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Recommendation for a

COUNCIL RECOMMENDATION

on the 2017 National Reform Programme of Romania

and delivering a Council opinion on the 2017 Convergence Programme of Romania

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies,¹ and in particular Article 9(2) thereof,

Having regard to the recommendation of the European Commission,²

Having regard to the resolutions of the European Parliament,³

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 16 November 2016, the Commission adopted the Annual Growth Survey,⁴ marking the start of the 2017 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report,⁵ in which it did not identify Romania as one of the Member States for which an in-depth review would be carried out.
- (2) The 2017 country report for Romania⁶ was published on 22 February 2017. It assessed Romania's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the recommendations adopted in previous years and Romania's progress towards its national Europe 2020 targets.

¹ OJ L 209, 2.8.1997, p. 1.

² COM(2017) 522 final.

³ P8_ TA(2017)0038, P8_ TA(2017)0039, and P8_ TA(2017)0040.

⁴ COM(2016) 725 final.

⁵ COM(2016) 728 final.

⁶ SWD(2017) 88 final.

- (3) On 5 May 2017, Romania submitted its 2017 National Reform Programme and its 2017 Convergence Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.
- (4) The relevant country-specific recommendations have been taken into account in the Member States' programmes for the European Structural and Investment Funds (ESI Funds) covering the 2014-2020 period. As foreseen in the legislation governing the ESI Funds,⁷ where it is necessary to support the implementation of relevant country-specific recommendations, the Commission may request a Member State to review and amend its relevant ESI Funds programmes. The Commission has provided further guidelines on the application of those rules.⁸
- (5) Between 2009 and 2015, Romania benefited from three balance of payments assistance programmes jointly run by the Commission and the International Monetary Fund and supported by the World Bank. Disbursements were only made under the first programme in 2009-2011, while those in 2011-13 and 2013-15 were precautionary. Post-programme surveillance on behalf of the Commission to monitor Romania's capacity to repay the loans granted under the first programme started in October 2015 and will continue until at least 70 % of the loan has been repaid, which is due in spring 2018.
- (6) Romania is currently in the preventive arm of the Stability and Growth Pact. In its 2017 Convergence Programme, the government plans a headline deficit of 2.9% of GDP both in 2017 and 2018, and its gradual reduction thereafter, to 2.0% of GDP by 2020. The medium-term budgetary objective, a structural deficit of 1% of GDP, is not expected to be reached by 2020, which is the programme horizon. The recalculated⁹ structural balance is expected to reach -2.6% by 2020. According to the Convergence Programme, the general government debt-to-GDP ratio is expected to increase from 37.6% of GDP in 2016 to 38.3% of GDP in 2018 and then decline to 37.6% of GDP in 2020. The macroeconomic scenario underpinning these budgetary projections is favourable. The main downward risk to the macroeconomic outlook stems from a lower impact of fiscal and structural measures on near and medium-term growth prospects. At the same time, the measures needed to support the planned deficit targets have not been sufficiently specified. Moreover, the draft unified wage law poses a significant downward risk to the fiscal forecast.
- (7) On 12 July 2016, the Council recommended Romania to limit the deviation from the medium-term budgetary objective in 2016 and achieve an annual fiscal adjustment of 0.5% of GDP in 2017 unless the medium-term budgetary objective is respected with a lower effort. Based on 2016 outturn data Romania was found to be in significant deviation from the medium-term budgetary objective. In line with Article 121(4) TFEU and Article 10(2) of Council Regulation (EC) No 1466/97, the Commission issued a warning to Romania on 22 May 2017 that a significant deviation from the

⁷ Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006, OJ L 347, 20.12.2013, p. 320.

⁸ COM(2014) 494 final.

⁹ Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

medium-term budgetary objective was observed in 2016. [On XX, the Council adopted a subsequent recommendation confirming the need for Romania to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure¹⁰ does not exceed 3.3% in 2017, corresponding to an annual structural adjustment of 0.5% of GDP.] Based on the Commission 2017 spring forecast, there is a risk of a significant deviation from the recommended adjustment in 2017.

- (8) In 2018, in the light of its fiscal situation, Romania is expected to further adjust towards its medium-term budgetary objective of a structural deficit of 1% of GDP. According to the commonly agreed adjustment matrix under the Stability and Growth Pact, that adjustment translates into a requirement of a nominal growth rate of net primary government expenditure which does not exceed 4.3%. It would correspond to a structural adjustment of 0.5 % of GDP. Under unchanged policies, there is a risk of a significant deviation from that requirement in 2018. In addition, the Commission 2017 spring forecast projected a general government deficit of 3.5% and 3.7% of GDP for 2017 and 2018, above the 3%-of-GDP reference value of the Treaty. Overall, the Council is of the opinion that significant further measures will be needed as of 2017 to comply with the provisions of the Stability and Growth Pact, in light of a strongly deteriorating fiscal outlook[, in line with the recommendation addressed to Romania on XX with a view to correcting the significant deviation from the adjustment path toward the medium-term budgetary objective].
- (9) Romania's fiscal framework is sound, but is not fully enforced. The 2016 budget substantially departed from the medium-term objective of a structural deficit of 1 % of GDP in breach of the deficit rule in the national fiscal framework. The 2017 budget further deviated from the national fiscal rules. In 2016, as in previous years, the authorities did not send an update of the fiscal strategy to the parliament by the statutory August deadline. As a result, the medium-term fiscal strategy has not been guiding the annual budget process.
- (10) On the back of comfortable capital buffers and increasing profitability, the health of the banking sector continued to improve in 2016. The authorities committed to perform a comprehensive asset quality review and stress test of the banking sector in 2018. The law on debt discharge entered into force in May 2016, but risks to the banking sector have been largely mitigated by a ruling of the constitutional court that courts will have to assess whether borrowers comply with the legal provisions on hardship. The CHF-denominated loan conversion law adopted by the parliament in October 2016 was recently judged non-constitutional. However, recurrent legislative initiatives continue to challenge legal predictability, with possible negative impacts on investor sentiment.
- (11) Tax evasion has been prevalent in Romania, reducing tax revenues and tax fairness and distorting the economy. In addressing a country-specific recommendation to strengthen tax compliance and collection, Romania has made limited progress. In 2016, the procedures for VAT registration and reimbursement were amended, and a nation-wide roll-out of electronic cash registers connected to the tax authority is

¹⁰ Net government expenditure is comprised of total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

underway. From 2017, a special scheme applies to sectors such as the hotel, catering and other related industries, where the duty is established irrespective of revenue bracket. In addition, restrictions were also adopted on self-employment and family businesses, to discourage tax avoidance. An improvement in compliance was observed in 2016 for tax declarations and payments, but the joint tax and labour inspections and audits failed to achieve improved results. Furthermore, the turnover threshold for the tax regime on micro enterprises was substantially increased while the rate was cut, enabling tax compliance to the detriment of budgetary revenues. The sectorial and categorical approaches to business taxation risk imposing an administrative burden on both businesses and the tax authority, while they are not conducive to improving tax collection.

- (12) The distribution of disposable household income (accounting for the size of the household) is particularly unequal in Romania, thereby impairing its potential for sustainable and inclusive growth. The richest 20 % of the population have an income over eight times higher than the poorest 20 %. This ratio is significantly higher than the EU average. Inequalities are driven to a large extent by unequal access to health care, education, services and access to labour market. Moreover, the difference between income inequality before and after taxes and social transfers is amongst the smallest in the EU. The social reference index at the basis of the main social benefits has not been updated since its introduction in 2008. Undeclared work including envelope wages remains prevalent and continues to weigh on tax revenue, distort the economy, and undermine the fairness and effectiveness of the tax and benefits system. Joint national inspections by the Fiscal Administration and labour inspectorates were undertaken as part of a pilot project, but this has failed to have a systemic impact so far. Resources are not focused on sectors with the highest risks of tax evasion, limited focus is given on envelope wages, while coercive measures prevail over preventive ones.
- (13) Labour market outcomes improved in 2016, when the unemployment rate reached its pre-crisis low. The labour force continues to shrink, as the population is ageing and emigration remains high. Low unemployment is matched by one of the highest inactivity rates in the EU. Employment and activity rates for young people, women, the low-skilled, people with disabilities and Roma in particular are well below the EU average. The number of young people not in employment, education or training remains very high.
- (14) Although declining, the risk of poverty or social exclusion has been very high, in particular for families with children, people with disabilities, Roma, and the rural population. In 2016, a comprehensive anti-poverty package was adopted in a policy shift toward the enhanced provision of services catered to specific groups of the population. It envisages a pilot project setting up integrated services in marginalised communities. A nation-wide roll-out would significantly improve the currently low provision of integrated services. Addressing successive country-specific recommendations, the law on the minimum inclusion income was adopted, to enter into force in 2018. The minimum inclusion income increases the adequacy and coverage of social assistance. It combines passive support with compulsory active labour market measures and inspections. Its activation potential is modest though, as the target is to reach 25 % of the beneficiaries by active labour market policy measures by 2021.
- (15) Activation policies have been strengthened in the context of reforming the National Employment Agency. Reforms include more tailor-made support and integrated

services to jobseekers and employers. The outreach and service offered to young people not in employment, education or training is being improved. However, activation policies offered to groups furthest away from labour market remain limited and recently proposed activation measures no longer focus on these specific groups. Their scale and link to social services is insufficient to significantly improve labour force participation for these groups in particular.

- (16) Pension adequacy and old-age poverty have significant gender dimensions as, all else being equal, lower retirement ages for women result in lower pension entitlements. Romania is among the very few EU countries that do not provide for the convergence of women's retirement ages to men's. The law on equalisation of pensionable ages for men and women was submitted to the parliament in 2013. So far it has only been adopted by the Senate.
- (17) Given productivity developments, income convergence and the competitiveness position of Romania, increases in public and private sector wages deserve special attention. Public wage increases have the potential to spill over to the private sector, impacting Romania's competitiveness. Romania's minimum wage level, while still among the lowest in the EU, has increased significantly in recent years. Ad hoc minimum wage increases have significantly raised the share of workers earning the minimum wage and led to strong compression at the bottom of the wage distribution recently. Addressing a country-specific recommendation, a tripartite working group to establish a mechanism for minimum wage-setting based on objective economic, labour market and social criteria was established in early 2016 but work suffered significant delays and needs to be adequately taken up. Social dialogue remains characterised by low collective bargaining at sector level and by institutional weaknesses that limit the effectiveness of reforms.
- (18) Sufficient basic skills are key to finding and keeping good and stable jobs and successfully participating in economic and social life. International surveys point to severe deficiencies in basic skills among Romanian teenagers. High early school leaving rates, low higher education attainment, and high emigration result in the under-supply of skilled labour. Access to quality mainstream education is limited in rural areas and for Roma children in particular. The difficulty to attract good teachers in rural areas and Roma-predominant schools, coupled with segregation and often discriminatory attitudes, result in lower educational achievement of Roma children. In response to repeated country-specific recommendations, Romania adopted and started implementing a strategy on early school leaving. Recent measures include integrated interventions, a warm meal pilot programme, improved reimbursement of commuting costs, and social vouchers to encourage poor children's pre-school education. Project-based measures with EU funding to improve the quality of teaching in disadvantaged schools are planned for autumn 2017, and the modernisation of the curricula, albeit incomplete, is underway. Anti-segregation legislation was improved, including the reinforcement of school inspectorates' mandate in this area. However, a monitoring methodology is still missing. Further steps are needed for sustained progress in fighting socioeconomic inequalities in education. The Youth Guarantee has only partially reached early school leavers so far and second chance programmes are not readily available. The vocational education and training system is not sufficiently aligned with labour market needs, and participation in adult learning is very low.
- (19) Romania's population is exposed to poor health outcomes. Accessible quality healthcare is impaired by shortages of health professionals, under-funding and over-

reliance on hospitals, and corruption, affecting people with low income and rural areas in particular. Beside informal payments to medical professionals, corruption concerns public procurement in hospitals, insurance fraud, and bribery for certificates giving entitlement to benefits. Addressing a country-specific recommendation and in the context of ex-ante conditionality for the 2014-2020 EU funding period, Romania took some policy action to shift from inpatient to outpatient care. Regional healthcare plans were developed to identify needs for infrastructure and services, and the implementation of the national health strategy is being monitored. In line with the national anti-corruption strategy 2016-2020, legislation was adopted to revamp the feedback system on informal payments, and health professionals' salaries were improved. The anti-corruption strategy comprises of comprehensive measures in healthcare, including fostering the accountability and transparent recruitment of hospital managers. Nonetheless, the reinforcement of community care, ambulatory care, and referral systems is still in an initial stage, informal payments remain prevalent, transparency in hospital management is yet to be ensured, and a national health workforce strategy is pending adoption.

- (20) Romania's administrative and policy-making capacity has been suffering from opaque processes and decision-making, burdensome administrative procedures, little recourse to quality evidence, weak coordination across sectorial policies, and widespread corruption. Progress in public administration reform has been limited. Organisational structures remain unstable, which affects the independence and effectiveness of public administration. Civil service strategies were launched in 2016, but the legislative framework does not incorporate yet some of their main objectives, especially as regards objective criteria for staff recruitment, assessment and reward of performance. Pay levels are proposed to be harmonised to some extent, but there is no clear link between performance and remuneration, at central and local levels. The capacity and authority of the Civil Service Agency still needs to be strengthened. Some of the transparency measures in policy making, initiated in 2016, have been set for reversion. Strategic planning and regulatory impact assessment are not firmly established in administrative practice.
- (21) Insufficient transport infrastructure in quality and quantity has been among the key bottlenecks to economic development in Romania. To confront the associated deficiencies, in response to a country-specific recommendation, Romania adopted the transport master plan in autumn 2016. To speed up investment in road infrastructure, the management of infrastructure investments was split from the authority in charge of infrastructure administration. A body was established in 2016 to reform the railway system, to be operational by mid-2017.
- (22) Romania has had one of the highest investment ratios in the EU lately. However in 2016, public investment declined, also due to a low implementation of EU funds. High absorption and efficient use of EU funding are critical for Romania to tap its development potential, in key sectors such as transport or waste in particular. The quality of public investment has been impaired by management deficiencies and changing priorities among others. In response to a country-specific recommendation, little progress was made with strengthening project prioritisation and preparation in public investment. Since August 2016, ministries need to consider the investment priorities in their spending plans, but no other steps were taken to enhance the role of the Ministry of Finance in investment prioritisation and to better coordinate the preparation of public investment projects across ministries. The adoption of the national waste management plan and waste prevention programme expected by the

end of 2016 is still pending. The plans are also needed to improve governance and regulatory enforcement to channel national and EU funds to attain EU-level environmental standards.

- (23) Efficient public procurement is key for attaining strategic objectives and addressing key policy challenges to Romania, including efficient public spending, the modernisation of public administration, the fight against corruption, and fostering innovation and sustainable and inclusive growth. It is also instrumental to citizens' trust in public authorities and democracy. Romania took steps to implement the public procurement strategy and action plan lately. As a follow-up to the public procurement law in force since May 2016, implementing legislation was adopted by the end of 2016, and the national agenda for public procurement provides for corruption prevention and control. However, several key measures in the strategy are still pending, such as reinforced controls and other anti-corruption measures, the implementation of e-procurement, and the training of public procurement officers.
- (24) Over 45 % of Romania's population live in rural areas, which remain far behind urban areas in terms of employment and education, access to services and infrastructure, and material well-being. In response to a country-specific recommendation to improve access to integrated public services, extend basic infrastructure and foster economic diversification in rural areas in particular, in 2016 Romania adopted a comprehensive set of measures on rural development, on modernising small farms, supporting non-agricultural SMEs, investment in infrastructure, including social services and education, and formalising employment. Their longer-term success will hinge on the capacity to roll-out the pilot actions on a larger scale, and to effectively target and absorb available EU funding.
- (25) State-owned enterprises (SOEs) play a major role in the economy, in particular in key infrastructure sectors. Weaknesses in SOE's governance translate into their lower profitability relative to private counterparts, with negative impacts on public finance. Addressing a country-specific recommendation, Romania achieved substantial progress to improve SOE corporate governance. The by-laws supporting the main legislation on SOE corporate governance were swiftly adopted in autumn 2016. The legislative framework follows good international practice on transparency in the appointment of board members and the management of SOEs, and provides the Ministry of Finance with specific powers of monitoring and enforcement. Measures were also taken to raise awareness of the new rules among local authorities, and budgetary information on SOEs was made public. However, delays in the appointment of professional managers raise concern on further implementation.
- (26) Romania's competitiveness has been suffering from weaknesses in non-cost competitiveness and structural barriers to the transition to a higher value added economy, complex administrative procedures being among these. Addressing a country-specific recommendation in 2016, Romania adopted several legislative acts to simplify administrative procedures and facilitate the relation between citizens and public administration, albeit limited to a small number of procedures.
- (27) Corruption persists at all levels and remains an obstacle for doing business. Romania made substantial progress on much of the reform of the judicial system and in tackling high-level corruption. However, key steps remain to address concerns in these areas so that reforms are sustainable and irreversible. Some progress was made on developing further measures to prevent and fight corruption, in particular within

local government, but significant challenges remain in the effective implementation of the national anti-corruption strategy adopted in 2016. Efforts are required on the respect for judicial independence in Romania's public life, finalising reforms of the criminal and civil codes and ensuring efficiency in the implementation of court decisions. Under the Cooperation and Verification Mechanism, Romania receives recommendations in the areas of judicial reform and the fight against corruption. These areas are therefore not covered in the country-specific recommendations for Romania.

- (28) In the context of the European Semester the Commission has carried out a comprehensive analysis of Romania's economic policy and published it in the 2017 country report. It has also assessed the Convergence Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Romania in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Romania, but also their compliance with EU rules and guidance, given the need to strengthen the EU's overall economic governance by providing EU-level input into future national decisions.
- (29) In the light of this assessment, the Council has examined the Convergence Programme and its opinion¹¹ is reflected in particular in recommendation 1 below,

HEREBY RECOMMENDS that Romania take action in 2017 and 2018 to:

1. In 2017, ensure compliance with the Council recommendation of [XX] with a view to correcting the significant deviation from the adjustment path toward the medium-term budgetary objective. In 2018, pursue its fiscal policy in line with the requirements of the preventive arm of the Stability and Growth Pact, which translates into a substantial fiscal effort for 2018. Ensure the full application of the fiscal framework. Strengthen tax compliance and collection. Fight undeclared work, including by ensuring the systematic use of integrated controls.
2. Strengthen targeted activation policies and integrated public services, focusing on those furthest away from the labour market. Adopt legislation equalising the pension age for men and women. Establish a transparent mechanism for minimum wage-setting, in consultation with social partners. Improve access to quality mainstream education, in particular for Roma and children in rural areas. In healthcare, shift to outpatient care, and curb informal payments.
3. Adopt legislation to ensure a professional and independent civil service, applying objective criteria. Strengthen project prioritisation and preparation in public investment. Ensure the timely full and sustainable implementation of the national public procurement strategy.

Done at Brussels,

*For the Council
The President*

¹¹ Under Article 9(2) of Council Regulation (EC) No 1466/97.