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Recommendation for a

COUNCIL RECOMMENDATION

on the 2018 National Reform Programme of Romania

and delivering a Council opinion on the 2018 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 policies¹, and in particular Article 9(2) thereof,

Having regard to the recommendation of the European Commission²,

Having regard to the resolutions of the European Parliament³,

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 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester of economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, 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 2018 country report for Romania⁴ was published on 7 March 2018. It assessed Romania's progress in addressing the country-specific recommendations adopted by

¹ OJ L 209, 2.8.1997, p. 1.

² COM(2018) 422 final.

³ P8_TA(2018)0077 and P8_TA(2018)0078.

⁴ SWD(2018) 221 final.

the Council on 11 July 2017, the follow-up given to the recommendations adopted in previous years and Romania's progress towards its national Europe 2020 targets.

- (3) Romania submitted its 2018 National Reform Programme on 10 May and its 2018 Convergence Programme on 14 May 2018. To take account of their interlinkages, the two programmes have been assessed at the same time.
- (4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council⁵, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the European Structural and Investment Funds to sound economic governance⁶.
- (5) Romania is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Convergence Programme, the government plans a headline deficit of 2.95 % of GDP in 2018, and its gradual reduction thereafter, to 1.45 % of GDP in 2021. The medium-term budgetary objective, a structural deficit of 1 % of GDP, is not expected to be reached by 2021, which is the end of the programme horizon. The recalculated structural balance is expected to reach -2.1 % in 2021. According to the Convergence Programme, the general government debt-to-GDP ratio is expected to remain below 40 % by 2021. The macroeconomic scenario underpinning those budgetary projections is favourable. Moreover, the measures needed to support the planned deficit targets have not been sufficiently specified.
- (6) 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 medium-term objective occurred in Romania in 2016. In view of the established significant deviation, on 16 June 2017 the Council recommended Romania to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure⁷ does not exceed 3.3 % in 2017, corresponding to an annual structural adjustment of 0.5 % of GDP. On 5 December 2017 the Council found that Romania had not taken effective action in response to the Council recommendation of 16 June 2017 and issued a revised recommendation. In the new recommendation the Council asked 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. On

⁵ 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). COM(2014) 494 final.

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⁷ Net primary government expenditure comprises 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.

XX June 2018 the Council found that Romania had not taken effective action in response to the Council recommendation of 5 December 2017. Moreover, based on 2017 outturn data Romania was found to be in significant deviation from the recommended adjustment in 2017. 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 23 May 2018 that a significant deviation from the adjustment path toward the medium-term budgetary objective was observed in 2017. On XX June 2018, 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 expenditure does not exceed 3.3 % in 2018, corresponding to an annual structural adjustment of 0.8 % of GDP. Based on the Commission 2018 spring forecast, there is a risk of a deviation from that recommendation in 2018.

- (7) For 2019, the Council on XX June 2018 recommended Romania to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 5.1 %, corresponding to an annual structural adjustment of 0.8 % of GDP. Based on the Commission 2018 spring forecast, there is a risk of a deviation from that requirement in 2019. In addition, the Commission 2018 spring forecast projected a general government deficit of 3.4 % and 3.8 % of GDP for 2018 and 2019, above the 3 %-of-GDP Treaty reference value. Overall, the Council is of the opinion that significant further measures will be needed as of 2018 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 June 2018 with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective.
- (8) Romania's budgetary planning regularly ignores the prescriptions of its fiscal framework despite the need for responsible fiscal policy-making. Romania's fiscal responsibility law transposes the Fiscal Compact into national legislation. Its rules are well designed but are recurrently overlooked in practice. In 2016 the structural deficit increased above the medium-term objective, in breach of the deficit rule. Both the 2017 and 2018 budgets targeted a headline deficit of close to 3 % of GDP, implying a deterioration of the structural balance against the rule. The two budget amendments undertaken in 2017 were not compliant with the rules prohibiting increases of the headline and primary deficit ceilings and increases in personnel and total government expenditure during the ongoing fiscal year respectively. Furthermore, as in earlier years, in 2017 the update of the fiscal strategy was provided to Parliament long after the statutory deadline, thus failing to provide a longer-term perspective to budgetary planning.
- (9) Tax compliance remains low, in particular for the value added tax. In the past year, Romania achieved limited progress in addressing the repeated country-specific recommendation to strengthen tax compliance and collection. As regards the value added tax, the difference between theoretically expected and actually collected revenues remains very high. To improve compliance, the authorities introduced split payments. This is optional except for insolvent companies and taxpayers with significant outstanding value added tax's liabilities. However, the measure has yet to deliver significant results. The introduction of electronic cash registers connected to the tax administration's information technology system is still pending implementation.
- (10) The health of the financial sector has further improved, but some developments need monitoring. The banking sector is well capitalised and asset quality has improved.

However, several ongoing legislative initiatives, which risk adversely affecting non-performing loan disposal and credit and investment, warrant close monitoring. The recent reduction in the contributions to the pre-funded second pillar pension funds eased short term fiscal concerns but could have negative implications for the development of capital markets.

- (11) The labour market has been tightening due to employment growth along with a reduction of the labour force due to demographic ageing and emigration. Romania has at the same time substantial unused labour potential, and several groups such as young people, Roma, the long-term unemployed and people with disabilities have difficulties in accessing the labour market. In the past year, Romania made little progress addressing the country-specific recommendation to strengthen targeted activation policies and integrated public services, focusing on those furthest away from the labour market. Despite increased financial incentives for mobility schemes, participation in active labour market policies has remained very low, and the administrative burden has been high. Public work programmes of local interest have done little to provide relevant skills and support transitions into standard employment. There is no case management for the long-term unemployed and recipients of social assistance. Cooperation among public employment services and social and education service providers and external providers respectively has been limited.
- (12) The risk of poverty or social exclusion has been very high. Families with children, people with disabilities, Roma, and the rural population have been particularly affected. High income inequality persists, also due to the low impact of the tax-benefit system on mitigating market income inequality. The social reference index, which provides a reference when calculating the most important social benefits, has not been updated since 2008. The minimum inclusion law, scheduled for entry into force in 2018, would have increased the coverage and adequacy of social assistance. However, its entry into force was postponed by more than a year. The lower retirement age for women results in lower pension entitlements, aggravating old-age poverty and the gender employment gap.
- (13) The involvement of social partners in the design and implementation of economic and social reforms has been very limited. The views of social partners are frequently not taken into account even when they converge. Romania's collective bargaining framework is not conducive to a well-functioning system of industrial relations. Social dialogue is characterised by a low level of collective bargaining, especially at sectoral level, and low membership of trade unions and employers' organisations. High representativeness thresholds and the vague definition of sectors are among the key obstacles to more effective social dialogue. Legislative amendments to improve the framework have progressed little so far.
- (14) In the past few years, the minimum wage has been repeatedly increased in a discretionary manner. Since 2015, the net minimum wage has risen by more than 60 %. In 2017, around 30 % of workers earned the minimum wage, implying a highly compressed wage distribution. A proposal for an objective mechanism for minimum wage increases has been endorsed by social partners but not been applied by the government.
- (15) The supply of skills is not keeping up with the needs of the economy. Low attainment levels in basic skills and digital skills have an adverse impact on competitiveness, employment and convergence. Participation in adult learning has been very low. A mechanism to match active labour market policies with the demand for skills is not yet

in place, and the capacity to anticipate future skills needs and estimate the expected impact of new technologies is weak. Vocational education and training remains a second choice option and is not sufficiently aligned with labour market needs and regional or sectoral specialisation strategies.

- (16) The weak performance of the education system contributes to the high inequality of opportunity and Romania's long-run growth prospects. The provision of and access to quality inclusive mainstream education is a challenge, in particular for Roma and children in rural areas. The monitoring methodology to tackle school segregation has yet to be developed. The rate of early leavers from education and training is decreasing but still high. An early-warning mechanism to identify children at risk of dropping out is being developed, but the focus on quality education is weak. Despite some measures having been taken, quality assurance in school and higher education is faced with challenges. Tertiary education attainment is very low. Investment in education is relatively low, and disadvantaged schools in particular are lacking appropriate support.
- (17) The health status of the population has improved, but remains below EU standards. Access to healthcare remains a challenge, with negative impacts on child development, workforce employability and healthy ageing. Low funding and the inefficient use of resources limit the effectiveness of the healthcare system, against the background of a sizeable shortage of doctors and nurses. Access to healthcare is limited by the prevalence of informal payments and distance to health infrastructure. Romania made some progress addressing the country-specific recommendation to curb informal payments, and a monitoring mechanism is being implemented, though its actual impact is still to be assessed. Addressing the country-specific recommendation to shift to outpatient care has seen limited progress so far. The ongoing implementation of the national health strategy is marred by shifting priorities and poor investment planning.
- (18) Strategic planning, the public consultation process and regulatory impact assessment remain weak in the design, implementation and monitoring of policies. This impairs the quality and predictability of regulation. Furthermore, frequent changes in legislation, such as amendments to the fiscal code, weigh on the business environment. The involvement of stakeholders in the design and implementation of reforms is weak, and genuine dialogue is rarely applied, although relevant institutional structures are available. The mechanism for addressing stakeholders' opinions in public consultations does not ensure their proper follow-up. A specific recent example is the disregard of a proposal endorsed by social partners for an objective mechanism for increasing the minimum wage, which would have addressed a country-specific recommendation. No tangible results were achieved on public administration reforms. The adoption of relevant legislation on human resource management in public administration has been delayed. The general secretariat of the government has a limited role in the quality control of policy design.
- (19) The poor quality of infrastructure, including in the transport, waste and waste water sectors, limits Romania's growth prospects. Public investment is characterised by low efficiency particularly in project preparation and prioritisation. The general condition and reliability of road, rail and waterways infrastructure remain poor and the reform of the transport sector is progressing very slowly. Progress in waste management reform is slow too, while the solid waste and waste water sectors are facing challenges alike. The transport masterplan and the national waste management plan are intended to provide a stable roadmap for investments and strengthen administrative capacity in the sectors, but the alignment of project preparation with strategic planning has been limited so far. Romania achieved limited progress in addressing a country-specific

recommendation to strengthen project prioritisation and preparation in public investment.

- (20) Efficient and transparent public procurement remains pivotal to addressing key policy challenges to Romania, including efficient public spending, the fight against corruption, and fostering innovation and sustainable and inclusive growth. Romania made some progress in addressing the country-specific recommendation to implement the public procurement strategy, but the plan is not yet fully implemented. At the same time, enhancing the efficiency and strategic use of public procurement, effective audit and fraud control still remain challenges. The sustainability of measures taken and the irreversibility of reforms need continued monitoring. Efficiency and transparency challenges associated with public procurement apply in particular to the large healthcare infrastructure investments in the regional hospitals for Iași, Cluj and Craiova.
- (21) State-owned enterprises have a key role in critical infrastructure sectors such as energy and rail transport. However, their operational and financial performance is weaker than that of private-sector counterparts. The corporate governance of state-owned enterprises has been substantially weakened lately, reversing progress made on country-specific recommendations from 2015 and 2016. Not only has implementation of the new legislation been hesitant, but there are ongoing attempts to exempt a number of companies from its scope. Furthermore, the publication of financial data on state-owned enterprises has been delayed. As a result, key conditions for promoting the efficient use of public resources are being impaired, and space is allowed for distorted investment decisions. In February 2018 the Constitutional Court called on Parliament to revise the above exemptions.
- (22) Developments throughout the past year have largely brought into question the irreversibility and sustainability of Romania's substantial progress on reforming its judicial system and tackling high-level corruption. Judicial independence is being challenged and pressure being put on the judicial institutions and on the legal framework for fighting corruption, while progress on remaining challenges is being further held back. The implementation of the 2016-2020 national anti-corruption strategy developing further measures to prevent and fight corruption is progressing at technical level but more tangible political support is needed, as corruption and governance issues in the public sector persist at all levels and are among the top challenges for the business environment.
- (23) Under the Cooperation and Verification Mechanism, the Commission continues to monitor the judicial reform and the fight against corruption in Romania. These areas are therefore not covered in the country-specific recommendations for Romania, but are relevant for the development of a positive socio-economic environment in the country.
- (24) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Romania's economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme and the 2018 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 Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(25) In the light of this assessment, the Council has examined the 2018 Convergence Programme and its opinion⁸ is reflected in particular in recommendation 1 below.

HEREBY RECOMMENDS that Romania take action in 2018 and 2019 to:

1. Ensure compliance with the Council recommendation of XX June 2018 with a view to correcting the significant deviation from the adjustment path toward the medium-term budgetary objective. Ensure the full application of the fiscal framework. Strengthen tax compliance and collection.
2. Complete the minimum inclusion income reform. Improve the functioning of social dialogue. Ensure minimum wage setting based on objective criteria. Improve upskilling and the provision of quality mainstream education, in particular for Roma and children in rural areas. Improve access to healthcare, including through the shift to outpatient care.
3. Increase the predictability of decision-making by enforcing the systematic and effective use of regulatory impact assessment and stakeholder consultation and involvement in the design and implementation of reforms. Improve the preparation and prioritization of large infrastructure projects and accelerate their implementation, particularly in the transport, waste and waste water sectors. Improve the transparency and efficiency of public procurement. Strengthen the corporate governance of state-owned enterprises.

Done at Brussels,

For the Council
The President

⁸ Under Article 5(2) of Council Regulation (EC) No 1466/97.