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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

EXPLANATORY MEMORANDUM

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

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty on the Functioning of the European Union. 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 in 2008/09. 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 explained that the stimulus should be differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness, and that it should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted 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.

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.

2. PREVIOUS STEPS IN THE EXCESSIVE DEFICIT PROCEDURE

Article 126 of the Treaty on the Functioning of the European Union (TFEU) 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.

According to Article 126(2) TFEU, 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)

[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 10 November 2009, available at: http://ec.europa.eu/economy_finance/other_pages/other_pages12638_en.htm .

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).

Article 126(3) TFEU (ex Article 104(3) of the Treaty establishing the European Community (TEC)) 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".

On the basis of the data notified by the Romanian authorities in April 2009[2], subsequently validated by Eurostat[3], and taking into account the Commission services' spring 2009 forecast, the Commission adopted a report under Article 104(3) TEC for Romania on 13 May 2009[4].

Subsequently, and in accordance with Article 104(4) TEC, the Economic and Financial Committee formulated an opinion on the Commission report on 28 May 2009.

On 24 June 2009, the Commission, having taken into account its report under Article 104(3) TEC and the opinion of the Economic and Financial Committee under Article 104(4) TEC, addressed to the Council, in accordance with Article 104(5) TEC, its opinion that an excessive deficit existed in Romania.

Subsequently, acting upon a recommendation by the Commission, the Council decided on 7 July 2009 that an excessive deficit existed in Romania in accordance with Article 104(6) TEC, and, also on a recommendation by the Commission, it addressed recommendations to Romania in accordance with Article 104(7) TEC with a view to bringing an end to the situation of an excessive government deficit by 2011. In its recommendations, the Council established a deadline of 7 January 2010 for effective action to be taken.

Regulation 1467/97, Article 3(5), states that if effective action has been taken in compliance with a recommendation under Article 126(7) TFEU and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation, the Council may decide, on a recommendation from the Commission, to adopt a revised recommendation under Article 126(7) TFEU. To this end, the Commission has assessed recent macro-economic and budgetary developments as well as effective action taken by Romania.

3. RECENT MACRO-ECONOMIC AND BUDGETARY DEVELOPMENTS

According to Art. 3(5) of Council regulation (EC) 1467/97, the occurrence of unexpected adverse economic events with major unfavourable budgetary effects shall be assessed against

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2 According to Council Regulation (EC) No 479/2009, 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: http://ec.europa.eu/economy_finance/sgp/deficit/countries/index_en.htm.

the economic forecast underlying the initial Council recommendation, adopted on 7 July 2009.

The Commission services' spring 2009 forecast, on which the July Council Recommendation was based, assumed real GDP to contract by 4% in 2009. Based on this scenario, the general government deficit was projected to reach 5.1% of GDP, consistent with the target set by the authorities in the May 2009 Convergence Programme and included in the multilateral financial assistance programme to Romania.[5] To achieve this target, the government committed to take measures to cut expenditure by about 4½% of GDP. The deficit target of 5.1% of GDP was also in line with the economic policy programme agreed in the framework of the multilateral financial assistance programme.[6] However, in the first half of 2009 real GDP contracted by a sharper-than-anticipated 7.6% yoy, compared to a 3.0% decline projected over that period in the spring forecast. As in many other countries in the region, the recession was led by a large drop of export volumes, followed by a very sharp contraction of domestic demand. The Commission services now estimate the real GDP contraction in 2009 at 7%, instead of 4% projected in the spring.

		2008	**2009**	**2010**	**2011**
Real GDP (% change)	COM Spring forecast	**7.1**	**-4.0**	**0.0**	n.a.
	Update COM forecast[1]	6.2	-7.0	1.3	2.6
Nominal GDP (% change)	COM Spring forecast	**22.1**	**5.3**	**6.6**	n.a.
	Update COM forecast	21.1	0.2	6.7	7.9
General government balance (% of GDP)	COM Spring forecast	**-5.4**	**-5.1**	**-5.6**	n.a.
	Update COM forecast	-5.5	-7.8	-6.4	-5.1

Note: [1] Updated forecast prepared in January 2010 by the Commission services in the framework of the implementation of the multilateral financial assistance programme.

The sharper than anticipated recession has resulted in a significant worsening of the fiscal position. The general government deficit in 2009 is now expected to have reached 7.8% of GDP, compared to 5.1% of GDP projected in the Commission services' spring 2009 forecast. This increase by 2¾% of GDP is mainly linked to a shortfall in tax revenues by 2½% of GDP. The sharpest drops have been observed in VAT (about 1% of GDP compared to the spring forecast) and in social security contributions (1¼% of GDP). Furthermore, absorption of EU-funds was lower than anticipated by around ¾% of GDP, and non-tax revenue by ¾% of GDP, leading to an underperformance of government revenues by just below 4% of GDP.

Overall, it can be concluded that, assessed against the economic forecast underlying the initial Council recommendation, adopted on 7 July 2009, unexpected adverse economic events with major unfavourable budgetary effects have occurred in Romania.

[5] Against the background of increased financial stress, on 6 May 2009, the Council adopted Decision 2009/459/EC 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. The EU assistance for Romania comes in conjunction with loans of the IMF (EUR 13bn), the World Bank (EUR 1bn) and the EIB and the EBRD (EUR 1bn).

[6] Council Decision 2009/459/EC providing Community medium-term financial assistance for Romania.

4. ASSESSMENT OF EFFECTIVE ACTION TAKEN

According to Regulation 1467/97[7] and the Code of Conduct[8] a Member State should be considered to have taken effective action if it has acted in compliance with the Article 126(7) TFEU recommendation. The Code of Conduct states that the assessment of effective action should in particular take into account whether the Member State concerned has achieved the annual improvement of its cyclically adjusted balance, net of one-off and other temporary measures, initially recommended by the Council. In case the observed adjustment proves to be lower than recommended, a careful analysis of the reasons for the shortfall should be made. In case of a multi-annual adjustment, the Code of Conduct specifies that the assessment should mainly focus on the measures taken in order to ensure an adequate fiscal adjustment in the year following the identification of the excessive deficit.

On 7 July 2009 the Council recommended the Romanian authorities to implement all fiscal measures 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 to adopt and implement further measures if necessary to achieve the 2009 deficit target in order to ensure compliance with the commitments undertaken under the multilateral financial assistance programme. As mentioned above, the deeper recession implied much lower revenue than initially expected. On the expenditure side, measures have been taken to cut goods and services and personnel spending, although total savings turned out somewhat lower than expected. Other spending categories were however also reduced, reflecting inter alia delayed investment projects and lower interest payments. Overall, total spending was lower by about 1½% of GDP compared to plans at the time of the Council 104(7) recommendation, which partly cushioned the impact of the significant revenue shortfall on the deficit.

Regarding 2010 and 2011, the Council recommendation invited the Romanian authorities to continue fiscal consolidation with an annual average fiscal effort of at least 1½% of GDP. Furthermore, the recommendation underlined the need to spell out the detailed measures to achieve this consolidation path and that consolidation should be mainly expenditure driven. On 15 January, the Parliament adopted the budget for 2010, which targets a deficit of 5.9% of GDP in cash terms (corresponding to about 6.4% of GDP in ESA95 terms). This includes a package of measures cutting expenditure by about 2% of GDP and raising revenue by about ½% of GDP. On the expenditure side, measures consist of further cuts in the wage bill (including a nominal freeze in wages), a pension freeze and cuts in goods and services expenditure. On the revenue side, excise taxes will be raised and a tax on medical distributors will be introduced. The budget also includes the one-off positive effect from the reimbursement of tax arrears (the Rompetrol bond), representing about ½% of GDP. Full implementation of the measures included in the budget would imply a structural fiscal effort (i.e. in cyclically-adjusted terms net of one-off effects) of about 2% of GDP, in line with the July 2009 Council recommendation.

The Council also recommended Romania to improve fiscal governance, notably by introducing a binding medium-term fiscal 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. A draft Fiscal

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7 OJ L 209, 2.8.1997, p. 6.

8 "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.

Responsibility Law, in line with the above criteria, has been prepared by the government and is currently under discussion in Parliament. Furthermore, the Council recommended Romania to restructure the public compensation system, including by unifying and simplifying the pay scales and reforming the bonus system. In November 2009 the Parliament adopted a Unified Wage Law, which enhances the transparency of the public wage system and allows for a better control of the public wage bill, in line with the July 2009 Council recommendation. Follow-up legislation will however be needed to reap the full benefits of this reform.

To improve the long-term sustainability of government finances, the Government has prepared draft legislation on pension reform. The draft legislation introduces important parametric changes to the pension system, including an increase in the retirement age and a change in pension indexation rules. According to Commission services' estimates, the reform would significantly improve the long-term sustainability of the pension system while safeguarding appropriate replacement rates.

Overall, taking into account economic developments compared to the outlook in the Commission services' spring 2009 forecast, it can be concluded that Romania has taken effective action as required by the Council recommendation of 7 July 2009.

5. RECOMMENDATIONS TO END THE EXCESSIVE DEFICIT SITUATION

According to Article 3(4) of Council Regulation (EC) No 1467/97, the Council recommendation under Article 126(7) TFEU has to establish a deadline of six months at most for effective action to be taken by the Member State concerned Article 3(4) of the Regulation specifies that the Council has to recommend that the Member State achieves a "minimum annual improvement of at least 0.5% of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation".

The recommendation adopted on 7 July 2009 set the target date of 2011 to bring the general government deficit below the reference value. Since the Romanian authorities are considered to have taken effective action in compliance with this recommendation and unexpected adverse economic events with major unfavourable consequences for public finances can be considered to have occurred in Romania, a revised recommendation for Romania notably extending the deadline by one year is justified.

In order to achieve the correction of the excessive deficit by 2012 in the context of a medium-term framework, the Romanian government would have to make an annual average structural adjustment of 1¾% of GDP over the period 2010-2012. The 2010 budget, with an underlying structural effort of about 2% of GDP implies some moderate frontloading of the adjustment, which is justified given that the weak underlying fiscal position is a threat to macroeconomic stability in Romania. In line with the policy conditions under the multilateral financial assistance programme, the adjustment is mainly expenditure-driven. Measures concentrate on containing current expenditure at all levels of government. The detailed measures that are necessary to reduce the deficit after 2010 remain to be spelled out. Moreover, given the large deficit and the need for Romania to continue to restore market confidence, any opportunity to accelerate the reduction of the deficit should be seized.

General government gross debt remains well below the 60% of GDP reference value, but it is on a sharply increasing trend. The Commission services' autumn 2009 forecast projects the debt-to-GDP-ratio to increase from 18% of GDP in 2009 to 31% of GDP in 2011.

In order to further enhance the credibility of the medium-term consolidation strategy, it will be crucial implement the measures agreed in the context of the multilateral financial assistance programme in the area of fiscal governance. The authorities should adopt draft Fiscal Responsibility Law, which aims at setting-up a binding medium-term budgetary framework, ensuring more realistic revenue projections, establishing limits on budgetary revisions during the year, laying out fiscal rules and creating a fiscal council to provide independent expert scrutiny on public finances. Further action is also needed to simplify the compensation system in the public sector, including by strengthening the link between pay and responsibility and taking better account of other sources of remuneration on top of the base wage.

To reduce the risk to the long-term sustainability of public finances as defined by the Commission Communication[9] on 'Long-term sustainability of public finances for a recovering economy' and discussed by the ECOFIN Council[10] on 10 November 2009, it is important that the Romanian authorities adopt and rigorously implement the draft pension reform prepared by the government.

Enhanced surveillance under the EDP, which seems necessary in view of the deadline for the correction of the excessive deficit and of the multilateral financial assistance made available to Romania, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy to ensure the correction of the excessive deficit. In this context, a separate chapter in the updates of the Romanian convergence programme which will be prepared between 2010 and 2012 could usefully be devoted to this issue.

9 Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf.

10 Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf.

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	COM autumn forecast	6.3	6.2	-8.0	0.5	2.6	n.a.	n.a.
	Update COM forecast[1]	6.3	6.2	-7.0	1.3	2.6	n.a.	n.a.
	National forecast [2]	6.3	6.2	-7.7	0.5	2.4	3.7	4.4
Output gap[3] (% of potential GDP)	COM autumn forecast	8.8	10.0	-2.2	-4.4	-4.3.	n.a.	n.a.
	Update COM forecast[4]	8.8	10.0	-1.1	-2.6	-2.6	n.a.	n.a.
	National forecast	n.a.	n.a.	n.a.	n.a.	n.a.	n.a	n.a
General government balance (% of GDP)	COM autumn forecast	-2.5	-5.5	-7.8	-6.8	-5.9	n.a.	n.a.
	Update COM forecast	-2.5	-5.5	-7.8	-6.4	-5.4	n.a.	n.a.
	National forecast	-2.6	-5.5	-7.8	-6.4	n.a.	n.a	n.a
Primary balance (% of GDP)	COM autumn forecast	-1.8	-4.8	-6.2	-5.0	-3.9	n.a.	n.a.
	Update COM forecast	n.a.	n.a.	n.a.	n.a.	n.a.	n.a	n.a
	National forecast	-1.8	-4.7	n.a.	n.a.	n.a.	n.a.	n.a.
Cyclically-adjusted balance[3] (% of GDP)	COM autumn forecast	-5.1	-8.5	-7.1	-5.5	-4.6	n.a.	n.a.
	Update COM forecast	-5.1	-8.6	-7.4	-5.6	-4.2	n.a.	n.a.
	National forecast	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Structural balance[5] (% of GDP)	COM autumn forecast	-5.0	-8.5	-7.1	-5.5	-4.6.	n.a.	n.a.
	Update COM forecast	-5.0	-8.1	-7.9	-6.1	-4.6	n.a.	n.a.
	National forecast	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Government gross debt (% of GDP)	COM autumn forecast	12.6	13.6	21.8	27.4	31.3	n.a.	n.a.
	Update COM forecast	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	National forecast	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes:

[1] Updated forecast prepared in January 2010 by the Commission services in the framework of the multilateral financial assistance programme to Romania.

[2] National Forecasting Commission Autumn 2009 forecast and Ministry of Finance

[3] Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

[4] Based on estimated potential growth of 5.1%, 5.1%, 3.4%, 2.9% and 2.5% respectively in the period 2007-2011.

[5] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.1% of GDP in 2007 (deficit–reducing), 0.5% of GDP in 2008 (deficit-reducing), 0.5% of GDP in 2009 (deficit-increasing), 0.5% of GDP in 2010 (deficit-increasing) and 0.0% of GDP for 2011

Recommendation for a

COUNCIL RECOMMENDATION TO ROMANIA

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

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) thereof;

Having regard to the recommendation from the Commission;

Whereas:

(1) According to Article 126(1) of the Treaty on the Functioning of the European Union (TFEU) 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) On 7 July 2009 the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community (TEC), that an excessive deficit exists in Romania and issued recommendations to correct the excessive deficit by 2011 at the latest, in accordance with Article 104(7) TEC and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[11]. This implied an average annual fiscal effort of 1½% over the period 2010-2011. The Council also established a deadline of 7 January 2010 for effective action to be taken.

(5) The Council agreed on 20 October 2009 that, provided that the Commission services' forecasts continue to indicate that the recovery is strengthening and becoming self-sustaining, fiscal consolidation in all EU Member State should start in 2011 at the latest, that specificities of country situations should be taken into account, and that a number of countries need to consolidate before then.

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[11] OJ L 209, 2.8.1997, p. 6.

(6) Regulation (EC) No 1467/97 (which is part of the Stability and Growth Pact) establishes provisions for the implementation of Article 126 TFEU. According to Article 3(5) of Council Regulation (EC) No 1467/97, if effective action has been taken and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation, the Council may decide, on a recommendation from the Commission and before taking into account the relevant factors mentioned in Article 2(3) of Regulation (EC) No 1467/97, to adopt a revised recommendation under Article 126(7) TFEU.

(7) The Commission services' spring 2009 forecast, on which the July Council Recommendation was based, projected real GDP to contract by 4% in 2009. Based on this scenario, and assuming implementation of an ambitious fiscal consolidation package, the general government deficit was projected to reach 5.1% of GDP, from 5.4% of GDP in 2008. However, in the first half of 2009 real GDP contracted by a sharper-than-anticipated 7.6% yoy, compared to a 3.0% decline over that period projected during the spring forecast. For the year, the Commission services now estimate the real GDP contraction in 2009 at 7%. The larger than expected recession resulted in a significant shortfall in government revenue (almost 4% of GDP), which pushed the deficit to an estimated 7.8% of GDP despite efforts to reduce government expenditure. In view of the above, unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred after adoption of the recommendation under Article 104(7) TEC.

(8) The July 2009 Council recommendation established the deadline of 7 January 2010 for the Romanian government to take effective action. It recommended the Romanian authorities to implement the fiscal measures in 2009 as planned in order to ensure compliance with the commitments taken under the multilateral financial assistance programme.[12] Total government expenditures were lower than projected by 1½% of GDP. Measures were taken to reduce goods and services and personnel spending, and absorption of EU funds and interest payments were lower than expected. Regarding 2010, the budget targets a deficit of 6.4% of GDP and is underpinned by a package of measures which concentrates mainly on current spending. The budget deficit target is consistent with a structural effort of about 2% of GDP. In line with the policy conditions under the multilateral financial assistance programme, the planned adjustment is mainly expenditure-driven with measures focusing on savings in wages and pensions.

(9) Furthermore, the Romanian authorities have undertaken several steps to improve fiscal governance in line with the policies recommended in the context of the EU medium-term financial assistance to Romania. Revised public compensation legislation has been adopted, improving transparency and cost-control, and draft legislation has been submitted to parliament reforming the pension system and strengthening the fiscal framework. In view of these elements, the Romanian authorities can be considered to have taken effective action.

(10) Since the Romanian authorities are considered to have taken effective action in compliance with the Council recommendations of 7 July 2009 under Article 104(7) TEC and unexpected adverse economic events with major unfavourable consequences

[12] Council Decision 2009/459/EC providing Community medium-term financial assistance for Romania.

for government finances can be considered to have occurred in Romania, revised recommendations under Article 126(7) TFEU for Romania are justified. A new deadline for correction of the excessive deficit in Romania by 2012 at the latest is appropriate. This would require an average annual fiscal effort of 1¾% of GDP over the period 2010-2012. A rigorous implementation of the measures included in the 2010 budget is necessary to make adequate progress towards the correction of the excessive deficit. Furthermore, additional consolidation measures will be needed to achieve the correction of the excessive deficit by 2012, cyclical conditions permitting. Given the large deficit and the need for Romania to continue to restore market confidence, any opportunity to accelerate the reduction of the deficit should be seized.

(11) 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 package in the area of fiscal governance. Regarding public compensation legislation, further action should be taken to simplify the compensation system in the public sector, including by strengthening the link between pay and responsibility and taking better account of other sources of remuneration on top of the base wage. The authorities should also adopt and rigorously implement the Fiscal Responsibility Law, which aims at setting-up a binding medium-term budgetary framework, ensuring more realistic revenue projections, establishing limits on budgetary revisions during the year, laying-out fiscal rules and creating an independent fiscal council. To reduce risks to the long-term sustainability of public finances as defined by the Commission Communication[13] on 'Long-term sustainability of public finances for a recovering economy' and discussed by the ECOFIN Council[14] on 10 November 2009, the authorities should adopt and implement the pension reform plans prepared by the government in the context of the multilateral financial assistance programme to Romania, which foresee a gradual increase in the retirement age and changes in indexation rules for pensions.

(12) General government gross debt remains well below the 60% of GDP reference value, but it is on a sharply increasing trend. The Commission services' autumn 2009 forecast projects the debt-to-GDP-ratio to increase from 18% of GDP in 2009 to 31% of GDP in 2011.

(13) Enhanced surveillance under the EDP, which seems necessary in view of the deadline for the correction of the excessive deficit and of the EU medium-term financial assistance made available to Romania, 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 2010 and 2012 could usefully be devoted to this issue.

(14) In general, 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.

(15) In addition, in view of the importance of achieving a medium-term budgetary objective (MTO) to provide an adequate safety margin against cyclical downturns and

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13 Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf.

14 Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf.

to ensure convergence of the debt ratio towards a prudent level, also taking into account implicit liabilities related to ageing, Romania should also ensure that budgetary consolidation towards the MTO is sustained after the excessive deficit will have been corrected.

HEREBY RECOMMENDS:

(1) Recognising that Romania's budgetary position in 2009 resulted from the operation of automatic stabilisers in the context of a larger than expected recession, Romania should put an end to the present excessive deficit situation by 2012.

(2) Romania should bring the general government deficit below 3% of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, Romania should:

   (a) implement the fiscal measures in 2010 as planned in the budget law, while avoiding any further deterioration of public finances, and continue consolidation in 2011 and 2012;

   (b) ensure an average annual fiscal effort of 1¾% of GDP over the period 2010-2012; and

   (c) specify the measures that are necessary to achieve the correction of the excessive deficit by 2012, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

(3) To limit risks to the adjustment, Romania should also continue the implementation of the measures to improve fiscal governance agreed in the framework of the multilateral financial assistance programme. In particular, the adoption and implementation of the Fiscal Responsibility Law would greatly enhance the credibility and predictability of public finances through, among others, the creation of a fiscal council, setting up a binding medium-term fiscal framework, ensuring more realistic revenue forecasts and establishing limits on budget revisions during the year.

(4) Romania should adopt and implement the draft pension reform which will improve the long term sustainability of public finances, while safeguarding adequate replacement rates.

(5) The Council establishes the deadline of [16 August 2010] for Romania to take effective action to implement the fiscal consolidation measures in 2010 as planned in the 2010 Budget and to outline the consolidation strategy 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' autumn 2009 forecast.

(6) Romania 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 2010 and 2012.

(7) Furthermore, the Council invites Romania to implement reforms with a view to raising potential GDP growth. This includes improving the absorption of EU funds, while

ensuring they target the right priorities, and enhancing the functioning of labour markets against the background of ongoing structural economic transformation.

This recommendation is addressed to Romania.

Done at Brussels,

For the Council
The President