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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject: COUNCIL RECOMMENDATION with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective in Romania

COUNCIL RECOMMENDATION

of ...

**with a view to correcting the significant observed deviation
from the adjustment path toward the medium-term budgetary objective
in Romania**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 121(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 the second subparagraph of Article 10(2) thereof,

Having regard to the recommendation from the European Commission,

¹ OJ L 209, 2.8.1997, p. 1.

Whereas:

- (1) In accordance with Article 121 of the Treaty, Member States are to promote sound public finances over the medium term through the coordination of economic policies and multilateral surveillance in order to avoid the occurrence of excessive government deficits.
- (2) The Stability and Growth Pact (SGP) 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) On 16 June 2017, the Council recommended¹ that Romania take the necessary measures to ensure that the nominal growth rate of net primary government expenditure² does not exceed 3,3 % in 2017, corresponding to an annual structural adjustment of 0,5 % of GDP, thereby putting the country on an appropriate adjustment path toward the medium-term budgetary objective. On 5 December 2017, the Council concluded that Romania had 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 Recommendation³ 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.

¹ Council Recommendation of 16 June 2017 with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective in Romania (OJ C 216, 6.7.2017, p. 1).

² 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.

³ Council Recommendation of 5 December 2017 with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective in Romania (OJ C 439, 20.12.2017, p. 1).

- (4) In 2017, based on the Commission 2018 spring forecast and the 2017 outturn data validated by Eurostat, the growth of net primary government expenditure was well above the expenditure benchmark, which indicates a significant deviation by a large margin (namely a deviation of 3,3 % of GDP). The structural balance deteriorated to -3,3 % of GDP from a position of -2,1 % of GDP in 2016, which also indicates a significant deviation from the recommended structural adjustment by a large margin (namely a deviation of 1,7 % of GDP). The size of the deviation indicated by the structural balance is negatively impacted by a higher point estimate for potential GDP growth compared to the medium-term average underlying the expenditure benchmark, as well as by a drop in public investment, which is smoothed out in the expenditure benchmark. Irrespective of that difference, both indicators confirm a significant deviation from the requirements of the preventive arm of the SGP in 2017.
- (5) On 23 May 2018, following an overall assessment, the Commission considered that a significant observed deviation from the adjustment path towards the medium-term budgetary objective exists in Romania and issued a warning to Romania in accordance with Article 121(4) of the Treaty and the first subparagraph of Article 10(2) of Regulation (EC) No 1466/97.

- (6) In accordance with the second subparagraph of Article 10(2) of Regulation (EC) No 1466/97, within one month of the date of the adoption of the warning, the Council is to address a recommendation to the Member State concerned to take the necessary policy measures. Regulation (EC) No 1466/97 provides that the recommendation will set a deadline of no more than five months for the Member State to address the deviation. On that basis a deadline of 15 October 2018 for Romania to address the deviation appears appropriate. Within that deadline, Romania should report on action taken in response to this Recommendation.
- (7) Based on the output gap projections of the Commission 2017 spring forecast, Romania is in normal economic times in 2018 and 2019. Romania's general government debt ratio is below the 60 %-of-GDP threshold. Henceforth, the minimum required structural effort prescribed by Regulation (EC) No 1466/97 and the commonly agreed adjustment matrix under the SGP, which factors in the prevailing economic circumstances and possible sustainability concerns, amounts to 0,5 % of GDP for both 2018 and 2019.

- (8) Romania's structural deficit has increased by 2,1 % of GDP in 2016 and by 1,2 % of GDP in 2017, to 3,3 % of GDP in 2017. An additional and persistent effort necessary to correct the cumulated deviation and to bring Romania back on an appropriate adjustment path following the slippages in 2016 and 2017 should complement the minimum adjustment requirement. An additional effort of 0,3 % of GDP seems appropriate given the magnitude of the significant observed deviation from the recommended adjustment path towards the medium-term budgetary objective and it will accelerate the adjustment back towards the medium-term budgetary objective.
- (9) The required improvement of the structural balance by 0,8 % of GDP in both 2018 and 2019 is consistent with the nominal growth rate of net primary government expenditure not exceeding 3,3 % in 2018 and 5,1 % in 2019.
- (10) The Commission 2018 spring forecast projects a further deterioration of the structural balance by 0,4 % of GDP in 2018 and by a further 0,4 % of GDP in 2019. Therefore, a structural improvement of 0,8 % of GDP in both 2018 and 2019 translates into a need to adopt measures of a total structural yield of 1,2 % of GDP in 2018 and additional measures of a structural yield of 1,2 % of GDP in 2019 compared to the current baseline in the Commission 2018 spring forecast.

- (11) The Commission 2018 spring forecast projects a general government deficit of 3,4 % of GDP in 2018 and 3,8 % of GDP in 2019, which is above the 3 %-of-GDP Treaty reference value. The required structural adjustment seems also appropriate to ensure that Romania respects the 3 %-of-GDP Treaty reference value in 2018 and 2019 with a margin.
- (12) The failure to act upon earlier recommendations to correct the significant observed deviation and the risk of exceeding the 3 %-of-GDP Treaty reference value call for urgent action to put Romania's fiscal policy back on a prudent path.
- (13) It is appropriate that this Recommendation be made public.
- (14) In order to achieve the recommended budgetary targets, it is crucial that Romania adopt and strictly implement the necessary measures and monitor the development of current expenditure closely,

HEREBY RECOMMENDS THAT ROMANIA:

- (1) take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 3,3 % in 2018 and 5,1 % in 2019, corresponding to an annual structural adjustment of 0,8 % of GDP in each year, thereby putting the Member State on an appropriate adjustment path toward the medium-term budgetary objective;
- (2) use any windfall gains for deficit reduction; budgetary consolidation measures should secure a lasting improvement in the general government structural balance in a growth-friendly manner;
- (3) report to the Council by 15 October 2018 on action taken in response to this Recommendation; the report should provide sufficiently specified and credibly announced measures, including budgetary impact of each of them, as well as updated and detailed budgetary projections for 2018-2019.

This Recommendation is addressed to Romania.

Done at ...,

For the Council

The President
