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2011/0072 (NLE)

Proposal for a

COUNCIL DECISION

Providing precautionary EU medium-term financial assistance for Romania

EXPLANATORY MEMORANDUM

1. INTRODUCTION

On 6 March 2009, against a background of strongly increased risk aversion during the global economic crisis leading to reduced capital inflows, pressures on the exchange rate and an increasingly restricted access to the bond market for public borrowing, the Romanian authorities made a request for EU medium-term financial assistance and also approached the International Monetary Fund (IMF) and the World Bank for additional complementary assistance. On 9 March 2009, the European Commission (Commission) together with the Council Presidency declared that the EU was ready to participate with the IMF in a coordinated financing package to underpin the sustainability of Romania's balance of payments. However, it was stressed that the financial assistance would be contingent upon the implementation of a supportive policy programme. This programme, sent in the form of a Letter of Intent to the EC and the IMF on 28 April 2009, had its focus on cushioning the effects of the sharp drop in private capital inflows while implementing policy measures to address the external and fiscal imbalances and strengthening the financial sector. Against the background of the coordinated financing package underpinned by this programme, in the context of the European Bank Coordination Initiative, the parent institutions of the nine largest foreign-owned banks incorporated in Romania committed to maintain their overall exposure to Romania at a high level. On 6 May 2009, in conjunction with an IMF Stand-by Agreement (SBA) in the amount of SDR 11.4 billion approved on 4 May 2009 and additional support from the World Bank, EIB and EBRD of up to EUR 2 billion, the Council of the European Union decided to grant mutual assistance for Romania and to provide EU medium-term financial assistance of up to EUR 5 billion for Romania.[1] On 23 June 2009, a Memorandum of Understanding (MoU) between the European Union and Romania was concluded, specifying the concrete policy measures to be implemented over the programme period and ahead of each disbursement of the five instalments of the EU loan.

Between October 2009 and February 2011, Commission services carried out review missions to assess progress regarding conditions attached to the EU medium-term financial assistance. Based on the findings of these missions, the Commission concluded that the conditions for disbursement of the five instalments of the EU loan had been broadly fulfilled. Between the first and the fifth instalment, a total of four addendums were joined to the MoU, reflecting the effects of changes in the economic environment as well as additional structural reform measures.

On 17 February 2011, after comprehensive discussions with Commission services and IMF staff during a mission from 25 January to 8 February 2011 in Bucharest, the Romanian authorities made a request for precautionary EU medium-term financial assistance of up to EUR 1.4 billion that would continue to support the government's economic reform programme. Similarly to the previous one, the new assistance would be provided in

[1] Council Decision of 6 May 2009 granting mutual assistance for Romania (2009/458/EC) (OJ L 1150, 13.6.2009) and Council Decision of the same date providing EU medium-term financial assistance for Romania (2009/459/EC) (OJ L 150, 13.6.2011, p. 8). On 16 February 2010, the Council amended this Decision to address the impact on programme targets of the larger than expected recession (2010/183/EU) (OJ L 83, 30.3.2010, p. 19).

conjunction with an IMF SBA in the amount of SDR 3.09 billion that Romania would also treat as precautionary, and loans from the World Bank. Thereby, the jointly provided precautionary assistance would appropriately address the remaining serious threats to Romania's balance of payments and the related risks for economic and financial stability for Romania and its main trading partners in the EU.

2. MACROECONOMIC DEVELOPMENT AND OUTLOOK

Following a fall of 7.1% in GDP and a further 1.3% fall in 2010, positive signs pointing to a pickup in sentiment and activity accumulate. Latest survey data confirm the improving trend in economic sentiment. Industrial production recovered by 5.5% in 2010. Likewise, industrial new orders in the second half of 2010 increased by around 25% y-o-y on average. Exports continued to grow healthily (by 27.3% in 2010 in RON value terms). While construction activity recovered strongly in December 2010, retail trade is still feeling the effects of the VAT hike and the reduction in public sector wages. Modest wage growth (the average net monthly salary in December rose by 1.3% y-o-y) signals improvements in the labour market and will provide support to consumption. While registered unemployment continued to fall in January 2011, the unemployment rate is likely to increase in the first half of the year, reflecting the impact of new registration obligations for unemployed.

The economy is expected to turn around in 2011, with real GDP forecasted to increase by 1.5%. After falling severely in 2009 and 2010, corporate investment should pick up as external demand is growing and capacity utilisation rates in the manufacturing sector are close to their historical highs of 2008. Strong exports and the jump in industrial orders are expected to reassure companies to invest even if risk spreads remain somewhat elevated. Residential construction will likely remain subdued as credit activity remains low and house prices are projected to stabilise further. After having declined considerably in 2009 and 2010, household consumption is expected to pick up slowly this year, supported by an upward adjustment in wages in the public sector (+15%, after the 25% cut in July 2010), as well as in industry, where activity has recovered strongly. A stronger rebound is impeded by the continuing fiscal retrenchment, the high debt-service-to-income ratio, and limited increase in household credit due to a high ratio of NPLs in retail banking. Real economic growth in 2012 is forecasted to be around 4%. Growth is expected to gradually become more broad-based, with domestic demand playing a decisive role in uplifting the economy. Private consumption expenditure will likely increase at a faster pace due to improvements in household balance sheets, driven by further increases in wages and employment.

Inflation peaked in December 2010 at 8.0% (y-o-y) on the back of significant hikes in indirect taxation. This was well-above the 3.5% ±1 percentage point inflation target set for end-2010 by the National Bank of Romania (NBR). In the first half of 2010, inflation was primarily kept up by increases in tobacco excise duties and higher fuel prices – annual inflation averaged 4.5%, while HICP inflation at constant taxes hovered at just around 2%. Inflation increased to 7.5% in the third quarter on the back of the VAT hike and increases in food prices. In the second half of 2011, inflation is expected to gradually return – as the price effects related to indirect tax hikes taper off – to the NBR's target band (3.0% ± 1 percentage point).

The NBR has kept the key rate stable since May 2010. Nonetheless, abundant liquidity at the interbank market kept short-term rates at much lower levels than the NBR's key policy rate in recent months. Despite the decline in money market rates, credit growth to the private sector remains stubbornly weak on the back of unfavourable cyclical conditions and tightened bank lending standards. Monetary policy continues to face difficult challenges, notably repeated overshooting of the inflation targets. The NBR's cautious approach to monetary easing in the second half of 2010 was warranted because of possible second-round effects from the VAT-related spike in inflation. In order to better anchor inflation expectations, the NBR will continue with active communication policy.

3. PUBLIC FINANCES

The 2010 budget deficit was 6.5% of GDP in cash terms, better then the 6.8% of GDP deficit target. Revenue increased by 7.2% in 2010, reflecting extra income from the increase in the VAT rate to 24%, as well as from excise taxes and non-tax revenue which grew by 28.2%. In contrast, profit tax revenue fell by 17.4% in 2010 as a result of the lagged effect of the crisis. In addition, social security contributions and the income tax also fell by 4.5% and 3.2% respectively. Nominal expenditure grew by 4.2% in 2010 due to increases in other transfers, social assistance and goods and services. The latter is partly explained by the repayment of arrears in the health sector of RON 2 billion in September. The main expenditure cuts were in capital spending which decreased by 11.7% in 2010, followed by personnel spending which fell by 8.6% and subsidies which were 6.7% lower.

Commission staff projects that Romania has also met the ESA deficit target for 2010, but this needs to be confirmed in the next months. It should, however, be noted that the reclassification of a number of SOEs into the general government sector by Eurostat in September 2010 and April 2011 would have a deficit-increasing impact of at least 0.5% of GDP until the relevant SOE deficits have been eliminated. Depending on budgetary performance in 2011, this may necessitate an adjustment in the deficit target for 2011 to take this development into account. Additional efforts on this account might then be needed to ensure that a deficit below 3% of GDP in ESA terms will be achieved in 2012 in line with applicable Council Recommendations under the Excessive Deficit Procedure.

Domestic payment arrears were reduced by end 2010 and the authorities committed to keeping them down throughout 2011. The stock of domestic payment arrears (older then 90 days) stood at RON 1.1 billion (0.2% of GDP) at end 2010, down from RON 1.6 billion (0.3% of GDP) at end 2009. The arrears are predominantly at local government level (around 84% of the total stock of arrears at end 2010), and to a lesser extent in the health sector, including hospitals. While local government arrears are more difficult to control, a new law with effect from 1 January 2011 on local government finances should help. Following payments of health-sector arrears of RON 2 billion (0.4% of GDP) in September 2010, health-sector arrears have been kept down except for hospitals.

Further health sector reform will be key to prevent a re-emergence of arrears in this area on a durable basis. The objective is to have an efficient health system that functions within its budgetary allocations. The measures that are being and will be taken include the introduction of a means tested co-payment system, the elimination of mandatory contracting with all hospitals by the Health Fund, and the reform of the package of benefits insured by the government to exclude coverage of non essential health services. The World Bank is, and will be, providing technical assistance on these matters. Furthermore, the Ministry of Finance will monitor the aggregate figures for hospital budgets in order to ensure that they are consistent with the programmed expenditure of the general government. If this is not the case, then it will take action together with the Health Ministry to prevent a re-accumulation of arrears at hospital level.

The authorities remain committed to reaching a 4.4% of GDP budget deficit in 2011 in cash terms (below 5% of GDP in ESA terms). They have adopted and enacted the 2011 budget, as well as the Medium-Term Budgetary Strategy for 2011-13. On the revenue side, all major taxes will remain unchanged so as to ensure predictability. On the expenditure side, the budget keeps the wage bill capped at RON 39 billion, excluding the social security contributions for the military (RON 1.6 billion) which will be paid by the State starting from this year as a result of the new pension law. Following a temporary emergency 25% cut in public wages in mid-2010 to bring the budget deficit back on track, public wages have been increased by 15% compared to their December 2010 level. However, this increase was offset by the elimination of the 13th salary and of the holiday bonus. Furthermore the number of employees in the public sector was reduced by an extra 20000 compared to what was necessary to fit into the overall wage bill. Other measures included in the 2011 budget consist of maintaining a freeze in pensions, continuing reductions in public employment with the policy of replacing only 1 of 7 departing workers, and eliminating heating subsidies. Moreover, the reform of the pension system, together with the unified wage law and the restructuring of the health sector, should generate significant savings.

For 2012 the authorities remain committed to reducing their deficit below 3% of GDP in ESA terms, but additional measures will be needed. The Commission's autumn 2010 economic forecast based on a no-policy change assumption already indicated the need for an additional effort of 0.5% of GDP. However, even more important measures may be necessary due to the reclassification of loss-making SOEs into the general government sector, bringing the total additional adjustment effort probably to around 1% of GDP. Continued expenditure restraint, including on wages and bonuses will also have to be observed.

The proposed precautionary programme will also aim to further strengthen the budget management system. The implementation of the Fiscal Responsibility Law and the adoption of the Medium-Term Fiscal Strategy should help improve the budget planning process. Furthermore, the budgeting of capital expenditure requires strengthening at the central government level. Even though Romania's public capital spending budgets tend to be sizeable (for 2011 7.2% of GDP is reserved), there is very little output to show for it, suggesting that capital spending has been rather inefficient. Moreover, a very large number of investment projects were started in previous years without ensuring the necessary resources for their completion. As a result, the resources currently available for capital spending are spread out thinly over a (too) large set of unfinished projects. A working group under the Prime Minister will establish a list of priority investment projects for which financing will be available over the next 3-5 years within the envelope defined in the updated fiscal strategy for 2011-2014. In addition, the monitoring and evaluation of investment projects at the central government level will be improved by strengthening the public investment monitoring unit in the MoPF and by improving the database on capital investment managed by the Ministry. Possible technical assistance from EU Member States may also be required. The MoPF will produce quarterly reports to the government on the status of ongoing and planned investment projects and the government will discuss this report and take measures to eliminate any potential fiscal slippages or other problems related to budget execution. Finally, capital spending will be gradually reoriented from entirely domestically financed investment to EU co-financed investment, which should also contribute to improve the absorption of EU funds.

4. FINANCIAL MARKETS

Romanian financial markets showed a solid performance since mid-2010, although the situation remains fragile. The continued turbulences in the euro-area periphery appear to have had little direct impact on Romanian markets. Financial stress eased in tandem with an upswing in global market sentiment and, to some extent, the anticipation of the EU/IMF follow-up programme for Romania. The exchange rate was stable and remained close to RON 4.20-4.30/EUR in recent months. After peaking at just above 400 basis points by mid-2010, CDS spreads on sovereign debt hovered at around 300 basis points since October 2010 (lower than in Greece, Ireland, Portugal and Hungary). The stock market index BET remained broadly flat in the fourth quarter 2010, but picked up again in January. Yields on domestic one-year T-bill auctions eased well below 7% p.a. in January and February 2011, implying lower refinancing costs for the budget than in most of 2010. Banking sector profitability suffered due to asset quality deterioration. Non-performing loans (NPLs) increased to 11.9% by end 2010 compared to 7.9% at end 2009. Given these trends in impaired assets, banking sector profitability suffered culminating in a net loss by year end (i.e. the return on equity was negative at -1%). However, banks have maintained sufficient capital buffers, with the capital adequacy ratio for the system remaining above 14%. In spite of the reduction in the exposure commitment to 95% of the March 2009 benchmark level as of October 2010, the parent banks involved in the European Bank Co-ordination "Vienna" Initiative have maintained their exposure close to the March 2009 level (98% as of end January 2011).

5. BALANCE OF PAYMENT AND EXTERNAL FINANCING REQUIREMENTS

The current account balance posted at a deficit of 4.2% of GDP in 2010. Private capital inflows have gradually increased. This has allowed a faster-than-expected accumulation of foreign exchange reserves which are now at comfortable levels (at around 130% of short-term debt). On current projections under the macro-economic baseline scenario, external debt sustainability would not be at stake over the programme horizon.

In case of a negative shock, Romania might need additional financing of up to EUR 5 billion. In such an alternative adverse scenario, Romania would not be able to fully cover its external financing needs from available funding resources, largely due to decreased inflows of foreign direct investment and lower roll-over rates for amortising debt, notably from banks. In this alternative set-up, the residual financing needs would have to be covered from activating the precautionary EU financial assistance (in conjunction with the IMF assistance). The alternative scenario has been developed in close co-operation with IMF staff and underpins the additional financing needs of around EUR 5 billion to be covered from international financial assistance.

While the economic crisis has helped to reverse the accumulation of imbalances in the economy, the imbalances still exist. The current account has been reduced from 11.4% of GDP in 2008 to around 4.2% in 2010. Credit growth has stalled and construction activity fell by double digit rates in the past two years. Inflation remains high. However, the sharp fall in wages, especially those in the public sector, and the further depreciation of the currency in 2010, have helped Romania gain price competitiveness. The measures adopted by the authorities have been successful in reducing the fiscal deficit below the agreed target for 2010. However, the current account and the government deficit (twin deficits) are still relatively high. Moreover, the continuous increase in foreign borrowing may pose a risk. This means that harmful macro imbalances still exist, seriously threatening the sustainability of Romania's balance of payments.

6. EU SUPPORT UNDER THE BALANCE OF PAYMENTS FACILITY COMES AS PART OF AN INTERNATIONAL EFFORT

In the light of the still elevated risk to encounter balance of payments difficulties and conditional on the Romanian authorities' firm commitment to implement a major programme of fiscal, financial and structural adjustment, the Commission, after having consulted the Economic and Financial Committee (EFC) on 3 March 2011, recommends to the Council to adopt a Decision as to continue the granting of mutual assistance foreseen by Article 143 of the Treaty (TFEU). The Romanian government shall implement its economic programme in order to address the remaining serious threats to the sustainability of its balance of payments.

Furthermore, the Commission, after consultation of the EFC, proposes to the Council to adopt a Decision providing precautionary EU medium-term financial assistance of up to EUR 1.4 billion for Romania to underpin the sustainability of Romania's balance of payments.[2] The proposed precautionary assistance would be available for activation until 31 March 2013.

A precautionary medium-term financial assistance for Romania under the balance of payments facility for Member States appears to be appropriate under the current circumstances of still reduced capital inflows and remaining elevated fiscal and external imbalances. While under present market conditions Romania does not intend to request a disbursement of funds made available from either the IMF or the EU, the precautionary assistance will facilitate a continued orderly adjustment of the fiscal and the external deficits.

The assistance will strengthen the credibility of the government's economic programme, including the continued fiscal adjustment, the consolidation of financial market reform, and an increased focus on product and labour market reforms and the increased absorption of EU structural funds. The implementation of the economic programme will enhance Romania's growth potential which should positively impact on the external value of Romania's currency RON and thereby reduce the likelihood of negative balance sheet effects in the corporate and household sectors. In turn, the economic recovery should be more sustainable and asset quality in the banking sector should improve, which again frees up resources for new investment.

Whereas the precautionary assistance reflects the fact that under normal market conditions, Romania can cover its financing needs without further official assistance, the negative risks up to the first quarter of 2013, seriously threatening the sustainability of Romania's balance of payments, are considered to be adequately addressed by the envisaged total of up to EUR 5 billion in precautionary loans, as the proposed precautionary EU assistance for Romania of up to EUR 1.4 billion would come in conjunction with IMF support through a precautionary Stand-by-Arrangement (SBA) in the amount of SDR 3.09 billion (300% of Romania's IMF quota; about EUR 3.6 billion). The World Bank will continue providing earlier committed support of EUR 400 million under its development loan programme (DPL3) and EUR 750 million under results based financing for social assistance and health reforms.

[2] The proposed assistance would be provided under the EU facility for Member States which have not yet adopted the euro, as governed by Council Regulation (EC) No 332/2002.

The precautionary EU financial assistance is provided in support of the continued strong commitment by the Romanian authorities to implement a comprehensive economic programme. The programme will be fully reflected in an update of the Romanian Convergence Programme as well as in Romania's National Reform Programme (NRP). The specific economic policy conditionality attached to the disbursement of instalments under the EU loan will be set out in a MoU to be concluded by the Commission with the Romanian authorities; the principal elements of this conditionality are the following:

A: Fiscal consolidation

Fiscal consolidation remains a crucial element in the reform programme which foresees a reduction of the fiscal deficit to 4.4% of GDP deficit for 2011 on a cash basis (below 5% of GDP in ESA terms) and to below 3% of GDP deficit for 2012 in ESA terms, thereby putting an end to the excessive deficit. Furthermore, the programme will step up efforts to reduce government payment arrears, both at central government and local government levels. The financial reporting system of those state-owned enterprises (SOEs) that are, or risk being, classified within general government needs to be enhanced in order to allow a monthly monitoring of their financial situation, including the stock of payments arrears, with a view to gradually reduce the latter. The public sector wage bill will remain capped at RON 39 billion (excluding 1574 million RON in social security contributions for the military as a result of the application of the new pension law) in 2011 and will need to respect the relevant limits set in the Medium-Term Fiscal Strategy over the 2012-2014 period.

B: Fiscal governance and structural fiscal reform

Fiscal governance will strongly benefit from the ongoing Technical Assistance provided by the IMF and the World Bank in the area of Public Financial Management and Control. This also includes training of staff and the refurbishing of the entire IT infrastructure in the central government's budget and expenditure management. The economic programme caters for the fact that public investment needs to be better prioritized and the planning, monitoring and evaluation of public investment projects have to be improved. The economic programme contains several measures to this end, including the creation of a project database, increased capital investment planning and monitoring capacity in the Office of the Prime Minister and in the Ministry of Finance, respectively. Hospital budgets under the subordination of the Ministry of Health will be closely monitored by the Ministry of Finance in order to avoid a re-accumulation of payment arrears. The Romanian authorities will continue to review and update the debt management strategy on an annual basis, i.e. under this programme by end-December 2011 and end-December 2012.

C: Financial sector regulation and supervision

In the financial sector, authorities will ensure that the prudential treatment of debt-for-equity swaps will not lead to a weakening of the financial positions of credit institutions. To prepare the introduction of IFRS as of 2012, authorities will develop proposals for prudential filters aiming at preserving the prudent approach to loan-loss provisioning, solvency and reserves. Preserving credit discipline and avoiding moral hazard among debtors contributes significantly towards 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. Moreover, authorities will make the necessary amendments to correlate the provisions of the law on the bankruptcy of insurance undertakings with the general law on insolvency and the law on insurance business and insurance supervision.

D: Monetary Policy

Monetary policy will remain geared towards price stability and the achievement of the National Bank of Romania's inflation targets (3.0% ± 1 percentage point at end-2011 and end-2012).

E: Structural reforms

The economic programme of the Romanian Government has a strong focus on product and labour market reform with a view to improve the functioning of these markets and thereby make the Romanian economy more resilient when faced with external shocks and to strengthen its long-run growth potential. The structural reform agenda of this program shall be included in Romania's forthcoming National Reform Programme and will help Romania achieve its national goals set out in the framework of the Europe 2020 growth strategy.

In the energy sector, the programme foresees the deregulation of the price-setting and the trade with electricity and gas with the aim to increase market access and transport capacity and to contribute to build a fully functioning, integrated and interconnected internal market in electricity and gas as recalled by the European Council of 4 February 2011. The programme foresees the creation of a strong and independent energy regulator, able to fulfil its tasks and responsibilities as defined in the third energy package. The restructuring plan for the coal sector will be notified to the Commission. The programme contains a comprehensive reform of the railway sector aiming at increased efficiency for the provision of passenger transport services and the planning of railway infrastructure, while making the sector more attractive for non-passenger transport (cargo). The reform will be helped by a strong and independent regulatory body for the railway sector.

The Romanian legal framework on public-private partnerships needs to be reviewed in order to ensure full compliance with EU public procurement Directives. Further, a review of the public procurement environment shall be completed. The programme foresees the establishment of an operational Point of Single Contact (PSC), provided for in the Services Directive, to help businesses with all administrative procedures involved for the establishment in Romania or for the cross-border service provision and will remove restrictions for the setting up of retail shops.

The programme continues the reform of the labour market through the amendment of the Labour Code expected to be approved in 2011, and streamlining wage setting institutions. The labour market rigidity shall be addressed through a wider use of fixed-term labour contracts, through the reduction in the generosity of compensation for overtime, and extending the probationary period of permanent contracts. The Romanian Government will seek with the relevant stakeholders how to rationalise wage bargaining in the private sector. Finally, the policy programme contains measures to increase labour supply incentives while reducing undeclared labour. The reforms shall be in compliance with EU Directives and core labour standards and shall take due account of the need to have an integrated approach to flexicurity.

Authorities will take measures to strengthen corporate governance of State Owned Enterprises, including in the financial sector.

On the much needed increase in the absorption of EU funds, the programme foresees the implementation of the Government's Action Plan which is currently being finalized by the Romanian authorities in reply to the letter by the President of the Commission of 13 December 2010. The programme sets specific targets for the cumulative aggregate level of certified expenditures until the end of 2012, including the insurance that adequate national resources for co-financing are being secured in the annual budgets in order to avoid the situation where Romania loses a substantial part of the structural funds made available for its economic development.

2011/0072 (NLE)

Proposal for a

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

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

Whereas:

(1) By Decision 2011/xxx/EU, the Council has decided to continue to grant mutual assistance to Romania.

(2) A precautionary medium-term financial assistance for Romania under the balance of payments facility for Member States appears to be appropriate under the current circumstances of still reduced capital inflows and remaining elevated fiscal and external imbalances. While under present market conditions Romania does not intend to request the disbursement of any instalment, the precautionary assistance will facilitate a continued orderly adjustment of the fiscal and the external deficits by strengthening credibility of the government's economic programme, including the continued fiscal adjustment, the consolidation of financial market reform, and an increased focus on product and labour market reforms and the increased absorption of EU structural funds. These measures should enhance Romania's growth potential, underpin monetary and financial stability, as well as confidence in Romania's currency (RON), and reduce the likelihood of negative balance sheet effects in the corporate and household sectors.

(3) If negative risks attached to the current baseline scenario of the Government's economic programme materialize, Romania would not be able to cover its external financing needs from available funding resources, largely due to decreased inflows of foreign direct investment and lower roll-over rates for amortising debt, notably from banks. In such a stress scenario, the residual financing needs would have to be covered

[3] OJ L 53, 23.2.2002, p. 1.

from activating the precautionary EU financial assistance. The stress scenario has been developed in close collaboration with IMF staff and underpins the additional financing needs of around EUR 5 billion to be covered from international financial assistance.

(4) It is appropriate to provide EU support to Romania of up to EUR 1.4 billion on a precautionary basis under the facility providing EU medium-term financial assistance for Member States' balance of payments established in by Council Regulation (EC) No 332/2002. This assistance should be provided in conjunction with financial support from the International Monetary Fund of SDR 3.09 billion (around EUR 3.6 billion) under a precautionary Stand-by arrangement approved on [21] March 2011. The World Bank will continue support of EUR 400 million committed earlier under its development loan programme (DPL3) and will provide up to EUR 750 million of results based financing for social assistance and health reforms.

(5) The assistance should be managed by the European 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 EU loan, unless Romania is in difficulty as regards its balance of current payments or capital movements. In the case 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 for making available any such instalment. The detailed financial terms related to possible disbursements will be laid down in a Framework Loan Agreement.

(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 ADOPTED THIS DECISION:

Article 1

1. The European Union shall make available to Romania a precautionary medium-term financial assistance amounting to a maximum of EUR 1.4 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 7 years.

2. The precautionary EU financial assistance shall be available for activation, and disbursements may be requested, until 31 March 2013.

Article 2

1. The assistance will 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 as well as of the annual update of Romania's Convergence Programme.

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 Framework Loan Agreement.

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 EU 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 programme and the subsequent 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 three instalments, the amount and timing of which shall be laid down in an addendum to the MoU. Each instalment may be disbursed in one or more tranches.

2. Upon an activation of the assistance, any disbursement of the loan, or parts thereof, shall be subject to the entry into force of the addendum to the MoU referred to in paragraph 1. The Commission shall decide on the disbursement of the EU 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 Convergence Programme and the National Reform Programme; 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 clear fiscal targets for the fiscal years 2011 to 2013 that underpin the continued fiscal consolidation with a view to stabilize the government debt to GDP ratio and put an end to the excessive deficit in line with the Council Recommendations under the excessive deficit procedure,

   (b) the requirement to attain progressively more restrictive benchmarks for the reduction in government payment arrears both at central government and local government levels,

   (c) the introduction of an enhanced reporting system for the state-owned enterprises which are already part of the ESA definition of the general government, and also for those which will likely be re-classified into the general government sector by Eurostat in 2011 and 2012, with a view to enabling the government to assess on a continuous basis the likely impact on the general government deficit and the evolution of arrears, subsidies and transfers, and losses linked to these enterprises,

(d) the continued monitoring of the public sector wage bill such that it respects the relevant limits set in the Medium-Term Fiscal Strategy,

(e) the introduction of a means-tested co-payment system for medical services, as well as an adequate system of checks and controls against the accumulation of arrears in the health system,

(f) the implementation of measures to improve the management of the public investment budget in line with the fiscal strategy 2012-14 and with a focus on shifting from entirely domestically financed investment to EU co-financed investment,

(g) the review, update and publication of a multi-annual debt management strategy on an annual basis,

(h) the implementation of policy measures aimed at rationalising the wage setting system with a view to allow wage developments to better reflect productivity and reforms increasing the flexibility of labour contracts and working time arrangements within an integrated flexicurity approach,

(i) the adoption of measures aiming at improving the market functioning in energy and transport, in line, where applicable, with EU legislation,

(j) the implementation of measures to facilitate the business environment in services in line with the service Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market[4],

(k) measures to further strengthen the prudential framework for credit institutions and to prepare the introduction of IFRS as of 2012,

(l) legislatives amendments to ensure the mutual consistency between the law on the winding-up of insurance undertakings, the general law on insolvency and the law on insurance business and insurance supervision.

(m) to improve the absorption of EU Structural and Cohesion Funds and specific targets to be met for the cumulative aggregate level of certified expenditure under these funds.

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 is addressed to Romania.

[4] OJ L 376, 27.12.2006, p. 36.

Article 5

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

Article 6

This Decision shall be published in the *Official Journal of the European Union*.

Done at Brussels, [date].

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) in the amount of up to EUR 1.4 billion. It will be provided in the context of an international financing package, and in particular by an IMF loan of SDR 3.09 billion (around EUR 3.6 billion) supported by the stand-by facility. The World Bank has committed a total of EUR 1.15 billion, EUR 400 million of which had already been committed under the preceding international financing package. The precautionary EU medium-term financial support to Romania is intended to address the still elevated risks attached to the balance of payments sustainability of Romania which has been seriously threatened since 2009. The precautionary assistance also continues to provide support to the economic programme of the government aiming, among other things, at consolidating regained investor confidence and to decrease the likelihood of further peaks of stress in financial markets. The newly provided precautionary assistance is expected to make a contribution to financial stability that goes beyond the beneficiary country in view of the important international (including interbank) links. The government's economic package hereby supported includes a continued deficit reduction in the period 2011-2013, which would decrease the government's financing need. Finally, the assistance managed by the Commission, in consultation with the Economic and Financial Committee, is a way to ensure that the EU remains closely involved in the shaping of economic policies in Romania and that those policies are consistent with Romania'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 borrowings 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 and 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 1.4 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						