011. In its opinion of [7 July 2009] on the Romanian convergence programme, the Council concluded that the budgetary targets are subject to downside risks throughout the programme period. Risks stem mainly from the macroeconomic outlook which could

² The total multilateral financial assistance amounts to up to EUR 20 billion over the period to the first quarter of 2011. On 6 May 2009, the Council adopted a decision to make available to Romania a medium-term financial loan of up to EUR 5 billion under the balance of payments (BoP) facility for Member States. This assistance was provided 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 (EUR 1 billion), the European Investment Bank and the European Bank of Reconstruction and Development (EUR 1 billion together) on top of their general lending activities. The multilateral financial assistance is conditional on the implementation by the Romanian authorities of a comprehensive economic policy programme.

be worse than anticipated. In addition, there are risks concerning the effective implementation of the planned expenditure measures in 2009. Moreover, in 2010 and 2011, the achievement of the budgetary targets needs to be underpinned by concrete measures.

- (10) General government gross debt remains well below the 60% of GDP reference value, but it is on a sharply increasing trend. The June 2009 convergence programme foresees the debt-to-GDP ratio to increase to 18% in 2009 and 22% in 2010. This is in line with the Commission services spring 2009 forecast which anticipates the debt-to-GDP ratio to increase to 18¼% in 2009 and 22¾% in 2010.
- (11) In 2009 the deficit target should be achieved by implementing the fiscal measures foreseen in the 2009 budget and the April 2009 amended budget. In the following years, a structural effort of at least 1½% percentage points of GDP annually is required to achieve a deficit below 3% of GDP by 2011. In line with the policy conditions under this financial assistance, the fiscal consolidation towards achieving a deficit of below 3% of GDP by 2011 should be expenditure driven. In particular, measures should concentrate on containing current expenditure, notably with respect to the public sector wage bill. The detailed measures that are necessary to achieve this consolidation path beyond 2009 should be spelled out and any opportunity should be seized to accelerate the reduction of the deficit. Additional annual fiscal efforts might be necessary so as to achieve the government deficit targets up to 2011 if downside risks were to materialise with a view to bringing the government deficit below 3% of GDP in that year in a credible and sustainable manner.
- (12) In order to further enhance the credibility of the medium-term consolidation strategy, Romania should implement the measures agreed in the medium-term financial assistance in the area of fiscal governance and long-term sustainability of public finances. In particular, in order to improve the budgetary strategy and process, the Romanian authorities committed in the context of the financial assistance programme to adopt decisions aiming at setting up a binding medium-term budgetary framework, ensuring more realistic revenue projections, establishing limits on budget revisions during the year, laying-out fiscal rules and creating a fiscal council to provide independent and expert scrutiny. In order to improve budgetary predictability and transparency, the public compensation system should be restructured, including by unifying and simplifying the pay scales and reforming the bonus system. To help improve the long-term sustainability of public finances key parameters of the pension system should be reformed, in particular the indexation mechanism of public pensions and the retirement age.
- (13) Enhanced surveillance under the EDP, which is necessary in view of the Community medium-term financial assistance made available to Romania, and also of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy. In this context, a separate chapter in the updates of the Romanian convergence programme which will be prepared between 2009 and 2011 could usefully be devoted to this issue.
- (14) In general, in the view of the Council, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy.

HEREBY RECOMMENDS:

- (1) On the basis of the macroeconomic outlook of the Commission services' spring 2009 forecast, the Romanian authorities should put an end to the present excessive deficit situation by 2011.
- (2) The Romanian authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner by taking action in a medium-term framework in accordance with the multi-annual path for deficit reduction as specified in the Council opinion of [7 July 2009] on the June 2009 update of the convergence programme. Specifically, to this end, the Romanian authorities should:
 - (a) implement the fiscal measures in 2009 as planned in the February 2009 budget and the April 2009 amended budget, especially in the area of public sector wages and pension reform and adopt and implement further measures – if necessary – to achieve the 2009 deficit target in order to ensure compliance with the commitments undertaken under the balance of payments programme;
 - (b) ensure an average annual fiscal effort of at least 1½% of GDP starting with 2010;
 - (c) spell out the detailed measures that are necessary to achieve this consolidation path beyond 2009 and implement the envisaged corrective measures rigorously; in particular, the consolidation should be expenditure driven and measures should concentrate on containing current expenditure, notably with respect to the public sector wage bill; seize any opportunity to accelerate the reduction of the deficit; stand ready to adopt the additional measures which may be necessary to achieve the correction of the excessive deficit by 2011.
- (3) To limit risks to the adjustment, Romania should implement the measures agreed in the medium-term financial assistance in the area of fiscal governance. In particular, in order to improve the budgetary strategy and process, the Romanian authorities should adopt decisions aiming at setting up a binding medium-term budgetary framework, ensuring more realistic revenue forecasts, establishing limits on budget revisions during the year, laying-out fiscal rules and creating a fiscal council to provide independent and expert scrutiny. In order to improve budgetary predictability and transparency, the public compensation system should be restructured, including by unifying and simplifying the pay scales and reforming the bonus system.
- (4) In order to help a sustainable achievement of lower budgetary deficits, the Council urges the Romanian authorities to ensure measures will be taken to improve the long-term sustainability of public finances by reforming key parameters of the pension system.
- (5) The Council establishes the deadline of [7 January 2010] for the Romanian government to take effective action to implement the measures to achieve the 2009 deficit target of 5.1% of GDP and to specify the measures that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' spring 2009 forecast.

- (6) The Romanian authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the convergence programmes which will be prepared between 2009 and 2011.

In addition, the Council highlights the importance of achieving the medium-term objective (MTO) for appropriate budgetary management of economic downturns. It therefore invites the Romanian authorities to ensure that budgetary consolidation towards the medium-term objective for the budgetary position – a structural deficit of 0.9% of GDP – is sustained after the excessive deficit will have been corrected. . Finally, the Council calls upon the Romanian authorities to further improve the collection and processing of general government data.

This recommendation is addressed to Romania.

Done at Brussels,

For the Council
The President