COUNCIL OF
THE EUROPEAN UNION

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	COUNCIL RECOMMENDATION with a view to bringing an end to the situation of an excessive government deficit

COUNCIL RECOMMENDATION TO ROMANIA

of

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) In accordance with Article 126(1) of the Treaty on the Functioning of the European Union (TFEU), Member States are to 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 excessive deficit procedure (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 existed 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[1]. This implied an average annual fiscal effort of 1½ % over the period 2010-2011. The Council also set a deadline of 7 January 2010 for effective action to be taken.

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

(5) On 20 October 2009, the Council agreed that, provided that the Commission services' forecasts continued to indicate that the recovery was strengthening and becoming self-sustaining, fiscal consolidation in all Member States should start in 2011 at the latest, that specificities of country situations should be taken into account, and that a number of countries needed to consolidate before that date.

(6) Regulation (EC) No 1467/97 (which is part of the Stability and Growth Pact) establishes provisions for the implementation of Article 104 TEC (now Article 126 TFEU). Under Article 3(5) of Regulation (EC) No 1467/97, if effective action has been taken in compliance with a recommendation under Article 104(7) TEC (now 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 and before taking into account the relevant factors referred to in Article 2(3) of Regulation (EC) No 1467/97, to adopt a revised recommendation under Article 104(7) TEC (now Article 126(7) TFEU).

(7) The Commission services' spring 2009 forecast, on which the Council Recommendation under Article 104(7) TEC of 7 July 2009 (hereinafter "the Council Recommendation of 7 July 2009") 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 % year-on-year, 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 Council Recommendation of 7 July 2009.

(8) The Council Recommendation of 7 July 2009 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 set out in Council Decision 2009/459/EC of 6 May 2009 providing Community medium-term financial assistance for Romania[1]. Total government expenditure was lower than projected by 1½ % of GDP. Measures were taken to reduce goods and services and personnel spending, and absorption of Union 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 Union's medium-term financial assistance to Romania. Revised public compensation legislation has been adopted, improving transparency and cost-control, and draft legislation which aims to reform the pension system and strengthen the fiscal framework has been submitted to the Romanian parliament. In view of these elements, the Romanian authorities can be considered to have taken effective action.

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[1] OJ L 150, 13.6.2009, p. 8.

(10) Since the Romanian authorities are considered to have taken effective action in compliance with the Council Recommendation of 7 July 2009 and unexpected adverse economic events with major unfavourable consequences 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 cautious 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 entitled 'Long-term sustainability of public finances for a recovering economy'[1] and discussed by the ECOFIN Council[2] 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.

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

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

(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 21,8 % of GDP in 2009 to 31,3 % 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 Union's 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 to ensure convergence of the debt ratio towards a prudent level, also taking into account implicit liabilities related to ageing, Romania should 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 its budget law 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 correct 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 implementing 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 cautious 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 Union 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