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PROPOSAL

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
To:	Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union
No. Cion doc.:	COM(2013) 708 final
Subject:	Proposal for a COUNCIL DECISION providing precautionary EU medium-term financial assistance to Romania

Delegations will find attached document COM(2013) 708 final.

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Proposal for a

COUNCIL DECISION

providing precautionary EU medium-term financial assistance to Romania

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EXPLANATORY MEMORANDUM

1. Introduction

After a joint EU-IMF medium-term financial assistance programme for Romania from spring 2009 to spring 2011, during which EUR 5 billion were disbursed on the European side and EUR 12.9 billion by the IMF, the Council of the European Union adopted on 12 May 2011 a decision on a follow-up precautionary programme, making available EU medium-term financial assistance of up to EUR 1.4 billion for Romania[1]. In the second programme, which was also a joint EU-IMF programme, no funds were disbursed either by the EU or by the IMF in line with its precautionary character.

On 4 July 2013, in the light of remaining risks to its balance of payments, the Romanian authorities requested a third EU medium-term financial assistance programme, again jointly with an IMF Stand-By Arrangement. The EU and IMF assistance is expected to be treated as precautionary, with no actual disbursements foreseen. On 9 July, the EFC responded favourably to this request and mandated the Commission to negotiate a new joint EU-IMF precautionary programme.

From 17 to 31 July 2013, the Commission services conducted with the IMF staff a joint negotiation mission to Bucharest. Staff-level agreement on the modalities and contents of a new programme was reached. A new programme would continue to provide support to the economic programme of the government aiming, among other things, at consolidating macroeconomic, fiscal and financial stability, increasing the resilience and the growth potential of the economy, enhancing administrative capacity, reforming the tax administration and improving public financial management and control. A new programme would run for 24 months and would be composed of precautionary assistance by the European Union of up to EUR 2 billion and by the IMF of up to SDR 1.75 billion (around EUR 2 billion) supported by a stand-by arrangement. In addition, the World Bank will continue providing earlier committed support of EUR 891 million, of which EUR 514 million is still to be disbursed.

2. Macroeconomic development and outlook

Romania has registered positive economic growth since 2011. Recent developments suggest that growth in 2013 will be at about 2%, somewhat stronger than the 1.6% projected in the Commission's spring forecast. A stellar export performance (mainly on account of the automotive industry and services) and a good harvest are the main drivers of growth. These positive trends, however, mask weak domestic demand, with consumption being flat and investment contracting in the first half of 2013.

Going forward, growth is expected to gradually strengthen as structural reforms start paying off, EU funds absorption improves, and exports remain strong as the European economy recovers. Assuming an average harvest, growth is projected to be slightly above 2% in 2014. Domestic demand is expected to be the main driver of growth, driven by investment and private consumption, while net exports is projected to have a small negative contribution, as imports are expected to pick up in 2014 on the back of strengthening domestic demand.

[1] The first programme was covered by Council Decision 2009/459/EC and the second programme by Council Decision 2011/288/EU.

Inflation, as measured by the HICP, remained high, at around 6%, in Romania in 2009-2011, but came down in 2012 to an average of 3.4%. Upward price pressures, however, became stronger again towards the end of 2012 and in the first half of 2013. Inflation is expected to subside during the second half of 2013 thanks to a sharp drop in food prices and a reversal of base effects, and to fall below 3.5% by end-2013, thus within the central bank's target range (2.5% ±1pp). A further deceleration is expected in 2014.

3. Public finances

Romania has successfully consolidated its public finances over recent years, reducing its budget deficit from 9% of GDP in 2009 to just below 3% in 2012. This achievement allowed the Council, on 21 June 2013, to abrogate the excessive deficit procedure for Romania. A new programme would support the government's further fiscal consolidation efforts which aim to reaching Romania's medium-term objective (MTO) of a structural budget deficit of 1% of GDP by 2015. The authorities remain committed to the previous programme's deficit target of 2.4% in ESA terms for 2013. In 2014, further consolidation in line with the Stability and Growth Pact (SGP) requirements is planned. Based on current indications, Romania would target a 2% deficit in ESA terms in line with its 2013 update of its convergence programme.

The July negotiation mission agreed on the mid-year budget rectification allowing for some shifts in revenue and expenditure while maintaining the overall deficit target for 2013 of 2.3% in cash and 2.4% in ESA terms. The revised budget caters for lower revenues and lowers domestic capital investments, reduces provisions for corrections related with EU Funds, and lowers transfers to other public administration units. Regarding the 2014 budget, the authorities are looking into ways to increase revenues, mainly via base broadening. On the expenditure side, one important challenge is the phasing in of the Unified Wage Law agreed under the first programme.

With the main part of the required fiscal consolidation having been achieved, the focus of a new programme will be on improving fiscal governance. It will aim to upgrade the fiscal framework to bring it in line with Fiscal Compact requirements, along with a number of other improvements to the content of the Fiscal Strategy and to the transparency of the budgeting process. It will require improvements in annual and medium-term capital budgeting, the finalisation of the commitment control system (to prevent new arrears), as well as improvements in tax administration aimed at more efficient tax collection.

4. Financial markets and banking sector developments

Financial market conditions have significantly improved since the summer of 2012 amid an improvement in global market sentiment and following the stabilisation of the domestic political situation towards year-end. It has moved broadly in tandem with the regional peers, and remained relatively favourable in the first half of 2013. The 5-year CDS sovereign spreads for Romania dropped from nearly 500 basis points in May 2012 to below 200 bps in early January 2013, and it has hovered slightly above 200 bps since end-June 2013. After substantial losses in May 2012 the BET stock market index recovered until end-2012; it has been volatile since then but gained around 10% until early-September 2013.

Notwithstanding the upward trend in impaired assets (the non-performing loans (NPL) ratio reached 20.3% in June 2013), the banking sector's capitalisation remained at reassuring levels (the capital adequacy ratio stood at 14.7% in June). Risks associated with increasing NPLs have been mitigated by a prudent loan-loss provisioning policy, although provisions continue to put a strain on profitability (return on equity reached 6% in H1 2013 after 3 years of losses). The central bank continues to closely oversee banks with parents from peripheral euro-area countries which have maintained sufficient capital buffers. The spill-overs from the crisis in Cyprus were mitigated through the agreement to transfer the local deposit base of the Romanian branch of Bank of Cyprus to Marfin Bank, the subsidiary of the Laiki Group, the deleveraging process of foreign banks and the reduction in parent bank funding (-14.6% since December 2012., albeit in line with regional developments and overall conducted in an orderly fashion, continue to require close attention by the supervisor.

5. Balance of payment and external financing requirements

Romania is expected to maintain full access to sovereign debt markets over the envisaged programme period (24 months) barring adverse external developments. CDS spreads have reached their lowest levels since 2010. The current-account deficit is expected to decrease from around 4% of GDP in 2012 to around 2% in 2013, mainly thanks to a decline in trade deficit.

Under the baseline scenario no sovereign or external financing gap should materialise in the next two years. However, Romania remains vulnerable to exchange-rate volatility and volatile international capital movements. In an adverse scenario, the financing of the current account could become difficult and sovereign market access could be impeded. In the latter case, a first line of defence would be the Treasury’s cash buffer (about 6-month of financing needs) and to a lesser extent the NBR's international reserves. Should Romania experience protracted and acute financing difficulties, the precautionary programme could be activated and the funds available (EUR 2 bn from the EU disbursable in two EUR 1 bn instalments and up to EUR 2 bn from the IMF Stand-By Arrangement) would allow to cover sovereign financial and budgetary commitments. A new programme would also provide reassurance to the financial markets that Romania is committed to an ambitious economic reform agenda.

6. EU support under the balance-of-payments facility comes as part of an international effort

In the light of remaining vulnerabilities and risks to its balance of payments and conditional on the Romanian authorities' commitment to implement a programme of fiscal, financial and structural adjustment, the Commission, after having consulted the Economic and Financial Committee (EFC) on 3 October 2013, recommends the Council to adopt a Decision granting further mutual assistance to Romania as foreseen by Article 143 of the Treaty (TFEU). The Romanian government shall implement its economic programme in order to deal with the remaining vulnerabilities, to mitigate remaining threats to the sustainability of its balance of payments and shall develop the necessary capacity to design and implement economic policies without international support.

Furthermore, the Commission, after consulting the EFC, proposes the Council to adopt a Decision providing precautionary EU medium-term financial assistance of up to EUR 2 billion to Romania so as to underpin the sustainability of Romania's balance of payments. Activation of the precautionary Union financial assistance and disbursements may be requested until 30 September 2015.

7. Main contents of a new programme

The new precautionary financial assistance provides support to the economic programme of the government aiming, inter alia, at consolidating macroeconomic, fiscal and financial stability, increasing the resilience and the growth potential of the economy, enhancing administrative capacity, reforming the tax administration, and improving public financial management and control. The specific economic policy conditionality will be set out in a Memorandum of Understanding (MoU) to be concluded by the Commission with the Romanian authorities. It will preserve the achievements of the previous two programmes and will carry over the yet unfulfilled conditions from the second programme.

A: Fiscal consolidation

Following the correction of its excessive deficit, Romania is expected to reduce its structural budget balance in line with SGP requirements until it reaches its medium-term objective of a structural general government deficit of 1% of GDP by 2015, and maintain it thereafter. Furthermore, the programme will continue efforts to prevent the build-up of government arrears, both at central and local government level. The public sector wage bill will need to stay on a sustainable footing, limiting wage growth as well as public sector employment levels.

B: Fiscal governance and structural fiscal reform

To firmly anchor fiscal consolidation, the programme will involve a further strengthening of the fiscal governance framework.. The implementation of the Fiscal Compact is crucial in this respect, as well as improvements in multi-annual budgetary planning will ensure a more sustainable fiscal policy.

The government will be supported by extensive technical assistance provided by the IMF and the World Bank in the area of public financial management and control. The implementation of a commitment control system, which will be rolled out in several steps, will help ensure the reduction and control of arrears. In the health sector, budget control mechanisms will be strengthened through improved reporting and monitoring frameworks, in particular with regard to hospitals and pharmaceutical spending in order to avoid a re-accumulation of payment arrears. Prioritisation of public investments will be strengthened, to enhance the country's growth potential.

C: Public debt management

The authorities will take the necessary steps to improve public debt management with a view to reducing funding cost and risks and increase average maturity of public debt.

D: Financial sector regulation and supervision

In the financial sector, authorities will continue improving the bank resolution framework and the legislation on the Deposit Guarantee Fund by amending GO 39/1996 and GEO 99/2006. To speed up the process of balance sheet cleaning, the National Bank of Romania (NBR) has clarified the provisions applicable to the write-off of loans with the Romanian Banking Association and will produce a comprehensive analysis of the asset quality in the banking sector. In order to further develop the capital market and diversify the sources of funding for banks, authorities will amend the covered bonds legislation. Preserving credit discipline and avoiding moral hazard among debtors contributes significantly to enhancing financial stability. Therefore, the government will continue refraining from adopting legislative initiatives (such as the personal insolvency law) and promoting provisions in the debt collection law, which would undermine credit discipline. Authorities will consult extensively with all relevant stakeholders, taking into account also the impact assessment finalised by the NBR, on the new provisions on abusive clauses in the law for the application of the civil procedure code, will ensure that court cases involving abusive clauses are dealt with by higher ranking courts or by a unique specialised court, and will take all other necessary measures to ensure a consistent application of these provisions. To strengthen the supervision of non-bank financial market and foster consumer protection, authorities will ensure that the legislation on the integrated non-bank financial regulator, the Financial Supervisory Authority (FSA), will be amended to comply with international good practices.

E: Structural reforms

The structural reforms aim at improving market functioning, at increasing resilience to external shocks and at strengthening Romania's long-run growth potential. The structural reform agenda of this programme is a part of the broader agenda set in Romania's National Reform Programme and covered by the country-specific recommendations addressed to Romania in the context of the European Semester.

The restructuring of state-owned enterprises (SOEs), including privatisation, will be stepped up in order to reduce risks to the general government budget from accumulated arrears and operational losses, while increasing the financial viability of most of these companies' operations. Authorities will take measures to strengthen corporate governance of SOEs, including in the financial sector.

In the energy sector outstanding measures agreed under the two previous programmes will be implemented, among which the implementation of the roadmaps for the gas and electricity market liberalisation.

Improvement of the business environment and facilitating access to finance for the small and medium-size enterprises (SMEs) is another important pillar of the structural reform agenda of the programme. The programme aims at reducing administrative burden for the SMEs, facilitating their access to bank and equity capital, reducing the legal uncertainty by improving the land and property registration and supporting SMEs when going abroad. Furthermore, the programme supports the reform of the intellectual property rights framework, in particular in relation to patents, with the view to attract foreign direct investment in research and innovation activities.

In the field of labour markets, the programme supports the completion of the 2010 pension reform by equalising the pensionable age for men and women.

In addition to the above described broad areas of measures to improve the efficiency of public administration in areas critical to program implementation, the Romanian authorities will be invited to report every six months to the Economic and Financial Committee (EFC)/Economic Policy Committee (EPC) on the progress made in this area.

F: Monetary Policy

Monetary policy will remain geared towards price stability with a view to keeping inflation within the National Bank of Romania’s inflation target band (2.5% ± 1 percentage point).

2013/0338 (NLE)

Proposal for a

COUNCIL DECISION

providing precautionary EU medium-term financial assistance to Romania

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 332/2002[2] of 18 February 2002 establishing a facility providing medium-term financial assistance for Member States' balances of payments and in particular Article 3(2) thereof,

Having regard to the proposal from the Commission made after consulting the Economic and Financial Committee (EFC),

Whereas:

(1) By Decision 2013/XXX/EU[3], the Council has decided to grant mutual assistance to Romania.

(2) Precautionary medium-term financial assistance for Romania under the balance-of-payments facility for Member States is appropriate under the current circumstances of unstable capital flows affecting in particular emerging markets, risks to the macroeconomic scenario, and remaining vulnerabilities in the banking sector. While under present market conditions Romania does not intend to request the disbursement of any instalment, the precautionary assistance can be expected to help consolidate macroeconomic, budgetary and financial stability and, through the pursuit of structural reforms, increase the resilience and the growth potential of the Romanian economy.

(3) If negative risks materialise, Romania may not be able to cover its external financing needs from available funding resources. These risks are associated, among others, with important external debt and financial sector roll-overs, a high negative net investment position, and spill-overs from adverse developments in the euro-area. In such a stress scenario, the residual financing needs may have to be covered from activating the precautionary EU financial assistance.

(4) It is appropriate to provide EU support to Romania of up to EUR 2 billion on a precautionary basis under the facility providing Union medium-term financial assistance for Member States' balance of payments established in Council Regulation (EC) No 332/2002. This assistance should be provided in conjunction with IMF support through a Stand-by Arrangement (SBA) in the amount of SDR 1,751.34

[2] OJ L 53, 23.2.2002, p. 1.
[3] See page xx of this Official Journal.

million (about EUR 2 billion, 170% of Romania's IMF quota), approved on 27 September 2013, which the authorities will also treat as precautionary. The World Bank (WB) has made EUR 1 billion available under a Development Policy Loan (DPL) with a deferred drawdown option (DDO) valid through June 2015. In addition, the WB will continue providing earlier committed support of EUR 891 million of which EUR 514 million is still to be disbursed.

(5) The assistance should be managed by the Commission who will agree with the authorities of Romania, after consulting the EFC, the specific economic policy conditions attached to the precautionary financial assistance. Those conditions should be laid down in a Memorandum of Understanding.

(6) In view of the precautionary nature of the assistance, Romania will not request the disbursement of any instalment under the Union loan, unless difficulties as regards its balance of current payments or capital movements emerge. If Romania makes a request for funding to the Commission, the latter will decide, after having consulted the EFC, on the activation of the programme and on the amount and timing of such instalments. The detailed financial terms related to possible disbursements will be laid down in a Precautionary Loan Facility Agreement (PLFA).

(7) The precautionary financial assistance shall be provided with a view to contributing to the successful implementation of the Government's economic policy programme, and, in this way, shall support the sustainability of Romania's balance of payments,

HAS DECIDED AS FOLLOWS:

Article 1

1. The Union shall make available to Romania a precautionary medium-term financial assistance amounting to a maximum of EUR 2 billion. In case the facility is activated and disbursements are provided, the assistance shall be provided in the form of a loan with a maximum average maturity of eight years.

2. Activation of the precautionary Union financial assistance and disbursements may be requested until 30 September 2015.

Article 2

1. The assistance shall be managed by the Commission in a manner consistent with Romania's undertakings and the recommendations by the Council, in particular in the context of the implementation of the national reform programme (NRP) as well as of the annual update of Romania's convergence programme (CP).

2. The Commission shall agree with the Romanian authorities, after consulting the EFC, the specific economic policy conditions attached to the precautionary financial assistance as listed under Article 3(3). Those conditions shall be laid down in a Memorandum of Understanding (MoU) consistent with the undertakings and recommendations referred to in paragraph 1. The detailed financial terms shall be laid down by the Commission in a PLFA.

3. The Commission shall verify at regular intervals, in collaboration with the EFC, that the economic policy conditions attached to the assistance are fulfilled.

Article 3

1. The activation of the precautionary Union financial assistance shall be examined by the Commission, following a written request by Romania to the Commission. The Commission, after consulting the EFC, shall decide if the activation of the assistance and the request for disbursements under the assistance is justified, and shall decide on the amount and timing of such disbursements. In case the financial assistance is being activated, the funds may be made available in not more than two instalments. Each instalment may be disbursed in one or more tranches.

2. Upon an activation of the assistance, the Commission shall decide on the disbursement of the Union loan, or parts thereof, after having obtained the opinion of the EFC.

3. Any disbursement shall be made on the basis of a satisfactory implementation of the economic programme of the Romanian Government to be included in both the CP and the NRP; more particularly, the specific economic policy conditions laid down in the MoU, shall include, inter alia:

   (a) the adoption of budgets and the implementation of policies in line with the fiscal consolidation path derived from Romania's obligations under the Stability and Growth Pact with a view to reaching Romania's medium-term budgetary objective by 2015, and to maintaining it thereafter;

   (b) the full preservation of the measures agreed under the previous two programmes and the implementation of any remaining parts of yet unfulfilled conditionality;

   (c) the further strengthening of the fiscal governance framework, including through the implementation of Article 3 of the Treaty on Stability, Coordination and Governance in the EMU (the Fiscal Compact), so as to ensure that fiscal consolidation is well anchored. Particular attention shall be given to reinforcing multi-annual budgetary planning, to the implementation of an effective commitment control system, to improving tax collection, and to improving the capital budgeting process;

   (d) the implementation of the action plans adopted in response to the findings of the functional reviews carried out by the WB in 2010-2011 in a timely manner and the establishment of a central delivery unit to improve the government-wide policy prioritisation;

   (e) the clearing of arrears and the strengthening of budget control mechanisms in the health sector through improved reporting and monitoring frameworks;

   (f) the implementation of the strategic action plan for healthcare, rationalizing the hospital structure and increasing the scope for primary care activities, in order to improve health outcomes;

(g) the improvement of public debt management with a view to reducing risks and to consolidating and extending the yield curve for sovereign debt;

(h) the further strengthening of the bank-resolution framework, the central bank's contingency planning and the corporate governance of the Deposit Guarantee Fund, as well as the implementation of measures to speed up the process of banks' balance sheet cleaning and the preservation of credit discipline in the banking sector;

(i) the alignment of the legislation on the Financial Supervisory Authority (ASF) to international good practices to strengthen the supervision of the non-bank financial market;

(j) the restructuring of state-owned enterprises (SOEs), including sales of stakes in their capital, and strengthening the corporate governance of SOEs;

(k) the further implementation of measures to improve the business environment, including through the reduction of administrative burdens for the small and medium-sized enterprises (SMEs), and measures to facilitate access to finance for SMEs.

4. If required in order to finance the loan, the prudent use of interest rate swaps with counterparties of highest credit quality shall be permitted. The EFC shall be kept informed by the Commission of possible refinancing of the borrowings or restructuring of the financial conditions.

Article 4

This Decision shall take effect on the day of its notification.

Article 5

This Decision is addressed to Romania.

Done at Brussels,

For the Council
The President

BUDGETARY IMPACT STATEMENT

(cf. Article 16 of the Internal Rules)

POLICY AREA: TITLE 01 – ECONOMIC AND FINANCIAL AFFAIRS
ACTIVITY: FINANCIAL OPERATIONS AND INSTRUMENTS

1. NAME OF THE PROPOSAL, BUDGET LINE CONCERNED AND TITLE

Proposal for a Council Decision providing precautionary EU medium-term financial assistance for Romania in conjunction with the Recommendation for a Council Decision granting mutual assistance for Romania.

01 04 01 01 European Union guarantee for EU loans raised for balance-of-payments support.

2. LEGAL BASIS:

Art. 143 TFEU, Art. 352 TFEU, Council Regulation N° 332/2002.

3. OVERALL FIGURES FOR THE FINANCIAL YEAR (IN EUROS)

This item constitutes the structure for the guarantee provided by the European Union. It will enable the Commission to service the debt (principal, interest and other costs) should the debtor (Romania) default.

The budget entry ("p.m.") reflecting the budget guarantee will be activated only in the case of an effective call on the guarantee. It is expected that normally the budget guarantee will not be called.

3a – Current year

Not applicable

		CA
Initial appropriation for the financial year (budget)		
Transfers		
Additional appropriation		
Total appropriation		
Appropriations already set aside by another work programme		
Balance available		

Amount for the action proposed		

3b – Carry overs

Not applicable

		CA
Carry-overs		
Appropriations already set aside by another work programme		
Balance available		
Amount for the action proposed		

3c – Next financial year

Not applicable

		CA
Initial appropriation for the financial year (budget)		p.m.
Transfers		
Additional appropriation		
Total appropriation		
Appropriations already set aside by another work programme		
Balance available		
Amount for the action proposed		p.m.

4. DESCRIPTION OF THE ACTION

The proposed precautionary EU medium-term financial assistance to Romania, if activated, consists of an EU loan (to be financed by EU borrowings in the international capital markets or with financial institutions) in the amount of up to EUR 2 billion. It will be provided in the context of an international financing package, and in particular by an IMF loan of SDR 1.75 billion (around EUR 2 billion) supported by a stand-by arrangement. The World Bank has made EUR1 billion available under a Development Policy Loan (DPL) with a deferred drawdown option (DDO). In addition, the WB will continue providing earlier committed support of EUR 891 million, of which EUR 514 million is still to be disbursed. The precautionary EU medium-term financial support to Romania is intended to address the remaining risks surrounding the sustainability of the balance of payments of Romania; even if the current account deficit has clearly come down, volatile capital flows imply risks for its financing. The precautionary assistance also continues to provide support to the economic programme of the government aiming, among other things, at consolidating macroeconomic, fiscal and financial stability, enhancing administrative capacity, reforming the tax administration, improving public financial management and control, and increasing the resilience and the growth potential of the Romanian economy. Finally, the assistance managed by the Commission, in consultation with the Economic and Financial Committee, is a way to encourage economic policies in Romania to be consistent with the country's undertakings in the EU context and recommendations by the Council, in particular as concerns the implementation of the National Reform Programme as well as of the Convergence Programme.

The EU funds raised on the capital markets or from financial institutions for the purpose of extending the loan to Romania, in case of a request by Romania and a positive evaluation of such a request by the Commission after consulting the EFC, are covered by the EU guarantee. The loan is raised on the capital markets or from financial institutions. The amount in principal of loans which could be granted to Romania would amount to up to EUR 2 billion.

The structure for the guarantee provided by the EU will enable the Commission to service the debt should Romania default.

In order to honour its obligations, the Commission may draw on its cash resources to service the debt provisionally. In this case, Article 12 of Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 2007/436/EC, Euratom on the system of the European Communities' own resources (OJ L 130, 31.5.2000, p. 1) will apply.

5. METHOD OF CALCULATION ADOPTED

Not applicable.

6. PAYMENT SCHEDULE (IN EURO)

Not applicable.

Heading	**Appropriations**		**Payments**				
			Year n	Year n+1	Year n+2	Year n+3	Subsequent financial years
	Year n						
	Year n+1						

	Year n						
	Year n+1						
	Total						