Recommendation for a

COUNCIL DECISION

Granting mutual assistance for Romania

Proposal for a

COUNCIL DECISION

Providing EU medium-term financial assistance for Romania
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and

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Providing EU medium-term financial assistance for Romania

EXPLANATORY MEMORANDUM

1. INTRODUCTION

Romania has experienced a very high economic growth over the last years, averaging 6.5% since 2002, and even reaching 7.1% in 2008. Growth has been mainly driven by domestic demand for consumption and investment, fuelled by a foreign-financed boom in financial intermediation, and strong wage growth. High external borrowing has led to a rapid build-up of external debt, reaching 53% of GDP end-2008, and widespread foreign currency lending has increased households’ and companies’ balance sheet vulnerability to sudden shifts in the exchange rate. Domestic demand pressures have been further exacerbated by a pro-cyclical fiscal policy, with net public borrowing soaring from 1.2% of GDP in 2005 to 5.4% of GDP in 2008, despite successive Council Opinions and the June 2008 Commission Policy Advice calling for fiscal consolidation and for an improvement of budgetary management.

The global economic downturn and increased risk-aversion towards home-grown vulnerabilities has resulted in a significant tightening of capital flows to Romania. Pressures on the exchange rate have increased, resulting in a more than 30% cumulative depreciation since August 2007. In the fourth quarter of 2008, domestic demand contracted by more than 4% yoy, mainly driven by a decline in private consumption, from double digit growth rates in the first three quarters. In addition, external competitiveness and productivity developments have been hampered by the slow pace of structural reforms undertaken since EU accession. The government is also facing increasing difficulties on the bond market with average yields up by about 300bps since one year ago and almost entirely based on short-term maturities.
Against this background, on 6 March 2009, the Romanian authorities\(^1\) have requested Balance of Payments support to the EC and have also approached the IMF and the World Bank with a similar request. While at the moment there is no acute crisis, they consider that external financial support at this stage is warranted to enhance Romania’s foreign reserve buffer, based on a scenario of significant strains on external financing for both the public and the private sector in the coming two years. A programme would also contribute to strengthening confidence in Romania’s ability to meet its external obligations.

The Commission together with the Council Presidency announced on 9 March that the EU was ready to participate with the IMF in a coordinated financing package to underpin Romania’s balance of payments stability. However, it was stressed that the financial assistance is contingent upon a strong commitment by the Romanian authorities to implement a supportive policy programme.

Based on discussions with the Commission and the IMF, the Romanian authorities will send a Letter of Intent to the Commission and to the IMF highlighting the key elements of their economic adjustment programme. Council financial assistance to Romania is conditional on receipt of this letter. The principal aim of this adjustment programme is to cushion the effects of the sharp drop in private capital inflows while implementing policy measures to address the external and fiscal imbalances and to strengthen the financial sector. Against the background of this programme, the parent institutions of the nine largest foreign-owned banks incorporated in Romania subscribed to a coordinated commitment to maintain their overall exposure to Romania and to provide additional capital as necessary.

2. **MACROECONOMIC DEVELOPMENT AND OUTLOOK**

After several years of strong GDP growth, averaging 6.5% yoy since 2002, growth has declined sharply in the fourth quarter of 2008 to 2.9% yoy. This has been mainly driven by a contraction of private consumption by almost 4% yoy, which came alongside a virtual stop in bank lending. In the fourth quarter, gross fixed capital formation sharply decelerated from over 30% yoy in the first quarter to just below 3%. On the supply side, the slowdown was driven by a contraction in the industrial sector by about 8%, from an expansion by 5.5% in Q1-2008. Construction and services also registered a sharp slowdown.

The sharp decline in domestic demand in the fourth quarter also led to decelerating imports, with yoy growth rates turning negative toward the end of the year (-18% yoy) and registering even further declines in January 2009 (-28% yoy, in RON terms). Export performance also weakened significantly (-8% yoy in December 2008 and -13% in January 2009). Overall, in 2008, the current account deficit slightly narrowed, but still remained at a high level of 12.3% of GDP, from 13.5% of GDP in 2007. On the financing side, FDI covered about 54% of the current account deficit in 2008. The remainder was mainly financed through (mostly private) external debt, which increased to around 53% of GDP end-2008.

During the economic boom, labour shortages attributable to large migration outflows and a relatively high proportion of unskilled workforce contributed to the emergence of a wage-
price spiral, with wage growth outstripping the poor productivity developments. Wage growth remained very strong in the first two quarters of 2008 (with nominal wages increasing by around 25% yoy), but have moderated since, reaching 13% yoy in January 2009. Notwithstanding falling commodity and food prices, CPI inflation picked-up again from 6.3% in December 2008 to 6.9% in February 2009 on the back of an 8% nominal effective depreciation over this time span.

Given the sharp slowdown of economic activity in the fourth quarter of 2008 and the likely further weakening of the global economic outlook, GDP growth is projected to turn negative in 2009 to around -4%, driven by the contraction in consumption and investment, partly offset by a correction of the external deficit.

3. **PUBLIC FINANCES**

Romania pursued a pro-cyclical fiscal policy during the demand boom between 2005-2008, with headline deficits rising from 1.2% of GDP in 2005 to 5.4% of GDP in 2008, amidst an average real GDP growth of 6.5% and against repeated advice given in the February 2008 Council Opinion on Romania's Convergence Programme and the June 2008 Commission Policy Advice. This was due to a large degree to overall weak budgetary planning and execution. Windfall revenues were typically spent through the process of intra-year budgetary rectifications and no additional headroom was left for more difficult times. Weaknesses in the public administration also contributed to a recurrent under-execution of plans for capital expenditure and part of the resources budgeted for investment were subsequently shifted to current spending such as public wages and social transfers. Public sector wage growth has become the driver of private sector wage increases, with wage levels higher in the public sector. Over the period 2005-2008 the public sector wage bill doubled in nominal terms. Finally, large expenditure outlays are concentrated in the last weeks of the year, severely affecting budgetary credibility and predictability. Despite the recommendations of the June 2008 Commission Policy Advice, no progress has been made with the implementation of a binding medium-term fiscal framework.

The 2009 budget submitted by the new Government and adopted by the Parliament at the end of February contains several measures with the aim of cutting the deficit from 5.4% of GDP in 2008 to 2.0% of GDP in 2009, against a 2.5% real GDP growth assumption. The measures include freezing recruitment and cutting various bonuses in the public sector, a reduction in the expenditure for goods and services, limiting increases of public sector wages and linking pensions to inflation rather than to wage developments. On the other hand, the government plans a substantial increase in public investment. However, at the date of adoption it was already clear that this deficit target was unrealistic, notably given that the underlying macroeconomic scenario and the revenue projections were too optimistic. In addition, in the absence of a comprehensive reform of expenditure policy, there were potential implementation risks concerning the spending measures.

4. **FINANCIAL MARKETS**

Romania's financial system is dominated by the banking sector, which has developed very quickly over the last couple of years. Total net assets of the Romanian banking sector amounted to some RON 315 billion at the end of 2008 (62% of GDP). Banks are largely foreign owned. In December 2008, credit institutions with majority foreign capital (including foreign bank branches) controlled around 88% of total net assets of all credit institutions
operating in Romania. Banks from Austria, Greece, France and Italy are the most exposed in Romania.

During the last few years, the Romanian banking sector promoted fast credit expansion with loans-to-deposit ratio increasing to 122% in 2008. Although credit growth started from a low base, the expansion of mainly foreign currency-denominated loans (representing some 59% of total domestic credit to the private sector in January 2009) made the Romanian banking sector heavily dependent on foreign financing. In the second half of 2008, lending activity slowed dramatically, with annual credit growth falling from above 60% in June 2008 to 36.5% in December 2008.

Although at the moment the banking sector remains apparently relatively sound and well-capitalised (with the capital adequacy ratio at 12.3% at the end of 2008), financial stability in Romania could come under strain. The deteriorating macroeconomic outlook implies that the share of non-performing loans is likely to increase rapidly in the coming months. Furthermore, as the Romanian private sector is heavily relying on foreign currency-denominated credit, any further depreciation of the leu would weigh heavily on household and enterprise balance sheets.

5. **BALANCE OF PAYMENT AND EXTERNAL FINANCING REQUIREMENTS**

Romania's economic boom in recent years was characterized by the emergence of large external imbalances and an unsustainable build-up of external liabilities. The current account deficit increased from 5.8% of GDP in 2004 to 13.5% of GDP in 2007 and remained at above 12% of GDP in 2008. As a result, gross external debt reached 55% of GDP at the end of 2008.

Romanian financial markets have been under continued pressure since the beginning of October 2008. Deleveraging, Romania's weak fundamentals and sub-investment grade grade are weighing heavily on currency, interbank, equity and bond markets. External financing is expected to remain under significant pressure for some time as the persistent, although declining, current account deficit, together with the need to roll over sizeable short-term and longer-term foreign currency-denominated debt, are likely not to be covered fully by FDI and other financial and capital account inflows in 2009-2011.

In light of the above, the Commission is of the opinion that there is a serious threat to the Romanian balance of payments. The Commission thus recommends to the Council a decision granting mutual assistance. Total financing needs in the period up to the first quarter of 2011 are estimated at EUR 20 billion. This sum comprises allowance for the expected continued current account deficit, incomplete rollover of maturing loans, some capital outflows and official foreign reserve accumulation to a prudent level. Foreign banks’ rollover rate of their exposures to Romania is assumed at 100% once the mutual assistance is awarded, consistent with the required commitment of main foreign banks to maintain their exposure to Romania (as confirmed in their joint statement of 26 March 2009), whereas the rollover rate for corporate external debt to parents and for external debt of Romanian banks is assumed at 50% in 2009. For 2010 and 2011, all maturing foreign liabilities are assumed to be rolled over at 100% in line with the expected financial market stabilisation and start of the recovery in Romania's major export markets. Apart from sufficiently high foreign exchange reserve target (of more than 100% of short-term external debt at remaining maturity) conservative assumptions were made about other capital outflows such as non-resident deposit outflows, decreases in trade credits and portfolio outflows in order to incorporate additional buffers into
the calculations. The underlying GDP growth assumption is -4% in 2009 and about 0% in 2010. The current account deficit is projected at 7½% of GDP in 2009 and 6½% of GDP in 2010.

6. **EU SUPPORT UNDER THE BALANCE OF PAYMENTS FACILITY, PART OF INTERNATIONAL EFFORT**

In the light of the serious balance of payments difficulties being experienced by Romania and conditional on the Romanian authorities' firm commitment to implement a major programme of fiscal, financial and structural adjustment, the Commission, following consultation with the Economic and Financial Committee on 17 March 2009, recommends the Council grant mutual assistance foreseen by Article 119 of the Treaty.

Furthermore, the Commission, following consultation with the Economic and Financial Committee, proposes that, after adopting the above-mentioned decision of the Council to provide mutual assistance to Romania on a recommendation from the Commission, the Council adopt a decision providing under the EU facility for Member States (as governed by Council Regulation (EC) No 332/2002 of 18 February 2002) a medium-term financial assistance to Romania of up to EUR 5 billion to underpin its balance of payments sustainability.

Medium-term financial assistance for Romania under the balance of payments facility for Member States (in view of Regulation No 332/2002) appears to be appropriate under the current circumstances of reduced capital inflows and high fiscal and external imbalances. The immediate objective is to facilitate an orderly adjustment of the external deficit, thus easing excessive pressures on the exchange rate which could otherwise cause severe balance sheet effects on the corporate and household sectors, resulting in a sharper recession and strains in the banking sector.

The total estimated financing needs up to the first quarter of 2011 are EUR 20 billion. The EU assistance for Romania comes in conjunction with IMF support through a Stand-by-Arrangement (SBA) in the amount of SDR 11.40 billion (about EUR 12.95 billion, 1085% of Romania's IMF quota). Additional multilateral support of EUR 2 billion will be provided in the following way: on top of their regular lending activities the World Bank provides EUR 1 billion and the EIB and the EBRD provide another EUR 1 billion.

On 26 March 2009, the parent institutions of the 9 largest foreign-owned banks incorporated in Romania jointly committed to maintaining their overall exposures to Romania over the programme period, and agreed to support their Romanian subsidiaries in order to preserve their current good financial standing throughout the period of market turbulences and economic slowdown. This commitment will be reaffirmed in the individual comfort letters from the key banks to the National Bank of Romania (NBR) which will, in conjunction with home country supervisory authorities, monitor this commitment closely. The EU financial assistance is provided in support of the strong commitment by the Romanian authorities to implement a comprehensive economic programme. This programme has been agreed upon with the Romanian authorities.

The Commission will verify at regular intervals in collaboration with the EFC that the economic policy conditions attached to the assistance are fulfilled, through missions and regular reporting by the authorities. Throughout the implementation of the programme, the
Commission will also provide additional policy advice and technical assistance in specific areas. The main elements of this programme are:

a. Fiscal consolidation

The government is committed to undertake additional fiscal adjustment efforts of 1.1% of GDP, on top of the measures amounting to 3% of GDP included in the 2009 budget adopted in February 2009. Based on the revised forecast of a contraction of GDP by 4% in 2009 and on the additional budgetary measures, the authorities target a general government deficit of 5.1% of GDP, implying an important structural adjustment compared to the 2008 outturn. An amended 2009 budget, based on the updated economic outlook and the further measures will be approved by the Parliament in the second quarter of 2009.

The fiscal consolidation will be concentrated on the expenditure side. Primary government expenditure will be reduced by an additional 0.85 percentage point of GDP compared to the 2009 budget. This will be achieved through i) a cut (by an estimated 4 – 4½% with respect to the 2008 level) in the public sector wage bill by foregoing public sector wage increases (totalling 5 percent) scheduled for 2009 or equivalent further cuts in employment and by reducing public employment, including by replacing only 1 in 7 departing employees; ii) additional reduction in spending on goods and services and in subsidies to public enterprises; iii) some cuts in capital spending on items like vehicles and office equipment and ensuring a realistic timetable for EU-supported investment projects. Nevertheless, public investment is projected to substantially increase in 2009 compared to 2008 (some 6½ % of GDP in 2009 compared to 5¾% of GDP in 2008). On the revenue side, measures to eliminate certain tax deductions and allowances (in particular on company cars, and depreciation of revalued assets) are expected to generate an additional 0.25% of GDP. The government is committed to continue the expenditure-driven fiscal consolidation and reduce the deficit further to 4.1% of GDP in 2010 and to below 3% of GDP in 2011.

Throughout the execution of the programme, the Commission will provide continued guidance and advice to the Romanian authorities with the aim of ensuring a sustainable correction of the deficit.

b. Fiscal governance reform

In order to help a sustainable achievement of lower budgetary deficits, measures will be taken to improve the budgetary strategy and process. A key-component will be a fiscal responsibility law, which inter alia would require setting up procedures for improved multiyear budgeting, establish limits on budget revisions during the year and lay-out fiscal rules in order to improve budgetary implementation and achieve full compliance with the requirements of the SGP. The law should also create a fiscal council to provide independent and expert scrutiny.

In order to improve budgetary predictability and transparency, the public compensation system will be restructured, including by unifying and simplifying the pay scales and reforming the bonuses system. This is aimed at tackling the major problems with the public compensation system: bonuses comprise too much of the
total compensation, there is not unified wage scale and there is a large number of laws regulating wages in different part of the compensation system.

To help improve the long-term sustainability of public finances, key parameters of the pension system will be reformed. Changes will include moving toward indexing public pensions to consumer prices and limiting the scope for discretionary pension increases and gradually increasing further the retirement age beyond the currently agreed plans (particularly for women), taking into account the evolution of life expectancies. In addition, groups of public employees currently excluded from pension contributions will have such contributions phased-in. The programme foresees the continuation of the implementation of the second pension pillar with regularly scheduled increases in contributions as originally planned.

c. Monetary and financial sector policy

Monetary policy will remain geared towards price stability and the achievement of the NBR’s inflation target (currently 3.5% ±1 percent at end-2009). Regarding the financial sector, the NBR will perform stress tests of individual bank balance sheets and lending portfolios under different scenarios following EU guidelines on valuation, which will be used to assess the potential increases in own funds needed to ensure that solvency ratios remain above 10 percent throughout the programme period. Once stress tests are completed, in line with their commitment to adequately support their subsidiaries (confirmed in their joint statement of 26 March 2009), parent banks will be required to secure, by the end of September 2009, sufficient resources to cover any potential shortfalls revealed by the stress tests.

Moreover, the programme foresees that banking and winding-up laws will be amended to be able to respond in a timely and effective fashion in the event of bank distress. A key objective of the amendments will be to strengthen the powers of the administrators of banks placed under special administration. Beyond bank resolution, other measures aim at strengthening the NBR’s remedial powers with provisions allowing it to request that significant shareholders increase their share capital and financially support the bank, and to prohibit or limit profit distributions. Financial supervision will be strengthened in line with the relevant EU legislation. In addition, more detailed reporting requirements on liquidity will be introduced and, at an appropriate time, the regulatory minimum level of the capital adequacy ratio should increase from 8 percent to 10 percent. Furthermore, procedures for the activation of deposit insurance will be modified to simplify and accelerate payouts. Under modified legislation, deposit insurance will be activated upon the NBR’s determination within the 21-day period. Finally, in order to guarantee sufficient liquidity provision, the NBR is committed to widening the range of assets acceptable as collateral.

d. Structural reforms

The economic programme will also include structural reform measures, in line with the policy areas covered in the Country Specific Recommendations issued by the Council in the framework of the Lisbon strategy. Reforms will include policies towards improving the efficiency and effectiveness of public administration, enhancing the quality of public expenditure, sound use and increased absorption of EU funds, the improvement of the business environment and tackling undeclared
work. The Commission also contributes to local capacity building via the structural funds, a specific part of which has been earmarked for technical assistance.

This programme is reflected in the economic policy conditionality included in the Commission recommendation for a Council decision. The detailed economic policy conditionality attached to EU loan disbursements will be set out in a Memorandum of Understanding to be concluded with the Romanian authorities. This programme will also be fully reflected in an update of the Romanian Convergence Programme.

The proposed decision would expire three years after entry into force. To ensure the necessary flexibility in the current market context, it is proposed to allow the option of using interest rate swaps for the borrowing operation which finances the loan. In order to safeguard the EU budget, the counterparties of a potential swap would have to be of the highest credit quality.

In line with the stipulations of the Commission proposal of 8 April 2009 for a Council Regulation, amending Regulation (EC) No 332/2002, establishing a facility providing medium-term financial assistance for Member States' balances of payments, the Commission, including the European Anti-Fraud Office, and the European Court of Auditors can send their own agents or duly authorised representatives to carry out any technical or financial controls or audits that they consider necessary in relation to the management of this assistance. Investigation and satisfactory treatment of any suspected and actual cases of fraud, corruption or any other illegal activity in relation to the management of the EC balance of payments assistance, detrimental to the EC's financial interests, will be ensured. All such cases as well as measures related thereto taken by national competent authorities will be reported to the Commission without delay. The Memorandum of Understanding and the Loan Agreement will also already integrate the new technical provisions of the Commission proposal for a Council Regulation amending Regulation (EC) No 332/2002.

In parallel to the policy conditionality of this programme, the Commission will also continue monitoring progress in the area of judicial reform and fighting corruption under the Cooperation and Verification Mechanism. The lifetime of this mechanism is independent of the duration of the assistance programme. The February 2009 Interim Report concluded that the Romanian authorities should regain momentum on judicial reform and the fight against corruption so as to reverse certain backward movements of recent months. This means in particular adopting the codes needed to modernise the legal system and showing, through an expeditious treatment of high-level corruption cases, that the legal system is capable of implementing the laws in an independent and efficient way.

In addition to the policy conditionality, the Commission will also continue monitoring the correct use of pre-and post-accession EU transfers, among others through the compliance assessments and regular reviews.
Recommendation for a

COUNCIL DECISION

Granting mutual assistance for Romania

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 119,

Having regard to the recommendation from the Commission made after consulting the Economic and Financial Committee,

Whereas:

(1) Romanian capital and financial markets have recently come under increasing pressure, reflecting the global economic downturn and rising concerns about the health of the Romanian economy, given its wide external deficit, and the rapidly increasing public deficit. Pressures on the exchange rate have also increased and entail a considerable risk to the wider banking sector stability.

(2) In response, the government and the National Bank of Romania (NBR) have developed a comprehensive strategy to firmly anchor macroeconomic policies and reduce financial market stress and outlined this strategy in a letter of intent received by the Commission on […]. A cornerstone of the economic programme is the reduction of the fiscal deficit from 5.4% of GDP in 2008 to 5.1% of GDP in 2009 and to below 3% of GDP by 2011. In order to help a sustainable achievement of lower budgetary deficits, measures will be taken to improve the budgetary strategy and process. This economic programme and in particular the fiscal targets will be reflected in the Government budget as well as in the convergence programme.

(3) The Council is reviewing on a regular basis the economic policies implemented by Romania, in particular in the context of the annual reviews of Romania's update of the convergence programme and implementation of the National Reform Programme and the regular review of progress made by Romania in the context of the Convergence Report and of the Annual Progress Report.

(4) External financing is expected to remain under significant pressure as the persistent, although declining, current account deficit, together with the need to roll over sizeable short-term and longer-term foreign currency-denominated debt, are likely not to be covered fully by FDI and other financial and capital account inflows in 2009-2011. External financing needs are estimated at around EUR 20 billion in the period until the first quarter of 2011. Foreign banks’ rollover rate of their exposures to Romania is assumed at 100% once the mutual assistance is awarded, consistent with the required commitment of main foreign banks to maintain their exposure to Romania (as confirmed in their joint statement of 26 March 2009), whereas the rollover rate for
corporate external debt to parents and for external debt of Romanian banks is assumed at 50% in 2009. For 2010 and 2011, all maturing foreign liabilities are assumed to be rolled over at 100% in line with the expected financial market stabilisation and start of the recovery in Romania's major export markets. Apart from sufficiently high foreign exchange reserve target (of more than 100% of short-term external debt at remaining maturity) conservative assumptions were made about other capital outflows such as non-resident deposit outflows, decreases in trade credits and portfolio outflows in order to incorporate additional buffers into the calculations.

(5) The Romanian authorities have requested substantial financial assistance from the EU and other international financial institutions to support balance of payments sustainability and bring international currency reserves to a prudent level.

(6) There is a serious threat to the Romanian balance of payments which justifies the urgent granting of mutual assistance by the Community.

HAS ADOPTED THIS DECISION:

Article 1

The Community shall grant mutual assistance to Romania.

Article 2

This Decision is addressed to the Member States.

Done at Brussels,

For the Council
The President
Proposal for a

COUNCIL DECISION

Providing Community medium-term financial assistance for Romania

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

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' balance 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 [….] the Council has decided to grant mutual assistance to Romania.

(2) Despite the expected improvement in the current account, Romania's external financing needs in the period until the first quarter of 2011 are estimated by the Commission, IMF and Romanian authorities in March 2009 at EUR 20 billion, as in view of the recent financial market developments the capital and financial account could substantially deteriorate.

(3) It is appropriate to provide Community support to Romania of up to EUR 5 billion under the Facility providing medium-term financial assistance for Member States' balance of payments established by Regulation (EC) No 332/2002. That assistance should be provided in conjunction with a loan from the International Monetary Fund of SDR 11.40 billion (around EUR 12.95 billion) under a Stand-by arrangement expected to be approved on 6 May 2009. The World Bank has also agreed to provide a loan to Romania of EUR 1 billion and the EIB and EBRD will provide a total EUR 1 billion of additional support.

(4) The Community assistance should be managed by the Commission. The specific economic policy conditions agreed with the authorities of Romania after consultation of the EFC should be laid down in a Memorandum of Understanding. The detailed financial terms should be laid down by the Commission in the Loan Agreement.

(5) The Commission should verify at regular intervals that the economic policy conditions attached to the assistance are fulfilled through missions and regular reporting by the Romanian authorities.

Throughout the implementation of the programme, the Commission will provide additional policy advice and technical assistance in specific areas.

The European Court of Auditors shall have the right to carry out any financial controls or audits that it considers necessary in relation to the management of this assistance. The Commission, including the European Anti-Fraud Office, shall have the right to send its own officials or duly authorised representatives to carry out technical or financial controls or audits that it considers necessary in relation to the management of the Community medium-term financial assistance.

In parallel to the policy conditionality of this programme, the Commission will also continue monitoring progress in the area of judicial reform and fighting corruption under the Cooperation and Verification Mechanism. The lifetime of this mechanism is independent of the duration of the assistance programme. In addition to the policy conditionality, the Commission will also continue monitoring the correct use of pre- and post-accession EU transfers, among others through the compliance assessments and regular reviews.

The assistance should be provided with a view to supporting the balance of payments sustainability in Romania and, in this way, contributing to the successful implementation of the Government's economic policy programme,

HAS ADOPTED THIS DECISION:

Article 1

1. The Community shall make available to Romania a medium-term loan amounting to a maximum of EUR 5 billion, with a maximum average maturity of seven years.

2. The Community financial assistance shall be made available during three years starting from the first day after the entry into force of this Decision.

Article 2

1. The assistance shall be managed by the Commission in a manner consistent with Romania's undertakings and recommendations by the Council, in particular the Country Specific Recommendations in the context of the implementation of the National Reform Programme as well as of the convergence programme.

2. The Commission shall agree with the authorities of Romania, after consulting the EFC, the specific economic policy conditions attached to the financial assistance as laid down in Article 3(5). Those conditions shall be laid down in a Memorandum of Understanding consistent with the undertakings and recommendations referred to in paragraph (1). The detailed financial terms shall be laid down by the Commission in the 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. To this end, the Romanian authorities shall place all the necessary information at the disposal of the Commission and cooperate in full with the latter. The EFC shall be kept informed
by the Commission of possible refinancing of the borrowings or restructuring of the financial conditions.

4. Romania shall be ready to adopt and implement additional consolidation measures to ensure macro-financial stability, in case such measures will be necessary during the assistance programme. The Romanian authorities shall consult the Commission in advance of the adoption of any such additional measures.

Article 3

1. The Community financial assistance shall be made available by the Commission to Romania in maximum five instalments, the size of which will be laid down in the Memorandum of Understanding.

2. The first instalment shall be released subject to the entry into force of the Loan Agreement and Memorandum of Understanding.

3. If required in order to finance the loan, the prudent use of interest rate swaps with counterparties of the highest credit quality shall be permitted.

4. The Commission shall decide on the release of further instalments after having obtained the opinion of the EFC.

5. The disbursement of each further instalment shall be made on the basis of a satisfactory implementation of the new economic programme of the Romanian Government to be included in the Convergence Programme of Romania, in the National Reform Programme and, more particularly, the specific economic policy conditions laid down in the Memorandum of Understanding. These shall include, inter alia,

   (a) Adoption of a clearly-set medium-term fiscal programme designed to lower by 2011 the general government deficit to not more than the Treaty reference level of 3% of GDP.

   (b) Adoption and execution of an amended budget for 2009 (by the second quarter of 2009), targeting a general government deficit of no higher than 5.1% of GDP in ESA 95 terms.

   (c) Reduce the public sector wage bill in nominal terms compared to the 2008 outcome by foregoing public sector wage increases (totalling 5 percent in nominal terms) scheduled for 2009 (or equivalent further cuts in employment) and by reducing public employment, including by replacing only 1 of 7 departing employees.

   (d) Additional reductions in spending on goods and services and in subsidies to public enterprises.

   (e) Improving the budgetary management by the adoption and implementation of a binding medium-term fiscal framework, establish limits on budget revisions during the year, including fiscal rules and create a fiscal council to provide independent and expert scrutiny.
Reforming the public compensation system, including by unifying and simplifying the pay scales and reforming the bonus system.

Reforming key parameters of the pension system by moving towards indexation of pensions to consumer prices rather than wages, gradually adjusting retirement age beyond the currently agreed plans, especially for women, and phasing in pension contributions of groups of public employees currently excluded from such contributions.

Amending banking and winding-up laws to be able to respond in a timely and effective fashion in the event of bank distress. A key objective of the amendments will be to strengthen powers of the administrators of banks placed under special administration. Beyond bank resolution, the NBR’s remedial powers should be strengthened with provisions allowing it to request that significant shareholders increase their share capital and financially support the bank, and to prohibit or limit profit distributions. Financial supervision will be strengthened in line with the relevant EU legislation. In addition, more detailed reporting requirements on liquidity will be introduced and, at an appropriate time, the regulatory minimum level of the capital adequacy ratio should increase from 8 percent to 10 percent. Furthermore, procedures for the activation of deposit insurance should be modified to simplify and accelerate payouts. Under modified legislation, deposit insurance will be activated upon the NBR’s determination within the 21-day period. Finally, in order to guarantee sufficient liquidity provision, the NBR is committed to widening the range of assets acceptable as collateral.

Structural reform measures in the areas of the Country Specific Recommendations issued in the context of the Lisbon strategy. These will include measures towards improving the efficiency and effectiveness of public administration, enhancing the quality of public expenditure, sound use and increased absorption of EU funds, reducing administrative, fiscal and legal burdens on business and tackling undeclared work, thereby broadening the tax base.

In order to ensure the smooth implementation of the programme conditionality and to help restoring imbalances in a sustainable way, the Commission will provide continued advice and guidance on fiscal, financial market and structural reforms.

Romania shall open a special account with the National Bank of Romania for the management of the Community medium-term financial assistance.

This Decision is addressed to Romania.

It shall be published in the *Official Journal of the European Union*. 
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
TITLE OF ACTION: EU MEDIUM-TERM FINANCIAL ASSISTANCE FOR ROMANIA

1. NAME OF THE PROPOSAL: BUDGET HEADING CONCERNED AND TITLE

01 04 01 01 EC guarantee for Community loans raised for balance-of-payments support

2. LEGAL BASIS:

Art. 119 EC and 308 EC; Council Regulation N° 332/2002 of 18 February 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

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<th>Initial appropriation for the financial year (budget)</th>
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<td>Transfers</td>
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<td>Additional appropriation</td>
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<td><strong>Total appropriation</strong></td>
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<td>Appropriations already set aside by another work programme</td>
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<td>Balance available</td>
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<td><strong>Amount for the action proposed</strong></td>
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</table>

Not applicable
3b – Carry overs

Not applicable

<table>
<thead>
<tr>
<th>Carry-overs</th>
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<tr>
<td>Appropriations already set aside by another work programme</td>
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<td>Balance available</td>
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<td>Amount for the action proposed</td>
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3c – Next financial year

Not applicable

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<th>Initial appropriation for the financial year (budget)</th>
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<td>Transfers</td>
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<td>Additional appropriation</td>
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<tr>
<td>Amount for the action proposed</td>
<td>p.m.</td>
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4. DESCRIPTION OF THE ACTION

The proposed medium-term financial assistance to Romania consists of a Community loan (to be financed by Community borrowings in the international capital markets) in the amount of EUR 5 billion. It will be provided in the context of an international financing package, and in particular by an IMF loan of SDR 11.40 billion (around EUR 12.95 billion) supported by the stand-by facility. The World Bank has committed a total of EUR 1 billion, and the EIB and the EBRD will also provide a total of EUR 1 billion. The Community medium-term financial support to Romania is intended to support the balance of payments sustainability of Romania which is seriously threatened and thereby also to support the new economic programme of the government aiming, among other things, at restoring investor
confidence and alleviating the stress recently experienced in financial markets. At the same time, this assistance makes a contribution to financial stability that goes beyond the beneficiary country in view of the important international (including interbank) links. The new economic package hereby supported includes an accelerated deficit reduction in the period 2009-2011, 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.

On 26 March 2009, the parent institutions of the 9 largest foreign-owned banks incorporated in Romania jointly committed to maintaining their overall exposures to Romania over the programme period, and agreed to support their Romanian subsidiaries in order to preserve their current good financial standing throughout the period of market turbulences and economic slowdown. Together with the assistance provided by the Community, the IMF, the World Bank, the EIB and the EBRD, this declaration underscores the broad-based character of support to the Romanian authorities.

The Community borrowings raised on the capital markets or from financial institutions for the purpose of extending the loan to Romania are covered by the Community guarantee. The loan is raised on the capital markets or from financial institutions. The amount in principal of loans which will be granted to Romania amounts to EUR 5 billion.

The structure for the guarantee provided by the European Union 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 2000/597/EC, Euratom on the system of the 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.

<table>
<thead>
<tr>
<th>Heading</th>
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<th>Payments</th>
<th>Subsequent financial years</th>
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