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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK AND THE
EUROGROUP**

**2018 European Semester: Assessment of progress on structural reforms, prevention and
correction of macroeconomic imbalances, and results of in-depth reviews under
Regulation (EU) No 1176/2011**

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EXECUTIVE SUMMARY

In the absence of structural reforms and fiscal consolidation, Romania's buoyant economic growth risks setting the stage for a hard landing. The current economic boom has been driven mainly by consumption, while investment has remained subdued. The strong economic upswing represents an opportunity to rebuild fiscal buffers and prepare the economy for leaner times. Inequality and poverty rates remain high despite the strong economic growth. Some structural reforms were reversed in 2017 while others stalled. The progress made in the fight against corruption was again put at risk. Ensuring continuity of past reforms would support Romania's transformation to a higher value added economy and could improve the economy's resilience to an eventual downturn ⁽¹⁾.

The economy's cyclical upswing continued in 2017 but is expected to ease off in 2018. Real GDP growth accelerated in 2017 to a post-crisis high on the back of booming private consumption, spurred by wage hikes in both the public and private sector and indirect tax cuts. Growth is forecast to decelerate but stay above potential. Despite export market share gains, the growth of imports has outpaced that of exports and the current account deficit is widening. Inflation turned positive in 2017 and is forecast to accelerate.

The labour market has been tightening in line with the strong economic growth. Employment growth was positive in 2017 (0.7 %) and the unemployment rate dropped to 4.9 %, its lowest level in more than 20 years. The low unemployment rate, coupled with a declining labour force and persistent skills shortages, has led to very tight labour market conditions. The compensation of employees is low relative to the EU average but the strong wage growth of 2017, also driven by a 16 % minimum wage hike and public sector wage increases, risks putting pressure on competitiveness and inflation, if not

accompanied by corresponding productivity increases.

Due to tax cuts and increases in public wages and pensions, the public deficit is on an increasing path. Indirect taxes were cut in 2017 while the personal income tax rate was cut from January 2018. On the expenditure side, public wages and old-age pensions were significantly increased in 2017 and are set to advance further in 2018. As a consequence, the nominal and structural budget deficits are on an increasing path, causing Romania to diverge from the targets in its national fiscal framework. In 2017 the Council launched a significant deviation procedure addressed to Romania.

The financial sector has further strengthened, whereas some segments need monitoring. The banking sector remains well-capitalised and its overall health, including asset quality, has continued to improve. However, recurrent legislative initiatives warrant close monitoring. The insurance sector is strengthening, as the measures to address the financial situation of weaker companies have started to bear fruit. The recent reduction in the contributions to the pre-funded second pillar pension funds, which have displayed strong performance since they were set up, eased short term fiscal concerns but could have negative implications for the development of capital markets.

Romania has made limited progress on addressing the 2017 country-specific recommendations. No progress was made on ensuring that the national fiscal framework is implemented and there was limited progress in strengthening tax compliance and collection. By contrast, there was some progress on fighting undeclared work while limited progress was made on strengthening targeted labour activation measures. No progress was made on how the minimum wage is set and on equalising the pensionable age for men and women. Limited progress was made on improving access to quality mainstream education. In the healthcare system, limited progress was made on shifting to outpatient care and some progress was achieved on curbing informal payments. There was limited progress on adopting legislation to ensure a professional and independent civil service and on prioritising public investment. Finally, some progress was made on

⁽¹⁾ This report assesses Romania's economy in the light of the European Commission's Annual Growth Survey published on 22 November 2017. In the survey, the Commission calls on EU Member States to implement reforms to make the European economy more productive, resilient and inclusive. In so doing, Member States should focus their efforts on the three elements of the virtuous triangle of economic policy — boosting investment, pursuing structural reforms and ensuring responsible fiscal policies.

implementing the national public procurement strategy, but sustainability of measures and irreversibility of reforms should be further monitored.

Regarding progress in reaching the national targets under the Europe 2020 strategy, Romania is performing well in the areas of employment rates, national greenhouse gas emission, renewable energy, energy efficiency and tertiary education. The national target for reducing the number of people at risk of poverty or social exclusion has already been reached. However, research and development intensity and early school leaving remain some distance away from their respective targets.

Romania faces challenges with regard to a number of indicators of the Social Scoreboard supporting the European Pillar of Social Rights.

The high economic growth has translated into improved employment outcomes and resulted in a strong increase of household disposable incomes. However, Romania has a high number of early school leavers, and young people not in education, employment or training. Romania has not yet achieved a mature social dialogue, and on social protection and inclusion, challenges remain.

Key structural issues analysed in this report, which point to particular challenges for Romania's economy, are the following:

- **Labour and skills supply are not keeping up with the fast-changing needs of the economy.** Romania's unfavourable demographic trends are expected to continue. Population aging, limited internal labour mobility and continued emigration represent a significant drag on potential economic growth. Despite recent improvements, labour force participation rates remain well below EU averages. This concerns particularly women, older people, Roma, young people, and people in rural areas. Active labour market policies are insufficient in scope and design. Skills shortages and mismatches have an adverse impact on competitiveness and convergence. Undeclared work continues to distort the labour market. Minimum wage increases are decided in a discretionary manner while social partners' involvement in policy-making is very limited, with no substantive

process of involvement and cooperation. Collective bargaining rates are low.

- **Poverty increased and income inequality remains high.** Inequality of opportunity remains a challenge, especially for rural areas. Income inequality is high, while the redistributive effect of the tax and benefit system is below the EU average. The limited integration of employment, education and social services prevents disadvantaged groups from escaping poverty. The provision of services is limited, especially in disadvantaged areas. Child poverty is high and rising. The entry into force of the Law on minimum inclusion income that would increase the adequacy and coverage of social benefits was postponed again to 2019. Legislation equalising pension ages for men and women has not been adopted. The adopted shift of social security contributions places the burden of financing social protection almost entirely on employees. Access to social protection for all is not ensured.
- **No tangible results were achieved on public administration reforms, and the business environment shows weaknesses.** Draft legislation on human resource management is currently aligned with the strategy for civil servants but implementation has not started and results are expected only in 2019. The public consultation process, strategic and budgetary planning as well as the use of regulatory impact assessments remains weak, limiting evidence-based policy making. Cumbersome administrative procedures for businesses, slow progress in the provision of e-government solutions, complex insolvency procedures and frequent regulatory changes with limited use of impact assessment and consultation procedures weigh on the business environment.
- **The weak performance of the education system limits growth prospects in the long run.** Low attainment levels in basic skills and digital skills, persistently high early school leaving, poor Roma inclusion and rural-urban disparities in education result in lost human capital and growth potential. Quality assurance and initial teacher education programmes face challenges. Vocational education and training

remains a second choice option and in most cases is not adapted to labour market needs. Access to adult learning is limited, in particular for the low-skilled.

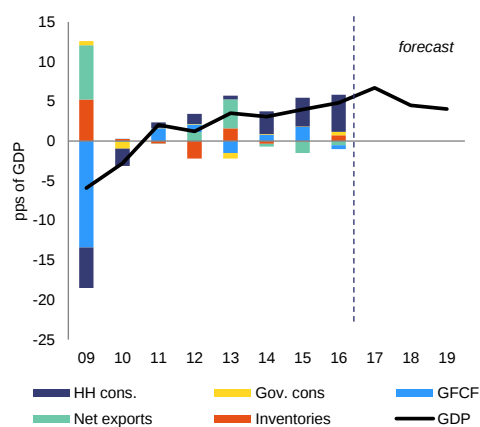
- **The health status of the population has improved, but remains below EU standards.** Access to healthcare remains a key challenge, also in relation to equality of opportunities, with negative repercussions on child development, workforce employability and healthy ageing. Low funding and inefficient use of public resources limit the health system's effectiveness, against the background of a sizeable shortage of doctors and nurses. Health infrastructure and the prevalence of informal payments remain sources of concern.
- **Performance in the area of research and innovation remains modest.** Despite a solid IT infrastructure and the rapid development of the ICT sector, Romania continues to score low on all European Innovation Scoreboard indicators and there are no signs of improving performance. The degree of digitisation of both the public and private sector remain very low. Despite increasing public funding and a dynamic start-up ecosystem, technology adoption, internationalisation and scaling-up of companies remain significant challenges. The weak innovation performance could have a negative impact on growth prospects.
- **High public spending is not reflected in the country's infrastructure.** Despite relatively high public investment rates, the supply of infrastructure is limited, with the perceived quality of infrastructure being one of the lowest in the EU. The general condition and reliability of road and rail infrastructure remain poor and the reform of the transport sector progresses very slowly. Water, waste and energy infrastructure remain deficient. State-owned enterprises' efficiency is not improving and the corporate governance framework is being weakened. Public investment is characterised by low efficiency particularly in project preparation and prioritisation and public procurement. Businesses see investment in infrastructure as a major priority for public spending.
- **The irreversibility of the progress in the fight against corruption was recently put at risk.** The continued good results of the judicial institutions in the fight against corruption were largely brought into question by events throughout the past year. The ongoing reforms of the justice laws risk harming judicial independence and undoing progress achieved over the past 10 years. Moreover, judicial institutions and the legal framework for fighting corruption crimes continue to be under intense pressure.

1. ECONOMIC SITUATION AND OUTLOOK

GDP and potential growth

Growth accelerated further in 2017, fuelled by domestic demand. Real GDP is estimated to have increased by 6.7 % in 2017, following the 4.8 % advance in 2016, marking a new post-crisis peak. Real GDP growth is forecast to ease off but remain above potential growth, at 4.5 % in 2018 and 4.0 % in 2019. Private consumption was the main contributor to growth in 2017, supported by indirect tax cuts and wage hikes both in the public and the private sectors. Private consumption is forecast to slow down in 2018, as inflation increasingly weighs on real disposable income, but is expected to remain the main growth driver. The output gap, which is estimated to have turned positive in 2017, is projected to increase further as actual GDP growth continues to outpace potential growth.

Graph 1.1: GDP components and output gap



Source: European Commission

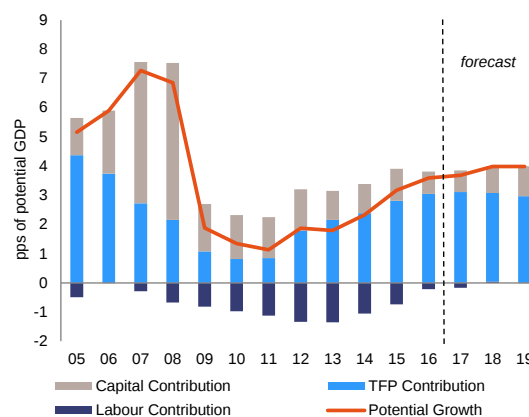
This strong upswing will not be sustainable in the absence of reforms to increase the economy's potential. Private consumption has accounted for most of the strong growth over the past few years, supported by a pro-cyclical fiscal policy⁽²⁾ (Graph 1.1). In contrast, the contribution of investment to GDP growth has mostly been modest in recent years. In the longer run, insufficient progress on implementing structural reforms supporting investment and the

⁽²⁾ Loosening fiscal policy when the economy is doing well and tightening it when the economy is doing badly

transformation to a higher value added economy will constrain economic growth (see Section 3).

Potential growth has improved somewhat driven mainly by total factor productivity. Potential growth is estimated to have been around 3.7 % in 2017, compared to an average of 4.6 % over 2000-2008 (Graph 1.2). Growth in total factor productivity⁽³⁾ has been the main driver of potential growth since 2012 and is expected to remain so in the coming years. The contribution of capital accumulation continued to be positive, but smaller compared to pre-crisis times. The contribution of labour was close to zero in 2016 and is estimated to have remained so in 2017 as the effects of a shrinking working-age population and a falling unemployment rate cancelled each other out. Demographics will continue to weigh on growth, calling for sustained improvements to labour productivity (both through total factor productivity growth and more efficient investment) and to labour force participation so as to allow further convergence towards EU average income levels (see Sections 3.3-3.5).

Graph 1.2: Contributions to potential growth



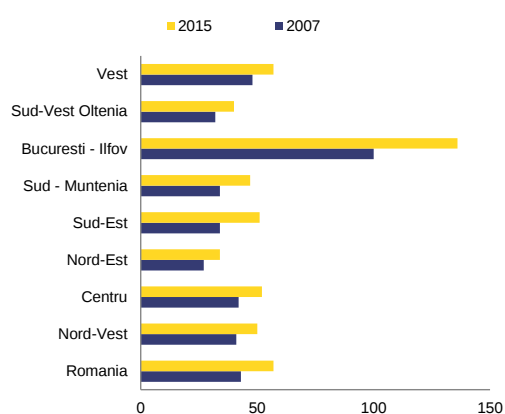
Source: European Commission

Per capita GDP is converging towards EU averages but regional disparities persist. GDP per capita in Romania increased from slightly more than 40 % of the EU average at the time of accession in 2007 to almost 60 % in 2016. Nevertheless, Romania remains one of the EU countries with the lowest GDP per capita.

⁽³⁾ Change in output that cannot be accounted for by the change in either labour or capital inputs.

Although all regions have made progress on GDP convergence, the capital region advanced at a markedly faster pace with GDP per capita reaching almost 140 % of the EU average in 2015, further widening the already large gap with the rest of the country (Graph 1.3).

Graph 1.3: GDP by region



(1) GDP in purchasing power standard (PPS) per inhabitant as a percentage of the EU average

Source: European Commission

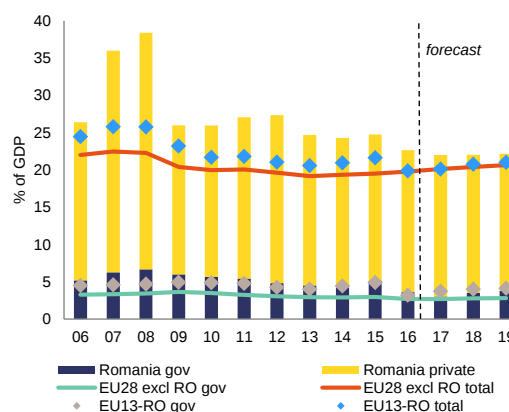
Investment

Romania has one of the highest investment ratios in the EU but the quality of investment is not improving. Total investment reached 22.7 % of GDP in 2016, above the average for the EU (19.8 %) and for the new Member States (19.9 %) (Graph 1.4), consistent with the catching-up process of the Romanian economy. However, the quality of public investment remains constrained by management deficiencies, frequently changing priorities and difficulties in absorbing EU funds while private investment is hampered by continued legal uncertainty and red tape (see Section 3.4).

After a contraction in 2016, investment growth started to recover in 2017. Overall, investment increased by 3.4 % in the first nine months of 2017, following a reduction by 3.5 % in 2016. However, public investment fell sharply in 2017 for the second consecutive year as the uptake of projects financed by EU funds under the 2014-2020 programming period lagged behind. Public investment is estimated to have dropped to 3 % of GDP in 2017, more than 2 percentage points (pps) below the average of the last 10 years. Private

investment, driven mainly by housing construction and equipment investment, recovered somewhat but could only partially compensate for the drop in public investment.

Graph 1.4: Gross fixed capital formation



Source: European Commission

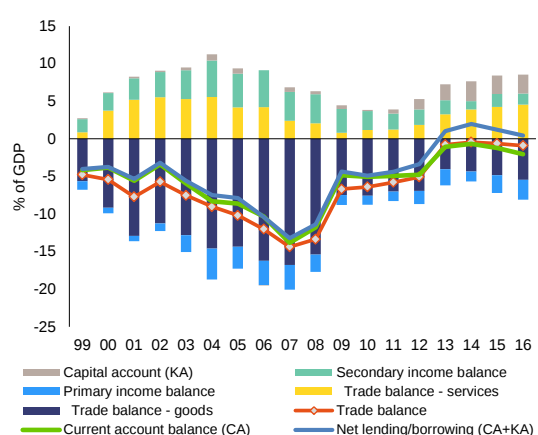
Investment is expected to strengthen but uncertainties persist. Public investment is projected to start recovering on the back of a pick-up in the implementation of projects financed by EU funds and amount to 3.5% of GDP in 2018. The 2018 budget provides for a 7.3% increase in domestically-funded capital expenditure compared to 2017 budget execution. However, in the past the initial investment budget has often been substantially under-executed, pointing to similar risks for the future. The tightening of monetary policy in response to mounting inflationary pressures could weigh on private investment.

External position

The current account deficit has widened since 2014. The reduction of macroeconomic imbalances under the balance-of-payments programmes contributed to a significant improvement of the current account deficit from the trough of 12.7 % of GDP in 2007 to a balanced position in 2014 (European Commission, 2015a). The adjustment was driven by improvements in the trade balance, especially in services (Graph 1.5). However, on the back of robust consumption-led import growth, the current account balance turned around and deteriorated to -0.6 % of GDP in 2015, - 2.3 % in 2016 and - 3.1 % in 2017. As of 2016, the current account deficit was more than 1 pp. higher than

expected from the fundamentals. Import growth is projected to continue outpacing that of exports, leading to a further widening of the current account deficit to 3.2 % in 2018 and 3.4 % in 2019. Despite the persistent current account deficit, Romania's negative international investment position has improved as a share of GDP on the back of the strong economic growth (see Section 3.4).

Graph 1.5: Current account breakdown



Source: European Commission

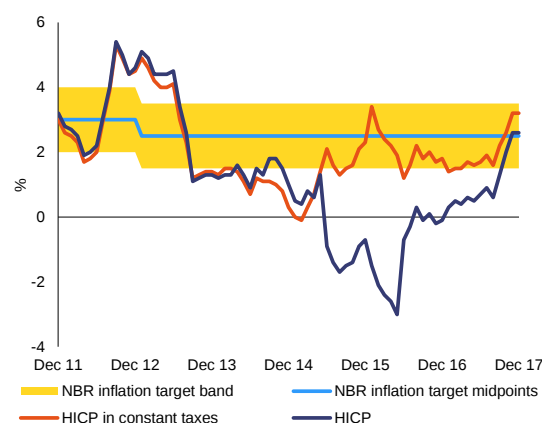
Inflation and monetary policy

After 2 years of falling consumer prices, inflation is picking up. Inflation has been markedly influenced by the successive reductions of the VAT rates for different categories of products and dampened by persistently low global oil prices. After reaching a -3 % low in May 2016, the average harmonised index of consumer prices (HICP) inflation progressively increased but remained subdued due to a further 1 pp. VAT cut in January 2017 and a reduction in excise duties on fuel. Inflation started to accelerate in the second half of 2017, re-entering the National Bank of Romania's (NBR) target band of 2.5 % $\pm$ 1 % (Graph 1.6). Headline inflation is projected to further pick up in 2018 as demand pressures mount and the effect of disinflationary tax cuts fades away – or, in the case of excise duties, the cuts themselves are reversed.

The NBR has started to reverse its very accommodative monetary policy stance. In January 2018 the NBR increased its key monetary policy rate, which had been unchanged since May

2015, from 1.75 % to 2 %. Market participants expect further hikes in 2018 given the mounting inflationary pressures. In November 2017, the symmetrical corridor formed by the interest rates on permanent credit and deposit facilities was narrowed to $\pm$ 1 pp. around the monetary policy rate. So far the corridor has been narrowed by 150 bps since November 2014. The aim is to mitigate interbank money market rate volatility and further strengthen the transmission of the policy rate signal.

Graph 1.6: Harmonised index of consumer prices (HICP) inflation in constant taxes

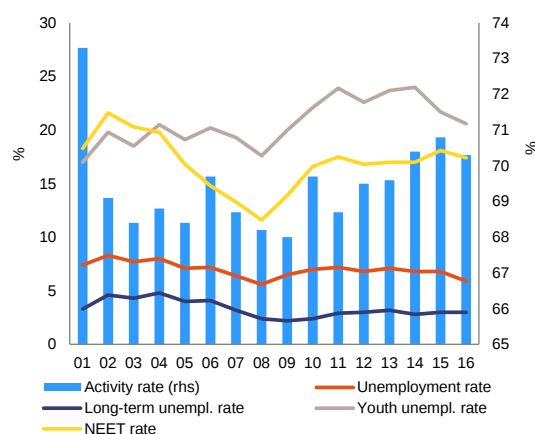


(1) HICP in constant taxes assumes a full pass-through of VAT changes to consumer prices.
(2) Inflation targets are formulated in terms of the annual change in the consumer price index and are set as midpoints within a target band of $\pm$ 1 percentage points.
Source: European Commission, National Bank of Romania

Labour market

Labour market conditions further improved owing to strong economic growth. Unemployment declined further and is estimated to have reached 4.9 % in Q3-2017, the lowest level in more than 20 years. Employment growth was robust and the employment rate increased to 69 % in Q3-2017, within reach of the national Europe 2020 target of 70 %. The activity rate has also been increasing steadily since mid-2016 but remains one of the lowest in the EU.

Graph 1.7: Labour market outcomes



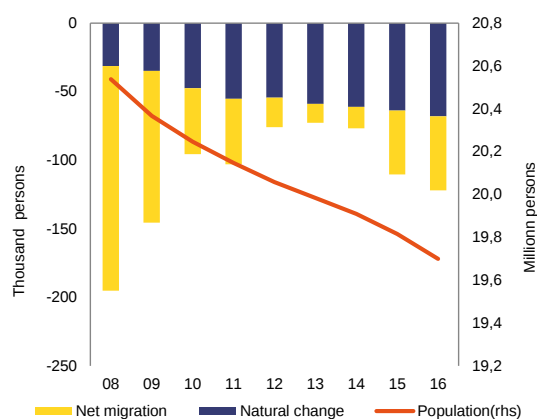
(1) Activity rate in % of population, total, ages 20-64; unemployment rate and long-term unemployment rate in % of labour force, total, ages 15-74; youth unemployment rate in % of labour force, total, ages 15-24; NEET: not in education, employment or training in % of population, total, ages 15-24

Source: European Commission

Despite these positive developments, access to the labour market remains highly unequal. Access is particularly challenging for women, people with disabilities, Roma and young people. While youth unemployment has been declining since 2015, the share of young people not in education, employment or training (NEET) remains high, and only recently showed signs of improvement. Moreover, the gender employment gap has increased slightly in 2016 to 17.6 % and remains one of the largest in the EU.

Labour supply is not keeping up with the fast-changing needs of the economy. Romania is facing unfavourable demographics. The population has been declining for almost three decades and this trend is expected to continue for the foreseeable future (Graph 1.8). Population ageing will represent a further significant drag on potential economic growth, with the share of people of working age (15-64) expected to fall from 67 % in 2016 to 55 % by 2050. Continued migration poses an additional challenge. Despite recent improvements, labour force participation rates, particularly for women and people older than 50, remain well below EU averages. Skills shortages and mismatches also have an adverse impact on the quality and quantity of labour supplied.

Graph 1.8: Population, natural change and net migration



Source: European Commission based on national data

The growth in labour compensation has accelerated in recent years. The low unemployment, combined with a shrinking labour force and persistent skills shortages, led to a tighter labour market and economy-wide wage increases. After strong growth in 2016, wages increased further in 2017, also driven by a 16 % minimum gross wage hike in February to RON 1 450 (c. EUR 315) and public-sector wage increases. Wages are projected to increase further in 2018 as the net minimum wage was increased by a further 9 % in January while the average net wage in the public sector could progress by 11.5 % (see Section 3.1) ⁽⁴⁾. Wages in Romania remain low compared to the EU average and relatively high wage growth is to be expected from a catching-up economy. However, current patterns of wage growth may not be sustainable. Public wages increased by more than 70% between Q1-2015 and Q3-2017 and have considerably outpaced wages in the private sector. The minimum wage has also increased by more than 60% in net terms since 2015. Around 30% of workers earned the minimum wage in 2017, which indicates a highly compressed wage distribution. The strong wage growth may put pressure on competitiveness and inflation if productivity growth does not keep pace with the increases in wages (see Section 3.4.1).

⁽⁴⁾ Taking into account the shift of social contributions from employers to employees, which is expected to partly offset gross wage increases.

Social developments

Poverty remains high. In 2016 the risks of poverty and social exclusion increased, affecting 38.8 % of the population and reversing a decreasing trend of several years. The trend does not appear to improve, driven by increases in equivalised disposable income for all households except for the poorest 10 % ⁽⁵⁾. The divide between the rich and the poor and between rural and urban areas remains high. High poverty risks are mostly associated with high inactivity levels.

High economic growth is accompanied by high inequality. The income of the top 20 % of the population exceeds by seven the income of the bottom 20 % compared to a ratio of five for the EU-28 (see Section 3.3). Meanwhile, inequality at the lower end of the income distribution appears more pronounced, with the bottom 10 % of the population earning 14 times less than the bottom 50 %, one of the highest ratio in the EU.

Inequality remains high along many dimensions. Income inequality remains one of the highest in the EU despite the recent decline, while the tax and benefit system has a limited effect on reducing market income inequality (i.e. before taxes and transfers including pensions) (see Section 3.1.1). Opportunities are also unequal, with educational outcomes and risk of poverty for children highly correlated with parents' education levels (see Section 3.3). The gap in unmet healthcare needs between the richest and the poorest households (6.5 %) is one of the widest in Europe. These in turn affect labour market outcomes (see Section 3.3).

Public finances

The public deficit has been widening due to pro-cyclical fiscal policy. Indirect taxes (in particular the standard VAT rate) were cut in 2017, while the personal income tax rate was cut from January 2018. On the expenditure side, public wages and old-age pensions significantly increased in 2017 and will continue to do so in 2018. As a consequence, the structural deficit ⁽⁶⁾ is projected to have widened from 2.2 % of GDP in 2016 to

3.3 % in 2017 and to reach 4.3 % in 2018. Meanwhile, the headline deficit is projected by the Commission to have remained at 3.0 % of GDP in 2017 and increase to 3.9 % in 2018 assuming no-policy change (see Section 3.1.1).

The tax cuts and expenditure increases are being financed with public debt. Because of the widening of the public deficit, the general government debt is projected to increase from 37.6 % of GDP in 2016 to 40.5 % of GDP in 2019. Assuming no policy change, public debt is projected to increase to above 60 % of GDP in 2027 (see Section 3.1.4).

Financial sector

Credit growth picked up in 2017. After several years of decline, credit to non-financial corporations started to increase in the second half of 2017 (Graph 1.10). Meanwhile, the growth of credit to households remained stable as a slowdown in the growth of mortgages was compensated by a pick-up in consumption credit. The stock of foreign currency loans continued to fall for both household and corporations, with the domestic currency increasing its share of the total loan stock to 61.8 % in November 2017 (up from a low of 35.6 % in May 2012).

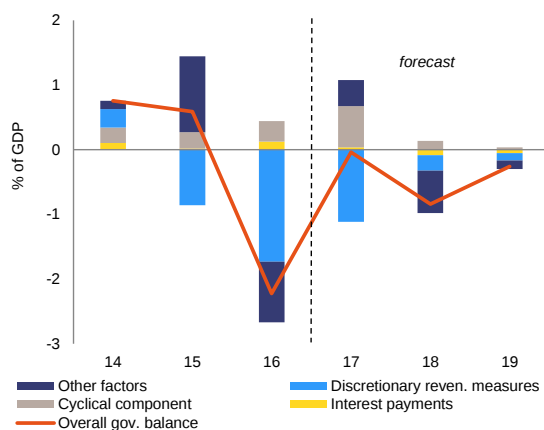
House prices are increasing fast, but from a still low level. House prices corrected strongly between 2008 and 2012, falling by more than half in real terms. The correction reversed in 2015 and prices picked up in 2016, increasing by 6.5 % in real terms. The strong momentum continued in the first quarters of 2017, supported particularly by increasing household disposable income and rapid economic growth. Despite a strong increase in 2015 (+15.5 %) and 2016 (+12.0 %) which provided further support to house price growth, mortgages in Romania continue to account for a relatively small share of GDP (7.6 % versus 37.5 % in the euro area in 2016). In spite of the recent increase, valuation metrics suggest that house prices remain undervalued ⁽⁷⁾ so the increase in house prices could continue.

⁽⁵⁾ Based on Eurostat experimental flash estimates for income reference year 2016, which can be used in preliminary analysis until the final EU-SILC data becomes available.

⁽⁶⁾ Defined as the deficit corrected for the business cycle

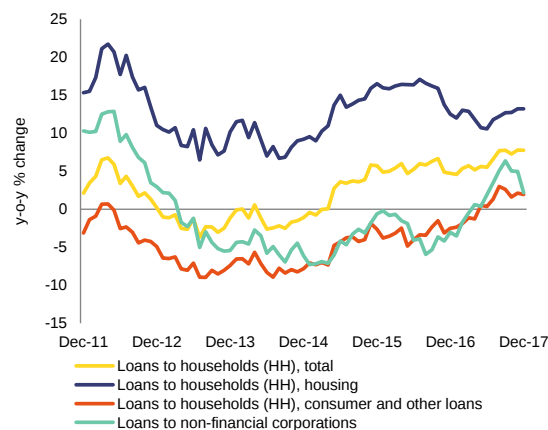
⁽⁷⁾ Methodology in Philipponnet and Turrini (2017)

Graph 1.9: Breakdown of change in general government balance



Source: European Commission

Graph 1.10: Loans to households and non-financial corporations

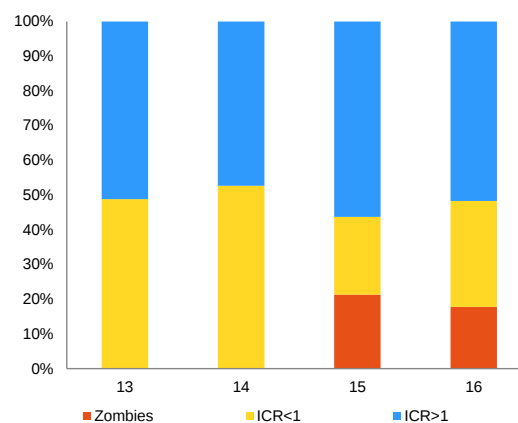


Source: National Bank of Romania

The banking sector continues to be profitable, well capitalised and liquid. Capital adequacy at system level has been stable since end-2015 and stood at 19 % at the end of September 2017. Liquidity remained at comfortable levels, with the loan-to-deposit ratio around 80 % at end-September 2017. The share of non-performing loans (NPLs) has fallen significantly (see Section 3.2). Despite compressed interest margins, banking profitability has remained in positive territory since 2015.

Non-performing loans continue to fall but the share of companies facing financial distress remains high. In 2016, more than 40 % of companies in selected sectors had an interest coverage ratio lower than 1, suggesting a limited ability to meet interest payments (Graph 1.11). The large share of financially stressed companies can act as a drag on economic growth. Besides being significantly less productive, financially constrained companies also tend to reduce employment and invest less than non-financially stressed companies. State-owned enterprises accounted for a substantial share of financially distressed companies (see Section 3.4).

Graph 1.11: Share of debt in companies facing financial stress



(1) Zombies are defined as companies that are less than 10-years old and for which the interest coverage ratio has been below one for more than 3 years in a row (only available from 2015 onwards). The analysis does not include firms in agriculture, mining, finance and insurance, public administration, the arts and households as employers.

Source: Orbis and European Commission calculations

Table 1.1: Key economic, financial and social indicators – Romania

	2004-07	2008-12	2013-14	2015	2016	forecast		
						2017	2018	2019
Real GDP (y-o-y)	6.8	0.4	3.3	4.0	4.8	6.7	4.5	4.0
Potential growth (y-o-y)	5.8	2.5	1.9	3.2	3.6	3.7	4.0	4.0
Private consumption (y-o-y)	13.2	-0.4	2.7	5.9	7.6	.	.	.
Public consumption (y-o-y)	-2.4	1.1	-2.0	0.2	3.1	.	.	.
Gross fixed capital formation (y-o-y)	23.2	-3.6	-1.2	7.4	-2.0	.	.	.
Exports of goods and services (y-o-y)	9.9	4.0	13.7	4.6	8.7	.	.	.
Imports of goods and services (y-o-y)	22.3	-0.5	8.8	8.0	9.8	.	.	.
Contribution to GDP growth:								
Domestic demand (y-o-y)	14.4	-1.4	1.0	5.5	4.6	.	.	.
Inventories (y-o-y)	-1.4	0.0	0.6	-0.1	0.7	.	.	.
Net exports (y-o-y)	-6.4	1.3	1.6	-1.4	-0.5	.	.	.
Contribution to potential GDP growth:								
Total Labour (hours) (y-o-y)	-0.4	-1.0	-1.2	-0.7	-0.2	-0.2	0.0	0.0
Capital accumulation (y-o-y)	2.2	2.3	1.0	1.1	0.8	0.7	0.9	1.0
Total factor productivity (y-o-y)	4.0	1.2	2.0	2.8	3.0	3.1	3.0	3.0
Output gap	5.5	-1.5	-3.2	-2.1	-1.2	0.7	1.1	1.2
Unemployment rate	7.2	6.6	7.0	6.8	5.9	5.3	5.1	5.0
GDP deflator (y-o-y)	13.4	6.3	2.5	2.6	2.1	2.0	3.2	3.3
Harmonised index of consumer prices (HICP, y-o-y)	8.1	5.7	2.3	-0.4	-1.1	1.1	4.1	3.0
Nominal compensation per employee (y-o-y)	15.8	8.0	5.3	1.9	9.8	13.2	10.9	7.8
Labour productivity (real, person employed, y-o-y)	7.4	2.1	3.3	5.3	5.8	.	.	.
Unit labour costs (ULC, whole economy, y-o-y)	7.8	5.8	1.8	-3.3	3.8	7.9	6.6	3.7
Real unit labour costs (y-o-y)	-4.9	-0.5	-0.7	-5.7	1.7	5.8	3.2	0.4
Real effective exchange rate (ULC, y-o-y)	9.6	-2.5	2.2	-6.0	1.8	6.1	4.1	1.7
Real effective exchange rate (HICP, y-o-y)	8.5	-2.9	2.6	-2.4	-1.2	-2.0	0.7	.
Savings rate of households (net saving as percentage of net disposable income)	-22.3	-16.9	7.5	.	.	.	.	.
Private credit flow, consolidated (% of GDP)	13.9	3.0	-1.9	0.2	0.6	.	.	.
Private sector debt, consolidated (% of GDP)	43.2	70.7	64.3	59.1	55.8	.	.	.
of which household debt, consolidated (% of GDP)	11.9	21.4	18.6	17.5	16.8	.	.	.
of which non-financial corporate debt, consolidated (% of GDP)	31.4	49.3	45.7	41.7	39.0	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) (2)	.	.	16.9	10.7	7.7	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	-2.8	6.3	-2.6	-5.6	-5.0	-5.6	-4.9	-5.4
Corporations, gross operating surplus (% of GDP)	25.8	28.3	31.6	31.7	32.0	30.0	29.2	28.0
Households, net lending (+) or net borrowing (-) (% of GDP)	-4.7	-5.6	6.2	8.2	6.7	7.2	7.3	7.9
Deflated house price index (y-o-y)	.	.	-3.0	1.9	6.5	.	.	.
Residential investment (% of GDP)	2.0	2.9	2.4	2.4	2.6	.	.	.
Current account balance (% of GDP), balance of payments	-10.2	-6.2	-0.9	-1.2	-2.1	-2.8	-2.8	-2.6
Trade balance (% of GDP), balance of payments	-11.3	-7.4	-0.6	-0.6	-0.9	.	.	.
Terms of trade of goods and services (y-o-y)	5.7	1.1	1.3	2.8	0.4	-1.5	-0.5	0.5
Capital account balance (% of GDP)	0.5	0.6	2.4	2.4	2.5	.	.	.
Net international investment position (% of GDP)	.	-61.7	-60.0	-54.6	-49.9	.	.	.
Net marketable external debt (% of GDP) (1)	.	-22.2	-18.2	-13.0	-7.4	.	.	.
Gross marketable external debt (% of GDP) (1)	.	57.7	53.4	45.2	40.2	.	.	.
Export performance vs. advanced countries (% change over 5 years)	84.0	70.5	53.7	22.7	20.1	.	.	.
Export market share, goods and services (y-o-y)	13.9	2.4	10.7	-0.2	8.5	.	.	.
Net FDI flows (% of GDP)	-7.1	-2.8	-1.9	.	-2.7	.	.	.
General government balance (% of GDP)	-1.7	-6.1	-1.7	-0.8	-3.0	-3.0	-3.9	-4.1
Structural budget balance (% of GDP)	.	.	-0.7	-0.3	-2.2	-3.3	-4.3	-4.6
General government gross debt (% of GDP)	14.8	27.4	38.6	37.9	37.6	37.9	39.0	40.4
Tax-to-GDP ratio (%)	28.4	27.3	27.4	28.0	26.0	25.6	26.0	26.2
Tax rate for a single person earning the average wage (%)	27.2	28.5	25.8	25.3	.	.	.	.
Tax rate for a single person earning 50% of the average wage (%)	22.7	25.5	23.0	22.9	.	.	.	.

(1) NIIP excluding direct investment and portfolio equity shares

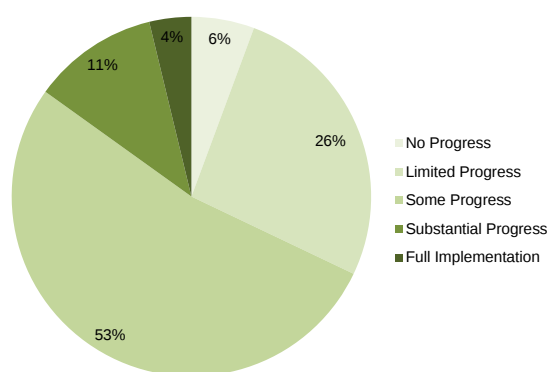
(2) Domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches.

Source: Eurostat and ECB as of 30 Jan 2018, where available; European Commission for forecast figures (Winter forecast 2018 for real GDP and HICP, Autumn forecast 2017 otherwise)

2. PROGRESS WITH COUNTRY-SPECIFIC RECOMMENDATIONS

Progress with the implementation of the recommendations addressed to Romania in 2017⁽⁸⁾ has to be seen in a longer-term perspective since the introduction of the European Semester in 2011. Looking at the multi-annual assessment of the implementation of the CSRs since these were first adopted, 68 % of all the CSRs addressed to Romania have recorded at least 'some progress'. 32 % of these CSRs recorded 'limited' or 'no progress' (see Graph 2.1). Overall, Romania has advanced in implementing country specific recommendations (CSRs) since 2013, and some reforms have been pursued even during the economically challenging times. The decisiveness and speed of implementation have however been uneven, largely dependent on political developments. While there was an acceleration of reform in 2016, the recent follow-up on reform priorities in key sectors has been less strong. In several policy areas subject to CSRs measures have been slowed down or even reversed and significant efforts are still needed to achieve tangible results of reform implementation.

Graph 2.1: Overall multiannual implementation of 2011-2017 CSRs to date



(1) The overall assessment of the country-specific recommendations related to fiscal policy exclude compliance with the Stability and Growth Pact.
 (2) 2011-2012: Different CSR assessment categories.
 (3) The multiannual CSR assessment looks at the implementation since the CSRs were first adopted until the February 2018 country report.
Source: European Commission

On fiscal adjustment past progress has been gradually undone. Since 2009, Romania pursued a significant fiscal consolidation which led to achieving its medium-term objective in 2014 and 2015. However, the authorities have been pursuing an expansionary fiscal policy since 2016 that led to a substantial departure from that objective.

Progress on labour market and social assistance reforms moderated in 2017. Some progress was achieved on improving active labour market policies and the public employment service reform especially in 2016, but slowed down since then. The reform of the National Employment Agency is still to be implemented and sustained over the long term through a strong political commitment. No progress was made in 2017 on applying objective criteria for the minimum wage setting and on equalising pensionable age for men and women, following the advances seen in 2016. Progress has been uneven on social assistance reform. The implementation of the Minimum Inclusion Income Law, adopted in 2016, stalled in 2017 and is now postponed for 2019. The pilot project aiming to introduce integrated teams in a number of most deprived communities is delayed. The link with activation measures needs further strengthening. The poverty reduction power of social transfers is still among the lowest in the EU and there is no objective mechanism to update social benefits.

Access to quality and inclusive education is faced with continuous challenges. Over the last years, the Romanian authorities have taken some measures to address poor education outcomes and skill shortages by adopting relevant strategies. Some progress has been made in vocational education and training, lifelong learning and higher education but the quality of these services and their labour market relevance remain largely insufficient. After the adoption of the Strategy for Early School Leaving in 2015 and the progress observed the following year, efforts to continue implementation were modest in 2017. This is reflected in high early school leaving rates, unequal access to quality education including for the Roma and large gaps in terms of student performance all pointing to persistent hurdles.

Healthcare reform is progressing at a slow pace. Since 2013, the Romanian authorities have made some progress in implementing health-related

⁽⁸⁾ For the assessment of other reforms implemented in the past, see in particular section 3.1, 3.3, 3.4 and 3.5.

country specific recommendations on a yearly basis, albeit with some difficulties due to the modest administrative capacity of the Ministry of Health, shifting priorities, poor investment planning and in some cases the lack of political commitment. The shift to outpatient care remains at an early stage, with most efforts concentrated on hospital care. Past measures on reporting informal payments need more time to deliver visible results.

Progress on the reform of the public administration has been overall limited. Romanian authorities took some measures regarding the public administration reform by adopting in 2016 the new civil service and staff training strategies. However, draft legislation reflecting the relevant objectives is not yet adopted and results will be seen only around mid-2019. The incomplete human resource reforms limit the capacity to develop and implement policies in a strategic manner, weigh on investments and negatively impact the businesses environment.

Overall, Romania made limited progress⁽⁹⁾ in addressing the 2017 country-specific recommendations. There was limited progress on tax compliance and collection, activation measures, education, outpatient care, public administration and public investment prioritization. No progress was made on minimum wage setting, pensionable age and fiscal framework. In contrast, there was some progress on public procurement, fighting undeclared work and curbing informal payments in healthcare. Legislative changes adopted in 2017 reversed the substantial progress made the previous year in strengthening the corporate governance of state-owned enterprises, pointing to a significant backtracking on past reforms.

European Structural and Investment Funds (ESI Funds) are pivotal in addressing key challenges to inclusive growth and convergence in Romania, notably by reforming the public procurement system, strengthening the quality and accessibility of primary and community healthcare, and improving basic transport, waste and water infrastructure. The ESI Funds also help extend

broadband access and e-Government services, they support youth not in education, employment or training, reinforce the capacity of the public employment service and improve the integration of employment, social and education services.

Member States can request from the Commission technical support to prepare, design, and implement growth-enhancing structural reforms. The Structural Reform Support Service (SRSS) provides, in cooperation with the relevant Commission services, tailor-made technical support, which does not require co-financing and is provided at a Member State's request. The support addresses priorities identified in the context of the EU economic governance process (i.e., implementation of country-specific recommendations), but the scope of the SRSS support is wider as it can also cover reforms linked to other Commission priorities, or reforms undertaken at the initiative of Member States.

Romania has requested technical support from the SRSS to help implement reforms in various areas. These include governance and public administration, revenue administration, growth and the business environment, health, social services, education, the financial sector and access to finance. In particular, the SRSS provides support to improve the supervisory capacity of the Romanian Financial Supervisory Authority.

⁽⁹⁾ Information on the level of progress and actions taken to address the policy advice in each respective subpart of a CSR is presented in the Overview Table in the Annex. This overall assessment does not include an assessment of compliance with the Stability and Growth Pact.

Table 2.1: Summary table on CSR assessment

Romania	Overall assessment of progress with 2017 CSRs: Limited progress
CSR 1: In 2017, ensure compliance with the Council Recommendation of 16 June 2017 with a view to correcting the significant deviation from the adjustment path toward the medium-term budgetary objective. In 2018, pursue a substantial fiscal effort in line with the requirements of the preventive arm of the Stability and Growth Pact. Ensure the full application of the fiscal framework. Strengthen tax compliance and collection. Fight undeclared work, including by ensuring the systematic use of integrated controls.	Limited progress • No progress was made in ensuring that the national fiscal framework is implemented • and limited progress in strengthening tax compliance and collection. • Some progress was made on fighting undeclared work
CSR 2: Strengthen targeted activation policies and integrated public services, focusing on those furthest away from the labour market. Adopt legislation equalising the pension age for men and women. Establish a transparent mechanism for minimum wage-setting, in consultation with social partners. Improve access to quality mainstream education, in particular for Roma and children in rural areas. In healthcare, shift to outpatient care and curb informal payments.	Limited progress • Limited progress was made in strengthening targeted activation policies and integrated public services. • No progress was made on equalising of the pensionable age for men and women. • No progress was made on minimum wage setting. • Limited progress was made on improving access to quality mainstream education. • Limited progress was made on shifting to outpatient care • Some progress was made on curbing informal payments.
CSR 3: Adopt legislation to ensure a professional and independent civil service, applying objective criteria. Strengthen project prioritisation and preparation in public investment. Ensure the timely full and sustainable implementation of the national public procurement strategy.	Limited progress • Limited progress was made adopting legislation to ensure a professional and independent civil service. • Limited progress was made on strengthening project prioritization and preparation in public investment. • Some progress was made on implementing the national public procurement strategy.

(1) This does not include an assessment of compliance with the Stability and Growth Pact

Source: European Commission

Box 2.1: Tangible results delivered through EU support to structural change in Romania

Romania is a beneficiary of significant European Structural and Investment Funds (ESI Funds) support and can receive up to EUR 30.8 billion until 2020. This represents around 3 % of GDP annually over the period 2014-2018 and 49% of public investment ⁽¹⁾. By 31 December 2017, an estimated EUR 8.2 billion (27 % of the total) was allocated to projects on the ground. The investments already contracted will enable the hiring of 174 new researchers, the registration of 200 000 young people not in education, employment or training to the public employment services, the support of 55 marginalised communities through an integrated approach and the implementation of new primary and secondary education curricula. Out of the EU financing, EUR 300 million from the European Regional Development Fund is to be delivered via financial instruments, a 133% increase compared to the 2007-2013 period.

ESI Funds help address structural policy challenges and implement country-specific recommendations. Actions financed cover, among others, strategic investments in transport, energy, water and waste management infrastructure; strengthening primary and community healthcare and improving accessibility for vulnerable groups; improving the effectiveness of the justice system; extending broadband access and developing inter-operable eGovernment services. The capacity of the public employment service has been reinforced. Other measures aim to strengthen the management and control systems of EU funds and improve strategic planning. Public procurement reform is supported via the establishment of a Public Procurement Agency, the transposition of the 2014 public procurement directives and the adoption of secondary legislation. However, implementation on the ground is significantly delayed in several sectors.

Various reforms were undertaken already as precondition for ESI Funds support. ⁽²⁾ The National Transport Master Plan and the National Waste Management Plan aim to provide a stable and sustainable roadmap for future investments and strengthen the administrative capacity of state-owned enterprises in the sector. However, progress in the preparation of projects aligned to the new strategic planning is very slow. Efforts are made for the swift completion of the preconditions on waste and transport so as to avoid a possible suspension of payments. Romania has received support for the design and implementation of regional smart specialization strategies and for ensuring synergy with the national smart specialisation sectors. Given the success of the pilot phase of the project, focused on the North-East and North-West regions, the Commission is now preparing a roll-out to the other regions, with additional support from the World Bank. The two pilot regions will benefit from dedicated funding for project ideas developed as part of bottom-up, collaborative activities involving regional authorities, universities, businesses and technological transfer entities.

Romania is advancing the take up of the European Fund for Strategic Investments (EFSI). As of December 2017, overall financing volume of operations approved under the EFSI amounted to EUR 327 million, which is expected to trigger total private and public investment of EUR 1.1 billion into over 2 500 companies. RDI ranks first in terms of operations and volume approved, followed by energy and SMEs ⁽³⁾.

Funding under Horizon 2020, the Connecting Europe Facility and other directly managed EU funds is additional to the ESI Funds. By the end of 2017, Romania has signed agreements for EUR 1.2 billion for projects under the Connecting Europe Facility.

<https://cohesiondata.ec.europa.eu/countries/RO>

- 1) Defined as gross fixed capital formation+ investment grants + national expenditure on agriculture and fisheries.
- 2) Before programmes are adopted, EU countries are required to comply with a number of prerequisites, which aim at improving conditions for the majority of public investments areas.
- 3) For more details see EFSI factsheet for Romania at https://ec.europa.eu/commission/publications/country-factsheets-investment-plan-state-play_en.

3. REFORM PRIORITIES

3.1. PUBLIC FINANCES AND TAXATION

3.1.1. FISCAL POLICY

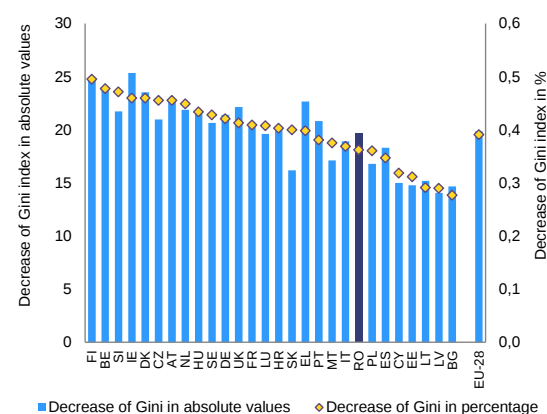
The government has been pursuing an expansionary, pro-cyclical fiscal policy, resulting in an increasing fiscal deficit. Indirect taxes were cut at the beginning of 2017 (in particular the standard VAT rate by 1 pp.) while the flat personal income tax rate was cut from 16 % to 10 % from January 2018. On the expenditure side, public wages have been significantly increased in 2017 and 2018, following the adoption of the Unified Wage Law (UWL) in summer 2017, although the fiscal impact of the increases of the gross wages in the public sector was partially contained by a switch of the social contributions to the employee side from January 2018 (see Box 3.1.1). The government also enacted significant increases to old-age pensions, going beyond the standard pension indexation mechanism, which enter into force in July 2017 and July 2018. As a consequence of these measures, the public deficit has been increasing (see Section 1). In June 2017 the Council launched a significant deviation procedure addressed to Romania.

3.1.2. TAXATION

The tax and benefit system has a relatively low degree of redistribution and hence relatively low influence on income inequality. Per capita spending on social protection is one of the lowest in the EU. The personal income tax has a tax-free allowance and a flat rate (reduced to 10% since January 2018). The tax wedge, i.e., the ratio between the amount of taxes paid by a worker and the corresponding total labour cost for the employer, on low income earners is above the EU average, while for high income earners it is below it ⁽¹⁰⁾. As a consequence, the degree of redistribution, measured as the difference between the market income inequality and the disposable

income inequality, is relatively limited (see Graph 3.1.1 and Sections 1 and 3.1).

Graph 3.1.1: Redistributive power of the tax and benefit system in EU Member States, 2016



(1) Difference between the Gini coefficients for market income inequality (i.e. before tax and benefits) and disposable income inequality (i.e. after tax and benefits). Income data are adjusted for household size (equalisation). The scale of Gini coefficients is from 0 to 100. The value 0 corresponds to perfect equality (same income to everybody) while 100 corresponds to maximum inequality (all income distributed to only one person and all the others have nothing).

(2) No 2016 data available for Ireland, Italy and Luxembourg, therefore 2015 data used instead. (3) The EU-28 average is calculated as the population-weighted average of individual national figures.

Source: Commission calculations based on Eurostat data

Tax compliance remains low, in particular in VAT. The VAT gap in Romania, i.e. the difference between theoretically expected VAT revenues and the VAT actually collected, is the highest in the EU. However, it decreased by 5.7 pps in 2015 (see Graph 3.1.2), the second biggest fall in the EU (CASE et al, 2017). As of October 2017, the government introduced an optional VAT split-payment system, aimed at addressing low VAT collection. By the first half of November only 300 companies decided to switch to this optional system. From 2018, the system is mandatory for insolvent companies and for taxpayers with significant old outstanding VAT liabilities. However, the mandatory introduction of electronic

⁽¹⁰⁾ The tax wedge for those earning 50 % of average wage (AW) was 36.8 %, while for those earning 167 % of AW it amounted to 39.5 % in 2016, compared to the EU average of 32.2 % and 44.4 % respectively. Source: European Commission, Tax and Benefits database, available at http://europa.eu/economy_finance/db_indicators/tab/#.

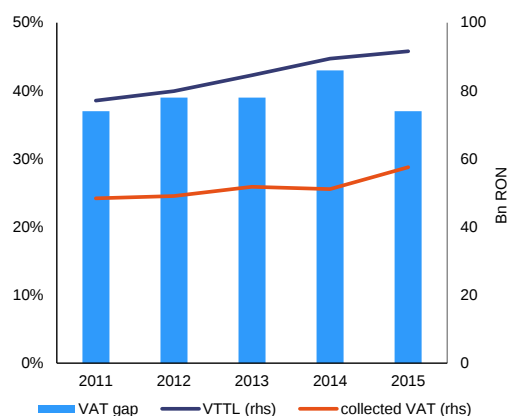
cash registers connected to the tax administration's IT system has been postponed ⁽¹¹⁾.

The incidence of undeclared work continues to be relatively high. The share of employees receiving envelope wages – i.e. with underreported salary – is estimated at double the EU average (Williams and Horodnic, 2017). The informal economy is large, ⁽¹²⁾ also given the high share of self-employment, especially in agriculture. ⁽¹³⁾ In 2017, the Labour and Fiscal Codes were amended ⁽¹⁴⁾ to broaden the definition of undeclared work and to introduce more coercive measures against disguised employment, by increasing fines. While a dedicated department was set up in the Labour Inspectorate to increase controls and run awareness campaigns, the organisation of the fight against undeclared work continues to be fragmented across a range of institutions and the preventive element is still insufficiently developed. Social partners are insufficiently involved in the fight against undeclared work. Since September 2017 (for employers) and January 2018 (for employees) social security contributions for part-time contracts have to be paid based on at least the minimum gross wage.. While the potential impact of this measure has not been fully assessed, it could overall lead to more full time employment. However, the higher tax burden may also create new incentives to avoid formalised employment altogether.

The authorities simplified tax compliance obligations, introduced specific anti-abuse measures and somewhat re-organised the tax administration. The Code of Fiscal Procedures was amended in August 2017. VAT registration and deregistration was made dependent on the

taxpayer's tax risk position (leading to a smoother VAT reimbursement system), the average duration of tax audits was reduced to 82 days, rules for deferring tax payments were made more flexible, and the use of the Private Virtual Space, i.e. an online portal with personal taxpayer accounts, was extended to legal entities, besides individuals ⁽¹⁵⁾. In November, the government introduced specific anti-abuse measures included in Directive 1164/2016 ⁽¹⁶⁾, complementing the general anti-abuse provisions set out already in the Fiscal Code. The Romanian tax administration (ANAF) and its IT system also underwent a minor reorganisation ⁽¹⁷⁾.

Graph 3.1.2: Romania: VAT Revenues, VAT theoretical tax liability (VTTL) and VAT gap



"VAT gap" - the difference between theoretically expected VAT revenues ("VTTL") and actually collected VAT, as a share of the theoretically expected VAT revenues.

Source: CASE et al. (2017)

⁽¹¹⁾ According to the Government Ordinance No. 20/2017, published in Official Gazette No. 705/2017, the new deadline for average and large-sized companies is June 2018, while the deadline for small companies was maintained (August 2018).

⁽¹²⁾ Using OECD methodology, the Romanian National Statistics Office estimated for 2014 a level of 22.1% for the informal/unobserved economy, a slight increase from the OECD estimate of 21.5% for 2010. According to the methodology used, the unregistered workforce is the biggest component of the unobserved economy in Romania.

⁽¹³⁾ Seasonal employment, highly present in agriculture, has to be declared by the employer, and the Labour Inspectorate is competent to conduct checks.

⁽¹⁴⁾ Government Emergency Ordinance No. 53/2017.

⁽¹⁵⁾ The portal's use seems rather limited, with only 144 000 taxpayers connected almost 3 years after its introduction, of which 67 000 are legal entities. See ANAF press release: https://static.anaf.ro/static/3/Anaf/20170717142252_720-17.07.2017-%20com%20spv.pdf

⁽¹⁶⁾ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

⁽¹⁷⁾ Notable changes are: (i) the creation of the so-called National Centre for Financial Information (CNIF) through the merger of some resources from the Large Taxpayers Office of ANAF, the National Agency for Public Procurement (ANAP) and the National Forecasting Commission (CNP); (ii) a further regional reorganisation, and (iii) the centralised management of non-resident taxpayers.

**Box 3.1.1: Emergency Ordinance No 79/2017:
distributive and macroeconomic impact**

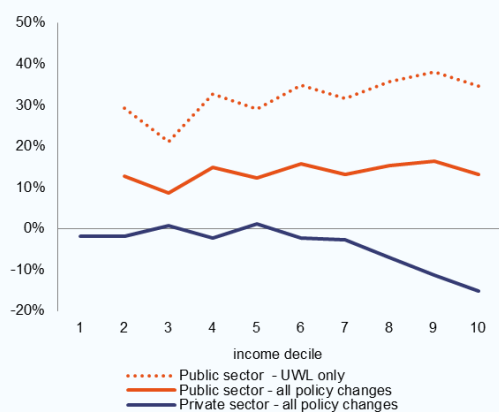
In November 2017 the government adopted Emergency Ordinance No 79/2017 which substantially changed the structure of social contributions by shifting their burden almost entirely to the employees, from 22.75 % for employers and 16.5% for employees to 2.25% and 35% respectively. It also reduced the personal income tax (PIT) rate from 16% to 10% and increased the PIT-free allowance. These changes entered into force on 1 January 2018. They follow the Unified Wage Law (UWL) adopted in summer 2017, which provided for a 25% gross wage increase for most government employees in January 2018 and additional increases in health and education sectors. Also, to compensate for the shift of social contributions, the government increased the minimum gross wage by 31 % to RON 1 900 (EUR 413) and requested social partners to re-negotiate the wages in the private sector. This concerns a very large number of contracts. These measures are set to have a negative impact on the general government balance. Expenditures on wages of public employees are set to increase and the revenues from PIT are set to decrease. The fiscal cost of the increased wages of public employees is set to be partially compensated by the higher social contributions they are paying.

The distributive and equity impact of these changes has been simulated by the European Commission Joint Research Centre using the EUROMOD microsimulation model¹ (Graph 1 below). The simulation is static, i.e. it does not incorporate second-round effects of the reforms on the economy. In the public sector, the disposable income increases across all income deciles, although significantly less than what would have occurred without the social contributions shift. For the private sector, the simulation presents a lower-bound scenario of no reaction of gross wages to the shift. Those earning more than RON 1 593 (EUR 341) in the baseline scenario increasingly lose. This is because the increased burden of the social contributions outweighs the higher minimum gross wage, higher PIT allowance and the reduced PIT rate. Moreover, part-time workers lose due to the introduction of a minimum contributory base for social contributions paid by them. The UWL increases market income inequality, as the public employees are mostly situated in the upper part of the income distribution (Graph 2). This impact is more than compensated by the impact on inequality of the increase of the minimum wage. Taken together, these two measures cause market income inequality to marginally fall. Assuming no adjustment of private gross wages, the Ordinance increases the degree of redistribution, in particular thanks to increased PIT-free allowance, and thus decreases the disposable income inequality. The redistributive effect of the Ordinance is, however, diminished by the reduced PIT rate. A renegotiation of private gross wages of those earning more than RON 1 593 (EUR 341) (not simulated) would cause both market and the disposable income inequality to slightly increase compared to the baseline scenario.

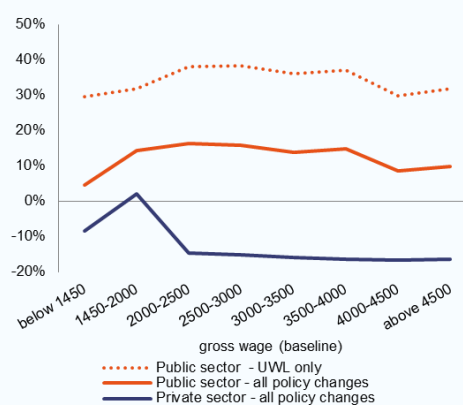
A simulation using the QUEST global macroeconomic model² shows the second round effects of the UWL and the Emergency Ordinance No 79/2017 (Graph 3). The model does not incorporate the minimum wage increase and assumes no spill-overs from public wages increases to private sector wages. The simulation indicates a gradual increase of real gross wages in the private sector in reaction to the social contributions shift. Therefore, real net wages and labour costs (not shown) in the private sector immediately drop and gradually adjust thereafter. GDP immediately increases thanks to an increase in private employment driven by the decrease in average labour tax-rate on employers (and thus a decrease in labour costs) brought by the shift. The gain in GDP would dissipate in the long run, as private wages adjust and the increase in employment dissipates. Adding the minimum wage increase and spill-overs between public and private sector wages would dampen the impact of the reforms on GDP and employment.

Graph 1: **Mean disposable income of public and private sector employees**

A. by decile (equivalised household disposable income)

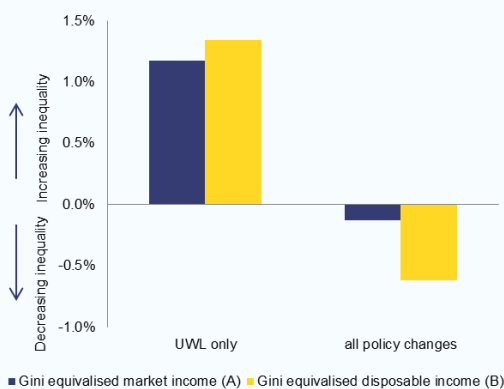


B. by initial gross wage in RON



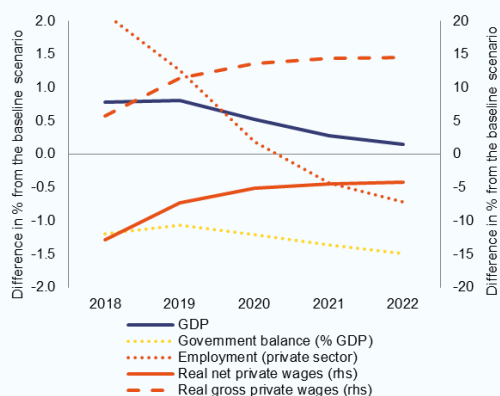
"Public sector – UWL only": pure impact of the public wage increases. "Public sector – all policy changes" and "Private sector – all policy changes": cumulative impact of UWL, Emergency Ordinance No 79/2017 and increased minimum gross wage (assumes no reaction of the gross wages in the private sector).

Source: European Commission Joint Research Centre, calculations based on the EUROMOD model.

Graph 2: **Impact on inequality**

"UWL only": pure impact of the public wage increases; "all policy changes": cumulative impact of UWL, Emergency Ordinance No 79/2017 and increased minimum wage (assuming no adjustment of gross wages in the private sector).

Source: European Commission Joint Research Centre, calculations based on the EUROMOD model.

Graph 3: **Macroeconomic impact**

The graph shows the percentage deviations from the baseline scenario without the reforms. Public wage increases resulting from UWL are simulated as a permanent increase of government expenditures on public wages. The Ordinance is simulated as a shift of labour tax burden from employers to employees.

Source: European Commission, calculations based on the QUEST model

¹ EUROMOD is the tax-benefit microsimulation model for the European Union. The simulations are based on representative survey data from the European Statistics on Income and Living Conditions (EU-SILC).

² QUEST is a dynamic stochastic general equilibrium model. See https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/economic-research/macroeconomic-models_en.

3.1.3. FISCAL FRAMEWORK

The national fiscal framework has not been respected, in what appears to have become a recurrent practice. The deficit rule embedded in the national fiscal framework requires compliance with or convergence to the medium-term budgetary objective of a structural deficit of 1 % of GDP. However, in 2016 structural deficit increased above the medium-term objective, in breach of the national deficit rule. Both the 2017 and 2018 budgets target a headline deficit of close to 3 % of GDP, which in presence of an increasing output gap implies a further deterioration of the structural balance, again contrary to the deficit rule. Additionally, the two 2017 budget amendments (from September and November) broke rules prohibiting increases of the headline and primary deficit ceilings during the fiscal year as well as rules prohibiting increases in personnel expenditure and total government expenditure excluding EU funds during the fiscal year.

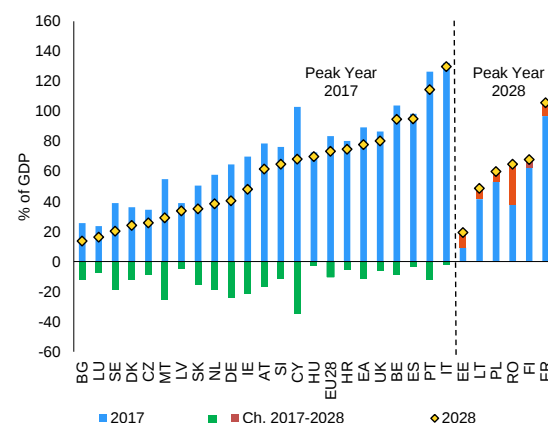
The medium-term fiscal strategy does not guide the annual budget process. Under the Fiscal Responsibility Law, the fiscal strategy sets out the macroeconomic assumptions, medium-term budget planning and expenditure ceilings that should guide the annual budget process. However, in 2017, as in previous years, the authorities did not send an update of the fiscal strategy to Parliament by 15 August, the statutory deadline. Instead the government sent it to Parliament simultaneously with the 2018 budget law in December, thereby undermining the guiding role of the medium-term fiscal strategy.

3.1.4. FISCAL SUSTAINABILITY

With a high fiscal deficit, the public debt ratio is expected to gradually increase, leading to high debt sustainability risks in the medium term. Due to a high structural primary deficit, interest expenditure is set to gradually increase. Increasing ageing costs related to health care and long-term care will also negatively impact the public debt dynamic. As a consequence, assuming no-policy change, the debt-to-GDP ratio is set on an upward path and expected to go beyond the 60 % Treaty reference by 2028. At the same time it is sensitive to shocks on the primary balance.

Romania is one of the few EU countries where debt is projected to rise by 2028 and it is the EU country with the largest projected debt increase ⁽¹⁸⁾ (Graph 3.1.3).

Graph 3.1.3: Public debt projection 2017-2028



(1) The green colour indicates a positive change in general government's debt, while the red colour indicates a negative change.

Source: European Commission

The government partially reversed the 2008 pension reform that introduced the multi-pillar pension system. The 2008 reform provides that a portion of social security contributions is directed to funded individual accounts (a defined contribution scheme) managed by pension funds (second pension pillar). It envisaged that contributions to the second pension pillar would be gradually raised to 6 % of gross wages based on a pre-determined schedule. However, in 2016 contributions were increased to only 5.1 % (instead of 5.5 %) and the 2017 budget maintained this rate. In November 2017 the government enacted an emergency ordinance cutting the rate to 3.75 % of gross wages as from 2018. This change will decrease the fiscal deficit in the short term, as the second pension pillar is classified outside of the general government sector. However, that fiscal gain would dissipate in the long term as the social contributions diverted from the second pillar would be accompanied by an obligation to pay old-age pensions in the future. In addition, this reversal will result in less diversified retirement income. It could also have negative implications for the development of capital markets (see Section 3.2).

⁽¹⁸⁾ For an overview of fiscal sustainability assessment see European Commission (2018a).

3.2. FINANCIAL SECTOR

Banking sector

Banking sector capitalisation continues to be reassuring and asset quality has further improved. Total capitalisation at system level remained roughly flat in the first 9 months of 2017, hovering around 19 %, well above the EU average. The Common Equity Tier 1 ratio⁽¹⁹⁾ has also remained robust, at 17.15 % at the end of September 2017. On the back of the measures adopted since 2014 by the supervisor, non-performing loans (NPLs) fell by roughly 14 pps to slightly below 8 % in September 2017, down from the peak registered in February 2014⁽²⁰⁾. NPLs are estimated to have further fallen to roughly 6 % by the end of December 2017.

However, the ongoing clean-up of banks' balance sheets faces obstacles. Bank balance sheets continue to be burdened by the quality of corporate exposures and the still high level of impaired consumer loans, which require close monitoring. Through the Fiscal Code amendments approved in August 2017, the government limited the tax deductibility of expenditure related to non-performing exposures sold by banks to 30 %, in contrast to the previous system of full tax deductibility. Whereas the current situation appears manageable, especially for highly provisioned NPLs, the new tax treatment is likely to significantly hinder NPL sales and hence the clean-up of bank balance sheets if NPLs were to increase again. Furthermore, if a legislative proposal by Parliament aiming to cap the recovery values from NPLs to no more than double the price paid for these loans by investors (and debt collection companies) is adopted, this is likely to significantly discourage future secondary market transactions with impaired assets.

The National Bank of Romania (NBR) has reiterated its commitment to conducting an asset quality review and stress test of the banking sector in 2018. Preparatory work started already in 2015 with a view to conducting the

exercise in 2016. However, the authorities subsequently postponed the exercise for 2018 to capture the impact of the Debt Discharge Law on banks' balance sheets and to allow for the completion of the IMF 2017 Financial Sector Assessment Programme. The asset quality review and stress test exercise is expected to cover all banks identified as having systemic relevance. It is also expected to be performed with the support of independent and reputable third parties. The exercise will be overseen by a Steering Committee, which includes representatives of the NBR as members, plus observers from the European Commission and the European Banking Authority.

Profitability has remained strong, supported also by the lower costs of risk and funding. On the back of the buoyant economic growth and the increase in lending activity, profitability at system level continued to improve in 2017. However, profitability has varied between banks, as the smaller credit institutions faced more difficulties to generate profit. Net interest income has continued to be the main source of operating revenues, with several banks, in particular smaller credit institutions, having limited capacity to generate non-interest income. The cost-to-income ratio at system level has been lower than the EU average, but there is further scope for improving efficiency, especially for smaller banks. The streamlining of the banks' networks continued, with the total number of branches down by some 3.6 % in September 2017 as compared to end-2016 and by 6.5 % since 2015.

The banks' business model continues to be geared towards lending to households. Whereas banks have become more prudent about household lending than in the pre-crisis period, they have been also more reluctant to switch to a business model focused predominantly on lending to companies. Several factors have contributed to this state of play: (i) the small size of companies, most of which do not meet the EU definition of SMEs and which among other things do not have a track-record of creditworthiness; (ii) the persistent undercapitalisation of a large number of companies, which have not been bankable and have also contributed to the decrease in payment discipline in the economy⁽²¹⁾; (iii) the difficulties

⁽¹⁹⁾ Defined as the ratio of a bank's Tier 1 capital (consisting mostly of common stock) to its risk-weighted assets.

⁽²⁰⁾ The National Bank of Romania's NPL definition is fully in line with that of European Banking Authority. Non-performing exposures are: i) material exposures which are more than 90 days past due; or ii) the debtor is assessed as unlikely to pay its obligations in full without realisation of the collateral, regardless of the existence of any past due amount or of the number of days past due.

⁽²¹⁾ Despite the buoyant economic growth over the past couple of years, the capital position of companies has worsened.

met by banks in hiring qualified staff to support the transition to a business model focused on corporate lending.

Risks to the banking sector posed by legislative initiatives have abated, but require close monitoring. Based on a referral by credit institutions, the Constitutional Court ruled in October 2016 that the Debt Discharge Law, which entered into force in May of that year, was constitutional if certain conditions are met so as to minimise the law's unwarranted adverse impact on the banking sector (European Commission, 2017a). The number of notifications by borrowers intending to use debt discharge has declined since this decision of the Constitutional Court. Similarly, following the 2016 Constitutional Court ruling on the unconstitutionality of Swiss franc-denominated loans conversion into local currency loans (European Commission, 2017a), credit institutions continued their efforts to support borrowers in difficulty by offering the possibility to convert Swiss franc-denominated loans into RON-denominated loans with a discount or by restructuring these loans. Despite these developments, the legislative framework applicable to the banking sector continues to require close oversight. A recent initiative by Parliament aims to introduce a maximum cap on interest rates in all loan contracts for lending to households, both for ongoing and new contracts. Under this proposal, the interest rate should not be higher than the policy rate of the NBR +50 % (i.e. 3 % at the end of January 2018).

Non-banking sector

Although insurance activity expanded in 2017, insurance penetration is still very low. Insurance activity expanded in the first half of 2017, as gross written premiums increased by 2 % in the non-life

sector and by 36 % in the life insurance sector as compared to the same period in 2016. Despite this increase in insurance activity, insurance penetration ⁽²²⁾ has remained one of the lowest in the EU at roughly 1.2 % of GDP. Furthermore, the insurance market is highly dependent on non-life insurance, in particular compulsory car insurance (third-party liability motor insurance). The efforts of several companies to diversify their insurance business are still to bear fruit.

Despite past corrective measures, several segments of the insurance sector require further improvement. Following the 2015 balance sheet review and stress test of the insurance sector, measures were taken by the Financial Supervisory Authority to restore the financial situation of insurers in distress. Nevertheless, several pockets of vulnerability remain to be addressed, including the thin capital buffers of some weaker insurers and their high reliance on compulsory car insurance. The caps on insurance premiums for compulsory car insurance, which became effective in November 2016, were lifted in May 2017 and replaced by reference prices. The removal of these maximum caps has not, so far, triggered an increase in insurance premiums, which have remained below the reference prices. To continue improving the health of the insurance market and increase the capacity of insurance companies to strengthen their capital basis, efficiency gains through cost-cutting measures appear warranted, in particular over the distribution of insurance products.

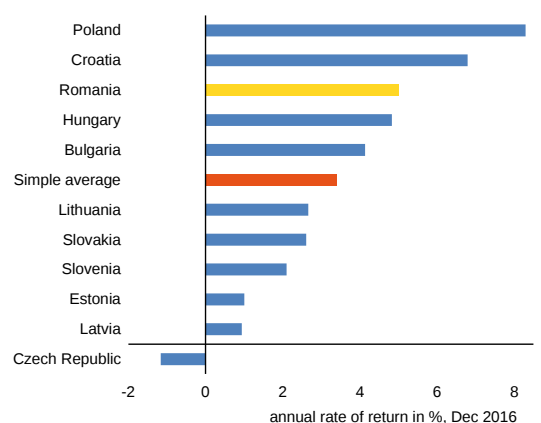
The independence of the non-banking supervisor has come under pressure. Following measures taken after the 2015 balance sheet review and stress test of the insurance sector (European Commission, 2017a) to address shortcomings related to insurance companies in financial distress and to the situation regarding compulsory car insurance, Parliament launched in late 2016 a procedure to revoke the mandate of the President of the Financial Supervisory Authority. The former President of the Authority was subsequently removed from office by Parliament in May 2017. This was an indication of political pressure in response to the Authority's supervisory actions. This limits the independence of the supervisor to

According to NBR data, roughly 44 % (276 500) of the total number of companies do not observe the legal requirements regarding capitalisation, with total own funds being lower than half of the subscribed equity. Out of these companies, 59 % (or 163 800 firms) are companies which registered losses in 2016. Furthermore, roughly 42 % (268 500) of the total number of companies had negative equity at the end of 2016. For further details see the presentation of NBR First Deputy Governor Florin Georgescu, *Real convergence – the fundamental criterion for joining the euro area*, 22 November 2017. <http://bnr.ro/Prezentari-si-interviuri-1332.aspx>

⁽²²⁾ Insurance penetration is defined as the share of gross written premium in a country's GDP.

tackle shortcomings identified in its area of competence in a timely manner.

Graph 3.2.1: Pension funds' real net investment rate of return, Dec 2016 (preliminary)



Source: OECD

The recent reductions in contributions to the second pillar pension funds were triggered by short-term fiscal concerns rather than their financial performance (see Section 3.1). The financial situation and functioning of Romanian private pension funds has not been a matter of concern. According to OECD data, they were among the top performing pension funds in the new EU Member States in 2016, together with the Polish and Croatian pension funds (OECD, 2017c). The real net investment rate of return of the Romanian second pillar pension funds stood at roughly 5% in 2016, higher than the average rate of return (simple average) of 3.4% of pension funds in the new EU countries.

Reform of the second pillar pensions could weaken pension sustainability and the performance of the local capital market. As of end-June 2017, the second pillar pension funds had total assets of EUR 7.9 billion and roughly 6.9 million participants (individuals). Over the past couple of years, the second pillar pension funds have increasingly diversified their investments. As of June 2017, roughly 65 % of their assets were invested in government bonds, down from around 70% in 2012. Furthermore, these pension funds invested roughly 19.6 % of their assets in equity, 6.4 % in deposits and the remaining in investment funds, corporate and municipal bonds. The investments of the second pillar pension funds in

shares listed on the Bucharest Stock Exchange amounted to roughly EUR 1.34 billion at the end of June 2017. These investments went up by roughly 20% compared to end-2016, thanks to the hike in the stock exchange indices and the increase of participations of these pension funds in some of the largest companies listed on the Bucharest Stock Exchange.

3.3. LABOUR MARKET, EDUCATION AND SOCIAL POLICIES

Labour market demand

Employment is growing, driven by strong domestic demand. Employment, including the number of self-employed people, is growing in expanding sectors, i.e. industry and services, which require medium to high levels of skills. At the same time, the total number of persons employed slightly increased over the past 12 months.

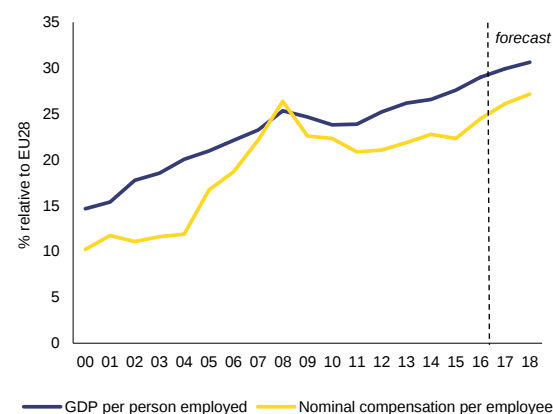
Employers increasingly report difficulties in hiring and retaining workers. According to survey information, in 2016 72 % of employers reported difficulties in filling jobs, the highest rate since 2008 (Manpower Group, 2016). Skill shortages exist for medium- to high-skill jobs in engineering, machinery, IT and services. Only 29 % of Romanians have at least basic IT skills ⁽²³⁾ while less than 6 % of firms provide ICT training to their staff. Higher wages abroad, low internal mobility ⁽²⁴⁾, limited entrepreneurship initiative and weak links between education and labour market needs contribute to increasing labour shortages.

Substantial wage increases in recent years reflect a tightening labour market. Both labour productivity and wages are converging towards the EU average ⁽²⁵⁾ (Graph 3.3.1). Romania has witnessed an acceleration of wage growth (in real terms) over the past 3 years, with the highest increases registered in manufacturing, the IT and financial sectors, and in the public sector. In addition to the increasing labour shortages leading to a rebound in wages after the crisis especially for medium-to-high skill sectors, other factors explaining the current trend are: (i) successive ad hoc increases in public-sector wages, and (ii) the surge in the statutory minimum wage. However, the 2018 shift of social contributions almost entirely onto employees could have a negative

impact on net wages in the short run (see Section 3.1).

The shift of social contributions to employees represents a major change. This alters the wage structure and transforms fundamentally the financing of social protection. In most EU countries the shares of employers' contributions are frequently higher than or equal to those of the employees (in Denmark social security contributions are financed from taxation). The shift marks also an important deviation from the system of social contributions generally agreed in industrial countries in which employers, employees and the state share the responsibility and burden of the financing. It is also enshrined in various international standards ⁽²⁶⁾.

Graph 3.3.1: Nominal compensation per employee and GDP per person employed



Source: European Commission

⁽²³⁾ Among the lowest in the EU and half the EU average; see footnote 65.

⁽²⁴⁾ Among other causes, home ownership is 96 %, the highest in the EU.

⁽²⁵⁾ GDP per person employed, as a measure of productivity, stood at around 31 % in 2016, with wages lagging behind at around 27 %.

⁽²⁶⁾ Romania ratified ILO Convention 102 on Social Security Minimum Standards and the Code of Social Security of the Council of Europe, thus legally committing to standards which stipulate that the total of the insurance contributions bore by the employees protected shall not exceed 50 % of the total of the financial resources allocated to the social protection of employees and their families. Moreover, a number of international standards of non-binding character lay out principles and recommendations of fair burden sharing and solidarity, including the role of employers.

Box 3.3.1: Monitoring performance in light of the European Pillar of Social Rights

The European Pillar of Social Rights, proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission, sets out 20 principles and rights to benefit citizens in the EU. In light of the legacy of the crisis and changes in our societies driven by population ageing, digitalisation and new ways of working, the Pillar serves as a compass for a renewed process of convergence towards better working and living conditions.

Romania faces a challenges with regard to a number of indicators of the Social Scoreboard⁽²⁷⁾ supporting the European Pillar of Social Rights. Romania has a comparatively high early school leaving rate, NEET rate, and a relatively large gender employment gap. Romania is also faced with a high risk of poverty and social exclusion, as well as income inequality. While labour market performance has improved, the inactivity of large segments of the working-age population remains a concern. Roma and people with disabilities also have difficulties in getting jobs. The design of active employment measures is still not fully aligned with demand.

ROMANIA		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Critical situation
	Gender employment gap	Critical situation
	Income quintile ratio (S80/S20)	Weak but improving
	At risk of poverty or social exclusion (in %)	Critical situation
	Youth NEET (% of total population aged 15-24)	Critical situation
Dynamic labour markets and fair working conditions	Employment rate (% population aged 20-64)	To watch
	Unemployment rate (% population aged 15-74)	Better than average
	GDHI per capita growth	Best performers
Social protection and inclusion	Impact of social transfers (other than pensions) on poverty reduction	Critical situation
	Children aged less than 3 years in formal childcare	Weak but improving
	Self-reported unmet need for medical care	Critical situation
	Individuals' level of digital skills	Critical situation

Members States are classified according to a statistical methodology agreed with the EMCO and SPC Committees. The methodology looks jointly at levels and changes of the indicators in comparison with the respective EU averages and classifies Member States in seven categories (from "best performers" to "critical situations"). For instance, a country can be flagged as "better than average" if the level of the indicator is close to EU average but it is improving fast. For methodological details, please consult the draft Joint Employment Report 2018, COM (2017) 674 final.

Particular difficulties pertain to equal opportunities. Inequality of opportunity persists in education, health care, access to employment and to services, and is particularly paramount in rural areas. This is also in the context of weaknesses in social dialogue.

Positive results were achieved in de-institutionalising children. The number of children in institutions dropped significantly. An institutional closure plan was drawn up and places the child's interest at the core of the process. The plan will be applied for a first batch of 50 institutions and fosters tailor-made measures for every child in the institutions concerned aiming first to reintegrate children in their family. The current funding is not yet sufficient to reach the targets. Sustained efforts were made on preventive services, and the number of families benefiting from it has increased by 35% from 2011 to 2016.

⁽²⁷⁾ The Social Scoreboard includes 14 headline indicators, of which 12 are currently used to compare Member States performance. The indicators "participants in active labour market policies per 100 persons wanting to work" and "compensation of employees per hour worked (in EUR)" are not used due to technical concerns by Member States. Possible alternatives will be discussed in the relevant Committees. Abbreviation: GDHI – gross disposable household income.

The minimum wage has more than doubled in nominal terms since 2012. The gross minimum wage increased from RON 700 (c. EUR 162) in 2012 to RON 1 450 (c. EUR 315) in 2017 and reached RON 1 900 (c. EUR 413) in 2018, including employers' social contributions. The minimum wage growth rate over 2012-2017 exceeded that of average wages and increased the

share of employees earning the minimum wage to some 30 % in 2016, making the wage distribution compressed at the bottom. Despite a proposal for a set of objective criteria to be taken into account, endorsed by social partners as a good basis for consultations, the minimum wage continues to be set by the government in a discretionary manner.

Shrinking labour supply

Demographics and emigration affect the labour market supply. Since 2008 the population has decreased significantly while its age structure has developed unfavourably⁽²⁸⁾. In addition, around 3.4 million Romanians work and live abroad. Sectors such as healthcare are particularly affected. Many emigrants are younger and more qualified than the average population⁽²⁹⁾, which further constrains the supply of skilled labour. While in the short run foreign remittances help improve the current account, in the long run negative demographics and emigration could hurt growth and income convergence (European Commission, 2017i: p. 56, IMF, 2016).

Although the working-age population is shrinking, there is a large untapped labour pool. The activity rate among the population aged 20-64 remains one of the lowest in the EU despite recent improvements (72.5 % in Q3- 2017). Furthermore, long-term unemployment is high, affecting 50 % of the unemployed (2016 data). Regional disparities remain high. An appropriate mix of active labour market policies could help activate several disadvantaged groups in particular prime-aged women with low education, Roma, and young people, mainly from rural areas (World Bank, 2017c).

The gender employment gap is high, affecting mainly older women. The gap has increased from 16.7 pps in 2014 to 17.6 pps in 2016. Employment and activity rates of women remain far below the EU average, especially for older women, partly due to the lack of affordable child care⁽³⁰⁾, after school facilities and long-term care. The government has taken some measures to formalise the employment of child minders and plans to finance 2 500 nurseries. Employment gaps lead in turn to a gender pension gap that is one of the highest in the EU. Despite these challenges, the bill on pension age equalisation for men and women has been pending before Parliament since December 2013 and no plans have been made to debate it in a plenary session.

The number of young people neither in education, employment or training (NEETs) remains very high. While youth unemployment has been declining (17.3 % in 2017), the situation of young NEETs only improved slightly, mainly driven by decreasing early school leaving. Many of the NEETs are economically inactive or discouraged workers (Eurofound, 2016) and the incidence among women and the Roma (FRA, 2016) is particularly high.

The implementation of the Youth Guarantee remains weak due to significant delays. The large majority of young NEETs still need to be reached and included in the scheme. Two thirds (65.7 %) of those registered had not received an employment offer within 4 months, while Romania's allocation under the EU's Youth Employment Initiative is unspent and risks being returned to the EU budget. There is no follow-up for most NEETs who have received an employment offer. A number of measures have been launched including the provision of Youth Guarantee offers by multi-disciplinary teams of employment and education counsellors, together with social assistants. First results are expected for the beginning of 2018.

Active labour market policies (ALMPs) appear insufficient in scope and design. Due to delays in accessing EU-financed ALMPs, financial allocations⁽³¹⁾ and participation rates in such policies⁽³²⁾ remain very low. Despite increased financial incentives, some measures are overlapping for the target groups, the use and uptake of the mobility schemes remains low, and the administrative burden remains a disincentive for employers. The development of innovative measures and cooperation of the public employment service with social and education services and external providers⁽³³⁾ are limited. There is no case management for the long-term unemployed and recipients of social assistance. Community work programmes do not provide relevant skills and appear to have limited value as stepping stones into standard employment. Some

⁽²⁸⁾ Romania's population decreased from 21.1 million to 19.8 million over 2007-2016. The proportion of the population aged 60+ to those aged 20-59 increased from 36.1 % to 44.1 % over the same period (Eurostat, 2017)

⁽²⁹⁾ More than half of those living abroad are aged 18 to 39 (World Bank, 2016b).

⁽³⁰⁾ The share of children below 3 in formal care is only 9.4 %

⁽³¹⁾ The national budget of ALMPs was 0.2 % GDP in 2015, excluding the European Social Fund allocation.

⁽³²⁾ 3.1 % of people willing to work and 6.3 % of unemployed people benefited from activation measures (in 2016).

⁽³³⁾ NGOs and social insertion enterprises (entities helping vulnerable groups prepare for and access the labour market, e.g. HIV positive in severe poverty, homeless or convicts).

measures have been taken to strengthen the capacity of the public employment service, while further reform plans (notably on the merger of these services with other institutions) may induce some uncertainty into the reform process.

Limited skill forecasting capacities could further affect labour market supply. The current evaluation of skills on which training programmes are based follows a standard procedure, which however is not sufficiently taking into account the rapidly changing needs in the economy (Cedefop, 2017). The capacity to anticipate future skills needs and estimate the expected impact of new technologies such as big data, biotechnologies, waste reuse technologies, advanced manufacturing, as well as public-sector innovations, is therefore weak. The skill forecasting system currently developed by public employment services is expected to guide the design of training programmes, including those funded by the European Social Fund.

The involvement of social partners in policy-making is very limited. Institutional structures for social dialogue are in place (e.g. the National Tripartite Council and the broader Economic and Social Council, but also Ministry and county-level committees), but they are mostly used by the government to provide information about planned initiatives, without a substantive process of involvement and cooperation (Eurofound, 2018). The views of social partners on policy-making are often ignored by the government, even when they converge, such as on the recent tax reform and the shift of social contributions from employers to employees. Romania has one of the lowest perceived degrees of cooperation in labour-employer relations in the EU (World Economic Forum, 2017). The capacity of social partners is also limited.

The framework for collective bargaining is not conducive to a well-functioning system of industrial relations. Social dialogue is characterised by low collective bargaining⁽³⁴⁾, especially at sectoral level, and low membership of

trade unions and employers' organisations. Among key obstacles to a more effective social dialogue are the high representativeness thresholds and the unclear definition of sectors. Amendments to the Social Dialogue Law aimed at improving the bargaining process and the definition of economic sectors have been under discussion but negotiations are not advancing.

Inequality

High income inequality persists, especially between rural and urban areas. Despite a small improvement in 2016 and recent policy changes, Romania still has one of the highest levels of income inequality in the EU, with the richest 20 % of the population earning seven times more than the poorest 20 %. In 2016, median incomes of rural households were only 52 % of those of urban households. High income inequality is the result of a highly unequal distribution before taxes and benefits (market inequality) and the limited ability of the tax and benefit system to reduce this.

Inequality of opportunity remains a challenge. Unequal access to education, healthcare and other services, together with high inter-generational transmission of poverty⁽³⁵⁾, prevents children from disadvantaged areas or families from reaching their full potential. Some social measures for pre-school and school-aged children have been introduced, but their take-up is low and kindergarten places face shortages. Rural areas are particularly affected by inequality of opportunity due to poor infrastructure, insufficient employment opportunities and inexistent or poor quality public services (European Commission, 2016a).

Poverty and social exclusion

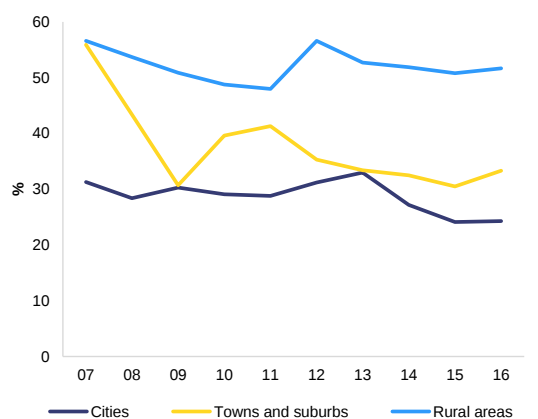
Despite economic growth, poverty and social exclusion increased after a four-year decline. The increase in poverty and social exclusion in 2016 is driven by the fact that the disposable income for the bottom 10 % did not increase, unlike for the rest of households. The in-work poverty rate is one of the highest in the EU, at 18.9 %, twice the EU average, reflecting the large

⁽³⁴⁾ Romania witnessed a drastic decrease in collective bargaining coverage from 98 % (2008) to 35 % (2016), compared to an EU average of 60 % (2016). Trade union density decreased from around 90 % in 1990 to around 20 % in 2012. Membership of employers' organisations is one of the lowest in the EU (based on 2013 data).

⁽³⁵⁾ Child poverty is correlated with parental education levels, with 63.2 % of children of low-skilled workers at risk of poverty against only 6.7 % of children from high-skilled families.

percentage of individuals who have near-zero monetary earnings despite working full time, especially in subsistence and semi-subsistence agriculture. The risk of poverty or social exclusion is the highest for young people, families with children, Roma, people with disabilities, the rural population and inactive people (European Commission, 2017a, FRA 2016). Women are more exposed to poverty due to shorter careers, lower retirement age and lower pension contributions. Rural residents face twice the risk of poverty or social exclusion compared to people living in cities (Graph 3.3.2).

Graph 3.3.2: **People at risk of poverty or social exclusion by degree of urbanisation**



Source: European Commission

Housing deprivation and exclusion affect large parts of the population. A large share of the population faces severe housing deprivation (19.8 % versus 4.9 % in the EU). The figure is also high for children. Housing cost overburden, though decreasing, remains an issue, with one in eight households allocating more than 40 % of their income to housing costs in 2016. Housing overcrowding is well above the EU average, especially for Romanians in monetary poverty.

Roma face multiple disadvantages. Compared to the rest of the population they are confronted with very high inequality of opportunity and poverty rates, low employment, poor educational attainment, low health coverage and adverse housing conditions (European Commission 2017a). Residential segregation, forced evictions and discrimination at work persist. While the specific bodies dealing with Roma show more

commitment, their impact depends on the work of other institutions. Measures addressing Roma inclusion are mainly supported by externally-funded projects. A good part of them are only just starting.

People with disabilities and children face a higher risk of poverty. Many people with disabilities leave school early and few reach tertiary education, which reduces their employability. Their situation is worsened by the absence of targeted employment services and the uneven availability of vocational counsellors and job coaches. Child poverty is among the highest ⁽³⁶⁾ in the EU and rising, also due to the low effectiveness of the family benefit system and limited integrated measures to address the situation.

Access to social protection is limited, in particular for workers without a standard employment contract, and for many self-employed. High poverty incidence is driven by unemployment, inactivity and unequal access to services and social protection. Most recipients of social assistance are poorly educated and live in rural or remote areas, where jobs and access to services are very limited. More than half of the rural population employed in subsistence agriculture is not covered by pensions or unemployment insurance and many do not have health insurance. Casual and seasonal workers are not covered by mandatory healthcare insurance and have less access to parental leaves. The risk of poverty for the self-employed is more than ten times higher than for employees. Part-time workers, more than half of which are in involuntary part-time (59.4 %, against an EU average of 15.3 %), also face a very high risk of poverty.

Unemployment benefits are very low. They have a very low and decreasing coverage and strict eligibility criteria ⁽³⁷⁾. The coverage rate for the short-term unemployed has decreased from 2013 to 2016, to around 10 % ⁽³⁸⁾. The adequacy of benefits is low and has been declining markedly

⁽³⁶⁾ One in two Romanian children is at risk of poverty or social exclusion.

⁽³⁷⁾ According to the results of the benchmarking exercise on unemployment benefits carried out by EU advisory committee the Employment Committee (EMCO).

⁽³⁸⁾ Based on Eurostat data.

since 2010. The net replacement rate for a worker at the average wage declined from 45 % to 30 % in 2016. With RON 500 per month, the Social Reference Index on which unemployment benefits are calculated is well below the minimum wage; it has not been indexed since its introduction in 2008.

Social service provision remains fragmented and increasingly dependent on the financial capacity of municipalities. There is little coordination in the provision of services between national, local, public and private bodies and the coverage of social services is limited, especially in rural areas. Some services, such as long-term care or counselling are mainly provided in big cities. Staffing levels vary greatly between big cities and rural communities, with many municipalities not having a social assistant. Social and employment services are not systematically linked⁽³⁹⁾ and ALMPs are not tailored to the individual needs of social assistance beneficiaries (see Section 3.4.5). A pilot project aiming to introduce integrated services in over 100 marginalised communities is advancing at a slow pace, despite long standing discussions.

Despite several years of preparation, the implementation of the Minimum Inclusion Income Law was again delayed. The current minimum income is one of the lowest in the EU not only in absolute terms but also as measured by its distance to both poverty line and low wage earners, with social assistance spending equally low. The Minimum Inclusion Income law will increase adequacy and coverage, but its long-awaited entry into force, initially scheduled for April 2018, was postponed by one more year, with negative effects on poverty and social exclusion.

Education and skills

The weak performance of the education and training system will limit growth prospects in the long run. Persistently high early school leaving rates (Graph 3.3.3), unequal access to quality education and large shortcomings in student performance, as measured by basic skills performance, point to a large unused human capital

potential. Vocational education and training is not well linked to labour market needs. These factors will translate into lost growth opportunities if left unaddressed, and assuming the country's negative demographics are not reversed (see also Box 3.3.2).

External school and higher education evaluation face continued challenges. Quality assurance in school education remains largely focused on compliance, due to fragmentation and overlaps in responsibilities. Mechanisms to support school improvement and development are relatively weak (OECD, 2017a), despite the recent efforts to make better use of quality assurance findings. The quality assurance body for pre-university education cannot make recommendations to support schools, while school inspectorates' tasks mostly relate to compliance with regulations. Despite recent efforts by the quality assurance body in higher education to improve external evaluation and standards for bachelor, master's and doctoral programmes, fostering excellence in higher education remains a significant challenge.

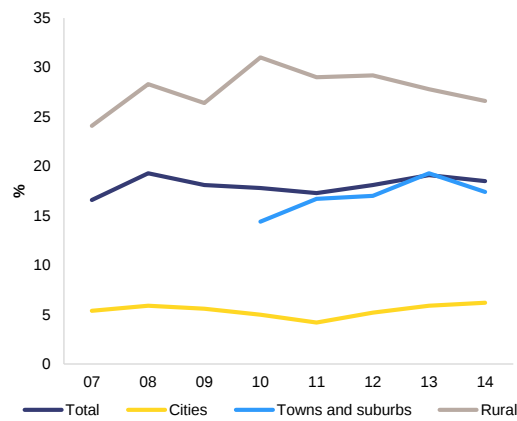
Rural-urban disparities, Roma exclusion and inequality in education often overlap. Schools in rural areas are less likely to provide quality education compared to urban schools⁽⁴⁰⁾. The gap in underperformance between advantaged and disadvantaged students is one of the highest in the EU (36.9 pps in science compared to 26.2 pps for EU-28). Roma inclusion in education remains a challenge with implications for social inclusion and future employability⁽⁴¹⁾. Segregation in education, in particular due to residential segregation, remains a challenge.

⁽⁴⁰⁾ In 2016, 37.5 % of 8th grade students (i.e. in the final year of lower-secondary education) in rural schools had poor results at the national evaluation, compared to 15 % in urban schools.

⁽⁴¹⁾ According to Fundamental Rights Agency estimates, only 38 % of Roma children attend kindergarten and 77 % of Roma aged 18-24 are early school leavers (FRA, 2016).

⁽³⁹⁾ Despite the transposition of the Council Recommendation 2016/67/C of 15 February 2016 on the integration of the long-term unemployed into the labour market.

Graph 3.3.3: Early school leaving rates



Source: European Commission

Inclusive education in the classroom requires strengthening. Initial teacher education offers insufficient training, especially on working with students from disadvantaged backgrounds, Roma and students with learning difficulties. Attracting high-quality teachers to disadvantaged schools is a persistent challenge. The current merit-based allowance system is insufficiently geared towards supporting work with students from disadvantaged backgrounds.

Healthcare

The health status of the population has improved, but remains below EU standards. Despite recent improvements, life expectancy in Romania is almost 6 years below the EU average. Heart diseases and strokes, though decreasing, remain the biggest contributors to mortality, while the incidence of some forms of cancers has increased sharply. Other major pressing challenges are the declining rates of vaccination for children and the high rate of tuberculosis and multidrug-resistant tuberculosis cases. These in turn are detrimental to children's development, workforce employability and healthy ageing.

Low funding and inefficient use of public resources limit health system effectiveness. Per capita health spending is one of the lowest in the EU⁽⁴²⁾. Over-reliance on hospital care to the

detriment of primary and community care points to a misallocation of resources and limits access to quality care (European Commission, 2017a). In addition, Romania is confronted with a substantial deficit of doctors and nurses. It is estimated that since early 2000 around 24 000 Romanian doctors and nurses have left the country (OECD, 2017b). The government expects the salary increases in the health sector in 2017-2018 to slow the emigration of health professionals.

Health coverage is *de facto* not universal, despite being a constitutional right. Social health insurance covers only around 86 % of the population, including those living abroad, with limited access in rural areas and for vulnerable sections of the population. Only half of the Roma are estimated to be covered by public health insurance (FRA, 2016). The uninsured are only entitled to a minimum benefits package. Accordingly, and despite the recent adoption of legislation to regulate community healthcare, the gap in unmet medical needs between the richest and the poorest (6.5 %) remains one of the highest in the EU. The main reasons for unmet needs are costs (including informal payments) and distance.

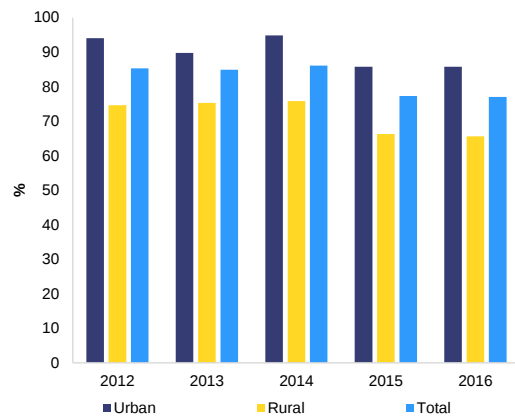
Access to medicines is a major challenge, although efforts are being made to improve the situation. To improve access to innovative drugs, the list of subsidised medicines has been substantially amended by introducing over 100 new medicines since 2014. Nonetheless, efforts to improve access to medicines are complicated by concerns that the low prices of some medicines compared to other EU countries may lead to parallel exports, limiting availability within Romania.

The ongoing implementation of the national health strategy is marred by shifting priorities and poor investment planning. Despite recent progress in the preparation of EU-funded investments in healthcare (e.g. the three regional hospitals in Iasi, Cluj and Craiova), the preparation of projects is significantly delayed, especially for the shift towards outpatient care and community-based services. The lack of clear political commitment to the project and involvement in overseeing it and the modest administrative capacity of the Ministry of Health risk generating further delays. A comprehensive human resources strategy announced by the Ministry of Health in

⁽⁴²⁾ EUR 814 in 2015, a third of the EU average. The annual spending on health represents 4.9 % of GDP, half the EU average of 9.9 % of GDP.

December 2016 is still pending (European Commission, 2017a).

Graph 3.3.4: **Proportion of people with health insurance, registered with a family practitioner**



Source: Casa Națională de Asigurări de Sănătate (Romania's national health insurance office)

Romania ranks high in perceived levels of healthcare corruption⁽⁴³⁾. Corruption in

healthcare covers a broad spectrum: the widespread practice of informal payments, the occurrence of double practice in public and private clinics, as well as corruption in the procurement of medical devices, authorisation and procurement of pharmaceuticals, in the appointment of hospital managers or Ministry of Health officials, and within the healthcare educational system. In this context, concerns remain as to whether the public procurement procedures for the construction of the three regional hospitals will be transparent and effective (European Commission, 2017b).

extra payment on top of the standard fees. Despite an improvement compared to the previous survey, the figure remains one of the highest in the EU (EU average: 4 %).

⁽⁴³⁾ According to a 2017 Eurobarometer survey, 19 % of respondents say that upon visiting a public healthcare practitioner or institution the past year they had to make an

Box 3.3.2: Main challenges for the education system as a driver of growth in Romania

Investment in education is low and lacks appropriate mechanisms to support disadvantaged schools. General government expenditure on education as a percentage of GDP is one of the lowest in the EU (3.1 % versus 4.9 % in 2015) and is the third lowest as a proportion of total government expenditure (8.6 % compared to 10.3 % in 2015). Expenditure per student in public and private institutions is also among the lowest in the EU for all levels of education. This underfunding poses a large financial burden to Romanian households ⁽¹⁾. There are no targeted programmes to channel additional resources to disadvantaged schools, while correction coefficients remain insufficient, despite a recent increase in the standard cost per student. The amendments to the Fiscal Code may result in the inequalities in local budgets financing school infrastructure getting worse. Capacities to develop and implement evidence-based policies and programmes require strengthening.

Human capital does not appear to sufficiently meet the needs of a competitive labour market. In 2016, 23.6 % of the population aged 25-34 had less than lower secondary education compared to an EU average of 16.6 %. Early school leaving, although decreasing ⁽²⁾, is still high. It remains a challenge due to high drop-out rates. The OECD Programme for International Student Assessment (PISA) found that one in four students is a low achiever in all three subjects tested (European Commission 2017d). Achieving excellence in school education adds to the challenge: the proportion of students who demonstrate complex problems solving abilities is low (2 % in reading, 3.3 % in mathematics and 0.7 % in science). The design of second chance programme lacks sufficient flexibility for adult learners while accessibility in rural areas is particularly difficult.

The link of education to the labour market remains weak, despite recent measures. Tertiary education is confronted with one of the lowest attainment rates in the EU ⁽³⁾. Adult participation in learning remains very low, particularly for the low skilled, despite the need for upskilling (1.2 % in 2016 compared to EU-28: 10.8 %). The fragmented system of adult learning lacks a coordinating body, resulting in limited capacity in the implementation of strategic documents. Weak skills governance, including on tracking of graduates, hamper evidence-based decision making. This also impedes on the effective delivery of the Upskilling Pathways Council Recommendation.

Despite recent measures, the quality and labour market relevance of vocational education and training (VET) remain largely insufficient. The attractiveness of VET as a career choice and not mainly as a ‘second choice’ option remains rather limited. The employment rate of recent VET graduates remains below the EU average (63.3 % vs 75 % in 2016). Despite continued reforms, especially on dual VET, several challenges remain to be addressed. An integrated and robust system of feedback from employers about the relevance of qualifications is yet to be established. Guidance and counselling services are still under-developed. The alignment between VET and second chance programmes is insufficient as is the provision of alternative pathways. Access to continuing VET learning programmes is hampered by entry requirements linked to the completion of lower secondary education.

⁽¹⁾ The ratio of household expenditure on education as a proportion of public expenditure equals 39 % for Romania against an EU average of 13 % (Eurostat data, 2015).

⁽²⁾ From 19.1 % in 2015 to 18.5 % in 2016 (% of population aged 18-24)

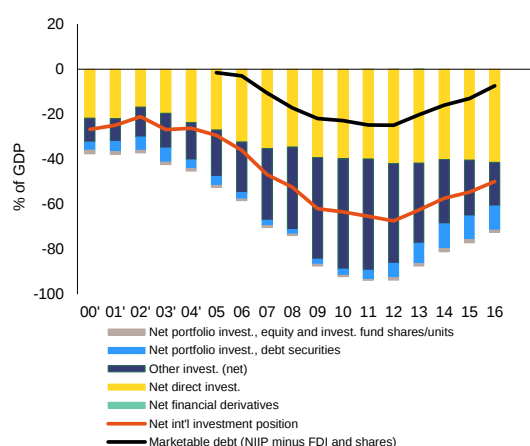
⁽³⁾ 25.6 % in Romania vs. 39.1 % in EU-28 for people aged 30 to 34 (Eurostat data 2016)

3.4. INVESTMENT

3.4.1. EXTERNAL COMPETITIVENESS

Romania's net international investment position (NIIP) has continued to improve. The NIIP reached -49.9 % of GDP in 2016, almost 5 percentage points above the 2015 level (Graph 3.4.1). This decrease has taken place despite the widening current account deficit and is mainly due to strong GDP growth. Foreign direct investment (FDI) has remained broadly stable as a share of GDP, while the share of other foreign liabilities declined as Romania repays its external debt, a trend which is expected to continue.

Graph 3.4.1: Net international investment position



(1) Merged BPM5/BPM6-ESA 2010 data.

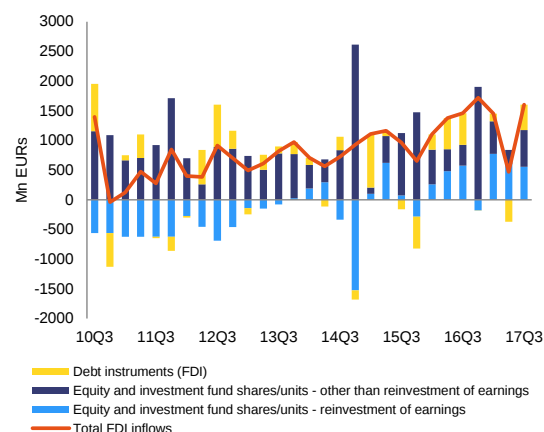
Source: European Commission

The trend for FDI flows continues to be volatile. After increasing by almost 50 % in 2016, FDI inflows declined in 2017. In the first 11 months of 2017, FDI inflows were around 9 % lower than in the same period of 2016 (Graph 3.4.2). However, FDI in equity and reinvested earnings increased substantially, with the entire fall in FDI accounted for by debt instruments (intercompany loans). The main sources of FDI inflows into Romania in the first three quarters of 2017 were Cyprus, Luxembourg, the Netherlands, Germany and France.

The current account balance has been worsening recently. Despite increasing export market shares (see below), the growth of exports was outpaced by that of imports. In the first 10 months of 2017, imports of consumer goods, intermediate goods, and capital goods all increased by double digit rates. The balance of trade

services, driven mainly by exports of transportation and IT services, remained positive but did not offset the negative and widening deficit in the trade of goods. The balance of primary incomes remained negative, reflecting mainly the outflow of investment income linked to the country's negative NIIP. The balance of secondary income, which consists mainly of remittances, continues to be positive but was outweighed by the negative balance of primary income. Overall, the current account deficit is estimated to have increased to around 3 % of GDP in 2017.

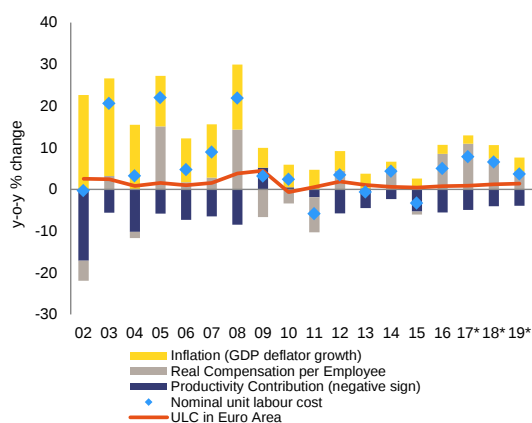
Graph 3.4.2: FDI flows by investment type



Source: European Commission

Unit labour costs (ULC) further increased in 2017 as the growth of compensation to employees outpaced that of productivity. Productivity convergence has been substantial over the past two decades. Labour productivity per hour worked increased from 22 % of the EU-28 average in 2000 to approximately 54 % in 2015. However, productivity levels continue to be the second lowest in the EU. The increase in real compensation per employee (27.8 %) was broadly in line with that of labour productivity (25.6 %) between 2011 and 2016. In 2017, the growth of real compensation per employee is estimated to have been more than double that of productivity (Graph 3.4.3). With Romania's nominal exchange rate broadly stable, the rise in unit labour costs has also been reflected in a real exchange rate appreciation. The real effective exchange rate, as deflated by unit labour costs has appreciated by around 7.8 % between Q1-2016 and Q3-2017.

Graph 3.4.3: Nominal unit labour cost, growth breakdown

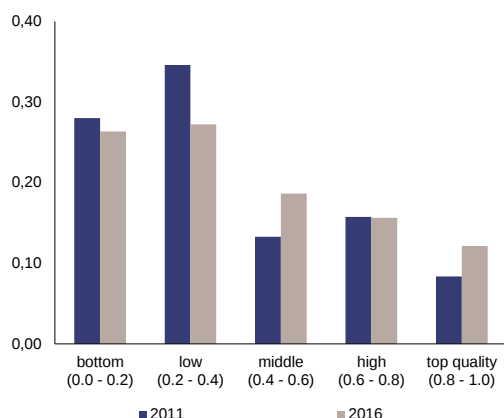


Source: European Commission

Non-cost competitiveness has improved.

Between 2011 and 2016 the share of top quality products in total export values increased by almost 50 %. Over the same period, the value share of low-quality products diminished substantially (Graph 3.4.4). Quality gains took place across Romania's main export industries but were most conspicuous for computer, electronic and optical products.

Graph 3.4.4: Share of export value by quality category, in manufacturing

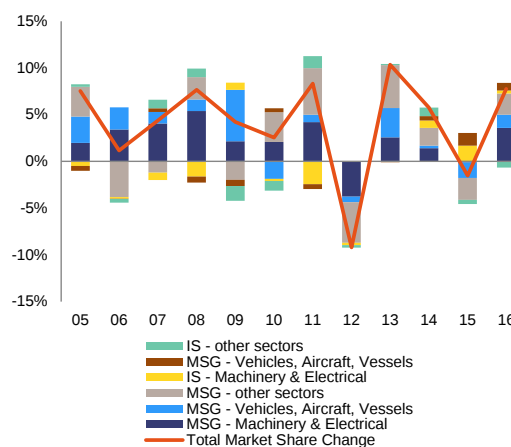


(1) A rank of 1 reflects the highest quality in the EU market for a particular 'country of origin-product', while 0 corresponds to the lowest quality (manufacturing exports to the EU-28 are proxied by EU-28 imports)

Source: European Commission based on Comext and Orbis

Export performance has been relatively strong in recent years. Between 2000 and 2016 export market shares increased almost fourfold, reflecting the contained evolution of unit labour costs after the crisis. Since 2016, however, unit labour costs began to increase as the growth in workers' compensation raced ahead of growth in productivity (see below). A continuation of this trend could threaten further increases in export market shares, unless accompanied by structural reforms sustaining a transition to higher value-added products, integration in global value chains and access to new export markets .

Graph 3.4.5: Export market share by industry



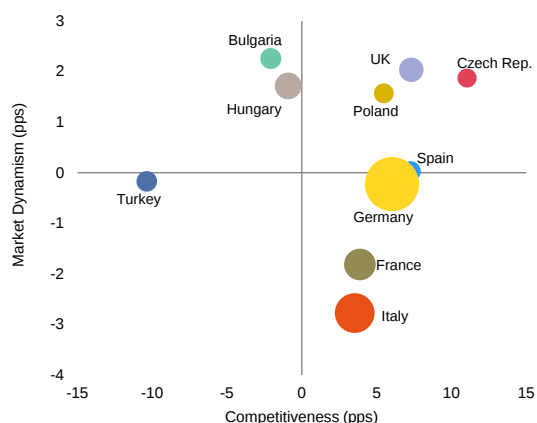
(1) IS stands for Romania's initial sectoral specialisation, while MSG (market share gain) captures how successful Romania has been in gaining market shares on average across export products.

Source: European Commission

Export market share gains in 2016 came mainly from traditional export industries.

The chief export industry, machinery and equipment, accounted for almost half of the increase in export market shares of goods in 2016 (Graph 3.4.5). Substantial gains also came from the vehicle industry, Romania's third largest industry in terms of share of exports. These gains came almost entirely from market share gains within these industries rather than from the sectors' global trade dynamism. Export market shares in services continued to expand as well, with most gains coming from transport and telecommunications, computers and information services.

Graph 3.4.6: Export market share by country



(1) The size of the bubbles indicates the weight of the trade partner in Romania's total exports
 'Market dynamism' stands for the difference between the annualised growth rates of world imports per geographical market and global world imports.
 'Competitiveness' stands for the difference between the annualised growth rates of Romania's exports per market and world imports per market.

Source: European Commission

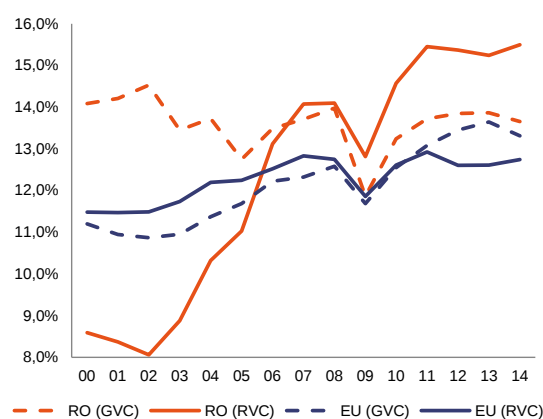
Geographically, the strong trade performance since 2011 is mainly due to market share gains in western Europe. Romania's chief export destinations between 2011 and 2016 were Germany, Italy and France. Over this period, Romania gained market shares in all three countries. Trade with each of them had a positive contribution to Romania's global export market share even though all three of them have seen their share of global imports declining (Graph 3.4.6).

Romania has captured an increasing part of trade related to EU production chains. The Romanian economy continues to benefit from its strong integration in EU value chains⁽⁴⁴⁾. An increasing specialisation in regional European value chains has enabled Romania to respond to the shift in global demand to emerging economies. This development is in contrast with the general trend. Since 2011, global value chain trade intensity has continued to grow and now accounts for more than half of all value chain trade, while the share of regional value chain trade has

⁽⁴⁴⁾ The main immediate production partners of Romania in regional EU value chains that together account for more than 70 % of Romanian regional value chain trade are: Germany (28.9 % of regional value chain trade), Italy (11.0 %), Hungary (9.2 %), France, Austria (7.2 % each) and Belgium (6.6 %). Immediate production relations with the UK are limited (1.8 %).

declined. The pattern for Romania is the opposite as it is the share of regional value chain integration that has continued to grow more strongly, particularly in manufacturing and business services (Graph 3.4.7).

Graph 3.4.7: Changes in regional and global value chain trade



(1) RVC/GVC indicate the share of regional EU value chain trade (RVC) and global value chain trade (GVC), respectively, as a % of total value added trade in the total economy

Source: Stehrer et al. (2017) based on World Input-Output Database release 2016

3.4.2. PUBLIC INVESTMENT AND INFRASTRUCTURE

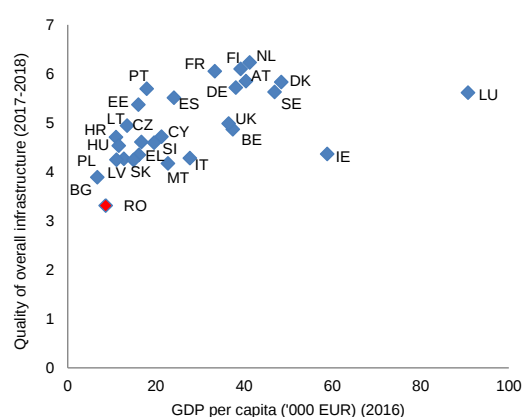
Investment spending needs improved efficiency to deliver results. Investment has been robust over the past decade and particularly after EU accession, when the country became one of the main beneficiaries of EU structural and cohesion funds. However, high inefficiencies in public investment management translated into sluggish EU funds absorption and prevented the country from reaping the full benefits of its increased capital spending and from improving the quality of its infrastructure.

High public investment spending is accompanied by insufficient infrastructure. Romania had one of the highest public investment rates in the EU over the past decade. This would suggest a corresponding supply of physical infrastructure. However, recent achievements under the National Local Development Programme notwithstanding, the discrepancy between inputs

(investment) and outputs (infrastructure) is particularly striking, raising questions concerning the efficiency of public capital spending. This is confirmed by recent empirical evidence which suggests that inefficiencies in public spending may lead to an overestimation of the actual capital stock (IMF, 2017a, 2017b).

The poor quality of infrastructure limits growth prospects. The quality of infrastructure fares badly when compared not only to more developed economies but also to peer countries (Graph 3.4.8). This can be seen in particular in the transport, water/wastewater and energy sectors. The weak performance of state-owned enterprises, the main providers of infrastructure in these areas, is of particular concern (see Section 3.4.3). In quantitative terms the supply of infrastructure is also low (see Section 3.5).

Graph 3.4.8: GDP per capita and quality of infrastructure



(1) Respondents rate 1 (worst) to 7 (best)

Source: European Commission and World Economic Forum: the Global Competitiveness Index 2017-2018

Viable projects are needed to bridge the infrastructure gap and support economic growth. Large infrastructure projects above RON 100 million (EUR 21 million) are evaluated and included on a priority list monitored by a dedicated unit within the Ministry of Finance. As of 2017, projects on the list are assigned a prioritization score that the line ministries are obliged to reflect in their proposed budgets. Despite recent progress, the capacity to develop and prioritise high-quality projects remains nevertheless limited.

European Structural and Investment Funds (ESIF) provide a significant source of financing for infrastructure. More than one third of the total EUR 30.8 billion ESIF available for the 2014-2020 programming period is allocated to investments in transport, energy and environment. Access to ESIF depends on compliance with regulatory, policy and institutional conditions intended to ensure an efficient and effective use of funds ⁽⁴⁵⁾ (see Box 2.1).

3.4.3. STATE-OWNED ENTERPRISES (SOE)

The operational and financial performance of state-owned enterprises has not improved. SOEs have higher debt ratios and lower profitability than their private-sector counterparts (Marrez, 2015; Bower, 2017) and preliminary data suggest that their performance did not improve in 2017. Arrears, which dropped significantly under the 2009-2015 EU/IMF financial assistance programmes are again increasing and no action plan is being taken to address the issue. CFR Marfă, the main cargo rail operator, is of particular concern ⁽⁴⁶⁾. Besides this lacklustre performance and the key role played by SOEs in critical infrastructure sectors such as energy and rail transport (Marrez, 2015), the restructuring of loss-making companies is not progressing.

SOEs' corporate governance was substantially weakened in 2017. Rules for SOEs' corporate governance were strengthened in 2016 with the adoption of the Law on corporate governance (Law 111/2016) and its implementing legislation. However, implementation has been sparse and transparency diminished in 2017 with the delay in the publication of financial data. More worryingly, in December 2017 the law was all but voided by a Parliament's amendment exempting almost 100 companies from its provisions, including most large SOEs. This decision amounts to a substantial backtracking on 2015 and 2016 country specific recommendations, which had been considered

⁽⁴⁵⁾ In 2017, Romania fulfilled several of these conditions, specifically those concerning, health, research and innovation, and transport. The requirements on public procurement and public administration are still pending and could trigger a possible suspension of payments to the programmes concerned.

⁽⁴⁶⁾ http://europa.eu/rapid/press-release_IP-17-5345_en.htm

fulfilled by the European Commission (European Commission, 2016a, 2017a) ⁽⁴⁷⁾.

Some of the most profitable SOEs may be transferred to a new Sovereign Development and Investment Fund. A draft law for the creation of a Sovereign Development and Investment Fund (FSDI) was put under public consultation in summer 2017. It has not yet been adopted by the government, but a legislative proposal substantially drawing on the government's draft was submitted to the Senate by a group of parliamentarians, kicking off the legislative process. According to the draft law, the Fund would be set up as a joint-stock company and would receive the state-owned shares of 27 profitable SOEs. The purpose of the Fund and its investment strategy are only vaguely set out in the draft law and it is unclear how the Fund would address the main barriers to public investment in Romania (see Box 3.4.1). Under the draft law the Fund is exempted from Law 111/2016 on SOEs' corporate governance. The draft law also generates concerns about transparency of decision-making, reporting and monitoring.

The fiscal risks generated by the new FSDI are not yet known. The government has sought Eurostat's opinion on the fiscal impact of the Fund if created under the draft legislation submitted to public consultation in August 2017. If the Fund is classified outside the general government sector, it would have a negative impact on the state budget in 2018 and possibly beyond as the dividends of the SOEs under the Fund would no longer go to the state budget. According to the authorities, this impact is temporary until the Fund starts distributing dividends. Information available to date does not allow, however, to assess the extent and timing of a turnaround in the budgetary impact. A broader concern is the implicit liability to the state budget from its operations and from the debt issued.

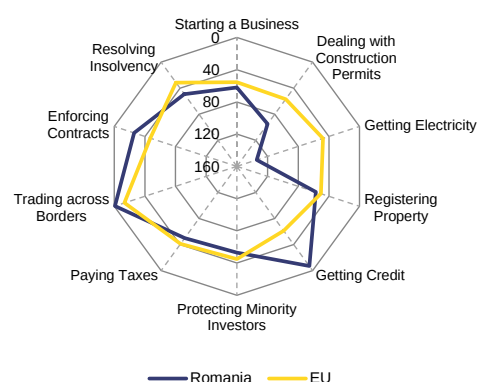
⁽⁴⁷⁾ The law will need to be reassessed by Parliament. On 13 February 2018, the Constitutional Court considered it unconstitutional due to procedural and substantive concerns.

3.4.4. BUSINESS ENVIRONMENT

Romania's business environment is deteriorating (Graph 3.4.9). Romania dropped nine ranks in the World Bank's Doing Business 2018 report, down to 45th, (World Bank, 2017a), while in the Global Competitiveness Report it dropped from 62nd to 68th (World Economic Forum, 2017). Performance remains particularly poor in governance, labour force qualification, infrastructure, health and education (see Sections 3.3, 3.4.2, 3.4.5). In this environment, more firms expect a reduction of investment activity than an expansion in the near future (European Investment Bank, 2017).

At sub-national level the business environment presents a more varied picture. Despite common legislation and provision of guidance by the National Trade Register Office, Romanian cities display considerably uneven performance in a number of areas, in particular on starting a business, obtaining a permanent electricity connection and enforcing contracts. Enforcing a contract takes 15 months in Timisoara but 23 months in Brasov. The time required to start a business varies between 12 days in Bucharest and Oradea and 25 days in Craiova. Getting electricity requires 173 days in Iasi and 209 days in Constanta (World Bank, 2017b).

Graph 3.4.9: Ease of doing business



(1) Ranking: (1) easiest to (190) most difficult
Source: World Bank 2017

Insolvency laws and procedures remain complex. Despite the availability of a simplified bankruptcy and asset liquidation procedure,

companies in financial distress are often brought to court by creditors, without the possibility of recourse to reorganisation or repayment plans. Notwithstanding the reform of the insolvency framework in 2014, and while a majority of cases under the simplified procedure can be solved in less than a year, the "time required to resolve insolvency" indicator has remained stable since 2008 at 3.3 years, one of the highest values in the EU (European Commission, 2017e).

SMEs rely heavily on bank financing, which has remained sluggish. Almost half of SME funding was secured via credit lines and bank loans in Q2-Q3 2017. After a significant drop over 2015-2016 to below 2 %, loan rejection rates increased to 18 % in 2017, a level last observed in 2009. Moreover, 10 % of SMEs report not having received the full loan requested (ECB, 2017). Among non-financial companies, the level of non-performing loans remains higher particularly for micro-enterprises and SMEs (NBR, 2017).

Further measures are needed to support SME's entrepreneurial initiatives. Romanian SMEs would benefit from increased capitalisation, simplification of the insolvency framework and mobilisation of additional private financing supported by EU financial instruments. An initiative signed by the Commission and the European Investment Bank with Romania is expected to generate some EUR 500 million in new SME loans under favourable conditions.

In an increasingly dynamic start-up ecosystem, scaling-up remains a challenge. Increased public support through the Start-up Nation programme notwithstanding ⁽⁴⁸⁾, scaling-up of existing companies is hampered by lack of clear legislation, administrative burden, skill shortages and low innovation (see Sections 3.3, 3.4.5 and 3.5). The share of high-growth businesses in Romania is among the lowest in the EU. Start-up entrepreneurs lack access to mentoring and school curricula are not aligned to the needs of future entrepreneurs.

⁽⁴⁸⁾ In 2017, 8 700 start-up projects were approved for funding from this programme.

Judicial reform

Challenges to judicial independence are a persistent source of concern (European Commission, 2017k). Recurrent public criticism of the judiciary and judicial decisions undermine judicial independence and the trust in the justice system. However, the Commission's findings over the last years, which have been supported by the Council ⁽⁴⁹⁾, have made a positive assessment of the judicial system and the role of the magistracy in pursuing reform (European Commission, 2017j).

The ongoing reform of the justice laws risks undoing progress achieved in the last 10 years and harming judicial independence. The three justice laws, dating back to 2004, regulate: (i) the status of judges and prosecutors; (ii) the organisation and functioning of the courts and prosecution offices; and (iii) the Superior Council of Magistracy. The laws have a direct impact on judicial independence and the justice system more broadly. Some of the amendments adopted by Parliament at the end of December 2017 touch upon safeguards for judicial independence or would affect the functioning of the judicial system. These amendments to the justice laws went through a fast-track procedure in Parliament, a process at odds with the Commission's CVM recommendation to have a transparent and consensus-based legislative process and to respect safeguards for the independence of the judiciary. Moreover, the Commission's recommendation to consult the Venice Commission, an advisory body of the Council of Europe, was not followed up. No proper consideration was given to the opinion of the Romanian magistracy, which, when consulted, has twice rejected drafts of these amendments citing concerns over judicial independence and serious negative impact on the functioning of the judicial system. Some of the amendments also raise questions about whether the positive assessment of Romania's progress on ensuring the independence of the judicial system would have to be reconsidered (European Commission, 2017k). The draft laws were referred to the Constitutional

⁽⁴⁹⁾ Council Conclusions on the Cooperation and Verification Mechanism (CVM) reports — March 2017 available at https://ec.europa.eu/info/files/council-conclusions-7-march-2017_en and December 2017 available at: https://ec.europa.eu/info/files/council-conclusions-12-december-2017_en

Court. The Court ruled unconstitutional a series of provisions. The laws therefore will need to be reconsidered in Parliament.

An action plan for the enforcement of court decisions is lacking concrete solutions and a timetable, and its implantation is slow. At the end of August, Romania updated the 2016 action plan it prepared for the Council of Europe in order to address structural problems over the non-enforcement of court decisions against the State identified by European Court of Human Rights⁽⁵⁰⁾. The implementation of the action plan requires concrete solutions and a detailed timetable to address the problems identified.

Corruption

Corruption persists at all levels and remains an obstacle for doing business. Corruption is widely acknowledged as a major issue in Romania, as shown regularly in perception surveys. Corruption and governance issues in the public sector are among the top challenges for the business environment, holding back growth (World Economic Forum, 2017). In 2017, corruption as well as patronage and nepotism are identified as obstacles to doing business in Romania by 85 % and 82 % of businesses respectively (EU averages: 37 % and 38 % respectively). 86 % of companies think that bribery and the use of connections is often the easiest way to obtain certain public services (an increase of 10 pps compared to 2015, EU average: 60 %) while 70 % think that the only way to succeed in business is to have political connections (an increase of 22 pps compared to 2015, EU average: 42 %) (European Commission, 2017f).

The fight against corruption continued but has faced increased pressure throughout the past year. Romania has a solid anti-corruption legal framework and the track record of the judicial institutions fighting corruption was maintained in 2017. However, the judicial institutions and the legal framework for fighting corruption crimes are facing intense pressure. Several legislative amendments under debate in Parliament raise

serious concerns over the ability of the judicial institutions to effectively continue the fight against corruption.

The implementation of the national anti-corruption strategy has kicked off at technical level, but tangible political support is needed to demonstrate progress (European Commission, 2017k). The 2016-2020 national anti-corruption strategy, for central and local public institutions has the potential to be an effective corruption prevention policy if properly implemented and followed up on the ground. At technical level, implementation started with the drafting of integrity plans in each public institution and the establishment of the first peer-review monitoring cycle. A high number of public institutions, including state-owned enterprises, are participating in the anti-corruption strategy. The first reporting on the implementation of the measures will take place at the beginning of 2018. Visible progress would help bring effective results in corruption prevention and reduce corruption prevalence. To encourage public bodies to devote time and resources to anti-corruption work, the strategy now needs visible political support from the government, the ministers responsible for central and public administration, ministers in key sectors such as education or health and local authorities.

3.4.5. PUBLIC ADMINISTRATION

Human resources

The human resources management reform has yet to produce results. The draft legislation is aligned with the strategy for civil servants. The government reconfirmed its commitment to implementing the key points of the reform and a project was recently signed with World Bank, which should enable the relevant authorities to start implementation. First results of the project will be available by mid-2019. So far, there has been no progress on integrating databases of employees in the public administration.

The Unified Wage Law does not include a proper pay for performance system and is not achieving wage equity, as provided for in the

⁽⁵⁰⁾ Action plan of structural measures in relation to the Săcăleanu group of cases (73970/01) [http://hudoc.exec.coe.int/eng#{"EXECDocumentTypeCollection":\["CEC"\]}](http://hudoc.exec.coe.int/eng#{)

relevant strategy.⁽⁵¹⁾ The new legislative framework aims to create a unified wage grid and thus improve transparency and quality of services. However, it appears to only reduce discrepancies within sectors rather than between sectors for similar functions. Moreover, at the local administration level, there is a high risk that wages will vary significantly between municipalities, for similar functions. This will impact staff mobility and could generate under-staffing in some sectors or municipalities.

Policy-making process

A culture of transparency and participative government at national and local level is not well established. Despite the acceleration of reform in this area, difficulties remain over streamlining and implementing transparency measures across all levels of administration. Factors slowing down reform are insufficient administrative capacity and weak political support for improving the quality and impact of the public consultation process. Also, the mechanism for addressing the observations received during public consultations does not ensure proper follow-up of stakeholders' opinions. This has a negative impact on the business environment and citizens' perception and trust.

Setting up an effective framework for strategic and budgetary planning remains a challenge. A recent legislative initiative proposing an updated methodology for strategic planning could help create a more effective and coherent mechanism⁽⁵²⁾. The main novelty is the link between the strategic plans of each public institution and the annual budgetary process, with an increased focus on implementing the annual operational plans. An integrated calendar for strategic planning, clear responsibilities and a mechanism for performance monitoring are also proposed. This should help increase the quality of the decision-making process.

Regulatory impact assessment is not systematically and adequately used. Political will to enforce appropriate use of the existing tools

in the legislative process remains below expectations. The government General Secretariat continues to have a limited role in the quality control of policy design. Explanatory memoranda accompanying new legislative initiatives are vague and not based on thorough impact assessments or stakeholder consultation. Romania is among the bottom-ranked OECD/EU countries (36 out of 41) on executive capacity (Bertelsmann Stiftung, 2017).

Public service delivery

The quality of public services, especially at local level, remains unsatisfactory. In a recent survey, only 27 % of respondents rated the quality of public services provided as good while 70 % took the opposite view. Funding availability for decentralised services remains the core issue. Other factors include weak administrative capacity of local administrations, unavailability of services in poor or remote areas, lack of skilled personnel and fragmentation of services offered.

In a context of decentralisation, the financial capacity of municipalities is increasingly important. Public and private social service providers often compete for public funding which has been drastically reduced for private operators. Limiting the income tax deductions for sponsorships also negatively impacts on private sources of financing. Local budgets' low ability to generate their own resources perpetuates their dependence on transfers from the state budget for more than 50 % of their funding. The framework and mechanisms for ensuring stability and predictability of income sources for administrative units are being developed. These include quality and control standards for services to be decentralised, with results expected for 2019.

Unequal access to basic public services and uneven service provision could worsen. The gap between the quality of services provided in wealthy municipalities compared with poor municipalities could widen further following several measures adopted in 2017⁽⁵³⁾. The

⁽⁵¹⁾ The Unified Wage Law allows public institutions to reward their employees for performance, but this is limited to 5 % of wage expenditures, and can be granted in a discretionary way.

⁽⁵²⁾ Government Emergency Ordinance 49/2017.

⁽⁵³⁾ Reduction of the income tax from 16 % to 10 % with no clear compensatory measures for the local budgets (Emergency Ordinance 79/2017); differences in wages for staff in local public administration, encouraging staff mobility towards wealthier municipalities and further weakening the administrative capacity of poor

adoption of the Code for Local Public Finances could address some of the issues by setting a minimum level of budget revenue per inhabitant or adapting local budget mechanisms. However, the exact content or effective impact of such measures is yet unknown.

Public service quality is also hindered by sluggish e-government reforms. Simplification measures for citizens and businesses have started being implemented, albeit at a slow pace. Interoperability and integration of different e-government systems in public administration remains a concern, with high negative impact on the effectiveness of public service delivery.

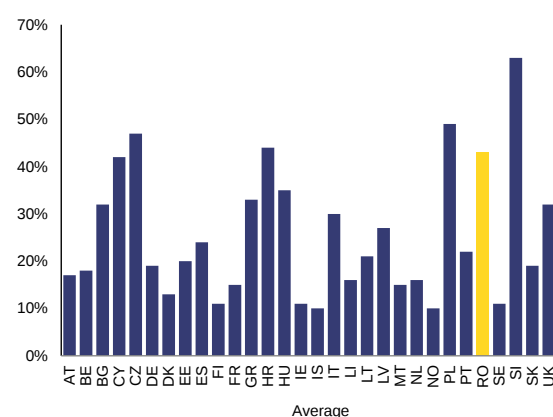
Public procurement

Progress was made on implementing the public procurement strategy but challenges remain. Despite efforts to carry out a thorough reform of the public procurement system and the tangible achievements observed so far, the national public procurement action plan is not yet fully implemented. Its completion is a precondition that has to be met across the board for ESIF funding to be granted and is a necessary condition for avoiding suspension of ESIF payments. The areas where further progress is needed include the professionalisation and empowerment of contracting authorities, the aggregation of purchases, use of strategic procurement and effective audit and fraud control.

municipalities (Law 153/2017); weak support and budget cuts for NGOs with a strong role in increasing the quality of public services (<http://dialogsocial.gov.ro/wp-content/uploads/2016/10/Evaluate-MCPDC-Raport-Finantarea-organizatiilor-neguvermentale-de-catr....pdf>).

The incidence of inefficient public procurement remains high. With 17 % in 2017, the share of negotiated procedures without prior publication has remained among the highest in the EU. Moreover, more than 40 % of contracts awarded by public institutions in 2017 were single bids (Graph 3.4.10). This reinforces the persistent perception of corruption involving public procurement among companies, in turn reducing competition and decreasing efficiency of public spending.⁽⁵⁴⁾

Graph 3.4.10: Award of contracts for single bids in 2017



(1) Percentage of awards of contract per country

Source: European Commission, TED database

⁽⁵⁴⁾ See the information contained in the 2017 Flash Eurobarometer no. 457, p. 71f., on the subject (European Commission, 2017).

Box 3.4.1: Investment challenges and reforms in Romania

Macroeconomic perspective

While Romania continues to have one of the highest investment ratios in the EU, the performance of investment since the crisis has been volatile. An acceleration of investment in 2015 was followed by a contraction in 2016 as public investment fell due to a slow uptake of projects financed by EU funds under the 2014-2020 programming period. Investment grew again in 2017 on account of a pickup in private investment, mainly in the construction sector. Public investment, however, declined for the second year in a row. Investment is expected to strengthen in the future as private investment growth remains steady and public investment recovers as the absorption of EU funds improves.

Assessment of barriers to investment and ongoing reforms

Public administration / Business environment	Regulatory/ administrative burden		Financial Sector / Taxation	Taxation	CSR
	Public administration	CSR		Access to finance	
	Public procurement / PPPs	CSR		Cooperation btw academia, research and business	
	Judicial system			Financing of R&D&I	
	Insolvency framework			Business services / Regulated professions	
	Competition and regulatory framework			Retail	
Labour market/ Education	EPL & framework for labour contracts		Sector specific regulation	Construction	
	Wages & wage setting	CSR		Digital Economy / Telecom	
	Education	CSR		Energy	
		Transport			

	No barrier to investment identified		Some progress
CSR	Investment barriers that are also subject to a CSR		Substantial progress
	No progress		Fully addressed
	Limited progress		

The overall business environment presents challenges hampering investment (European Commission, 2015b). These include continued political uncertainty and unpredictability of new policies. Some appropriate measures have been taken, but many barriers remain to be addressed to lift growth and accelerate convergence (see Sections 3.3-3.5).

Main barriers to investment and priority actions under way

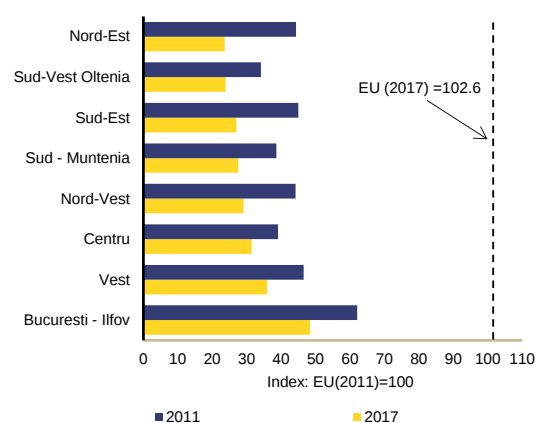
1. Despite relatively high public investment spending, the low quality of infrastructure is holding back investment. The development of quality infrastructure is being held back by: (i) comparatively low absorption of EU funds; (ii) remaining inefficiencies in project preparation, prioritisation and implementation; and (iii) limited efficiency and the recent weakening of corporate governance law applicable to state-owned enterprises. The adoption of the transport master plan in 2016 was an important step in the direction of improving strategic investments in road infrastructure but progress so far remains slow.
2. Inadequate labour supply weighs on investment. Persistent labour emigration and shortages, skill gaps and mismatches, low business innovation, lack of basic digital skills in large parts of the workforce reduce the supply of skilled workers, which affects investment decisions.
3. Poor governance and inefficient public administration continue to hamper the business environment. Investment can be held back by the continuing regulatory and administrative burden, inefficiencies in public administration and public procurement, lack of predictability of legislation and lack of timely and effective stakeholder consultation.

3.5. SECTORAL POLICIES

RESEARCH AND INNOVATION (R&I)

The innovation performance shows no signs of improvement, with consequences for growth prospects. Romania is a modest innovator, scoring below the EU average in all indicators analysed in the European Innovation Scoreboard 2017⁽⁵⁵⁾, apart from broadband penetration. More worryingly, Romania's innovation performance has deteriorated since 2011 in every region, including the most dynamic ones (Graph 3.5.1).

Graph 3.5.1: Regional Innovation performance in Romania



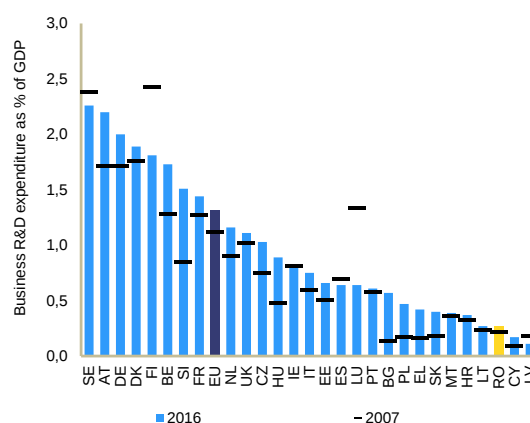
Source: European Commission, Regional Innovation Scoreboard 2017

R&D investment remains very low despite recent improvements in the private sector. In 2016, R&D intensity⁽⁵⁶⁾ fell slightly to 0.48 % of GDP, one of the lowest levels in the EU. Private sector R&D intensity increased in 2016 (Graph 3.5.2), but was only partly offset by the fall in public R&D expenditure. In the 2018 budget, the R&D allocation was increased by about 15 % compared to the budget executed in 2017.

⁽⁵⁵⁾ Innovation performance is measured by looking at a set of 27 indicators, including doctorate graduates, international scientific co-publications, R&D expenditure, SME innovation, medium- and high-tech product export http://ec.europa.eu/growth/industry/innovation/facts-figures/scoreboards_en

⁽⁵⁶⁾ Research and development (R&D) is the statistical proxy for expenditure in the research and innovation system (Eurostat). Intensity is measured as R&D expenditure as a percentage of GDP.

Graph 3.5.2: Business R&D intensity, 2007 and 2016



Source: European Commission, Regional Innovation Scoreboard 2017

Low and inefficient public R&D funding results in a low-quality science base⁽⁵⁷⁾. Inefficiencies in funding are linked particularly to the high fragmentation of the research and innovation system and its lack of international openness. Only 46 % of Romanian publications are internationally co-authored. Recent provisions adopted for the evaluation process of R&D projects funded from the national budget⁽⁵⁸⁾ will further reduce the international openness of the R&D system.

The low quality of the science base acts as a disincentive to private R&D investment. Despite an economic structure favourable to R&D activities⁽⁵⁹⁾, R&D business investment remains modest. Knowledge transfer from public research to businesses is limited. In 2016 the government adopted several measures to stimulate private R&D investment⁽⁶⁰⁾. While their impact is

⁽⁵⁷⁾ Measured as the share of Romanian scientific publications ranked among the top 10 % most-cited worldwide publications.

⁽⁵⁸⁾ In March 2017, the Minister for Research and Innovation adopted new rules for the evaluation of nationally funded research projects, limiting the number of international reviewers in the selection panels. Under the new rules, the Romanian research and innovation executive agency has to give priority to Romanian evaluators and rely on foreign evaluators only as a last resort, when no Romanian evaluators can be found in a specific field.

⁽⁵⁹⁾ Medium-high-tech manufacturing represents 28 % of the manufacturing sector while knowledge intensive services account for 47 % of the services sector.

⁽⁶⁰⁾ Most notably, an exemption from paying the personal income tax for specific R&D activities and for employees in start-ups having software development as their main activity (European Commission, 2017a).

difficult to assess at this stage, significant improvements cannot be expected as long as the low-quality science base limits potential investors' access to top-level human resources and collaboration opportunities. The EU's Horizon 2020 policy support facility for assessing the entrepreneurship ecosystem proposes a set of recommendations for a coherent policy mix to foster a healthy innovative entrepreneurial ecosystem (European Commission, 2017g).

Recent measures seek to support the development of the research infrastructure. A recently adopted roadmap for investing in research infrastructure and an investment prioritisation methodology aim to improve strategic planning and the effectiveness of funding from EU and national sources. The roadmap provides for an assessment of the quantity, quality and degree of utilisation of research equipment and laboratories and the compilation of a priority list of infrastructure to be financed either from national or EU funds. An adequate national infrastructure should not only support research programmes but also improve access to Pan-European infrastructures. Political commitment to the implementation of the roadmap has been expressed by a recent ministerial order.⁽⁶¹⁾

DIGITAL ECONOMY

The degree of digitisation of the economy remains very low. Despite boasting the highest ultrafast broadband penetration in the EU, the levels of broadband coverage (fixed and 4G) and digitisation of both the public and private sectors remain low, in particular in rural areas. In contrast with the increasing numbers of ICT specialists in the economy, the digital skills of the overall population are among the poorest in the EU⁽⁶²⁾. This in turn limits labour force mobility (see Section 3.3).

The government is taking steps to improve digital skills performance in schools. As of 2017,

⁽⁶¹⁾ The approval of the 2017-2025 national roadmap for research, development and innovation infrastructure has been a key element of the preconditions for EU funding in this area. These preconditions were confirmed to the Commission to have been attained by Ministerial Order 624/2017 of 3 October 2017.

⁽⁶²⁾ 29 % of Romanians only have basic digital skills (Digital Economy and Social Index 2018)

programming and technology classes are introduced as from the fifth grade (i.e. the first year of lower-secondary education). This complements what is already taught at high-school level. Measures have also been taken to ensure that there are sufficient teachers and that they have proper digital training. The skills mismatch is also caused by a sizable gap at university level. Although the number of STEM (science, technology, engineering, mathematics) students has doubled over the past few years, the number of teachers has remained the same.

Progress on implementing the Digital Agenda is very limited. There is a lack of coordination both within the government among institutions implementing the Digital Agenda and between the government and IT associations, initiatives and stakeholders. This leads to weak national digital policies and no common ground and direction towards digitisation. EU co-financed investments in public e-services addressing key life events (such as births, marriages, deaths) are under development but progress is slow. The preparation of projects on eEducation (EUR 100 million), eHealth (EUR 30 million) and eInclusion (EUR 25 million) in particular has been delayed.

ENERGY, RESOURCES AND CLIMATE CHANGE

Romania still needs to put in place appropriate energy market rules. The existing market structure remains inadequate and may prevent Romania from exploiting its gas potential. The Emergency Ordinance No 64 of October 2016 introduced crucial reforms for the energy market. It abolished existing regulatory barriers to the export of gas which breached EU rules and introduced essential aspects on competition and transparency. These changes put Romania on the path towards becoming a key regional player in the EU gas sector. However, the amendment of the Emergency Ordinance currently in Parliament is watering down the regulatory framework.

New infrastructure will increase Romania's integration in the regional energy market. The Romanian part of the BRUA bi-directional Bulgaria-Romania-Hungary-Austria Gas Corridor, a EUR 479 million investment to be completed by end-2019, will connect gas reserves in the Black Sea and from the Southern Gas Corridor with the central and eastern European markets. As for

electricity, several interconnectivity projects would still have to be carried out for Romania to reach the 10 % electricity interconnection target by 2020 and fully exploit its high generation capacity. Such projects include interconnection lines and upgrades of six internal lines to increase interconnection capacities with Moldova, Bulgaria and Serbia

Waste management reform is progressing only slowly. The national waste management plan and the waste prevention programme were adopted in December 2017. This is a prerequisite for accessing EU funds during the 2014-2020 period. The implementation of the reform is now needed by the national and regional authorities. The performance gap with the EU rules is, however, so large that even after adoption of the plan, meeting the required legal deadlines will be difficult to achieve in practice. The rate of landfilling is high and most waste is not recycled (European Commission, 2017a). The roll-out of effective measures to stimulate selective collection and recycling are urgently needed. In addition to the solid waste management sector, improvements in efficiency and coverage should also continue in the water/wastewater sector, as 2018 brings the final deadline for complying with EU rules.

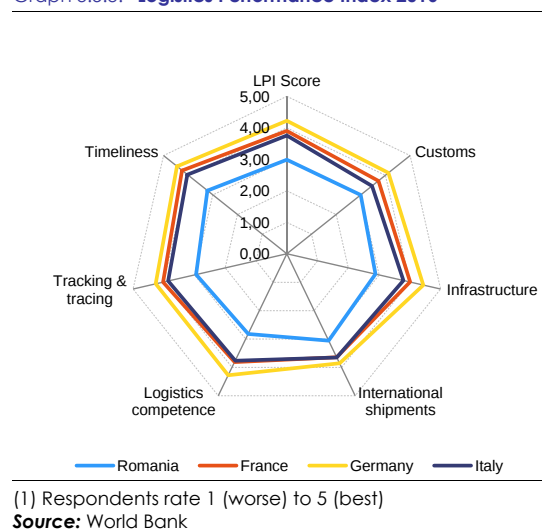
TRANSPORT

The general condition and reliability of road and rail infrastructure remains poor. Despite substantial investments, the state of the road infrastructure remains precarious. Motorways and national roads account for slightly more than 20 % of the road network, while some 90 % of national roads have only one traffic lane in each direction. This is detrimental to delivery times and road safety. Heavy underinvestment in maintenance has reduced train speed and affected rail freight delivery times (OECD, 2016). The poor state of the infrastructure affects the efficiency with which Romania can ship its goods and connect producers with consumers compared to its main trading partners (Graph 3.5.3).

The reform of the transport sector is progressing very slowly. The Romanian government adopted in September 2016 the national transport master plan, which is a precondition for accessing 2014-2020 European Structural and Investment Funds. However, the plan only gives a general picture of the priority

projects and their readiness. The railway network needs to become financially viable but reform of the railway sector is lagging behind. The rail reform agency is not fully operational and the socioeconomic analysis of the rail network still needs to be finalised. In 2017 the market for train services was assessed by Romanian consumers very poorly overall and significantly worse than in 2015 (European Commission, 2018b).

Graph 3.5.3: Logistics Performance Index 2016



Preparation, development and implementation of major infrastructure projects are advancing slowly. A realistic and mature project pipeline that can improve the quality and quantity of infrastructure, complete the multimodal corridor and fully use the EUR 6.3 billion⁽⁶³⁾ available for the 2014-2020 period is still needed (see Section 3.4). The projects currently implemented under the 2014-2020 programmes are those prepared but not completed during the previous programming period. In late 2017 and early 2018, three new major projects were submitted to the Commission⁽⁶⁴⁾. Although there is no more risk of foregoing part of the EU funds earmarked for the Large Infrastructure Operational Programme 2018-2019, given the size and complexity of many of the projects, there is a need to accelerate the implementation process. The performance

⁽⁶³⁾ From the European Structural and Investment Funds and the Connecting Europe Facility

⁽⁶⁴⁾ Notably on the construction of the Târgu Mureş – Ogra - Câmpia Turzii motorway, the rehabilitation of the railway line between the border with Hungary and Braşov, section km 614 – Gurasada – Simeria; construction of the Bucharest metro line 6 (1 Mai – Otopeni).

contracts that the Ministry of Transport concluded with the national road and rail companies in October 2017 should be used to improve motorway and railway planning and implementation, also by introducing modern management practices.

Box 3.5.1: Policy highlights: ICT innovative cluster development and advanced manufacturing in West Romania

The IT infrastructure is considered satisfactory by businesses and investors and it is supportive of the international competitiveness in fields such as software development, engineering and design. There is a vibrant ICT developers community which starts to show spill-overs in high-tech products and start-ups concentrated in specific sectors such as automotive, advanced packaging, logistical services and mobility technologies.

The development of clusters in ICT and advanced manufacturing is particularly dynamic in the capital region and West Romania; diversifying towards advanced manufacturing and higher-value techniques has been recognised as an opportunity for regional industrial development. The Regional Development Plan 2014-2020 and the Cluster Observatory scorecard for West Romania identify ICT as the most relevant key enabling technology for the region. More than 22% of the region's working age population is employed in the manufacturing sector, and more than half of all employed in manufacturing-oriented clusters.

The ICT sector has been developing rapidly in recent years especially in Timisoara, capitalising on the presence of important technical universities and their close partnerships with leading companies, for example in the field of big data analytics where students enrolled in the West University of Timisoara can receive training at IBM on issues related to cloud computing, analytics, mobilecam and securitys and where IBM professionals are involved in the re-design of the university curriculum for post-graduate degrees, doctoral studies and research projects.

The West region shows an emerging and dynamic ecosystem for advanced manufacturing, and there are opportunities in the development of cross-sector technological capabilities for the industry especially in fields such as ICT and big data, high-performance computing and supercomputing, mechatronics, electronics and nanoelectronics, as well as new materials testing. The regional Smart Specialisation (RIS3) Strategy targets improving SMEs' R&D&I capacities across the board, as well as the development of the six priority sectors where the region has a comparative advantage (automotives, ICT, agro-food, textiles, construction and tourism).

There are more and more cases of start-ups and local SMEs providing support with electronics, ICT services and software development for the manufacturing sector. The fields of Big Data and 3D printing have also proven to be interesting business opportunities for local SMEs and new multinational corporations alike. Their integration into the local production sector continues rising fast, especially in the automotive sector.

ANNEX A

Overview table

Commitments	Summary assessment ⁽⁶⁵⁾
2017 Country-specific recommendations (CSRs)	
CSR 1: In 2017, ensure compliance with the Council Recommendation of 16 June 2017 with a view to correcting the significant deviation from the adjustment path toward the medium-term budgetary objective. In 2018, pursue a substantial fiscal effort in line with the requirements of the preventive arm of the Stability and Growth Pact. Ensure the full application of the fiscal framework. Strengthen tax compliance and collection. Fight undeclared work, including by ensuring the systematic use of integrated controls.	Romania has made Limited Progress in addressing CSR 1 (the overall assessment of CSR 1 does not include an assessment of compliance with the Stability and Growth Pact).
In 2017, ensure compliance with the Council Recommendation of 16 June 2017 with a view to correcting the significant deviation from the adjustment path toward the medium-term budgetary objective.	The compliance assessment with the Stability and Growth Pact will be included in spring once final data for 2017 are available.
In 2018, pursue a substantial fiscal effort in line with the requirements of the preventive arm of the Stability and Growth Pact.	The compliance assessment with the Stability and Growth Pact will be included in spring once final data for 2017 are available.
Ensure the full application of the fiscal framework.	No Progress There was no progress on ensuring the application of the fiscal framework. The 2017 budget does not comply with the deficit rule, which contains the obligation to comply with the MTO; as in previous years, the authorities did not send an update of the fiscal strategy to Parliament by the statutory deadline.

⁽⁶⁵⁾ The following categories are used to assess progress in implementing the 2017 country-specific recommendations (CSRs):

No progress: The Member State has not credibly announced nor adopted any measures to address the CSR. This category covers a number of typical situations, to be interpreted on a case by case basis taking into account country-specific conditions. They include the following:

- no legal, administrative, or budgetary measures have been announced in the national reform programme, in any other official communication to the national Parliament / relevant parliamentary committees or the European Commission, publicly (e.g. in a press statement or on the government's website);
- no non-legislative acts have been presented by the governing or legislator body;
- the Member State has taken initial steps in addressing the CSR, such as commissioning a study or setting up a study group to analyse possible measures to be taken (unless the CSR explicitly asks for orientations or exploratory actions). However, it has not proposed any clearly-specified measure(s) to address the CSR.

Limited progress: The Member State has:

- announced certain measures but these only address the CSR to a limited extent; and/or
- presented legislative acts in the governing or legislative body but these have not been adopted yet and substantial further non-legislative work is needed before the CSR is implemented;
- presented non-legislative acts, but has not followed these up with the implementation needed to address the CSR.

Some progress: The Member State has adopted measures

- that partly address the CSR; and/or
- that address the CSR, but a fair amount of work is still needed to address the CSR fully as only a few of the measures have been implemented. For instance, a measure or measures have been adopted by the national Parliament or by ministerial decision, but no implementing decisions are in place.

Substantial progress: The Member State has adopted measures that go a long way towards addressing the CSR and most of them have been implemented.

Full implementation: The Member State has implemented all measures needed to address the CSR appropriately.

	of 15 August.
Strengthen tax compliance and collection.	Limited Progress Despite an improvement registered in 2015, the VAT gap in Romania remains the highest in the EU. The size of the informal economy is also large (22.1% according to 2014 estimates), reflecting significant tax evasion and undeclared work. Moreover, the mandatory introduction of electronic cash registers connected to the tax administration's IT system, which was supposed to help improve VAT collection, has been postponed again.
Fight undeclared work, including by ensuring the systematic use of integrated controls.	Some Progress. A number of important modifications were made to the labour and fiscal codes broadening the definitions of undeclared work. Under-declared earnings are now explicitly included. Coercive measures were expanded, also benefiting from media coverage, but preventive measures are still insufficiently used. However, in 2017 the labour inspection conducted fewer joint inspections compared to the previous year due to the late signature of the memorandum of understanding with ANAF. Social partners are still insufficiently involved, the dialogue with external stakeholders is still relatively weak, and quality management is at early stages.
CSR 2: Strengthen targeted activation policies and integrated public services, focusing on those furthest away from the labour market. Adopt legislation equalising the pension age for men and women. Establish a transparent mechanism for minimum wage-setting, in consultation with social partners. Improve access to quality mainstream education, in particular for Roma and children in rural areas. In healthcare, shift to outpatient care and curb informal payments.	Romania has made Limited Progress in addressing CSR 2
Strengthen targeted activation policies and integrated public services, focusing on those furthest away from the labour market.	Limited Progress Despite measures to include more categories of disadvantaged groups and to improve the financial attractiveness, the active labour market policies appear insufficiently well designed and the administrative burden remains a disincentive for employers. There is no case management for long-term unemployed and social assistance beneficiaries or cooperation procedures between public employment services and social assistance or educational services. Some progress has been made with outreaching young people not in education, employment or training following the signing of the project INTESPO. Progress on introducing integrated teams in the most disadvantaged communities is limited, despite several months of discussions, due to lack of involvement of certain actors, low political priority and rigid

	employment provisions.
Adopt legislation equalising the pension age for men and women.	No Progress The bill on pension age equalisation for men and women is still pending in parliament.
Establish a transparent mechanism for minimum wage-setting, in consultation with social partners.	No Progress Despite a proposal for an objective mechanism endorsed by the social partners as a good basis, the minimum wage continues to be set on a discretionary basis. Moreover, the opinions of the social partners are not taken into account, even when they converge, as it was the case for the recent transfer of social contributions to employees and the changes to the Fiscal code.
Improve access to quality mainstream education, in particular for Roma and children in rural areas.	Limited Progress Limited progress to improve access to quality mainstream education, in particular for Roma and children in rural areas. Implementation of the ESF-financed calls to attract highly qualified teachers in disadvantaged schools and to tackle early school leaving is delayed, with limited or no impact on the ground. The methodology to identify and tackle school segregation has yet to be developed. Implementation of the kindergarten coupon for children from disadvantaged backgrounds has continued, but the number of children not previously enrolled is very low and hence the impact on enrolment rates is only marginal. An early-warning mechanism to identify children at risk of drop-out is being developed and there are plans to launch an ESF-financed call for second chance programmes. However, prevention measures for early school leaving tend to be focused on social programmes, whereas the focus on the quality of education provided is rather limited. Existing measures to address Roma inclusion in education remain insufficient to tackle the magnitude of the challenge. Implementation of the new school curriculum is progressing, but is incomplete, while textbooks have raised a series of controversies. Beyond the ongoing ESF project to finance teacher training in view of the new curriculum, initial and in-service teacher education programmes remain insufficiently geared towards fostering inclusive education in the classroom. The strategy on education infrastructure has been finalized at the end of 2017. However, no specific budget has been set aside for the implementation of the strategy and the implementation capacity remains very modest.
In healthcare, shift to outpatient care	Limited Progress A variety of measures will be implemented in the 2018 Framework Contract of the National Health Insurance House with the providers: (i) The administrative burden for family doctors will be

	reduced using eHealth solutions. (ii) In rural areas, pilot projects will be implemented to increase the number of family doctors by setting a pay per performance system. (iii) The fees for specialised ambulatory care will be raised close to the level of day hospital. Other measures are planned in the context of the Regional Health Plans and Regional Master Plans, some of which will require some legislative changes that are currently discussed to be approved by the corresponding Commissions of Specialties: (i) Palliative care is being reorganised with an integrated approach (home-ambulatory-inpatient care) as part of a World Bank project; (ii) In connection with the building of the regional hospitals, some of the beds in the old county hospitals will be reconverted to palliative and long term care; (iii) The Romanian government will invest in infrastructure regarding the ambulatory specialised care (policlinics); (iv) A network of Integrated Community Centres equipped with integrated teams will be developed, complemented with training for community nurses. Nonetheless, the ongoing implementation of the National Health Strategy 2014-2020 (with the overall aim of shifting from inpatient to outpatient care) is marred by shifting priorities, poor investment planning, lack of clear political commitment and the modest administrative capacity of the Ministry of Health. The progress on mobilizing ESIF to reinforce outpatient care remains very limited. Efforts are still focused on the hospital sector (regional hospitals). While some ESIF calls have been launched and implementation can finally start, the political will to ensure the shift towards outpatient care seems to be lacking.
and curb informal payments.	Some Progress An Integrity Service within the Ministry of Health is connected to the National Integrity Agency and receives support from the National Anticorruption Directorate. The Service monitors patients' feedback mechanism which was revamped in December 2016. The feedback is based on two elements: a survey of patients' satisfaction following hospital discharge and a secure telephone line. Between July and October 2017, a total of 164 calls were registered of which 48 involved some offence and 37 were corruption-related. A report on the satisfaction survey is produced on a monthly basis (to be sent to the Commission). The Government and the hospitals are running awareness-raising campaigns. However, it is too early to assess the impact of the above measures on the reduction of informal payments.

CSR 3: Adopt legislation to ensure a professional and independent civil service, applying objective criteria. Strengthen project prioritisation and preparation in public investment. Ensure the timely full and sustainable implementation of the national public procurement strategy.	Romania has made Limited Progress in addressing CSR 3
Adopt legislation to ensure a professional and independent civil service, applying objective criteria.	Limited Progress Draft legislation sent to the Parliament in December is now aligned with the Civil Service Strategy. The National Institute of Administration has become operational since June 2017. A project with the World Bank was recently signed to implement some of the key actions of the human resource management reform. First results of the project may be available by mid-2019 and depend on the legal text adopted by Parliament and the effective implementation of the measures under the World Bank project. It is essential to address dysfunctionalities in public administration and public investments governance in all sectors including quality of implementation and absorption of ESIF.
Strengthen project prioritisation and preparation in public investment.	Limited Progress Despite some progress with public procurement reform, limited political ownership of structural measures, burdensome administrative procedures and lack of stable prioritization and strategic planning hold back the implementation of important policies across many sectors, including the timely implementation of ESI Funds. New administrative structures were set up in the Ministry of Finance in 2016 to facilitate public-private partnerships (Directorate for Management of Public Investments). The Government Programme 2017-2020 retains a focus on PPP. Technical assistance projects under the SRSP focus on improving the related existing legal framework and administrative capacity and enhancing public investment prioritisation. However the investment agenda remains influenced by changing priorities and the link with the adopted strategic framework remains modest.
Ensure the timely full and sustainable implementation of the national public procurement strategy.	Some Progress Despite efforts to engage a thorough reform of the public procurement system and tangible achievements made in 2017, the process was marked by instances of backtracking and lack of political ownership to implement some of the critical commitments taken in the context of the national public procurement action plan. Further focus and progress are needed to ensure the sustainability of reforms and the enforcement of measures allowing the use of the opportunities provided by the new public procurement directives. The areas where further

	progress is needed include the professionalization and empowerment of the contracting authorities, the aggregation of purchases, use of strategic procurement and balanced articulation of controls. The reform of the public procurement system is supported via the establishment of a Public Procurement Agency, the transposition of the 2014 public procurement directives and the adoption of secondary legislation. However, pressures to exempt some investments from public procurement rules continue to affect implementation. The irreversibility of the public procurement reform and further monitoring in the context of the EU Semester process remain essential.
Europe 2020 (national targets and progress)	
Employment rate target set in the NRP: 70 %.	The national target of 70 % by 2020 is within reach as the employment rate in the age group 20-64 was at 69.0% in Q3-2017.
R&D target set in the NRP: 2 % of GDP	Romania will not reach the R&D intensity target by 2020. The country's R&D intensity in 2016 was only 0.48% of GDP. To reach its 2020 target, R&D in Romania will need to grow by an average of 42.7% per year over the period 2016-2020. Moreover, the Romanian R&D intensity fell annually by 2% in the period 2007-2016. In 2016, public R&D intensity was 20% lower than in 2015, while business R&D intensity increased by 24%. Business R&D intensity reached 0.27% of GDP in 2016 (26th in the EU) while public R&D intensity fell to 0.22% of GDP (27th in the EU). EU-funded investments in R&D infrastructure are slowly taking off, but they are unlikely to have a significant impact on R&D performance before 2020.
Greenhouse gas emissions, national target: 19 % in 2020 compared to 2005 (in non-ETS sectors)	According to preliminary estimates in 2016, greenhouse gas emissions not covered by the EU ETS decreased by 4% between 2005 and 2016, while the target for 2015 allows an increase of 7% compared to 2005. According to the latest national projections based on existing measures, non-ETS emissions will increase by 1% between 2005 and 2020. The target is consequently expected to be met with a margin of 18 percentage points.
2020 renewable energy target: 24 %	With 24.8% renewable energy share in gross final consumption, Romania is well on track and even above in attaining its renewable energy target for 2020.

	Emergency Ordinance No 24/2017 was adopted on 30 March 2017, approving the amendments to the renewable energy support scheme. This provides support to promoting renewable energy in a sustainable manner while ensuring a reasonable consumer impact. This approach brings the much needed stability and predictability to the Romanian renewable energy sector.
Energy efficiency, 2020 energy consumption targets: 43 Mtoe (primary energy consumption); 30.3 Mtoe (final energy consumption).	ESI Funds should further contribute to meeting this target but the preparation and implementation of energy efficiency projects are significantly delayed.
Early school leaving (ESL) target: 11.3 %.	The rate of early school leaving decreased slightly to 18.5 % in 2016, but the target of 11.3 % remains far from being reached. Romania continues to have one of the highest early school leaving rates in the EU.
Tertiary education target: 26.7 %.	Progress on meeting the target has stalled. In 2016, tertiary attainment remained at the same level as in 2015 (25.6 %).
Target for reducing the number of people at risk of poverty or social exclusion, expressed as an absolute number of people: 580 000.	The national target of 580 000 people is already considered reached. In absolute terms, the number of people lifted out of the risk of poverty or social exclusion since 2008 is 1 420 000 (2016). The population taken out of poverty or social exclusion was however higher in 2015 (1 680 000) as compared to 2016.

ANNEX B

Macroeconomic Imbalance Procedure scoreboard

Table B.1: The Macroeconomic Imbalances Procedure scoreboard for Romania (AMR 2018)

			Thresholds	2011	2012	2013	2014	2015	2016
External imbalances and competitiveness	Current account balance, % of GDP	3 year average	-4%/6%	-4.9	-4.9	-3.6	-2.2	-1.0	-1.3
	Net international investment position	% of GDP	-35%	-65.4	-67.4	-62.6	-57.3	-54.6	-49.9
	Real effective exchange rate - 42 trading partners, HICP deflator	3 year % change	±5% (EA) ±11% (Non-EA)	-3.2	-2.0	0.4	-1.0	2.7	-2.5
	Export market share - % of world exports	5 year % change	-6%	50.2	12.8	14.2	20.7	20.9	23.6
	Nominal unit labour cost index (2010=100)	3 year % change	9% (EA) 12% (Non-EA)	-0.5	-0.2b	-3.2	7.3	0.3	6.0p
Internal imbalances	House price index (2015=100), deflated	1 year % change	6%	-15.8	-9.2	-2.8	-3.2	1.9	6.5
	Private sector credit flow, consolidated	% of GDP	14%	2.8	0.3	-1.4	-2.4	0.2	0.6p
	Private sector debt, consolidated	% of GDP	133%	72.9	71.9	66.6	62.1	59.1	55.8p
	General government gross debt	% of GDP	60%	34.4	37.3	37.8	39.4	37.9	37.6
	Unemployment rate	3 year average	10%	6.9	7.0	7.0	6.9	6.9	6.5
	Total financial sector liabilities, non-consolidated	1 year % change	16.5%	4.6	4.4	0.8	1.3	4.0	7.6
Employment indicators	Activity rate - % of total population aged 15-64	3 year change in pp	-0.2 pp	1.2	1.7	0.0b	1.6	1.3	0.7
	Long-term unemployment rate - % of active population aged 15-74	3 year change in pp	0.5 pp	0.5	0.8	0.8	-0.1	0.0	-0.2
	Youth unemployment rate - % of active population aged 15-24	3 year change in pp	2 pp	6.3	2.6	1.6	0.1	-0.9	-3.1

Flags:b:Break in series. p:Provisional.

(1) This table provides data as published under the Alert Mechanism Report 2018, which reports data as of 24 Oct 2017.

Please note that figures reported in this table may therefore differ from more recent data elsewhere in this document.

(2) Figures highlighted are those falling outside the threshold established in the European Commission's Alert Mechanism Report.

Source: European Commission 2017, Statistical Annex to the Alert Mechanism Report 2018, SWD(2017) 661.

ANNEX C

Standard tables

Table C.1: **Financial market indicators**

	2012	2013	2014	2015	2016	2017
Total assets of the banking sector (% of GDP) ⁽¹⁾	68.3	63.4	60.2	57.6	55.7	53.4
Share of assets of the five largest banks (% of total assets)	54.7	54.4	54.2	57.4	59.1	-
Foreign ownership of banking system (% of total assets) ⁽²⁾	89.8	90.0	90.0	90.5	91.4	91.2
Financial soundness indicators: ⁽²⁾						
- non-performing loans (% of total loans) ⁽³⁾	-	17.9	15.8	10.7	7.7	6.7
- capital adequacy ratio (%)	17.2	18.8	17.7	18.9	19.2	19.1
- return on equity (%) ⁽⁴⁾	-7.1	0.0	-15.2	11.3	10.6	6.1
Bank loans to the private sector (year-on-year % change) ⁽¹⁾	-0.7	-3.5	-1.3	4.5	3.3	7.5
Lending for house purchase (year-on-year % change) ⁽¹⁾	7.7	9.7	9.2	15.5	13.4	11.9
Loan to deposit ratio ⁽¹⁾	113.9	100.8	90.0	85.3	79.7	80.8
Central Bank liquidity as % of liabilities ⁽⁵⁾	3.9	0.3	-	-	-	0.0
Private debt (% of GDP)	71.9	66.6	62.1	59.1	55.8	-
Gross external debt (% of GDP) ⁽²⁾ - public	19.1	20.7	21.8	19.6	19.1	18.9
- private	33.5	30.1	28.9	26.8	28.3	26.8
Long-term interest rate spread versus Bund (basis points)*	518.4	384.4	333.1	297.8	323.4	359.9
Credit default swap spreads for sovereign securities (5-year)*	310.5	180.4	137.4	110.0	105.9	92.5

(1) Latest data Q3 2017. Includes not only banks but all monetary financial institutions excluding central banks.

(2) Latest data Q2 2017.

(3) As per ECB definition of gross non-performing debt instruments

(4) Quarterly values are not annualised

(5) Latest data May 2017.

* Measured in basis points.

Source: European Commission (long-term interest rates); World Bank (gross external debt); Eurostat (private debt); ECB (all other indicators).

Table C.2: **Headline Social Scoreboard indicators**

	2012	2013	2014	2015	2016	2017 ⁵
Equal opportunities and access to the labour market						
Early leavers from education and training (% of population aged 18-24)	17.8	17.3	18.1	19.1	18.5	:
Gender employment gap (pps)	16.1	16.3	16.7	17.5	17.6	16.8
Income inequality, measured as quintile share ratio (S80/S20)	6.6	6.8	7.2	8.3	7.2	:
At-risk-of-poverty or social exclusion rate ¹ (AROPE)	43.2	41.9	40.3	37.4	38.8	:
Young people neither in employment nor in education and training (% of population aged 15-24)	16.8	17.0	17.0	18.1	17.4	:
Dynamic labour markets and fair working conditions[†]						
Employment rate (20-64 years)	64.8	64.7	65.7	66.0	66.3	69.0
Unemployment rate ² (15-74 years)	6.8	7.1	6.8	6.8	5.9	4.9
Gross disposable income of households in real terms per capita ³ (Index 2008=100)	:	:	125.7	135.4	:	:
Public support / Social protection and inclusion						
Impact of social transfers (excluding pensions) on poverty reduction ⁴	20.5	18.4	12.8	13.3	14.2	:
Children aged less than 3 years in formal childcare	15.0	6.0	2.6	9.4	17.4	:
Self-reported unmet need for medical care	11.5	10.9	9.8	9.4	6.5	:
Individuals who have basic or above basic overall digital skills (% of population aged 16-74)	:	:	:	26.0	28.0	29.0

† The Social Scoreboard includes 14 headline indicators, of which 12 are currently used to compare Member States performance. The indicators "participants in active labour market policies per 100 persons wanting to work" and "compensation of employees per hour worked (in EUR)" are not used due to technical concerns by Member States. Possible alternatives will be discussed in the relevant Committees.

(1) People at risk of poverty or social exclusion (AROPE): individuals who are at risk of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in households with zero or very low work intensity (LWI).

(2) Unemployed persons are all those who were not employed but had actively sought work and were ready to begin working immediately or within two weeks.

(3) Gross disposable household income is defined in unadjusted terms, according to the draft Joint Employment Report 2018.

(4) Reduction in percentage of the risk of poverty rate, due to social transfers (calculated comparing at-risk-of poverty rates before social transfers with those after transfers; pensions are not considered as social transfers in the calculation).

(5) Average of first three quarters of 2017 for the employment rate and gender employment gap.

Source: Eurostat.

Table C.3: Labour market and education indicators

Labour market indicators	2012	2013	2014	2015	2016	2017 ⁵
Activity rate (15-64)	64.8	64.9	65.7	66.1	65.6	:
Employment in current job by duration						
From 0 to 11 months	5.3	5.2	5.0	6.2	4.9	:
From 12 to 23 months	6.6	5.8	6.0	7.4	6.4	:
From 24 to 59 months	22.1	21.2	20.0	19.5	20.5	:
60 months or over	66.0	67.8	69.0	66.8	68.2	:
Employment growth*						
(% change from previous year)	-4.8	-0.9	0.8	-1.3	-0.9	3.7
Employment rate of women						
(% of female population aged 20-64)	56.7	56.5	57.3	57.2	57.4	60.5
Employment rate of men						
(% of male population aged 20-64)	72.8	72.8	74.0	74.7	75.0	77.3
Employment rate of older workers*						
(% of population aged 55-64)	41.6	41.8	43.1	41.1	42.8	44.5
Part-time employment*						
(% of total employment, aged 15-64)	9.3	9.0	8.7	8.8	7.4	6.9
Fixed-term employment*						
(% of employees with a fixed term contract, aged 15-64)	1.5	1.4	1.5	1.4	1.4	1.2
Transition rate from temporary to permanent employment (3-year average)	57.3	57.7	57.8	56.5	:	:
Long-term unemployment rate ¹ (% of labour force)	3.0	3.2	2.8	3.0	3.0	2.1
Youth unemployment rate						
(% active population aged 15-24)	22.6	23.7	24.0	21.7	20.6	17.3
Gender gap in part-time employment	1.3	1.0	1.3	0.7	0.4	0.2
Gender pay gap ² (in undadjusted form)	6.9	4.9	4.5	5.8	:	:
Education and training indicators	2012	2013	2014	2015	2016	2017
Adult participation in learning						
(% of people aged 25-64 participating in education and training)	1.4	2.0	1.5	1.3	1.2	:
Underachievement in education ³	40.8	:	:	39.9	:	:
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	21.7	22.9	25.0	25.6	25.6	:
Variation in performance explained by students' socio-economic status ⁴	19.3	:	:	13.8	:	:

* Non-scoreboard indicator

(1) Long-term unemployed are people who have been unemployed for at least 12 months.

(2) Difference between the average gross hourly earnings of male paid employees and of female paid employees as a percentage of average gross hourly earnings of male paid employees. It is defined as "unadjusted", as it does not correct for the distribution of individual characteristics (and thus gives an overall picture of gender inequalities in terms of pay). All employees working in firms with ten or more employees, without restrictions for age and hours worked, are included.

(3) PISA (OECD) results for low achievement in mathematics for 15 year-olds.

(4) Impact of socio-economic and cultural status on PISA (OECD) scores. Values for 2012 and 2015 refer respectively to mathematics and science.

(5) Average of first three quarters of 2017, unless for the youth unemployment rate (annual figure).

Source: Eurostat, OECD.

Table C.4: Social inclusion and health indicators

	2012	2013	2014	2015	2016	2017
Expenditure on social protection benefits* (% of GDP)						
<i>Sickness/healthcare</i>	4.0	3.9	3.9	3.8	:	:
<i>Disability</i>	1.2	1.1	1.1	1.1	:	:
<i>Old age and survivors</i>	8.2	8.0	8.0	7.9	:	:
<i>Family/children</i>	1.3	1.2	1.2	1.3	:	:
<i>Unemployment</i>	0.2	0.2	0.1	0.1	:	:
<i>Housing</i>	0.0	0.0	0.0	0.0	:	:
<i>Social exclusion n.e.c.</i>	0.2	0.2	0.2	0.2	:	:
Total	15.2	14.6	14.4	14.3	:	:
<i>of which: means-tested benefits</i>	0.6	0.6	0.6	0.6	:	:
General government expenditure by function (% of GDP, COFOG)						
<i>Social protection</i>	12.3	11.5	11.4	11.4	11.6	:
<i>Health</i>	3.8	4.0	4.0	4.2	4.0	:
<i>Education</i>	3.0	2.8	3.0	3.1	3.7	:
Out-of-pocket expenditure on healthcare (% of total health expenditure)	22.4	20.2	20.3	21.3	:	:
Children at risk of poverty or social exclusion (% of people aged 0-17)*	52.5	51.4	50.7	46.8	49.2	:
At-risk-of-poverty rate ¹ (% of total population)	22.9	23.0	25.1	25.4	25.3	:
In-work at-risk-of-poverty rate (% of persons employed)	19.0	18.4	19.8	18.8	18.9	:
Severe material deprivation rate ² (% of total population)	31.1	29.8	25.9	22.7	23.8	:
Severe housing deprivation rate ³ , by tenure status						
<i>Owner, with mortgage or loan</i>	19.9	16.1	4.9	1.6	1.4	:
<i>Tenant, rent at market price</i>	19.0	21.2	32.8	53.0	46.0	:
Proportion of people living in low work intensity households ⁴ (% of people aged 0-59)	7.9	7.6	7.2	7.9	8.2	:
Poverty thresholds, expressed in national currency at constant prices*	3884	3888	3991	4253	4518	:
Healthy life years (at the age of 65)						
<i>Females</i>	5.1	5.2	5.7	5.7	:	:
<i>Males</i>	5.9	5.8	5.9	6.3	:	:
Aggregate replacement ratio for pensions ⁵ (at the age of 65)	0.7	0.7	0.7	0.6	0.7	:
Connectivity dimension of the Digital Economy and Society Index (DESI) ⁶	:	:	43.9	46.2	49.8	54.1
GINI coefficient before taxes and transfers*	53.2	51.8	52.1	54.1	54.4	:
GINI coefficient after taxes and transfers*	33.2	34.0	34.7	37.4	34.7	:

* Non-scoreboard indicator

(1) At-risk-of-poverty rate (AROP): proportion of people with an equivalised disposable income below 60 % of the national equivalised median income.

(2) Proportion of people who experience at least four of the following forms of deprivation: not being able to afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour TV, or ix) have a telephone.

(3) Percentage of total population living in overcrowded dwellings and exhibiting housing deprivation.

(4) People living in households with very low work intensity: proportion of people aged 0-59 living in households where the adults (excluding dependent children) worked less than 20 % of their total work-time potential in the previous 12 months.

(5) Ratio of the median individual gross pensions of people aged 65-74 relative to the median individual gross earnings of people aged 50-59.

(6) Fixed broadband take up (33%), mobile broadband take up (22%), speed (33%) and affordability (11%), from the Digital Scoreboard.

Source: Eurostat, OECD.

Table C.5: Product market performance and policy indicators

Performance Indicators	2010	2011	2012	2013	2014	2015	2016
Labour productivity (real, per person employed, year-on-year % change)							
Labour productivity in Industry	6.72	2.31	-4.52	4.24	1.38	9.36	2.48
Labour productivity in Construction	-20.16	-31.93	13.84	7.05	1.67	7.55	4.87
Labour productivity in Market Services	0.81	-8.82	41.17	0.83	-0.02	3.76	4.70
Unit labour costs (ULC) (whole economy, year-on-year % change)							
ULC in Industry	1.99	-2.48	18.48	-3.78	0.74	-0.53	2.66
ULC in Construction	7.50	37.79	-3.52	-5.01	-10.86	4.33	-3.78
ULC in Market Services	5.66	11.83	-29.30	6.19	7.37	-0.58	6.55
Business Environment	2010	2011	2012	2013	2014	2015	2016
Time needed to enforce contracts ⁽¹⁾ (days)	512.0	512.0	512.0	512.0	512.0	512.0	512.0
Time needed to start a business ⁽¹⁾ (days)	8.0	12.0	8.0	8.0	8.0	8.0	12.0
Outcome of applications by SMEs for bank loans ⁽²⁾	na	0.71	na	0.99	0.94	0.46	0.36
Research and innovation	2010	2011	2012	2013	2014	2015	2016
R&D intensity	0.45	0.49	0.48	0.39	0.38	0.49	0.48
General government expenditure on education as % of GDP	3.30	4.10	3.00	2.80	3.00	3.10	na
Persons with tertiary education and/or employed in science and technology as % of total employment	22	23	24	24	24	26	27
Population having completed tertiary education ⁽³⁾	12	13	14	14	14	15	15
Young people with upper secondary level education ⁽⁴⁾	78	80	80	80	80	80	80
Trade balance of high technology products as % of GDP	-1.62	-1.46	-1.79	-1.96	-1.66	-1.74	na
Product and service markets and competition					2003	2008	2013
OECD product market regulation (PMR) ⁽⁵⁾ , overall					na	na	1.69
OECD PMR5, retail					na	na	1.80
OECD PMR5, professional services					na	na	na
OECD PMR5, network industries ⁽⁶⁾					na	na	1.97

(1) The methodologies, including the assumptions, for this indicator are shown in detail here:

<http://www.doingbusiness.org/methodology>.

(2) Average of the answer to question Q7B_a. "[Bank loan]: If you applied and tried to negotiate for this type of financing over the past six months, what was the outcome?". Answers were codified as follows: zero if received everything, one if received most of it, two if only received a limited part of it, three if refused or rejected and treated as missing values if the application is still pending or don't know.

(3) Percentage population aged 15-64 having completed tertiary education.

(4) Percentage population aged 20-24 having attained at least upper secondary education.

(5) Index: 0 = not regulated; 6 = most regulated. The methodologies of the OECD product market regulation indicators are shown in detail here: <http://www.oecd.org/competition/reform/indicatorsofproductmarketregulationhomepage.htm>.

(6) Aggregate OECD indicators of regulation in energy, transport and communications (ETCR).

Source: European Commission; World Bank — Doing Business (for enforcing contracts and time to start a business); OECD (for the product market regulation indicators); SAFE (for outcome of SMEs' applications for bank loans).

Table C.6: **Green growth**

Green growth performance		2011	2012	2013	2014	2015	2016
Macroeconomic							
Energy intensity	kgoe / €	0.29	0.27	0.24	0.23	0.23	0.21
Carbon intensity	kg / €	0.99	0.96	0.86	0.83	0.81	-
Resource intensity (reciprocal of resource productivity)	kg / €	3.51	3.37	3.28	3.25	3.31	3.20
Waste intensity	kg / €	-	1.92	-	1.27	-	-
Energy balance of trade	% GDP	-2.7	-3.0	-1.9	-1.4	-0.9	-0.9
Weighting of energy in HICP	%	17.77	12.52	12.45	12.21	12.25	11.94
Difference between energy price change and inflation	%	1.0	1.3	5.0	0.1	2.8	-1.0
Real unit of energy cost	% of value added	24.9	25.6	23.6	22.6	-	-
Ratio of environmental taxes to labour taxes	ratio	0.18	0.18	0.19	0.22	0.24	-
Environmental taxes	% GDP	1.9	2.0	2.0	2.3	2.4	2.3
Sectoral							
Industry energy intensity	kgoe / €	0.18	0.20	0.18	0.18	0.17	0.15
Real unit energy cost for manufacturing industry excl. refining	% of value added	21.0	22.7	21.7	21.4	-	-
Share of energy-intensive industries in the economy	% GDP	13.67	11.79	11.59	12.20	12.56	12.77
Electricity prices for medium-sized industrial users	€ / kWh	0.08	0.08	0.09	0.08	0.08	0.08
Gas prices for medium-sized industrial users	€ / kWh	0.02	0.03	0.03	0.03	0.03	0.03
Public R&D for energy	% GDP	0.02	0.01	0.01	0.02	0.01	0.02
Public R&D for environmental protection	% GDP	0.02	0.02	0.02	0.01	0.01	0.02
Municipal waste recycling rate	%	11.7	14.8	13.2	13.1	13.2	-
Share of GHG emissions covered by ETS*	%	47.0	44.6	38.0	38.2	37.7	35.3
Transport energy intensity	kgoe / €	0.77	0.58	0.55	0.60	0.53	0.47
Transport carbon intensity	kg / €	2.07	1.63	1.55	1.70	1.50	-
Security of energy supply							
Energy import dependency	%	21.6	22.7	18.5	17.1	17.1	22.3
Aggregated supplier concentration index	HHI	16.7	12.4	12.8	14.2	17.8	-
Diversification of energy mix	HHI	0.23	0.23	0.23	0.23	0.23	0.23

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2010 prices)

Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)

Carbon intensity: greenhouse gas emissions (in kg CO₂ equivalents) divided by GDP (in EUR)

Resource intensity: domestic material consumption (in kg) divided by GDP (in EUR)

Waste intensity: waste (in kg) divided by GDP (in EUR)

Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP

Weighting of energy in HICP: the proportion of 'energy' items in the consumption basket used for the construction of the HICP

Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual % change)

Real unit energy cost: real energy costs as % of total value added for the economy

Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2010 EUR)

Real unit energy costs for manufacturing industry excluding refining: real costs as % of value added for manufacturing sectors

Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP

Electricity and gas prices for medium-sized industrial users: consumption band 500–20 000 MWh and 10 000–100 000 GJ; figures excl. VAT.

Recycling rate of municipal waste: ratio of recycled and composted municipal waste to total municipal waste

Public R&D for energy or for the environment: government spending on R&D for these categories as % of GDP

Proportion of GHG emissions covered by EU emissions trading system (ETS) (excluding aviation): based on GHG emissions (excl. land use, land use change and forestry) as reported by Member States to the European Environment Agency.

Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transport industry gross value added (in 2010 EUR)

Transport carbon intensity: GHG emissions in transport activity divided by gross value added of the transport sector

Energy import dependency: net energy imports divided by gross inland energy consumption incl. consumption of international bunker fuels

Aggregated supplier concentration index: covers oil, gas and coal. Smaller values indicate larger diversification and hence lower risk.

Diversification of the energy mix: Herfindahl index covering natural gas, total petrol products, nuclear heat, renewable energies and solid fuels

* European Commission and European Environment Agency

Source: European Commission and European Environment Agency (Share of GHG emissions covered by ETS); European Commission (Environmental taxes over labour taxes and GDP); Eurostat (all other indicators)

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