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Recommendation for a

COUNCIL DECISION

establishing that no effective action has been taken by Romania in response to the Council Recommendation of 5 December 2017

{SWD(2018) 366 final}

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Regulation (EC) No 1466/97[1], and in particular Article 10(2), fourth subparagraph, thereof,

Having regard to the recommendation from the European Commission,

Whereas:

(1) On 16 June 2017, the Council decided in accordance with Article 121(4) of the Treaty on the Functioning of the European Union ("TFEU") that a significant observed deviation from the adjustment path toward the medium-term budgetary objective existed in Romania. In view of the established significant deviation, the Council on 16 June 2017 issued a recommendation[2] for Romania to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure[3] does not exceed 3.3% in 2017, corresponding to an annual structural adjustment of 0.5% of GDP.

(2) On 5 December 2017 the Council concluded[4] that Romania has not taken effective action in response to the Council Recommendation of 16 June 2017. On that basis, on 5 December 2017 the Council issued a revised recommendation[5] for Romania to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 3.3% in 2018, corresponding to an annual structural adjustment of 0.8% of GDP. It also recommended that Romania uses any windfall gains for reduction of its deficit and that budgetary consolidation measures should secure a lasting improvement in the general government structural balance in a growth-friendly manner. The Council established a deadline of 15 April 2018 for Romania to report on the action taken in response to this recommendation.

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ C 216, 6.7.2017, p. 1.
[3] Net primary 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 four-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.
[4] OJ L 340, 20.12.2017, p. 49
[5] OJ C 439, 20.12.2017, p. 1

(3) On 10 and 11 April 2018, the Commission undertook an enhanced surveillance mission in Romania for the purpose of on-site monitoring under Article -11(2) of Council Regulation (EC) No 1466/97. After having transmitted its provisional findings to the Romanian authorities for comments, the Commission reported its findings to the Council on [23] May 2018. These findings were subsequently made public. The Commission report finds that the Romanian authorities do not intend to act upon the Council Recommendation of 5 December 2017. The authorities confirmed to the mission that their target for 2018 remains the headline deficit of just below 3% of GDP. Given a positive and increasing output gap, this indicates a further deterioration of the underlying structural deficit, contrary to the Council recommendation and reflects a clearly expansionary fical policy.

(4) On 20 April 2018, after the deadline established by the Council, the Romanian authorities submitted a report on action taken in response to the Council Recommendation of 5 December 2017. In the report, the authorities reiterated that their target for 2018 remains a headline deficit of just below 3% of GDP. The fiscal impact of the reported measures falls significantly short of the requirement stated in the Council Recommendation.

(5) Based on the Commission spring 2018 forecast, the growth of net primary government expenditure is set to amount to 10.8%, well above the expenditure benchmark of 3.3%. The structural balance is set to deteriorate by 0.5 % of GDP in 2018, reaching a deficit of 3.8% of GDP. This is the opposite of the recommended structural improvement of 0.8% of GDP relative to 2017. Therefore, both pillars point to a deviation from the recommended adjustment by a wide margin. The expenditure benchmark points to a deviation of 2.4% of GDP. The structural balance confirms this reading, indicating a somewhat smaller deviation of 1.8% of GDP. The size of the deviation indicated by the structural balance is negatively impacted by the higher underlying estimate of potential GDP growth as compared to the medium-term average underlying the expenditure benchmark. Taking this into account, the overall assessment confirms a deviation from the recommended adjustment by a wide margin.

(6) The deterioration compared to 2017 is largely driven by increases in expenditure on the compensation of public employees, enacted in summer 2017 and which entered into force in January 2018. Since the Commission autumn 2017 forecast, which was the basis for the Council Recommendation of 5 December 2017, the authorities have partially reversed the past systemic pension reform by lowering the proportion of social contributions transferred to the second pension pillar from 2018. This cut is set to have a positive short-term effect on government revenues and thus on the general government balance. However, that fiscal gain is set to dissipate in the long term as the social contributions diverted from the second pillar are be accompanied by an obligation to pay old-age pensions in the future.

(7) This leads to the conclusion that Romania's response to the Council Recommendation of 5 December 2017 has been insufficient. The fiscal effort falls short of the annual structural adjustment of 0.8% of GDP for 2018, corresponding to a nominal growth rate of net primary government expenditure that does not exceed 3.3% in 2018,

HAS ADOPTED THIS DECISION:

Article 1

Romania has not taken effective action in response to the Council Recommendation of 5 December 2017.

Article 2

This Decision is addressed to Romania.

Done at Brussels,

For the Council
The President