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Executive summary

This report assesses Romania's economy in the light of the European Commission's Annual Growth Survey published on 16 November 2016**.** In the survey the Commission calls on EU Member States to double their efforts on the three elements of the virtuous triangle of economic policy – boosting investment, pursuing structural reforms and ensuring responsible fiscal policies. In doing so, Member States should focus on enhancing social fairness to deliver more inclusive growth.

**The Romanian economy has been on a cyclical upswing for the past two years.** Growth hit a post-crisis peak in 2016 (at 4.9 %), fuelled by strong domestic demand on the back of pro-cyclical fiscal policies. Growth is set to remain robust over the forecast horizon at 4.4 % in 2017 and 3.7 % in 2018. The current account deficit deteriorated in 2016 and is expected to widen further driven by import growth due to strong domestic demand. Private consumption continued expanding, boosted by wage hikes and indirect tax cuts. While private investment was supported by low interest rates and stable investor confidence, public investment declined in 2016 due to a low implementation of EU funds.

**The labour market strengthened further driven by robust economic growth**. The tightening of the labour market has been associated with robust wage growth. Unemployment is approaching its pre-crisis low and is forecast to decline further in 2017-2018. Employment decreased slightly in 2016 and is expected to grow at a moderate pace.

**Reversing past consolidation, fiscal policy turned pro-cyclical in 2016 and the deficit is widening.** Driven by significant tax cuts and expenditure hikes, the general government deficit increased to 2.8 % of GDP in 2016 and is projected to increase further to 3.6 % in 2017 and 3.9 % in 2018. The structural deficit is projected to widen from below 1 % in 2015 to around 4 % in 2017, above its medium-term objective. The public debt ratio is expected to deteriorate but to remain below 60 % of GDP.

**Financial stability has improved but some challenges remain in the sector.** The overall health of the banking sector continued to improve in 2016 with comfortable levels of capital and rising profitability. Non-performing loans have come down markedly and credit is beginning to pick up again. However, the high level of non-performing loans is a challenge and recurrent legislative initiatives could undermine stability, legal predictability, and investor sentiment.

**Structural challenges may dampen the medium-term outlook.** For the first time since 2008, actual output was above potential and is expected to remain so in 2017-2018. Expansionary fiscal policy is boosting domestic demand. Although Romania made progress, particularly in governance, employment policies and poverty reduction, these reforms are not yet anchored in a sustainable manner. While some of these structural reforms are at risk of being reversed, others have stalled and the irreversibility of progress in the fight against corruption was recently put at risk. In the absence of an impetus in Romania's structural reform agenda, non-price competitiveness and potential growth will be constrained.

**Romania has made some progress in addressing the 2016 country-specific recommendations.** No progress was made in ensuring that the national fiscal framework is implemented and there was limited progress in strengthening tax compliance and collection. There was some progress in ensuring that legislative initiatives do not undermine legal certainty and do not put at risk financial stability. Substantial progress was made in strengthening the National Employment Agency's services and limited progress was made in minimum wage setting. Some progress was made in tackling early school leaving and increasing the provision of quality education, including for Roma, whilst this still needs to bear fruits on the ground. No progress was made on equalising the pensionable age for men and women. Some progress was made in curbing informal payments in the healthcare system and there was limited progress in increasing the availability of outpatient care. There was some progress in simplifying administrative procedures for businesses and the public and limited progress in strengthening the independence and transparency of human resources management in the public administration. There was substantial progress in strengthening the corporate governance of state-owned enterprises. Some progress was made in improving access to integrated services in rural areas and fostering economic diversification, and some progress was made with the transport master plan, which was adopted in September 2016. Finally, limited progress was made in prioritising public investment.

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

The main findings of the analysis in this report, and the related policy challenges, are as follows:

**Comprehensive reforms were started in 2016, but unused labour potential is limiting growth.** The public employment service was reinforced and active labour market policies are now substantially better targeted to inactive groups. However, employment and activity rates for women, the low-skilled, young people, people with disabilities and Roma remain below the EU average. Low unemployment is thus matched by one of the highest inactivity rates in the EU. The provision of active labour market policies and their link to social services is not yet sufficient to reverse this trend. Despite reinforced joint controls, undeclared work remains prevalent, also reducing both labour supply and fiscal revenue. Full equalisation of the retirement age for women and men remains to be adopted. Work on a minimum wage setting mechanism is underway, but minimum wages were already raised in February 2017.

**Poverty is declining, but high income inequality persists.** Romania has one of the highest levels of income inequality in the EU and rising, partially driven by decreasing redistributive effects of the tax and transfer system. Although poverty rates are declining, poverty and social exclusion persist for young people, families with children, people with disabilities, Roma, the rural population and inactive people. A change towards more integrated services targeted to disadvantaged groups is planned, as the provision of these services is low.

**Measures to improve healthcare are in place, but the system suffers from inefficiencies, limited accessibility and corruption**. New initiatives to improve cost effectiveness and integrity of healthcare were launched in 2016. In the absence of a national strategy on the workforce in healthcare, however, access to healthcare remains limited due to shortages of health professionals, affecting mainly rural areas. Persistently low funding and over-reliance on hospital-based healthcare limit access to universal quality care and impair the efficiency of the health system. Recent policy action notwithstanding, corruption remains prevalent, impacting on the quality of public health services.

**The unequal provision of quality education weakens human capital potential**. Underachievement in basic skills and the provision of quality education to disadvantaged groups, in particular students in rural areas and Roma, remains problematic. Persistently high early school leaving and low tertiary attainment do not meet the increasing need for a skilled labour supply against the background of persistent emigration. Measures to prevent drop-out are being implemented, but the availability of second chance programmes is not yet sufficient to reduce early school leaving.

**Public investment spending is high, but low infrastructure efficiency is constraining growth.** Public investment spending has been among the highest in the EU in the last decade but the perceived quality of infrastructure ranks among the lowest in the EU. Inefficient public investment and public procurement, high administrative burdens and low provision of e-government services are major obstacles to boosting growth and productivity.

**Public administration reform accelerated in 2016, but is not yet complete.** The Government adopted a renewed national anti-corruption strategy for effectively tackling corruption prevention in public administration. Measures to strengthen transparency and take proper account of consultations with the relevant authorities and stakeholders in decision-making and legislative activities were put in place. Civil service and staff training strategies were adopted, but the draft legislation does not yet fully incorporate their principles and objectives. Regulatory impact assessment instruments, strategic planning of policy, legislative and investment initiatives, and court decisions have not been systematically implemented. Delays and potential reversals of recent reforms are holding back investment.

**1.** Economic situation and outlook

GDP and potential growth

**Growth edged up in 2016 driven by domestic demand boosted by expansionary fiscal policies.** Following 3.9 % in 2015, real GDP growth is estimated to have reached 4.9 % in 2016, a new post-crisis peak. Growth was driven mainly by private consumption supported by wage increases, indirect tax cuts, and low interest rates.

**The robust rates of economic growth are forecast to moderate towards potential growth.** A strong fiscal impulse in the short run, alongside relatively favourable financing conditions, is expected to continue to support domestic demand. Economic growth is projected to moderate and return to potential as consumer prices pick up and as the additional fiscal stimulus in 2017 is of smaller magnitude than in 2016. Accordingly, real GDP is forecast (European Commission winter 2017 forecast) to expand by 4.4 % in 2017 and by 3.7 % in 2018.

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| Graph 1.1: **GDP and components and output gap** |
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| ***Source:*** European Commission |

**The boost from the fiscal stimulus is likely to be short-lived in the absence of reforms to enhance potential growth.** The fiscal impulse and strong domestic consumption lifted cyclical growth in 2016, closing the output gap. However, in the longer run, structural growth will remain constrained in the absence of sufficient progress on implementing structural reforms, including structural fiscal reforms (see Section 3).

**Household consumption will remain a main driver of growth.** Private consumption rose to a nine-year high, contributing estimated 5.6 percentage points (pps.) to growth in 2016. Stable employment growth, wage increases in 2017 and moderate inflation are expected to support real disposable incomes. Consequently, consumption is set to continue growing steadily in 2017 and somewhat slower in 2018 with the rise in consumer prices (Graph 1.1).

**On the supply side, services are increasingly contributing to growth.** The value added of services in the business sector has been continuously increasing since the crisis (Graph 1.2). Among services, ICT and scientific and administrative support activities are expanding the fastest. The ICT sector's share of GDP is one of the highest in the EU (5.6 % compared to an EU average of 4.2 %) ([[1]](#footnote-1)). At the same time, the contribution to growth of agriculture, construction, and most recently industry has been shrinking. The higher weight of services in the gross value added of the total economy is mirrored by the dynamic job creation in this sector (see Section 3.3).

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| Graph 1.2: **Gross value added distribution (current prices)** |
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| ***Source:*** European Commission |

Investment

**Investment has returned to pre-crisis growth rates.** Investment growth peaked at 8.3 % in 2015. In 2016, total investment (measured as gross fixed capital formation) is estimated to have increased by 5.5 %, supported by low interest rates and stable investor confidence. In contrast, public investment declined in 2016 partly due to the slow uptake of new projects financed by EU funds for the 2014-2020 period.

**Romania has one of the highest investment ratios in the EU.** Total investment reached 24.8 % of GDP in 2015, above the EU average (at 19.7 %) (Graph 1.3). However, the quality of public investment remains constrained by management deficiencies, changing priorities and difficulties in absorbing EU funds (European Commission, 2016a).

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| Graph 1.3: **Gross fixed capital formation (2005-2018)** |
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| ***Source:*** European Commission |

**The share of less capital-intensive sectors in gross value added is increasing.** Services are among the least capital-intensive sectors of the economy, and account for 35 % of the increase in gross value added since 2006. Specifically, the share of ICT, financial and insurance services and professional and scientific activities (circled in Graph 1.4) in gross value added increased from 10.7 % to 18 % from 2006 to 2015.

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| Graph 1.4: **Consumption of fixed capital by sector and gross value added (2006-2015)** |
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| ***Source:*** European Commission |

**Investment is projected to remain robust.** In 2017-2018, investment rates are forecast to remain high due to (i) sustained investor confidence supported by tax incentives (the abolition of the special construction tax from January) and positive economic growth prospects, and (ii) the gradual implementation of projects financed from EU funds in the 2014-2020 financing period. Some uncertainties remain, related mostly to the predictability of the legal and business environment (see Box 3.4.1).

External position

**As domestic demand grows, the current account deficit is set to widen through import growth.** The current account deficit significantly deteriorated in 2016 (2.2 % of GDP), as domestic demand surged. The deficit is expected to widen further on the back of import growth due to strong domestic demand and is forecast to reach 3.1 % of GDP in 2018. Additionally, export growth is expected to slow down in line with slow growth in main trading partners and a potential erosion of cost competitiveness.

**The sustainability of Romania's external position improved in 2015.** The net international investment position (NIIP) markedly improved in 2015, reaching ‑51.9 % of GDP, a 5.4 percentage point decrease on 2014. This decrease reflects a shrinking current account deficit and strong GDP growth. The share of foreign direct investment remained broadly stable while other foreign liabilities declined as Romania is repaying external debt, a trend which is expected to continue (Graph 1.5).

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| Graph 1.5: **Net international investment position** |
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| ***Source:*** European Commission |

Inflation

**Inflation fell to a record low in 2016, markedly influenced by fiscal measures.** Average harmonised index of consumer prices inflation moved into negative territory with the cut in the VAT rate for food products in June 2015, followed in January 2016 by a 4 pps. reduction in the standard VAT rate. Combined with persistently low international oil prices, inflation plunged even deeper to an all-time low of ‑3.0 % in May 2016 before it started a mild recovery. A further cut in the standard VAT rate by 1 pp. was implemented from January 2017. The impact of these successive VAT reductions on headline inflation has so far outweighed the upward pressures on prices stemming from the surge in domestic demand and higher wages.

**Risks to the inflation outlook are tilted to the upside** (Graph 1.6). As the effect of the implemented tax cuts fades out, inflation is set to pick up swiftly in 2017. Additional factors exerting upside pressures on prices in 2017-2018 include further wage increases, accelerating credit growth, fiscal loosening, and the positive output gap.

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| Graph 1.6: **Harmonised index of consumer prices inflation in constant taxes** |
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| (1) HICP in constant taxes assumes a full pass-through of VAT changes***Source:*** European Commission |

Labour market

**Labour market conditions are improving.** The labour market continued to improve in 2015 and 2016 on the back of strong GDP growth. Unemployment dropped from 6.8 % in 2015 to 6.0 % in 2016 and is approaching pre-crisis lows. Total employment decreased slightly in 2016 by estimated 0.6 % and is set to grow at a modest pace in 2017-2018 (see Section 3.3). Jobs were lost in agriculture and industry, but gained in services, reflecting the changing structure of the economy. Jobs were created in construction as economic growth has been picking up.

**The labour force continues to shrink.** Since 2007 the population has shrunk by 6 %, the third highest decrease in the EU. The population is ageing and by 2020 the working-age population (20-64) is expected to have declined further by around 4 %, while the number of elderly people is likely to have increased by 13 % by 2060 (Graph 1.7). With the projected continued emigration of predominantly young people, coupled with limited return migration, the country risks losing further labour resources. This, in turn, may slow down productivity growth and income convergence and have a downward impact on potential growth.

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| Graph 1.7: **Population, natural increase and net migration** |
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| ***Source:*** European Commission based on national data |

**At the same time, some potential labour supply remains largely untapped.** Inactivity remains one of the highest in the EU and the share of young people neither in education, employment or training has increased. Other groups, such as Roma, women and the rural population continue to face challenges on the labour market (see Section 3.3.1).

**Recently, labour compensation accelerated reflecting a tightening labour market.** Since 2012, nominal compensation per employee growth has been in line with developments in inflation, productivity and unemployment developments. However, in 2016, compensation per employee growth picked up, reflecting a tightening labour market and ahead of the rate suggested by fundamentals (Graph 1.8).

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| Graph 1.8: **Nominal compensation per employee** |
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| For methodology see Arpaia et al (2015)***Source:*** European Commission |

Social developments

**Poverty levels remain among the highest in the EU.** The poverty situation has improved and severe material deprivation dropped significantly during the last years. However, Roma and children remain particularly affected by poverty or social exclusion. The risk is also high for inactive people. Education and health outcomes remain unsatisfactory, especially for the most affected by poverty and social exclusion. Poor education and health outcomes in turn hinder employability**.**

**Income inequality has been increasing and is one of the highest in the EU.** Disposable income inequality has been gradually increasing since 2012, with a particularly strong push in 2015. The richest 20 % of the population have an income more than eight times higher than the income of the poorest 20 %, a ratio significantly higher than the EU average. The fact that lower income Member States appear to show higher income inequalities (Graph 1.9) only partially explains the figures for Romania. There is also a large difference between regions and a deep urban-rural divide ([[2]](#footnote-2)). Market income inequality (i.e. income inequality before taxes and transfers, including pensions) has been stable. Thus, the rise in disposable income inequality has been partially driven by decreasing redistributive effects of the tax and transfer system (see also Section 3.1.1).

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| Graph 1.9: **GDP per capita in PPS in 2015 vs income quintile ratio (S80/S20) for the EU-countries.** |
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| ***Source:*** European Commission |

Public finances

**Fiscal policy turned pro-cyclical in 2016 and the general government deficit is expected to widen.** The authorities have enacted a series of tax cuts, including to VAT rates, excise duties and an abolition of the special construction tax. On the expenditure side, public wages have been significantly increased over 2016-2017. The new government also enacted a significant additional increase of old-age pensions which will enter into force in July 2017. As a consequence, the structural deficit widened from under 1 % in 2015 to around 2½ % of GDP in 2016 and is forecast to reach around 4 % in 2017 (Graph 1.10). The general government deficit is estimated to have increased from 0.8 % of GDP in 2015 to 2.8 % of GDP in 2016 and is expected to widen further to 3.6 % in 2017.

**The public debt ratio is expected to increase moderately**. Because of the widening of the public deficit, the general government debt is projected to increase from 38 % of GDP in 2015 to 42.3 % of GDP in 2018. Sovereign financing conditions have been favourable but have recently deteriorated. In the event of an adverse shock to the exchange rate, the 60 % of GDP threshold would be breached by 2026 (see Section 3.1.3).

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| Graph 1.10: **Fiscal balance and output gap** |
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| ***Source:*** European Commission |

Financial sector

**Banks' balance sheets improved further but the sector continues to face challenges.** Banks capital positions and profitability continued to improve. The stock of non-performing loans remains elevated but has continued to decline markedly. However, recurrent legislative initiatives with retroactive application undermine legal predictability and investor sentiment (Section 3.2).

**The accommodative monetary policy stance provided stimulus to the economy.** In addition to improvements in banks' balance sheets, easy monetary conditions and pro-cyclical policies contributed to a pick-up of credit to the economy in recent years. The central bank reduced the key policy rate gradually from 6 % in December 2011 to the current 1.75 % which was reached in May 2015. Liquidity conditions improved as the minimum reserve requirements ratios were cut. Given improved monetary transmission, interest rates declined in line with changes in the monetary policy rate.

**Domestic currency lending is increasing.** The share of loans to the private sector in domestic currency continued to increase and reached 57.2 % of the total loan stock in December 2016, more than offsetting the decrease in foreign currency lending.

**Banks continue to focus on household lending.** Domestic credit to households in lei increased rapidly in 2016 (by 25 % in December for the year in nominal terms), supported by falling interest rates. Over half of the loans to households are for house purchases and are increasingly denominated in domestic currency (+54 % year-on-year in December 2016). However, overall household balance sheets improved. At 17.5 % of GDP, household debt remains one of the lowest among EU countries. After falling in the last 6 years, both in nominal and real terms, housing prices picked up in 2015-2016.

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| Graph 1.11: **Loans to households and non-financial corporations** |
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| ***Source:*** National Bank of Romania |

**Credit growth to non-financial corporations remained negative.** Corporate lending continued to lose ground (‑3.1 % year-on-year in December 2016). The increase in the stock of local currency- denominated loans (+4 %) did not compensate for the decline in foreign currency-denominated loans (‑11.0 %). Credit demand remained subdued due to balance sheet adjustments of resident corporates with a preference for reinvested profits.

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| Table 1.1: **Key macroeconomic, financial and social indicators** |
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| (1) Sum of portfolio debt instruments, other investment and reserve assets (2,3) Domestic banking groups and stand-alone banks(4) Domestic banking groups and stand alone banks, foreign (EU and non-EU) controlled subsidiaries and foreign (EU and non-EU) controlled branches.***Source:*** European Commission, ECB |
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**2.** Progress with country-specific recommendations

**Progress with implementing the recommendations addressed to Romania in 2016 (**[[3]](#footnote-3)**) has to be seen in a longer term perspective since the introduction of the European Semester in 2011**. Hard-won fiscal consolidation gains are at risk of being reversed, and progress on the structural reform agenda has been uneven.

**On fiscal adjustment progress is at risk of being undone**. Since 2009, Romania pursued a significant fiscal consolidation which led to achieving its medium-term objective in 2014 and 2015. However, the authorities are pursuing an expansionary fiscal policy that led to a substantial departure from the objective.

**Romania’s track record on labour market, education and social reforms is mixed.** Progress in reforming public employment services was initially slow, but accelerated substantially in 2016 supported by the country’s efforts to meet pre-conditions for obtaining EU funds. Repeated calls to extend the coverage and effectiveness of active labour market policies were significantly addressed in 2016, through changes in legislation, integration of national and European Social Funds budgets, and better coordination between employment and social services. Successive country-specific recommendations (CSRs) to address youth employment challenges and the high percentage of young people not in employment, education or training have triggered a more integrated approach, which was proposed in 2016, including a pivotal role for the National Employment Agency. These reforms have the potential for tangible and lasting effects, but only if implemented and sustained over the longer term. Labour taxation was reduced, but in an untargeted way. Repeated calls to fight undeclared work saw limited progress with some joint inspections by the tax administration and the Labour Inspectorate’ in 2016. There has been limited progress to date on setting-up a minimum wage setting mechanism was made so far with decisions being taken without objective criteria. On social inclusion, the minimum inclusion income law was adopted in 2016 as a response to successive CSRs. The law will be enacted in 2018. A change towards integrated services for disadvantaged groups has started in 2016 and could produce a substantial impact when fully implemented and scaled up at national level. Some progress has been made in increasing the provision and quality of early childhood education and care, with the introduction of social vouchers to poor families, including for the Roma. The early school leaving Strategy was adopted in response to repeated CSRs. There was some progress on this in 2016, but speeding up implementation on the ground will be instrumental to reduce the rate of school drop-outs. Some progress was made in vocational education and training (VET) by adoption of a VET Strategy, and by reinstating the professional schools, but with insufficient links to the labour market.

**Healthcare reforms have advanced in 2016** The Ministry of Health has revamped a patient feedback mechanism for reporting informal payments, with new legislative measures to empower patients, enforced role of ethics councils in public health units, and sanctions. Some measures have been taken to increase the availability of outpatient care, but are still at a very early stage.

**Efforts to strengthen the capacity of public administration were stepped up in 2016.** They covered in particular: (i) transparency, strategic orientation and coherence of public policies; (ii) decision-making tools; (iii) coordination within and between different levels of government. New civil service and training strategies were adopted, setting the reform lines for human resources management, but implementation has not started. These reforms could be reversed if they are not followed through and sustained over time.

**Progress was made in the simplifying administrative procedures.** After no progress in 2011-2013, progress in 2013-2015 was significant with the adoption of two dedicated strategies and an action plan for entrepreneurship, business environment and SMEs, and the adoption of the 2013-2016 government programme. The establishment of a dedicated department for SMEs, business environment and tourism further consolidated progress. As a result, in the past 3 years Romania has performed above the EU average on the ease of setting up new businesses.

**The analysis of progress of judicial reform and fight against corruption concluded that Romania has made substantial progress on much of the reform of the judicial system (**[[4]](#footnote-4)**) and the investigation of high-level corruption.** Efforts are still required as regards judicial independence in Romania's public life, finalising reforms of the criminal and civil codes and ensuring efficiency in the implementation of court decisions. Romania has made some progress towards further measures to prevent and fight against corruption, in particular within local government. Important challenges remain in the effective implementation of the preventive policies that have been defined in 2016 ([[5]](#footnote-5)). Romania has made substantial progress on the investigation of high-level corruption.

**Overall, Romania made some (**[[6]](#footnote-6)**) progress in addressing the 2016 country-specific recommendations.** There was overall limited progress on credibility of fiscal institutions, on tax compliance and collection and financial stability. In contrast there was overall some progress on employment, minimum wage setting, education and pensions. There was overall some progress on health, public administration, and state-owned enterprises. There was overall some progress on rural areas, transport and investments*.*

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| Table 2.1: **Summary table on 2016 CSR assessment** |
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| (1) This overall assessment of CSR1 does not include an assessment of compliance with the Stability and Growth Pact.***Source:*** European Commission |
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| <_DISABLED_nbr_DISABLED_>2.1</nbr> <title>Contribution of the EU budget to structural change in Romania</title> <_DISABLED_id_DISABLED_>8cdf8429-ce84-4803-8b93-efc8347a018f</id> <srcType>WORD</srcType> <srcPath>O:\2017 CRs\23 RO\Graphs tables boxes\</srcPath> <srcName>Box 2.1 EU budget and structural changes.docx</srcName> <type>box</type> <pos>top</pos> <numbering>external</numbering> <manNumb>no</manNumb> <multi>no</multi> <statAnn>no</statAnn> <float>no</float> <bottomShapePageNumber>-1</bottomShapePageNumber> <version>2</version> <scrFileTime>2017-02-12T22:05:58</scrFileTime> <imageInformation>  <dontScaleUp>no</dontScaleUp> </imageInformation> <url></url> |
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**3.** Reform priorities

3.1. Public finances and taxation

**Fiscal policy turned pro-cyclical in 2016 and the deficit is expected to widen, in breach of the fiscal framework.** As a consequence of significant tax cuts and expenditure increases, the general government deficit widened in 2016 and is projected to further widen in 2017. This increase breaches the country's fiscal framework, the provisions of which are sound in theory but lack enforcement. With a worse fiscal balance, the public debt ratio is expected to deteriorate gradually but remain below 60 % of GDP. High tax evasion and low tax compliance remain a challenge.

3.1.1. Taxation

**The overall structure of the tax system is favourable to economic growth.** Compared with the EU average, tax revenues depend to a larger extent on consumption taxes and to a lesser extent on taxes on corporate income and on labour ([[7]](#footnote-7)) (European Commission 2016f).

**The impact of the tax and benefit system on reducing income inequality is relatively low.** The difference between market income inequality (i.e. before taxes and benefits) and disposable income inequality (i.e. after taxes and benefits) is relatively low (Graph 4.1.1). The degree of progressivity in labour tax system is relatively low, contributing to this outcome. Nevertheless, the government has removed the cap of 5 average gross salaries, so that from 2017 the social security contribution and the health contribution apply to the entire income earned. Health contributions for pensioners have been eliminated, as well as personal income taxes for pensions below RON 2 000 (EUR 440). Since 2015 the government has reduced in several steps the standard VAT rate and the VAT rate on food and other products. However, reduced VAT rates are not the most efficient instrument for decreasing income inequalities, since they are not specifically targeted at vulnerable households.

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| Graph 3.1.1: **Income inequality (2015)** |
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| 2015 data partially available for IE. ***Source:*** European Commission, 2016b |

**The incidence of undeclared work continues to be high, weighing on tax revenue.** Undeclared work represents approximately 15 %‑20 % of GDP ([[8]](#footnote-8)). Despite increased number of joint controls of labour and tax authorities, their impact remains limited, partly because preventive measures are not yet sufficiently developed ([[9]](#footnote-9)). This was because resources are not always focused on sectors with highest risks, while preventative measures, including information campaigns, are insufficient. At the beginning of 2017, in an attempt to reduce the size of the informal sector, in particular in agriculture, the government introduced an exemption from income tax for individuals earning income from carrying out seasonal activities based on 12-month employment contracts.

**Tax compliance remains low as evidenced by Romania having the largest VAT gap in the EU.** The VAT gap, i.e. the difference between theoretically expected VAT revenues and effectively collected VAT, increased by 3.4 pps. in 2014 (Graph 3.1.2) despite a good economic environment and the introduction of anti-fraud measures. To tackle VAT evasion and fraud, the legislation for the registration and deregistration for VAT purposes was amended and clarified, while the procedures for VAT reimbursement were adjusted in 2016 ([[10]](#footnote-10)).

**More measures to fight tax avoidance were adopted in 2016.** A mandatory but progressive introduction ([[11]](#footnote-11)) of electronic cash registers connected to the National Agency for Fiscal Administration IT system is being pursued. A special annual income tax replaced the corporate income tax for taxpayers operating in specific business areas such as hospitality services and bars/restaurants. The tax is based on coefficients, such as the surface area of premises, irrespective of business's sales or net profits. However, from 2017 the turnover threshold for the application of the micro-enterprise tax regime has been increased fivefold and the tax rate was cut, therefore extending this departure from the standard tax regime and possibly contributing to further tax avoidance.

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| Graph 3.1.2: **VAT gap** |
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| ***Source:*** CASE et al. (2016) |

3.1.2. Fiscal framework

**The fiscal framework is sound, but lacks enforcement.** The fiscal rules, which are contained in the fiscal responsibility law ([[12]](#footnote-12)), are well designed ([[13]](#footnote-13)). However, the 2016 budget law was non-compliant as the deficit ceiling of RON 20.9 billion breached the medium-term budgetary objective of a structural deficit of 1 % of GDP ([[14]](#footnote-14)). The Romanian Fiscal Council had assessed the draft 2016 budget as "a deliberate and large deviation from all fiscal rules". Additionally, the first budget amendment (from August) broke the rule prohibiting increases in personnel expenditure during the fiscal year, while the second amendment (from November) broke the rule prohibiting increases of the primary deficit 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 2016, as in previous years, the authorities did not send an update of the fiscal strategy to the Parliament by 15 August, the statutory deadline. Instead the government sent it to the Parliament simultaneously with the 2017 budget law in December.

3.1.3. LONG-TERM sustainability

**With a worse fiscal balance, the public debt ratio is expected to deteriorate gradually.** Assuming no changes in fiscal policy (baseline scenario ([[15]](#footnote-15))), public debt would steadily increase from just below 38 % of GDP in 2015 to 61 % of GDP in 2027 (Graph 3.1.3). As the primary deficit is projected to deteriorate, interest expenditures will gradually increase.

**Without pension reform, aging costs would deteriorate debt dynamics**. The retirement age is not equal among genders (see Section 3.3.1) Moreover, implementation of the second pension pillar consisting of privately managed pension savings has been delayed. The original plan envisaged that contributions to the second pillar would be raised to 6 percentage points of the employees' contribution to the pension system. However, the 2016 budget provided for transfers corresponding to 5.1 pps. of contributions and the 2017 budget maintained this share. Over the long run, aging costs related to health care and long-term care will also negatively impact debt-to-GDP ratios ([[16]](#footnote-16)).

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| Graph 3.1.3: **Public debt sustainability** |
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| ***Source:*** European Commission |

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| Graph 3.1.4: **Annual rate of change in gross debt ratio, baseline scenario** |
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| ***Source:*** European Commission |

**Public debt is sensitive to exchange rate risk.** With over half of debt denominated in foreign currency, public debt is sensitive to exchange rate shocks. In a stress test scenario involving a 30 % depreciation of the lei in 2017 and 2018, general government debt would quickly increase to almost 51 % of GDP in 2018 and would breach the 60 % of GDP threshold by 2024 ([[17]](#footnote-17)).

3.2. Financial sector

**Financial stability improved in 2016, but legislative initiatives tend to undermine legal predictability and investor's confidence.** In the context of strong economic growth and a rebound in credit activity, bank balance sheets have continued to strengthen, while profitability recovered. Following the 2015 balance sheet review and stress test, further efforts have been made to ensure adequate capitalisation in the insurance sector. However, recurrent legislative initiatives could undermine the stability of the financial sector, and undermine investor sentiment by making the legal framework less predictable.

**The banking sector remains well capitalised and liquid, and profitability recovered in 2016.** In particular, capital adequacy at system level has remained roughly flat since end-2015 and stood at 18.7 % at the end of September 2016. Liquidity remained at comfortable levels, while the loan-to-deposit ratio fell to 87 % at end-March 2016. Following the balance sheet clean-up in 2014, banking sector profitability rebounded to positive territory in 2015 and further improved in 2016 despite compressed interest margins (Graph 3.2.1).

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| Graph 3.2.1: **Return on equity** |
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| ***Source:*** European Commission |

**On the back of write-offs and sales of impaired assets, non-performing loans (NPLs) declined.** Due to the 2014 NPL resolution plan by the National Bank of Romania (NBR) and additional measures adopted in April 2016 ([[18]](#footnote-18)), NPLs dropped sharply by roughly 12 pps. to 10.02 % in October 2016,  down from the peak registered in February 2014([[19]](#footnote-19)). However, banks continue to be burdened by the quality of corporate exposures and consumer loans, which are the loan portfolios with the highest level of delinquency (Graph 3.2.2).

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| Graph 3.2.2: **Non-performing loans** |
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| ***Source:*** National Bank of Romania. |

**The 2015 asset quality review (AQR) and stress test of the banking sector has been delayed.** The NBR decided to delay the start of the exercise to capture the impact of the law on debt discharge *('datio in solutum')* on banks’ balance sheet data at end-2016. Regarding the governance of the exercise, the asset quality review and stress test will be overseen by a steering committee with international participation and will be conducted with the support of independent and reputable third parties (including auditors, real estate appraisal companies). The exercise, which the NBR committed itself to starting at the beginning of 2017, will include all credit institutions of systemic relevance. The asset quality review methodology will be based on the 2014 ECB comprehensive assessment. The stress test will be broadly based on the methodology developed by the European Banking Authority for the 2016 EU-wide stress test.

**Following European Systemic Risk Board recommendations, Romania is setting up a macro-prudential authority.** To strengthen their powers in the area on macro-prudential policies, the authorities plan to establish a National Committee for Macro-prudential Oversight, which will replace the current National Committee for Financial Stability ([[20]](#footnote-20)). However, the law to set up this committee has yet to be adopted.

**The authorities introduced several macro-prudential measures in 2016.** In particular, the NBR identified nine banks as other systemically important credit institutions (O-SIIs) with an O-SII buffer of 1 % since 2016. In March 2016 the NBR adopted a systemic risk buffer of 1 %, applicable to banks whose parent institutions are domiciled in countries with a 'non-investment' long-term sovereign debt rating. However, this decision has been suspended until an impact study of recent legislative developments has been conducted. From 1 March 2017 the macroprudential measures adopted by the NBR following the recommendations of the National Committee for Financial Stability will refer to: (i) an O-SII buffer of 1 % of the total risk exposure amount applied to 11 banks identified by the NBR as O-SIIs based on data available as of June 2016; and (ii) deactivation of the Systemic Risk Buffer.

**The debt discharge law has to be amended to reflect the Constitutional Court decision.** The law (European Commission, 2016a), in force since May 2016 and retroactively applicable also to existing loan contracts, applies to loans with a value below the threshold of EUR 250 000 and covers loans granted for buying, building, renovating a property for living, or loans (irrespective of the scope) which are guaranteed with at least one dwelling as collateral. However, mortgage loans under the state sponsored "First House" programme were excluded from the scope of the law. Following a referral by credit institutions, the Constitutional Court ruled on 25 October 2016 that judges will assess whether borrowers comply with the legal provisions on hardship ([[21]](#footnote-21)) under the 2011 Civil Code. The ruling of the Constitutional Court minimizes the unwarranted adverse impact of this law on the banking sector and reduces moral hazard by focusing the applicability of the law on borrowers in difficulty.

**The full impact of the debt discharge law remains difficult to assess.** Although originally intended for borrowers in financial distress,, experience so far shows that borrowers without financial difficulties and delays in the servicing of loans have also made use of the law. At the time of adoption, banks increased the down-payment for mortgage loans, but they subsequently lowered it for certain categories of borrowers. In prudential terms, the law initially triggered the upward revision of banks’ risks weights of the loan portfolio falling under the scope of the law. ([[22]](#footnote-22)) However, after reassessment which took also on board the ruling of the Constitutional Court, this loan portfolio is no longer being treated as being impacted by a default event and therefore no longer subject to higher capital requirements.

**The Constitutional Court declared as unconstitutional the law on the conversion of Swiss franc-denominated loans.** In contrast to countries that adopted similar laws (such as Poland and Croatia), Romania has a limited exposure to Swiss franc-denominated loans with an outstanding stock amounting to 0.8 % of GDP (at end June-2016) and 3 % of the total loans to households. The total stock of Swiss franc loans has continued to fall in the first half of 2016 compared to 2015 on the back of voluntary negotiations between banks and clients on the conversion of loans in Swiss francs into lei. The law on the conversion of the Swiss franc loans into RON loans at historic exchange rates (i.e. at the moment when the loan contract was signed) adopted by Parliament in October 2016 was referred by the previous government to the Constitutional Court for a constitutionality check. In its decision of 7 February, the Constitutional Court rejected the conversion of Swiss franc-denominated loans into RON loans at historic exchange rates and held that the conversion should be done in line with the conditions at the conversion date ([[23]](#footnote-23)). Furthermore, the Constitutional Court declared the law as unconstitutional based on procedural grounds, as it did not respect the principle of bicameralism.

**Another legislative initiative, currently before Parliament, could be harmful for the banking sector.** A draft law on the National Agency for Consumer Protection may affect the mandate of the NBR and its prudential supervisory powers on credit institutions. The draft law includes several provisions which aim to increase the supervisory powers of the agency on financial intermediaries operating in Romania, including credit institutions. An adequate balance between consumer protection and prudential supervision is important in this context.

**The independence of financial sector regulators may be weakened by further initiatives.** A draft legislative proposal before Parliament aims to restrict the independence of the NBR, lift the legal protection of NBR staff members for actions taken in good faith and place the NBR under tighter parliamentary control. The Chamber of Deputies initiated a proposal to amend the legal framework of the Financial Supervisory Authority. The proposal includes new provisions on revoking the mandate of the Authority's board members, which is not in line with international good practices and have implications for supervisory independence. In addition, Parliament launched the procedure to revoke the mandate of the President of the Financial Supervisory Authority following measures taken after the 2015 balance sheet review and stress test of the insurance sector to address shortcomings related to compulsory car insurance. This is an indication of political pressure brought in response to supervisory actions and limits the independence of supervisors.

**Shortcomings in several insurance undertakings are being addressed** (European Commission, 2016a). Astra Asigurari was put into insolvency in August 2015, and the decision was declared irrevocable in April 2016. Following the court decision, the Insurance Guarantee Fund started paying of compensation to Romanian and foreign policyholders. Several follow-up measures (including capital increases) were taken to restore the financial situation of insurers in distress, based on the results of the 2015 balance sheet review and stress test, and of a second exercise performed on insurance companies not included in the first exercise. Such measures were taken in particular for Euroins, which was placed under financial recovery in October 2015, and City Insurance, which was under a financial recovery plan until the end of 2016. As the efforts since 2014 to restore the viability of Carpatica have been unsuccessful, the Financial Supervisory Authority withdrew Carpatica's licence in July 2016 and requested the opening of insolvency proceedings. The measures adopted so far have contributed to addressing the shortcomings identified during the 2015 balance sheet review and stress test, but several pockets of vulnerability, including thin solvency buffers for some insurers, still remain.

**The government introduced a cap on insurance premiums for compulsory car insurance.** The cap on insurance premiums, which became effective on 17 November 2016, was triggered by the increase in these premiums *inter alia* due to measures taken to address shortcomings identified during the 2015 balance sheet review and stress test. The government argues that the increase is the corollary of a distortion in competition as two main insures exited the market and passed an emergency ordinance to cap the insurance premiums for 6 months. The maximum caps on the premiums were calibrated by the Financial Supervisory Authority and adopted by government decision in November 2016. This intervention in the price setting of insurance premiums in the absence of a general system of price control does not appear to be in line with EU law, in particular with the provisions of the Solvency II directive. The measure is also likely to aggravate current distortions and put further pressure, in the short term, on the profit generation capacity of insurers.

3.3. Labour market, education and social policies

3.3.1. Labour market

Overview and challenges

**The labour market situation is improving, while also presenting structural challenges**. The employment rate increased (67.7 % in Q3 2016), still at some distance from both EU and national targets while unemployment is falling. However, Romania still faces negative demographics, (ageing and emigration), while the level of inactivity one of the highest in the EU. Large socio-economic disparities exist between fast-growing urban areas and poorer less developed rural areas and areas in the urban fringe. Differences in access to healthcare and quality education exacerbate these inequalities. Structural reforms that should help to tap the employment potential and address disparities have been initiated, but are yet to be fully implemented.

**A sectoral shift, typical of a transition economy, is under way.** As the economy is transforming, low-skilled manual jobs (in agriculture and industry) are being lost and job creation is taking place in services (both tradable and non-tradable) and in the public sector (Graph 3.3.1). At the same time, on the back of sustained economic growth, construction is picking up. Services are expected to be the net job creator in the next decade ([[24]](#footnote-24)). The transition of the labour force between sectors brings with it challenges.

**Difficulties with recruiting and retaining higher-skilled employees in fast-growing sectors are a challenge to growth.** Skills shortages exist particularly in the ICT sector, but also among health and services professionals and teachers (CEDEFOP, 2016a). Additionally, occupations such as skilled trades, engineering, transport and distribution (Manpower Group, 2015) are in short supply. Poor performance of education, vocational training and lifelong learning systems, unattractive working conditions and higher wages abroad (European Commission 2015c), contribute to labour shortages. Finally, internal labour mobility, which could balance some of the skills shortages, remains limited ([[25]](#footnote-25)). In order to increase the attractiveness of education and health sectors, wages in these areas have been increased, but their impact remains to be seen.

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| Graph 3.3.1: **Employment by sector** |
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| ***Source:*** European Commission |

**Sustained reform momentum is essential for boosting welfare and long-term growth.** Ensuring the continued implementation and sustainability of the ambitious reform measures taken in 2016 is essential to produce tangible effects with an impact on future economic growth, on the reduction of poverty and on the country's development potential. Successful implementation of reforms also hinges on having an effective social dialogue. The latter remains characterised by low collective bargaining at sectoral level and by institutional weaknesses (European Commission, 2016a).

Untapped labour force

**In this context, tapping into the unused labour potential is paramount for boosting growth.** Low levels of unemployment are matched by one of the highest inactivity rates of the working-age population in the EU (Graph 3.3.2) and a large informal sector ([[26]](#footnote-26)). Employment and activity rates remain below the EU average for women, the low-skilled, young people, people with disabilities and Roma.

**The share of young people neither in education, employment or training (NEET) remains high.** This situation further worsened in 2015, increasing by 1.1 pps. and driven mainly by the increasing early school leaving rate (see Section 3.3.2). Two thirds of NEETs remain inactive and include a relatively high share of Roma and women living in rural areas (Eurostat, 2016 and FRA, 2016).

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| Graph 3.3.2: **Activation potential\*** |
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| \* People from 25 to 54 years as percentage of total population in Q2 2016\*\* Part-time workers who would like to work additional hours and are available to do so\*\*\* People available to work but not seeking\*\*\*\* Inactive people on top of discouraged workers ***Source:*** European Commission |

**A new approach towards targeting young NEETs aims to offer better employment services.** The National Employment Agency plans to deploy integrated teams to identify and register NEETs. The teams will offer an integration pathway supported by more attractive active labour market policies. Since 2016 all NEETs can benefit for the first time from employment subsidies. The Youth Guarantee has so far only partially reached young NEETs (European Commission, 2016i).

**Roma are one of the most disadvantaged groups on the labour market.** Only one in three Roma aged 20-64 report having engaged in 'paid work'. This is roughly the same as for peer countries, with a high discrepancy between men and women ([[27]](#footnote-27)).In a context of labour force shortages and with 20 % of new labour market entrants being Roma (World Bank, 2014b), better employment prospects of Roma are essential for potential growth and the shock-absorbing capacity of the economy.

**Women's labour participation remains low.** The employment rate of women has not improved since 2008 and remains below the EU average ([[28]](#footnote-28)), partly due to the lack of affordable child and long-term care and afterschool facilities. Recent measures adopted by the Parliament to support extended (up to two years) ([[29]](#footnote-29)) and parental leaves, which are almost exclusively taken by women, may further deteriorate their employment situation. Full equalisation of the retirement age for women and men (65) has been pending before Parliament for several years.

Labour market policies

**Comprehensive measures were adopted in 2016 to improve active labour market participation**. The Ministry of Labour has for the first time an integrated overview of the European Social Fund and national budgets for active labour market policies. Take-up is expected to improve thanks to a mix of more attractive demand- and supply-side activation measures (including support for entrepreneurship and employment subsidies), tailor-made to groups furthest from the labour market. Financial incentives covering relocation and transport costs were increased to improve internal labour mobility in line with the national mobility plan. Measures to encourage the return of Romanians from the diaspora were launched with EU funding support.

**The National Employment Agency is set to have a pivotal role in activation policies.** In 2016, the Agency implemented a thorough reform of service delivery and developed a profiling procedure for jobseekers, subsequently enshrined in legislation. The Agency plans to take tailor-made action in close collaboration with social assistance and education counsellors. The Agency started training its counsellors in case management and intends to hire professionals oriented towards NEETs, the long-term unemployed and inactive groups.

**Minimum wage increases are still adopted without objective criteria.** Ad hoc minimum wage increases have significantly raised the share of workers earning the minimum wage and led to strong compression at the bottom of the wage distribution (European Commission, 2016a). In January 2016, the Government set up a tripartite working group to establish an indexation mechanism for future minimum wage adjustments. An impact study was conducted to evaluate the economic and social effects of the changes in the minimum wage and a group of experts was approved by the tripartite group to set up the mechanism based on the findings of the study. Despite these developments, in January 2017 the Government decided ad hoc to increase the minimum wage to RON 1 450 (EUR 322) from 1 February 2017 and to RON 1 750 (EUR 390) by 2020. These increases are not based on objective criteria, despite the work of the tripartite group.

Challenges in rural areas

**Urban-rural disparities are holding back economic and social development.** Over 45 % of the population lives in rural areas which remain far behind urban areas in terms of poverty reduction, employment and education, access to services and infrastructure (European Commission, 2016a). This urban-rural divide is holding back economic growth and income convergence.

**Recently adopted measures aim to tackle these socio-economic development challenges**. In 2016, the Government adopted a comprehensive set of measures to improve living standards and stimulate productivity and economic diversification. Measures include modernising and restructuring small farms, setting-up non-agricultural SMEs in rural areas, investments in rural infrastructure, including social and education infrastructure, and measures to formalise employment. Successful implementation will hinge on the capacity to effectively target and absorb available EU funding.

3.3.2. Poverty and social exclusion

**Poverty and social exclusion remain high.** Although declining (Graph 3.3.3), a high risk of poverty or social exclusion persists for young NEETs, families with children and people with disabilities. Compared with urban areas, twice as many people in rural areas live in marginalised communities confronted with housing, employment and social challenges (World Bank, 2014a). The share of poor people who live in very bad quality housing and spend over 40 % of their incomes on housing is one of the highest in the EU. In-work poverty (with a rate double the EU average) stems from the high share of unremunerated family workers in rural areas. Finally, Romania has one of the highest levels of income inequality in the EU and rising (Section 2).

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| Graph 3.3.3: **AROPE for selected groups** |
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| At-risk-of-poverty or social exclusion rate (% of total population). People who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation and/or living in household with zero or very low work intensity.2007-2009 EU27, 2010-2015 EU28***Source:*** European Commission |

**Poverty and social exclusion are particularly high among the Roma.** The risk of poverty for Roma is almost three times as high as for the general population. It is high in comparison with other Member States with a sizable Roma minority (BG, CZ, HU, SK including RO), where the rate of poverty for Roma is estimated to be between three to more than six times higher than for the general population (FRA, 2016) ([[30]](#footnote-30)). Roma are concentrated in marginalised communities and about two thirds live in housing lacking basic sanitation (FRA, 2016, p. 19). The increased use of dissuasive sanctions, such as fines, by the National Council on Combatting Discrimination is a promising development for the effective enforcement of anti-discrimination rules.

**High poverty incidence is associated with high inactivity levels.** The absence of any or recent work experience, a low level of skills and education and scarce employment opportunities are the main barriers preventing the poor from finding employment (World Bank, 2017, forthcoming, p. 4). The issue is acute in rural and marginalised areas, where employment opportunities outside (semi-) subsistence agriculture are rather limited (for policy response, see challenges in rural areas).

**The minimum inclusion income aims to tackle poverty and promote activation measures.** Adopted in 2016, the minimum inclusion income (MII) law, due to enter into force on 1 April 2018 ([[31]](#footnote-31)), consolidates three means-tested programmes (European Commission, 2016a). While almost doubling the current budget ([[32]](#footnote-32)), it increases the adequacy and coverage of the benefits, aiming to lift 10 % of the population out of extreme poverty. Moreover, the MII includes provisions to strengthen inspections and coercive measures. The MII will combine passive support with more attractive active labour market measures by maintaining a part of the benefits for those taking up work and introducing compulsory active labour market measures for this group. The activation potential of these compulsory measures, however, remains modest with a target to reach only 25 % of MII beneficiaries by 2021.

**However, social benefits are not yet revised in a fully predictable manner.** The level of the main social benefits, including unemployment benefits, is determined on the basis of the social reference index which has not been updated since its introduction in 2008 (European Commission, 2016a). A regular revision of the social reference index would help preserve the adequacy of social benefits over time while avoiding large unbudgeted ad hoc revisions.

**For the first time, a comprehensive anti-poverty package was adopted in 2016.** The package integrates EU and national funds and provides for a safety net for people at risk of poverty. It moves away from a benefit-driven policy towards providing more social services catered to each age group, such as access to early education and care, prevention of early school leaving, transition from school to work, and improved social and medical services for the elderly. Official accreditation of social services has been simplified. However, the lack of integration and overview of services provided with national and EU funds make the referral process difficult.

**The anti-poverty package includes integrated services targeted at marginalised communities.** A pilot project of integrated teams is planned to be rolled out in 2017 in 100 marginalised communities (out of over 500), mostly in rural areas. The teams comprise social assistants, community health assistants, or mediators and educational counsellors or mediators to provide services tailored to the specific needs of the most disadvantaged groups, working closely with public employment services. When scaled up to cover the whole country, the project is expected to have a significant impact on the currently low provision of integrated services.

3.3.3. Education

**Unequal provision of quality education is undermining human capital potential.** High underachievement in basic skills, the high and rising early school leaving and low tertiary attainment do not meet the increasing needs for skilled labour supply in the context of persistent emigration. The labour market relevance of education remains a challenge, while participation in lifelong learning is very low. Romania's public expenditure on education is one of the lowest in the EU (European Commission, 2016a). If unchanged, these factors will continue undermining human capital potential and economic growth.

**A high share of students do not possess an adequate level of basic skills**. The 2015 OECD Programme for International Student Assessment (PISA) found high levels of low achievement in basic skills (Graph 3.3.4). More than half of students from the lower socio-economic quarter are underachievers, indicating that socio-economic status has a large impact on student performance. Underachievement is also high in all other socio-economic quarters and the share of top performers in science is low. This risks hindering the country's future innovation potential and affect its long-term competitiveness. Efforts were made to revise the curricula towards competence-based learning, but results will take a long time to become visible ([[33]](#footnote-33)).

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| Graph 3.3.4: **Proportion of low achievers among 15-year-olds in PISA 2015** |
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| ***Source:*** OECD |

**Access to quality education is limited in rural areas and for the Roma.** Rural schools, which provide education to almost half of primary and lower secondary students, score below urban schools. Roma educational achievement is negatively affected by the lower teaching quality in Roma-predominant schools. Educational segregation ([[34]](#footnote-34)), partly stemming from uneven distribution of Roma in the country and from discriminatory attitudes, hinders inclusive education. Only 38 % of Roma children aged 4 to compulsory school age participate in early education and care. Social coupons have been introduced to support the participation of poor children in kindergarten.

**The rising share of early school leavers poses an additional challenge**. In 2015 the proportion of early school leavers rose to 19.1 %, the third highest in the EU, and is particularly high in rural areas, for Roma ([[35]](#footnote-35)) and for people with disabilities. This trend is driven by poverty and insufficient provision of quality education (European Commission, 2016a, pp. 64-65). National scale European Social Fund projects were launched to reduce early school leaving. The availability of second-chance programmes has increased, but remains insufficient (European Commission 2016h).

**The quality and relevance of tertiary education for the labour market remains a challenge.** Tertiary attainment is the one of the lowest in the EU (25.6 % in 2015, compared to 38.7 % EU28) and unlikely to improve significantly due to low passing rates at the baccalaureate (68.1 % in 2016) and high early school leaving. Despite some progress (European Commission, 2016h), labour market relevance remains a challenge as shown by the employment rate of graduates (77 % in 2015 vs 93 % in 2008).

**Progress in vocational education and training (VET) is insufficient to meet labour market needs.** Dual learning was recently introduced to support the reform of the VET system by offering private companies fiscal incentives for providing student training. A VET strategy was adopted as *ex ante* conditionality for EU funds and a reform of the apprenticeship system was initiated. However, VET qualifications and curricula continue to be insufficiently aligned with labour market needs.

**Participation in lifelong learning is one of the lowest in the EU.** There is limited cooperation between the ministries and institutions carrying out educational activities for adults. A national strategy to address the shortcomings of the VET and lifelong learning systems is in place, but its implementation is slow and ESF-funded action is still to be launched on the ground.

3.3.4. Health and long-term care

**The healthcare system faces structural and financing challenges.** The healthcare system is characterised by unequal access and inefficient spending as well as the lack of a long-term sustainable funding structure. The system remains hospital-centred, with few primary and outpatient care services, resulting in outdated and ineffective care (European Commission, 2016c). In addition, continuous overspending of the budget on pharmaceuticals constrains the introduction of innovative medicines. E-health systems which could improve efficiency and lower the incidence of corruption are not fully functional. Weak governance and the lack of comprehensive public health policies add to these challenges.

**Health outcomes are weak, negatively affecting workforce employability.** Due to the high mortality rate, 2 203 potentially productive life years are lost per 100 000 population (against an EU average of 1 236; data from 2013 (OECD/EU, 2016). Moreover, while decreasing over time, infant mortality, perinatal mortality, amenable and preventable mortality and mortality from diseases of the circulatory systems are among the highest in EU, although they are decreasing over time.

**Access to healthcare is limited and unequal.** Access to good quality care is hindered by the low density of general practitioners, specialist physicians ([[36]](#footnote-36)) and nurses, while medical staff migration to EU countries has not abated. Low levels of public funding contribute to informal payments, which is one of the main financial barriers to accessing health care. As the sector remains underfunded, in 2014 11 % of the population declared having offered money or gifts to doctors and 8 % to nurses (Ministry of Health of Romania *et al*., 2015). The gap in unmet needs for medical examination between the richest and the poorest is the fourth highest in the EU and double the EU average. Access to selected highly cost-effective essential medicines is limited. Primary healthcare and integrated community teams are not sufficiently deployed.

**New initiatives will improve the cost effectiveness of and access to healthcare**. New medicines have been introduced and a new pharmaceutical pricing scheme is supposed to improve access to cost-effective medicines. A new law on community care setting up health centres and teams adopted in October 2016 is expected to improve access to healthcare including for vulnerable groups in rural areas. In addition, ESIF investments for 2014-2020 focus on measures to improve healthcare access for vulnerable and marginalised groups. Already adopted measures include the development and approval of regional health care plans, and salary increases for medical staff.

**The reform agenda is incomplete.** Although the national health strategy 2014-2020 includes specific measures to address poor health outcomes, with some positive results, it will depend on long-term implementation to sustain these developments. A comprehensive approach on performance information systems and workforce strategy is not yet developed.

**Corruption in the healthcare system has been recognised as a particular problem** (European Commission, 2017c)**.** The main issues relate to public procurement in hospitals, insurance fraud and false reimbursements, bribery for issuance of medical certificates giving access to special benefits and the widespread practice of informal payments to medical professionals.

**Strengthening integrity and reducing corruption risks became a priority in 2016.** The national anti-corruption strategy 2016-2020 from August 2016 puts forward a comprehensive set of measures to fight corruption in healthcare. A revamped electronic reporting system aims at reducing informal payments. The Health Minister launched in December 2016 a special telephone line where patients, doctors or witnesses of corruption cases in any medical unit can report potential breaches. Other measures include changes to the hospital ethics councils' law, as well as increasing the accountability of hospital managers, ensuring they are recruited through open competition ([[37]](#footnote-37)). On the latter, there are signs of backtracking in 2017 ([[38]](#footnote-38)). Given the multifaceted issue of corruption in healthcare, the main challenge will be to effectively implement all the measures planned in the national anti-corruption strategy 2016-2020.

3.4. Investment

3.4.1. External Competitiveness

Current account

**Current account developments have been largely driven by the trade balance.** The current account markedly improved following the crisis and was close to balance in 2014. This correction was driven by improvements in the trade balance, especially in services (European Commission, 2016a). However, the current account went into a moderate deficit in 2015, which expanded further in 2016 due to a widening of the trade balance on the back of strong import growth.

**The current account deficit is expected to deteriorate as import growth strengthens.** Robust domestic demand is boosting import growth in Romania. European Commission staff suggest that imports of goods and services grew by 0.6 % in response to a 1 % increase in domestic demand ([[39]](#footnote-39))([[40]](#footnote-40)). With consumption growth forecast to remain buoyant (see Section 1.1), imports are expected to continue to grow strongly in 2017-2018, with the current account deficit widening to 3.1 % of GDP by 2018.

Export performance

**Competitiveness has been the main contributor to a strong export performance, albeit at declining pace.** Between 2000 and 2015, Romania's share in the global trade market more than doubled from 0.18 % to 0.39 %. Much of this improvement is explained by domestic 'push factors', such as labour costs, a proxy for the economy's competitiveness ([[41]](#footnote-41)). Competitiveness gains were especially strong in the crisis period but slowed in 2011-2015.

**External demand negatively contributed to export performance.** Changes in external demand had a positive impact before 2007, but became unfavourable with the start of the crisis. This was partially due to a concentration of exports towards the EU market, but also to a significant economic slowdown in the Romania's non-EU main trading partners, Russia and Turkey. The former even dropped out of the top-10 destinations for Romania's exports (Graph 3.4.1) ([[42]](#footnote-42)).

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| Graph 3.4.1: **Geographical specialisation in the 10 largest export destinations in 2015** |
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| The size of the bubbles indicates the weight of Romania’s exports in total imports of the destination country. 'Market dynamism' stands for the difference between the annualized growth rates of world imports per geographical market and global world imports. 'Competitiveness' stands for the difference between the annualized growth rates of Romania’s exports per market and world imports per market.***Source:*** European Commission |

**Traditional export sectors lost market share in 2015, reversing recent gains.** Breaking down recent export developments by product specialisation categories illustrates that Romania lost competitiveness in 2015 in its most important sectors: vehicles and machinery. These losses were compensated in part but not fully by the dynamism of these sectors (Graph 3.4.2).

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| Graph 3.4.2: **Breakdown of export performance** |
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| Note: IS stands for Romania’s initial sectoral specialisation, while MSG captures how successful Romania has been in gaining market shares on average across export products. ***Source:*** European Commission |

Wage dynamism

**Public-sector wage adjustments are leading changes in wages in the tradable sector.** Specifically, public-sector wages were leading the wage-setting process in the run-up to the crisis and shortly thereafter. In the wake of the crisis, the non-tradable sector joined forces with the public sector as the prime movers in the wage-setting process.

**Economy-wide wages grew swiftly in 2016, driven by public wage growth.** In recent years, wage growth in the public sector has been more volatile than in the private sector (Graph 3.4.3). Periods of public wage decreases and stagnation were followed by rapid increases. Overall, public wages have grown faster since 2010 than those in the private sector. Instances of large minimum wage increases have also driven wage growth ([[43]](#footnote-43)). Consequently, nominal compensation per employee accelerated in 2016 (see Section 1.5) after some years of moderate growth ([[44]](#footnote-44)).

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| Graph 3.4.3: **Labour cost index** |
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| ***Source:*** European Commission |

**Spillovers from the non-tradable to the tradable sector may weaken external competitiveness in the future.** With the tradable sector in all cases the follower in wage determination, it is likely that wage growth will catch up with higher wages in the public and the non-tradable sectors over the medium-term. Unpredictable changes in public wage policy may therefore divert economy-wide wage developments away from economic fundamentals.

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| Graph 3.4.4: **Minimum and public wage growth vs inflation and productivity developments (2009-2016)** |
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| ***Source:*** European Commission |

**A more predictable wage-setting process for public and minimum wages would help avoid adverse effects on competitiveness.** Commission staff estimates suggest that a 1 % increase in the unit labour cost-based real effective exchange rate would reduce exports by 0.7 %. This implies that export performance is highly affected by changes in labour costs and the exchange rate. Given productivity developments, income convergence and the competitiveness position of Romania, increases in public wages and their potential impact deserve special attention (Graph 3.4.4).

3.4.2. Public Investment and infrastructure

**Romania's infrastructure is a key factor limiting competitiveness.** Quality investment would boost growth in the long run, including in the process of catching-up and convergence with the EU. However, the poor shape of infrastructure is a key obstacle to doing business. In addition, the poor quality of infrastructure exacerbates regional disparities and inclusion problems (Section 3.3.1).

**Despite high public spending, the quality of infrastructure remains low.** Romania has the highest rate of public investment in the EU in the last decade. At the same time, although overall performance improved, the country ranks last in the EU in the perceived quality of infrastructure (Graph 3.4.6). This is particularly the case in the transport sector where Romania ranks 128 (out of 138 countries) for the quality of roads and 79 for the quality of railroad infrastructure (Graph 3.4.5). The transport sector remains dominated by loss-making state-owned enterprises (see Section 3.4.3), while the necessary institutional and legislative reform of the sector is delayed.

**The authorities adopted measures to improve investments in the transport sector.** The 2014-2030 general transport master plan was adopted in September 2016 with targets, strategic objectives and priority projects for the medium to long term. Additionally, to speed up investments in road infrastructure, the government split the national authority in charge of road construction into two bodies, one for infrastructure investments and one for infrastructure administration. The impact of these measures will depend on whether they are implemented effectively.

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| Graph 3.4.5: **Global Competitiveness Index** |
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| Note: Respondents rate 1 (worse) to 7 (best)***Source:*** World Economic Forum, 2016-2017. |

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| Graph 3.4.6: **Public investment spending and quality of infrastructure** |
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| Note: Respondents rate 1 (worse) to 7 (best)***Source:*** European Commission and World Economic Forum: the Global Competitiveness Index 2015-2016  |

**Stronger absorption of EU funding could play a key role in improving infrastructure spending**. Romania had one of the lowest financial execution rates for the 2007-2013 Structural and Cohesion Funds in the EU (Graph 3.4.7). Payment claims generated by projects cover only 77 % of the 2007-2013 budget allocation for transport. Improved absorption for the 2014-2020 period will depend on improved governance, removing public procurement delays and bureaucratic obstacles (e.g. obtaining building permits), and on improving beneficiaries' capacity to prepare high-quality projects and deliver them on time.

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| Graph 3.4.7: **Financial execution of Structural and Cohesion funds 2007-2013** |
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| Data include advanced payments. Excluding advanced payments, Romania managed to claim 77 % of its 2007-2013 budget allocation.***Source:*** European Commission |

3.4.3. State-Owned enterprises (SOE)

**SOEs play an important role in the economy, but are not on as firm a financial footing as their private-sector counterparts.** SOEs dominate critical infrastructure sectors such as energy and rail transport that are essential for sustainable growth. However, SOEs have higher debt ratios and lower profitability than their private sector counterparts (European Commission, 2016a; Marrez, 2015). Arrears to the state, to other SOEs and to private suppliers are a pervasive problem and represent contingent liabilities. Despite negative operational results in 2015 and 2016, the restructuring of loss-making SOEs has not advanced. Moreover, the privatization agenda has not yet started moving forward.

**Legislation on improving corporate governance was adopted**([[45]](#footnote-45)). The law and its implementing legislation follow good international practices in ensuring transparency in the appointment of board members and the management of SOEs. Moreover, the Ministry of Finance has greater powers to monitor how legislation is being implemented and companies' performance. This strengthened role is based on harmonised mandatory reporting of financial and operational performance and on the Ministry having the power to apply financial penalties for the failure to meet deadlines and procedures.

3.4.4. Business environment

**The business environment has improved but some weaknesses remain.** Romania's competitiveness significantly improved in 2011-2016 but it ranks 36th in the World Bank's Doing Business 2017 Report and dropped from rank 53 to 62 in the Global Competitiveness Report (Graph 3.4.8). Weaknesses persist in infrastructure (roads), administrative burden, labour market, efficiency, health and education (see Sections 3.3, 3.5, 3.6). Corruption and governance issues in the public sector are among the main challenges for the business environment.

**Administrative procedures for business and the public are being simplified.** During 2016 the Government adopted several emergency ordinances to simplify administrative procedures and facilitate relations between citizens and the public administration. This new legislation streamlines the process of submitting forms and promotes widespread use of email. In addition, in January 2017 the new government passed measures in support of entrepreneurship and simplification such as an increase of the threshold for micro-enterprises, an exemption of profit tax for R&D companies, and the elimination of 102 fees and duties.

**However, modern e‑government solutions remain largely untapped.** Romania's use of e‑government is one of the lowest in the EU (European Commission, 2016a, p. 47). Measures taken by the authorities target: (i) the reinforcement of governance; (ii) coordination of the implementation of e‑government solutions; (iii) adoption and implementation of a national interoperability framework. However, the national administration IT system is fragmented, adding to the administrative burden for the public and businesses.

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| Graph 3.4.8: **Global Competitiveness Indicator** |
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| Note: Respondents rates 1 (worse) to 7 (best)***Source:*** World Economic Forum, 2016-2017. |

**Access to finance is expected to improve with a set of new financial instruments**. Work on setting up a national promotional bank has been ongoing for two years. A draft law to transform parts of EximBank into a promotional bank was adopted in November 2015. Funding for an impact assessment of the planned transformation was approved in December 2016 and the tender procedure to select a consultant is under preparation. The setting up of a national promotional bank and the creation of a bank for SMEs, as announced by the new government, are expected to improve access to finance for enterprises.

**A strategy to put the economy on sustainable path was developed in 2016.** The 'Competitive Romania' strategy presents a EUR 16.9 billion economic development plan with the aim to reach political and societal consensus on the main areas for action by 2020 to put Romania on sustainable economic development path and accelerate convergence with the EU. The strategy was prepared jointly by the former government, the Central Bank and the Romanian Academy and was launched in July 2016 under the patronage of the President. Several measures from 2016 fit the purpose of the strategy: the legislative package on public procurement (in force since May 2016), the package for simplification and de-bureaucratisation (see Section 3.4.4), tax measures to retain skilled workers and address labour shortages and skill mismatches, among others.

**Political and media attacks of magistrates or judicial institutions risks undermining public confidence in the judicial system (**1**).** Magistrates and judicial institutions were exposed to increased criticism by high-level officials and public figures. This risks undermining public confidence in the judicial system as a whole and could potentially harm the business environment ([[46]](#footnote-46)).

**While the quality and efficiency of the judicial system is improving, concerns remain.** The judiciary has been developing assessment tools to monitor and manage courts' activity and take corrective action. Courts have become more efficient in dealing with incoming cases in recent years, as average clearance rates well above 100 % indicate ([[47]](#footnote-47)). However, the workload distribution among courts remains uneven. Courts have become more efficient in dealing with incoming cases in recent years, as borne out by clearance rates well above 100 % ([[48]](#footnote-48)). In contrast, no action was taken to address the long-standing problem of non-enforcement of final court decisions ([[49]](#footnote-49)).

**Progress on improving insolvency procedures remains limited.** The time taken to conclude procedures is among the longest in the EU, preventing honest entrepreneurs from getting a second chance. The 'breathing space' from enforcement of actions on viable companies in financial difficulties can last up to 3 years, even though 4 months would be sufficient to facilitate negotiations and provide predictability and legal certainty for creditors. The recovery rate for secured creditors in insolvency proceedings is 34.4 %, below the average of 65 % in the EU.

**E-commerce development is limited due to the lack of consumer protection.** While e-commerce could be a gateway to new markets and cheaper offers, the participation in online transactions of Romanian consumers (12 % vs 55 % EU) and SMEs (7 % vs 17 % EU) remains one of the lowest in the EU. Despite improvements in the last 2 years, unfavourable consumer conditions ([[50]](#footnote-50)) remain an obstacle to consumer confidence in online shopping ([[51]](#footnote-51)). The effective enforcement of rules in the digital environment remains limited due to weak enforcement capacity. An IT coordinator was appointed at secretary of state level, in line with Decisions 464/2016 and 21/2017.

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 ([[52]](#footnote-52)) and most recently in a Eurobarometer on the Cooperation and Verification Mechanism ([[53]](#footnote-53)). Corruption and governance issues in the public sector are among the top challenges for the business environment, holding back growth (World Economic Forum, 2017).

**Romania stepped up efforts to fight corruption over the past years**. Romania has a solid anti-corruption legal framework and the track record of the judicial institutions fighting corruption has been strong. Romania has a comprehensive framework for the integrity of public officials and an independent institution with a good track record (National Integrity Agency). The national anti-corruption strategy 2016-2020 from August 2016 aims to create a better corruption prevention policy and to promote integrity in the public sector. The strategy includes measures to improve transparency of the decision-making process and of budget allocation, while maintaining a culture of integrity within public organisations by enforcing managerial accountability.

**The irreversibility of progress in the fight against corruption was recently put at risk.** Romania's track record has pointed toward the growing irreversibility of reforms, as a number of internal safeguards have been put in place against abrupt reversal. However, in an emergency procedure on 31 January 2017, the Government introduced amendments to the Criminal Code, affecting the fight against corruption ([[54]](#footnote-54)).While a subsequent government emergency ordinance issued on 5 February ([[55]](#footnote-55)) abrogated these amendments, the parliamentary scrutiny of both ordinances is pending. Such initiatives risk challenging the progress already made over the past 10 years in this field.

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3.5. Sectoral policies

3.5.1. RESEARCH AND iNNOVATION (r&i)

**Structural shortcomings in the R&I system are holding back its growth contribution.** Structural challenges to R&I remain unchanged (European Commission, 2016a). These include insufficient funding, institutional fragmentation, low quality of the public science base, and weak public-private collaboration. In 2015, the European Innovation Scoreboard (European Commission, 2016j) placed Romania in the lowest country category ('modest innovator'), with scores well below the EU average on all dimensions and indicators (Graph 3.5.1). The lack of dynamism in R&I has implications for long-term competitiveness and growth prospects.

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| Graph 3.5.1: **Innovation performance of EU Member States in 2015** |
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| ***Source:*** European Commission EIS2016 |

**R&D intensity improved but the lack of investment impedes R&I capacities take-off.** Although R&D intensity ([[56]](#footnote-56)) improved in 2015 (Graph 3.5.2), Romania still has one of the lowest levels among EU Member States. Out of the total 2014-2020 structural funds allocated only 3.4 % were allocated for R&I, far from the EU average of 10.6 % for the same period. The 2016 budget provided for a slight increase in public R&D expenditure up to 0.29 % of GDP, largely insufficient to reach the 1 % of GDP target of public investments in R&D ([[57]](#footnote-57)) by 2020.

**Recently adopted measures to stimulate business investment have yet to gain traction.** In 2015, less than 200 business entities applied for the 50 % supplementary corporate tax deduction for R&D expenditure, even fewer than the 223 entities in 2014. Despite the slight increase in business R&D intensity in 2015, at 0.21 % of GDP it is still one of the lowest in the EU. To stimulate business R&D activities, the government introduced in August 2016 an exemption from paying the salary income tax for all R&D activities. Also, to stimulate the activity of computer programmes development, a measure of payroll taxes exemption was set up and is in place starting with 2017, for employees in start-ups with main activity in this area.

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| Graph 3.5.2: **Evolution of business R&D intensity and public R&D intensity in Romania, 2000-2015** |
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| ***Source:*** European Commission |

**Pervasive bottlenecks obstruct SMEs' investment in innovation.** SMEs have a low level of innovation and knowledge flows between public R&D and the business sector (Graph 3.5.3) are weak, as borne out by Romania ranking at the bottom of the 'Linkages & Entrepreneurship' dimension of the Scoreboard ([[58]](#footnote-58)). Red tape, poor infrastructure and the low level of entrepreneurial education hamper innovative entrepreneurship and the development and growth of technological start-ups.

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| Graph 3.5.3: **Quality of scientific output and public R&D investment levels** |
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| ***Source:*** European Commission |

**Key steps have been undertaken to improve governance and reduce fragmentation.** Developing and implementing effective smart specialisation strategies requires: (i) building on the strengths of clusters of entrepreneurial knowledge and resources, and (ii) involving all regional and national players. In this context, the establishment of the National Council for Science, Technology and Innovation Policy ([[59]](#footnote-59)) may be an important step towards improving the still weak coordination between the national and the regional levels in a coherent innovation system. High fragmentation in public research performance, with more than 150 public institutions undertaking R&D, and inefficient technological transfer policy remain issues to be tackled.

**The government is taking steps to improve the R&I environment.** Under 'specific support' provided under the European Commission's Horizon 2020 Policy Support Facility ([[60]](#footnote-60)) recommendations began to be drawn up in 2016 to create an environment conducive to the growth of technological start-ups. In September 2016, the European Investment Fund and the Romanian Ministry of European Funds launched a EUR 59.3 million ([[61]](#footnote-61)) *Competiveness fund-of-funds* to finance SMEs via several financial intermediaries.

3.5.2. Digital economy

**Companies' low level of digitisation is constraining productivity improvements** (European Commission 2016d). Measured against the 12 key digital technologies covered by the Digital Intensity Index ([[62]](#footnote-62)), Romania ranks among the three EU Member States with one of the lowest share of enterprises with high digital intensity. On the positive side, the share of companies with very high digital intensity exceeds that of peers and is close to the EU average (Graph 3.5.4).

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| Graph 3.5.4: **Digital intensity score for enterprises** |
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| ***Source:*** European Commission |

**The workforce's digital skills are one of the lowest in the EU.** Despite the existence of many skilled ICT specialists, the general workforce lacks digital skills with negative implications for increased labour participation. In 2016, only one third of the workforce possessed basic or above digital skills compared to two thirds in the EU. Moreover, in the overall population, only 28 % of Romanians possessed basic or above basic level of digital skills compared to 56 % in the EU.

**Broadband networks are underdeveloped in rural areas, with risk of digital exclusion**. Romania is one of the world's leading countries in terms of internet speed. Nevertheless, there are still rural areas with no access to the Internet. Barriers that jeopardise the successful completion of broadband projects include low implementation capacity, cumbersome administrative procedures for obtaining the building permits for broadband deployment and bureaucratic procedures for commissioning sites. To bridge the urban-rural digital divide and ensure a viable connection rate, investments in broadband networks could be complemented by demand stimulation measures.

3.5.3. Energy

**Recent reforms have improved energy efficiency but progress is slow in key areas.** Increased energy efficiency investment will keep production costs low, thus improving competitiveness and growth prospects. While energy efficiency is improving overall, progress remains slow in key areas, such as the renovation of the district heating infrastructure. With the EU's highest final energy consumption per square meter of dwelling in the residential sector, an energy inefficient building stock exacerbates the problem for many Romanian households This is mainly due to insufficient local financing and low absorption of EU and national funds ([[63]](#footnote-63)).

**Romania has made significant progress in liberalising the gas market**([[64]](#footnote-64)). Market reforms adopted in 2016 require gas producers to sell and suppliers to purchase gas via trading platforms. These reforms, along with the abolition of fixed prices paid to gas producers, will improve market liquidity and strengthen price signals. Further stimulus could come from the full implementation of EU-level market rules on gas trading and from increased cross-border interconnectivity, in order to secure more liquidity on the wholesale market.

**However, competition in gas supply still faces hurdles.** While price regulation for business customers was successfully phased out by 2015, regulated gas retail prices for household customers will be phased out by 2021. In addition, the gas wholesale market remains very concentrated, with more than 75 % of the market held by the three largest companies.

**Romania is not yet fully integrated into the EU energy market.** In 2016, the interconnection capacity for electricity was 7 %, below the 2020 target of 10 %. The upgrading of internal lines and aged network assets is slow. To reach the 10 % target by 2020, Romania will have to implement new Projects of Common Interest and upgrade six internal lines. Gas network development through the Bulgaria–Romania–Hungary–Austria trans-mission corridor would give access to the Caspian gas coming to Greece through the planned Trans-Adriatic pipeline. This would increase security of supply and gas source diversification in the EU's south-eastern region.

3.5.4. RESOURCE efficiency

**The economy is not resource efficient,** considerably less so than the EU average, with implications for competitiveness (World Economic Forum, 2014) and for the country's sustainable development (Eco-Innovation Observatory, 2015). Its recycling rate is one of the lowest in the EU (5 %), while the landfilling rate is one of the highest (82 % in 2013), with illegal landfill sites reappearing.

**Waste management reform is significantly delayed.** The national waste management plan and the waste prevention programme, due since 2014, were not finalised. The plan would channel national and EU investments to achieve the EU environmental standards. Specifically, an effective economic and legislative framework for waste recycling is lacking. Drawing up the waste management plan is a mandatory requirement for accessing EU funding for the 2014-2020 period.

3.6. Public administration

**Slow progress in public administration reform hinders the delivery of structural reforms.** Romania adopted new civil service strategies improving governance and transparency. However, the organisational structures remain unstable and vulnerable to political changes. Incomplete human resources reforms limit public institutions' capacity to develop and implement policies in a strategic and coordinated manner. Moreover, the low accountability of the public administration negatively impacts the quantity and efficiency of public services.

**Several measures strengthened transparency and accountability of public administration.** Two government ordinances simplified procedures for business and citizens (see Section 3.4.4). A transparency register for lobbying entities was opened. New tools and standards for public debates were incorporated in the process of policy and law formulation ([[65]](#footnote-65)). However, transparent practices are not yet firmly established and public consultation on draft legislation is insufficient. Romania ranks 110th (out of 138) in the global competitiveness index when it comes to transparency of policymaking.

**Policy and legislation lack systematic strategic planning.** Steps were taken in 2016 to strengthen strategic policy making by reinforcing the Chancellery of the Prime Minister to ensure coherence across departments, oversee implementation and integrate cross-sectoral measures combining national and EU funding. In 2017, the Government General Secretariat took over its strategic and coordination competences, but its capacity and leverage to steer policy design by sectoral departments remains to be strengthened. Moreover, mandatory strategic planning and regulatory impact assessment instruments are not systematically used and parliamentary legislative initiatives are not subject to budgetary impact analysis. Overall, Romania is one of the lowest ranked of OECD and EU countries on its executive capacity (Bertelsmann Stiftung, 2016, p. 17) (Graph 3.6.1).

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| Graph 3.6.1: **Executive capacity, 2016 (1)** |
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| 1) The graph shows 5 lowest and 5 highest ranked countries***Source:*** Bertelsmann Stiftung, 2016  |

3.6.1. Human resources

**Recently adopted strategies could ensure consistency and common standards across the public service**. Strategies for the civil service and staff training, adopted in 2016, provide for a comprehensive approach to human resources management in the public administration and an improvement in workforce planning and performance. The envisaged measures would clarify roles, functions and mandates for each staff category, review performance management systems, increase transparency and neutrality in recruitment, and coordinate and prioritize employee training.

**However, implementation hinges on legislative amendments and a proper institutional set-up.** The objectives of the new civil service strategies are not fully reflected in the civil service law and draft administrative code. The Civil Service Agency has neither the capacity nor the authority to implement effectively the new civil service strategies. The Agency has not standardised data for public administration employees ([[66]](#footnote-66)). Training is now mandatory in public institutions, but the sources of funding are unidentified and the selection of training providers is not transparent.

**Recruitment criteria and pay levels are not harmonized across public institutions.** The civil service strategy plans to introduce transparent criteria for staff selection and recruitment and mechanisms to reduce political interference in appointments by 2020. Some pay level harmonization has been introduced across staff categories within institutions, but substantial gaps persist between public institutions.

3.6.2. Public procurement

**Romania made progress in public procurement reform, but corruption remains a challenge (**[[67]](#footnote-67)**).** The implementation of the public procurement strategy and action plan progressed in 2016 ([[68]](#footnote-68)). In May 2016 the new public procurement laws transposing the EU directives entered into force and all necessary secondary legislation was adopted by the end of 2016. The law for the PREVENT system for systematic ex-ante checks of conflicts of interests was adopted. The National Agency for Public Procurement (ANAP) was set up in 2015 as single institution responsible for public procurement providing more robust and efficient corruption control and preventive institutional mechanisms. ANAP is responsible for the *ex ante* check of the public procurement procedures and is currently implementing a sample-based, more thorough, *ex ante* checks system, as opposed to the previous systematic controls. An inter-ministerial committee for public procurement was established in October 2015 aiming at ensuring the overall coherence of the public procurement system.

**Several measures are still outstanding.** The web-based guidelines which should help the contracting authorities step by step during the procurement process are still under development and should be fully completed by 2019. Other measures still pending will re-enforce the ex-ante and internal controls of the National Agency for Public Procurement and the contracting authorities, operationalization of anticorruption measures, e-procurement, and training of public procurement officers.

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| Annex AOverview Table**Commitments** | **Summary assessment(**[[69]](#footnote-69)**)** |

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| **2016 country-specific recommendations (CSRs)** |
| **CSR 1:** Limit the deviation from the medium-term budgetary objective in 2016 and achieve an annual fiscal adjustment of 0.5 % of GDP in 2017 unless the medium-term budgetary objective is respected with a lower effort. Ensure the application of the fiscal framework and strengthen further tax compliance and collection. Ensure that legislative initiatives do not undermine legal certainty and do not put at risk financial stability. If necessary, adopt measures that mitigate such risks.Limit the deviation from the medium-term budgetary objective in 2016 and achieve an annual fiscal adjustment of 0.5 % of GDP in 2017 unless the medium-term budgetary objective is respected with a lower effort.Ensure the application of the fiscal framework…and strengthen further tax compliance and collection. Ensure that legislative initiatives do not undermine legal certainty and do not put at risk financial stability. If necessary, adopt measures that mitigate such risks. | Romania made **limited progress** in addressing CSR1 (this overall assessment of CSR 1 does not include an assessment of compliance with the Stability and Growth Pact). * CSRs related to compliance with the Stability and Growth Pact will be assessed in spring once the final data are available.
* There was no progress on ensuring the application of the fiscal framework. The 2016 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 of 15 August.
* **Limited progress.** There are slight improvements with regard to the compliance ratios for tax declarations and payments for both natural persons and companies compared to the previous year. The tax administration (ANAF) and Labour inspection maintained their efforts in terms of inspections and audits, yet the results are not better compared to last year. ANAF introduced also an audience with the applicant as an additional step before issuing the final decision with regard to the VAT registration. The legislation for the registration and deregistration for VAT purposes has been modified and clarified again and the procedures for VAT reimbursement were adapted, respectively, in the course of 2016. The mandatory but progressive introduction of electronic cash-register connected to the National Agency for Fiscal Administration (ANAF) IT system is pursued, but further delays to the official deadlines were introduced. To tackle sectorial tax evasion, a special annual income tax will replace corporate income tax in specific business areas, such as accommodation services and bars/ restaurants, from 2017. Irrespective of the sales or the net profits of the business, the tax to be paid will be computed based on coefficients, such as the surface of premises, the seasonality or the location of the business. Moreover, as of 2017, self-employed and family businesses will be limited to the number of business activities they can perform and in the number of persons they can employ.
* **Some progress** was made on safeguarding financial stability. The law on debt discharge ("datio in solutum") was promulgated with retroactive application, but a recent decision of the Constitutional Court has mitigated some of the potential risks on financial stability. The CHF-denominated loan conversion law adopted by Parliament may put strain on several banks. However, before its enactment, the law was sent to the Constitutional Court for a constitutional heck.
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| **CSR 2:** Strengthen the National Employment Agency's services to employers and jobseekers, in particular by tailoring services to jobseeker profiles, better linking them with social assistance, including social services, and reaching out to unregistered young people. Establish, in consultation with social partners, objective criteria for setting the minimum wage. Take action to prevent early school leaving and increase the provision of quality education, in particular among Roma. Adopt the equalisation of the pension age for men and women.Strengthen the National Employment Agency's services to employers and jobseekers, in particular by tailoring services to jobseeker profiles, better linking them with social assistance, including social services, and reaching out to unregistered young people. Establish, in consultation with social partners, objective criteria for setting the minimum wage. Take action to prevent early school leaving and increase the provision of quality education, in particular among Roma. Adopt the equalisation of the pension age for men and women. | Romania has made **some progress** in addressing CSR2.* **Substantial progress** was made in strengthening the National Employment Agency's (NEA) services. The NEA is undergoing a major change process reflected in a strategy and including 1) establishing for the first time an initial profiling and segmentation process, which became a working procedure and legislation in October 2016 (most of the people in NEA database have already been profiled); 2) Adoption of a catalogue of services, for the first time bringing together the service offer of the organisation towards jobseekers and towards employers; 3) Reinforcement of case management capacity - pilot project developed in October/November; to be up-scaled through the ESF; 4) Setting up an integrated approach to NEETs outreach, including a substantial increase in agency staff for the delivery of the Youth Guarantee- to be rolled out. The Youth Guarantee has so far only partially reached young NEETs. The NEA also plans to reinforce its capacity to strengthen its services for employers. The active labour market policies have been revised to provide more incentives for take up and several disadvantaged groups benefit for the first time from some ALMPs. A national mobility plan aims to improve the internal mobility. As regards linking employment with social services, a pilot project, financed with EU funds, will be rolled out. This would target 100 deprived communities and would set up integrated teams that include social assistants, community health assistants/mediators and education counsellors/mediators. In the long run, these integrated teams are supposed to be scaled up at national level, in over 500 deprived communities. A common order of the ministers for Labour, Education and Health establishes the working methods of integrated teams. Special advisers dealing with disadvantaged groups are proposed to be hired in the Public employment service and would make the link with social services and integrated teams. The minimum inclusion income law increases the coverage and adequacy of social benefits and strengthens the provision of active labour market policies for Guaranteed Minimum Income beneficiaries. These reforms have the potential of tangible and lasting effects, but only if implemented and sustained over the longer term.
* **Limited progress** was made on minimum wage setting. In January 2016, the government set up a tripartite working group with the task of establishing an indexation mechanism that would make future minimum wage adjustments automatic. This group has commissioned a study to analyse all the economic and social aspects of the minimum wage in Romania. As a follow up to this and based on the results of the study, clear guidelines and criteria, endorsed by social partners are supposed to be established in the first quarter of 2017. However, the new government announced the increase of the minimum wage from 1 February 2017 and subsequent increases until 2020, despite tripartite ongoing work on a minimum wage setting mechanism.
* **Some progress** was made to tackle early school leaving and increase the provision of quality education. The situation for Roma inclusion in schools remains challenging. As a step on the implementation of the Early school Leaving Strategy, authorities have launched two national calls for proposals supported by the European Social Fund (approximately EUR 200 million) to tackle drop-out ('School for all') and improve the provision of quality education in disadvantaged schools ('Motivated teachers in disadvantaged schools'). These projects aim to address two of the main drivers of early school leaving, namely insufficient prevention measures and insufficient provision of quality education. 'School for All' seeks to finance a wide range of activities, including integrated interventions for students and their parents, after-school programmes, and scholarships. The second call specifically aims to increase teaching quality in disadvantaged schools, in particular for Roma and schools in rural areas. The projects are now in the evaluation phase, with implementation expected to start the latest in September 2017. Therefore, the impact on reducing drop-outs or increasing teaching quality in disadvantaged school is yet to be seen. Other recent measures to tackle early school leaving include a warm meal pilot programme running in 50 schools, and full reimbursement of commuting costs for students from rural areas. The methodology for teachers' allowances was changed to include criteria on working with children at risk of drop-out (ministerial order from 22 December).
* To support the participation of poor children in pre-school education (empirically shown to prevent early school leaving) authorities are implementing the programme 'Every child in kindergarten' providing social vouchers on condition of attendance. To improve take-up, the application procedures were simplified. Although the number of beneficiary children who had not gone to kindergarten before is increasing, it remains relatively low (2 700 out of 67 000). Modernisation of the curricula for pre-school education is underway.
* To increase quality in education, authorities have also approved the curricular frameworks for lower secondary education (grades 5-8). The new curriculum is expected to enter into force in September for 5th graders. However, plans to reform the curricula high school education have been delayed.
* To increase managerial capacities in schools, a competition for school principals was organized, albeit allowing for some exceptions.
* Anti-segregation legislation was improved by expanding the criteria and strengthening the responsibilities of school inspectorates which is expected to lead to a more inclusive education in schools for Roma and other disadvantaged groups. However, in the absence of monitoring criteria progress has yet to be seen. While a number of positive measures have been initiated, these are unlikely to be sufficient to address the challenge.
* **No progress** was made on the equalisation of the pensionable age for men and women. The draft law submitted to Parliament in 2013 has been adopted by the Senate, but not by the lower Chamber.
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| **CSR 3:** Curb informal payments in the healthcare system and increase the availability of outpatient care. Strengthen the independence and transparency of human resources management in the public administration. Simplify administrative procedures for business and the public. Strengthen corporate governance of state-owned enterprises.Curb informal payments in the healthcare system …and increase the availability of outpatient care. Strengthen the independence and transparency of human resources management in the public administration. Simplify administrative procedures for business and the public. Strengthen corporate governance of state-owned enterprises. | Romania has made **some progress** addressing CSR3.* **Some progress** was made with curbing informal payments in the healthcare system. In line with the new National Anti-corruption Strategy for 2016-2020, legislation was adopted in November 2016 to revamp the existing patient feedback mechanism. In 2014, the Ministry of Health put in place a patient feedback form mechanism for reporting informal payments. Reporting under the mechanism was not reliable and is now being revamped. The National Anti-corruption Strategy for 2016-2020 adopted in August planned to revise the existing patient feedback mechanism to eliminate the involvement of medical units in the collection of information on patients' experience. Consequently, new legislative measures were adopted in November 2016 to empower patients, also addressing the role of ethics councils in public health units, and sanctions. In addition, the salaries of health professionals have been improved (Emergency Ordinance no. 20 of June 8, 2016 amending and supplementing Government Emergency Ordinance no. 57/2015 on the salaries of staff paid from public funds in 2016).
* **Limited progress** was made with increasing the availability of outpatient care. Some measures have been taken in this regard, but overall a shift to outpatient care is still at a very early stage to consider a substantial fulfilment of the recommendation. The Ministry of Health has developed regional healthcare plans that include a mapping of needs for infrastructure and services. The regional plans, together with the national health strategy, offer a good basis for the planning of investments from ESIF and other sources. The first monitoring report of the national health strategy has been published mid-2016, the second report being expected in February 2017. A Working Group has been created to address ambulatory care; it is announced that outpatients’ centres will be developed in the context of the Regional Plans including a pilot project in the South-West region; on the other hand, on primary healthcare, the budget in 2016 has increased overall 5 % with higher increases (up to 15 %) for the expenditure per capita and the value of the points for service. Nonetheless, the shift to outpatient care is still at a very early stage. Likewise, the implementation of the World Bank´s project Health Sector Reform including the target of strengthening ambulatory care is unsatisfactory (World Bank, 2016).
* **Limited progress** was made in human resources management in the public administration. Strategies for Civil Service and Staff Training have been adopted, however the current legislative and institutional set-up makes it hard to effectively implement.
* **Some progress** was made on the simplification of administrative procedures for business and the public. Measures taken in 2016 include emergency ordinance n. 41/2016 to simplify administrative procedures and facilitate relations between citizens and the public administration; and the adoption in November 2016 of first elements of a second legislative package, including emergency ordinance 84/2016 amending the Fiscal Procedure Code contains also measures to simplify administrative procedures for businesses, including e.g. procedures to obtain a fiscal code, for the reactivation of inactive taxpayers, widening the use of remote means of payment (e.g. home banking, mobile banking) to pay taxes, wider provision of e-tools to pay taxes and some specific fee reductions; further development of the RIA framework; introduction of income tax exemptions for R&D tasks and activities, and clarification of tasks and activities exempt from income taxation for IT professionals; adoption of OUG 35/2016 for the modification and completion of the land registry law 7/1996, important both for agriculture and for infrastructure projects. The substantial measures taken in 2016 to increase transparency (public consultation and debates on draft legislation etc), are being reversed in 2017.
* **Substantial progress** was made in SOEs corporate governance. The bylaws supporting Law 111/2016 on SOEs corporate governance were adopted within the deadline, in October 2016. As Law 111/2016 applies to all SOEs, the Ministry of Finance started contacts with the larger local authorities to improve awareness of the new rules. The H1 2016 budget execution of SOEs under the central government was made public. However, the hiring of professional managers has not yet started raising concerns on the implementation of law 111/2016.
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| **CSR 4:** Improve access to integrated public services, extend basic infrastructure and foster economic diversification, in particular in rural areas. Adopt and implement the transport master plan. Strengthen public investment project prioritisation and preparation.Improve access to integrated public services, extend basic infrastructure and foster economic diversification, in particular in rural areas. Adopt and implement the transport master plan. Strengthen public investment project prioritisation and preparation. | Romania has made **some progress** addressing CSR 4.* Despite delays, in 2016 there was **some progress** with the completion of action plans for ex-ante conditionality on health, transport, public procurement and RD&I. This has created a basis for strategic planning of future ESIF investments in infrastructure for public services and SMEs. However, the institutional and operational setup of ESIF programmes is still not completed and a few key ex-ante conditionality items are not yet fulfilled, creating a risk of further delays in implementation. 348 projects of a value of 252 million EUR (19% of allocation) for investments in rural infrastructure (roads, water supply/waste water systems, education and social infrastructure) have been contracted. In August 2016 the government further launched a comprehensive IT programme, developed jointly with the private sector, to increase the inter-operability across different levels of administration and the quality of public services (GovITHub). Some progress was made on improving access to integrated services in rural areas, marking a shift from benefits towards service provision. As part of a pilot project, integrated services will be introduced in around 100 most marginalised communities, through teams at community level, mostly in rural areas. When scaled up, it can produce substantial progress concerning the provision of integrated services. ESF calls at national level have been launched, covering disadvantaged communities, including in disadvantaged areas. A comprehensive set of measures was adopted in early 2016 aimed at improving living standards, stimulating productivity and economic diversification in the rural areas. A set of measures was adopted in 2016 aimed at increasing the wealth in rural areas and developing the rural middle class. The Rural Development Programme has started to be implemented. Additional 533 projects of a value of 49 MEUR (16% of allocation) for investments in diversification of economic activities and setting-up of non-agricultural activities in rural areas have been contracted. While there is progress on contracting, implementation of the projects on the ground is just starting. Romania still has to spend by 2023 around 1.2 BEUR for investments in rural infrastructure and 275 MEUR for diversification of rural economy.
* **Some progress.** The Transport Master Plan was adopted in September 2016. The Railway Reform Authority, set-up in October 2016 and expected to become fully operational by mid-2017, should take the necessary measures to make the operation of railway transport more efficient. To speed up of investments in road infrastructure, the government has also split the national authority in charge of road construction into two bodies, one for infrastructure investments (CNIR) and one for infrastructure administration (CNAIR). Performance contracts between the national companies and the Ministry of Transport are currently developed.
* **Limited progress** was made with strengthening public investment project prioritisation and preparation. In August, a change to the ordinance 88 obliged the line ministries to take into account the public investment priority list in the budget preparation. However, no other steps have been made to enhance the role of the existing public investment prioritisation unit in the Ministry of Finance and to improve the prioritisation and preparation of all public investment projects.
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| **Europe 2020 (national targets and progress)** |
| Employment rate target  | The national target of 70 % by 2020 remains ambitious, as the employment rate in the age group 20-64 reached 67.7 % in the third quarter of 2016. |
| R&D target : 2 % of GDP | The Romanian R&D intensity target is ambitious and difficult to reach, given that the country’s R&D intensity in 2015 was 0.49 %. To reach its 2020 target, R&D in Romania will need to grow by an average of 32.6 % per year between 2015 and 2020. However, Romanian R&D intensity fell between 2007 and 2015 at a compound annual rate of 2.1 %. In 2015, both public and business R&D intensities show slight improvements compared with the previous year. In 2015, business R&D intensity rose to 0.21 % of GDP (26th in the EU) and the public R&D intensity to 0.27 % (27th in the EU). |
| National Greenhouse gas (GHG) emissions target:19 % in 2020 compared to 2005 (in non-ETS sectors) | **2020 target: 19 %**In accordance with the latest national projections based on existing measures, non-ETS emissions will increase by 3.7% between 2005 and 2020. The target is consequently expected to be met with a margin of 15.3 percentage points.**Non-ETS 2015 target: 7 %**In accordance with preliminary estimates in 2015, greenhouse gas emissions not covered by the EU ETS decreased by 6% between 2005 and 2015, while the target for 2015 allows an increase of 7% compared to 2005. |
| Renewable energy target: 2020 Renewable energy target: 24 % | With a renewable energy share of 24.7 % in 2015, Romania has already met its 2020 target for renewable energy ([[70]](#footnote-70)) especially due to its large hydro-power sector, which accounted for almost a third of the installed energy generation capacity, but also due to the deployment of wind power (9.4 % of power generation in 2014) and the use of biomass for heating (16.6 % of final energy consumption).  |
| Energy efficiency: reduction of energy consumptionRomania's 2020 energy efficiency target is 43 Mtoe expressed in primary energy consumption (30.3 Mtoe expressed in final energy consumption.) | Romania remains above the EU average in terms of both economy wide (primary) and industrial energy intensity but has improved more than most other Member States since 2005. Final energy consumption per capita in households is below the EU average. In terms of implementation of the Energy Efficiency Directive Romania, the latter started with some delay but made progress both in 2015 and 2016.Romania increased its primary energy consumption by 2.1 % from 30.64 Mtoe in 2014 to 31.29 Mtoe in 2015. Final energy consumption increased by 1 % from 21.72 Mtoe in 2014 to 21.89 Mtoe in 2015. Even if Romania has already achieved levels of primary and final energy consumption which are below the indicative national 2020 targets, it would need to make an effort to keep these levels until 2020.  |
| Early school leaving target | Romania made no progress on meeting the target. Its early school leaving rate increased further to 19.1 % in 2015. Romania has among the highest early school leaving rates in the EU and is getting further away from its national Europe 2020 target. |
| Tertiary education target | Romania made some progress on meeting the target. Its tertiary attainment rate improved, reaching 25.6 % in 2015, and is on track to reach the Europe 2020 national target of 26.7 %. |
| Target on the reduction of population at risk of poverty or social exclusion in number of persons:  | Substantial progress was made in reducing the population at risk of poverty or social exclusion as compared with the national target of 580 000 people. In absolute terms 1 680 000 people were lifted out of the risk of poverty or social exclusion between 2008 and 2015. |

Annex B

MIP scoreboard indicators

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| Table B.1: **The MIP scoreboard for Romania** |
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| Flags: p: provisional.Notes: (1) Figures highlighted are those falling outside the threshold established in the European Commission's Alert Mechanism Report. For REER and ULC, the first threshold applies to euro area Member States.***Source:*** European Commission |
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| Annex CStandard Tables |
| Table C.1: **Financial market indicators** |
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| 1) Latest data Q2 2016.2) Quarterly values are not annualised\* Measured in basis points.***Source:*** European Commission (long-term interest rates); World Bank (gross external debt); Eurostat (private debt); ECB (all other indicators |
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| Table C.2: **Labour market and social indicators** |
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| 1 The unemployed persons are all those who were not employed but had actively sought work and were ready to begin working immediately or within 2 weeks.2 Long-term unemployed are those who have been unemployed for at least 12 months.3 Not in education employment or training.4 Average of first three quarters of 2016. Data for total unemployment and youth unemployment rates are seasonally adjusted.***Source:*** European Commission |
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| Table C.3: **Labour market and social indicators (continued)** |
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| 1 People at risk of poverty or social exclusion : individuals who are at risk of poverty and/or suffering from severe material deprivation and/or living in households with zero or very low work intensity.2 At-risk-of-poverty rate : proportion of people with an equivalised disposable income below 60 % of the national equivalised median income. 3 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.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 For EE, CY, MT, SI and SK, thresholds in nominal values in euros; harmonised index of consumer prices = 100 in 2006 (2007 survey refers to 2006 incomes)***Source:*** For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC. |
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| Table C.4: **Product market performance and policy indicators** |
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| 1 The methodologies, including the assumptions, for this indicator are shown in detail at: 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 if the outcome is not known. 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 at: http://www.oecd.org/competition/reform/indicatorsofproductmarketregulationhomepage.htm 6 Aggregate OECD indicators of regulation in energy, transport and communications.***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)." |
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| Table C.5: **Green growth** |
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| All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2005 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 HICPDifference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual % ch.).Real unit energy cost: real energy costs as a percentage of total value added for the economy.Environmental taxes over labour taxes and GDP: from European Commission's database, ‘Taxation trends in the EU’.Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR) Real unit energy costs for manufacturing industry excluding refining : real costs as a percentage 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 00MWh 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 greenhouse gas (GHG) emissions covered by EU Emissions Trading System (ETS) (excluding aviation): based on greenhouse gas 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 2005 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 over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels. ***Source:*** European Commission; \* European Commission and European Environment Agency |
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1. () PREDICT project. See <http://is.jrc.ec.europa.eu/pages/ISG/PREDICT.html> [↑](#footnote-ref-1)
2. () In Romania, the average income in rural areas is only 67 % of that in urban areas, against an EU average of 80 %. This is the second lowest in the EU. [↑](#footnote-ref-2)
3. () For assessment of other reforms implemented in the past, see in particular section 3. [↑](#footnote-ref-3)
4. () European Commission (2017c) [↑](#footnote-ref-4)
5. () National Anti-Corruption Strategy 2016-2020 [↑](#footnote-ref-5)
6. () Information on the progress and action 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. [↑](#footnote-ref-6)
7. () Property taxes followed by consumption taxes are the least detrimental to growth, while corporate income taxes appear to have the most negative effect. See Arnold, 2008. [↑](#footnote-ref-7)
8. () In addition, the discrepancy between the relatively high tax wedge on labour (calculated on the basis of the legal tax obligation) and the low implicit tax rate on labour (derived from actual tax receipts) suggests a high amount of concealed earnings. The tax wedge on labour was 42.1 % in 2014 (slightly above the EU-28 average of 41.8 %). The tax wedge data are for single earners with no children, on an average wage. The implicit tax rate on labour of 32.8 % in 2014 was significantly below the EU-28 average of 36.4 % (European Commission, 2016g). [↑](#footnote-ref-8)
9. () Similarly to previous years, less than 40 % of employment relations found to be undeclared were formalised as a result of inspections in 2016. [↑](#footnote-ref-9)
10. () Orders of the President of the National Agency for Fiscal Administration 1503/2016 and 1559/2016, respectively. [↑](#footnote-ref-10)
11. () The introduction of such cash registers is currently planned for 2018, after series of delays. [↑](#footnote-ref-11)
12. () See European Commission, 2016a, for description of the fiscal framework. For the fiscal governance reform which laid the basis of the current framework see European Commission 2012. [↑](#footnote-ref-12)
13. () Captured by the Numerical Fiscal Rule Index that reflects the strength of the design of all fiscal rules in place in a country. Romania registered a steep jump in the index value in 2014 (latest year available). See: <http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/fiscal_rules/index_en.htm>. [↑](#footnote-ref-13)
14. () The deficit rule requires compliance with or convergence to the medium-term budgetary objective of a deficit of ‑1 % of GDP (or -0.5 %, if the debt is above 60 % of GDP). [↑](#footnote-ref-14)
15. () This scenario assumes a constant structural primary deficit of 2.3 % of GDP from 2018 to 2027. This is the value in 2018, in accordance with the European Commission winter 2017 forecast. [↑](#footnote-ref-15)
16. () The total costs of aging are projected to increase from 15.6 % of GDP in 2016 to 16.2 % of GDP in 2030. [↑](#footnote-ref-16)
17. () Hedging of foreign currency positions may mitigate this risk, but this is not considered here. [↑](#footnote-ref-17)
18. () Following the measures adopted in 2014, the NBR required in April 2016 credit institutions to make an additional effort to fully provision non-performing loans (more than 180 days past due, unsecured, or with a very low probability to recover the collateral), to facilitate their write off. [↑](#footnote-ref-18)
19. () The NPL definition used by the NBR is fully in line with the European Banking Authority's (EBA) definition. In accordance with the EBA, non-performing exposures are those that satisfy any of the following criteria: i) material exposures which are more than 90 days past due; and ii) the debtor is assessed as unlikely to pay its credit 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. [↑](#footnote-ref-19)
20. () Macro-prudential instruments under the CRR/CRDIV are currently activated upon recommendation from the National Committee for Financial Stability. They are implemented by the NBR for credit institutions and by the Financial Supervisory Authority for investment firms. [↑](#footnote-ref-20)
21. () Hardship refers to exceptional circumstances which could not have been foreseen by the contractual parties when they agreed upon the loan contract. [↑](#footnote-ref-21)
22. () In line with the provisions of EU Regulation 575/2013 on prudential requirements for credit institutions and investment firms (capital requirements regulation – CRR). [↑](#footnote-ref-22)
23. () Conversion at historic exchange rates was expected to generate losses for the banking sector. The NBR preliminarily estimated that converting the Swiss franc-denominated loans into lei-denominated loans at historic rates would have generated a total loss for banks of RON 2.4 billion (EUR 530 million), causing a 1.8 pps fall in the capital adequacy ratio at system level. Some banks would have been more severely hit, while some exchange rate volatility could have occurred, as banks would have needed to buy foreign exchange to close their open positions. [↑](#footnote-ref-23)
24. () Distribution and transport are one of the most dynamic sectors, followed by business and other services (including ICT) and non-marketed services such as education and health (CEDEFOP 2016b). [↑](#footnote-ref-24)
25. () Recently, public wages in the education and healthcare sectors have been increased, however in an ad hoc manner, without applying a comprehensive policy based on qualifications and performance of workforce. [↑](#footnote-ref-25)
26. () National data estimate people in the informal economy at around 1.2 million, representing 0.6 pp. of total population. [↑](#footnote-ref-26)
27. () 17 % Roma women and 49 % men reported to have engaged in 'paid work' when surveyed or in the four weeks prior to the survey. The discrepancy is more pronounced in Romania than in peer countries on average (FRA, 2016). [↑](#footnote-ref-27)
28. () The gender employment gap is even more acute for older women as compared to the EU average (19.1 % v 13.2 %). [↑](#footnote-ref-28)
29. () Increase of parental leave from one to two years, remunerated at 85 % of the previous salary and with no upper ceiling. [↑](#footnote-ref-29)
30. () The 2016 survey by the Fundamental Rights Agency improved the sampling and weighting methods developed for the 2011 Roma survey, thus the results are a more accurate representation of the situation of Roma in the countries covered. Indicators used are a close approximation to those applied in standard European surveys (EU SILC, EU LFS), but full comparability was not intended. For more details see FRA, 2016. [↑](#footnote-ref-30)
31. () See European Commission, 2016a, for background on existing social benefits. [↑](#footnote-ref-31)
32. () The budget for the scheme will increase from RON 1.4 to 2.4 billion (EUR 310 to 530 million). [↑](#footnote-ref-32)
33. () Following the revision of the curricula for primary education (grades 1-4), a new curriculum for grades 5-8 is set to be phased in from September 2017. Plans to reform the curricula for high-school education have been delayed. [↑](#footnote-ref-33)
34. () About 29 % of Roma children receive education in schools where all or most students are Roma (FRA, 2016). [↑](#footnote-ref-34)
35. () The Fundamental Rights Agency estimates the share of Roma early school leavers at 77 %. [↑](#footnote-ref-35)
36. () 236.3 physicians per 100 000 residents while EU average is 349.6. [↑](#footnote-ref-36)
37. () Including special commissions selected according to objective criteria. [↑](#footnote-ref-37)
38. () The Government had adopted an emergency ordinance in November (79/2016) which modified the selection of hospital managers to ensure they are selected by open competition and extended the coverage of conflict of interest provisions for a wider category of hospital management staff. This ordinance was rejected in the Senate in January 2017, but still needs to pass through the Chamber of Deputies. [↑](#footnote-ref-38)
39. () Research by the National Bank of Romania (monthly bulletin, June 2016) also concluded that strong domestic demand had a relatively high impact on import growth, as domestic supply was slow to react to increased consumer demand following lower indirect taxes and rising wages. [↑](#footnote-ref-39)
40. () European Commission staff also estimated the export-import elasticity to be 0.4, which is consistent with the relatively low import intensity of exports. The domestic value added share of exports was 73 % in Romania in 2014, above the EU average of 63 % (Source: www.wiod.org). [↑](#footnote-ref-40)
41. () The conclusion is based on a shift-share analysis. Export market share changes are broken down into 'pull' factors, which capture the impact from changes in external demand or sectoral shifts in global markets, and 'push' factors, which reveal how different structures of individual countries’ exports affect their relative performance. The 'push' factors can be interpreted as a broad measure of an economy’s 'competitiveness'. [↑](#footnote-ref-41)
42. () Commission staff estimates suggest that Romania's exports of goods would fall by 2.4 % in response to a 1 % decrease in external demand. [↑](#footnote-ref-42)
43. () See Box 2.1.1 in European Commission, 2016a, pp. 10-11. [↑](#footnote-ref-43)
44. () Compensation of employees consists of wages and salaries, and of employers' social contributions. [↑](#footnote-ref-44)
45. () Law 111/2016 on the corporate governance of state-owned enterprises approved by Parliament in May 2016. It replaced government emergency ordinance 109/2011. [↑](#footnote-ref-45)
46. () 2017 EU Justice Scoreboard (forthcoming). See section 2.1 of 2017 CVM Technical Report - SWD (2017) 25. Upon the backdrop of growing trust in the judiciary over the years, the improvement of businesses' perception of independence stalled in 2016. [↑](#footnote-ref-46)
47. () Ibid. [↑](#footnote-ref-47)
48. () 2017 EU Justice Scoreboard (forthcoming) [↑](#footnote-ref-48)
49. () Romania has proposed an Action Plan to address this issue in December 2016, which will be examined by Council of Europe Committee of Ministers in March 2017. [↑](#footnote-ref-49)
50. () Twice as many Romanians compared to other Europeans report unfair contract terms and unanticipated charges by retailers and a higher than EU average prevalence of unfair commercial practices. Awareness of alternative dispute resolution amongst Romanian retailers’ is among the lowest in the EU (44 % vs 55 % EU-28), with decreasing participation in such mechanisms (21 % vs 32 % EU-28), upcoming Consumer Conditions Scoreboard (2017). [↑](#footnote-ref-50)
51. () Despite an increase of 7 pps. in the last 2 years, Romanian consumers’ confidence in online shopping is still below the EU average (57 % vs 72 % EU28). In addition, retailers' confidence in online selling in Romania decreased and is below the EU average (47 % vs 57 % EU28) (upcoming Consumer Conditions Scoreboard 2017). [↑](#footnote-ref-51)
52. () Flash Eurobarometer 428: Businesses’ attitudes towards corruption in the EU, available at <http://ec.europa.eu/COMMFrontOffice/PublicOpinion/index.cfm/Survey/getSurveyDetail/instruments/FLASH/surveyKy/2084> ; [↑](#footnote-ref-52)
53. () Flash Eurobarometer 445: The Cooperation and Verification Mechanism for Bulgaria and Romania, published on 25 January 2017. [↑](#footnote-ref-53)
54. () Emergency Government Ordinance no.13 of 31.01.2017 for the modification of Law no. 286/2009 regarding the Criminal Code and Law no. 135/2010 regarding Criminal procedure code. Official Journal of Romania, Part II, No. 9 of 1 February 2017. [↑](#footnote-ref-54)
55. () Emergency Ordinance no. 14 from 05.02.2017 for the abrogation of the Government Emergency Ordinance no. 13/2017 amending and supplementing Law no. 286/2009 regarding the Criminal Code, Law no. 135/2010 regarding the Criminal Procedure Code and amending Law no. 135/2010 regarding the Criminal Procedure Code.  Official Gazette no. 101 from 05.02.2017. [↑](#footnote-ref-55)
56. () Research and development (R&D) is the statistical proxy for expenditure in the R&I system (Eurostat). Intensity is measured as R&D expenditure in percent of GDP. [↑](#footnote-ref-56)
57. () Romania's Europe 2020 target is 2 % of GDP investments in R&D, with 1 % from the public sector and 1 % from the private sector. [↑](#footnote-ref-57)
58. () It covers performance indicators on SMEs innovating in-house, innovative SMEs collaborating with others and public-private scientific co-publications. [↑](#footnote-ref-58)
59. () The National RDI Strategy 2014-2020, provides for the creation of a consultative body responsible for coordination and harmonization of R&I policy, under the coordination of the prime-minister. [↑](#footnote-ref-59)
60. () <https://rio.jrc.ec.europa.eu/en/policy-support-facility> [↑](#footnote-ref-60)
61. () Funded by the European Regional Development Fund. [↑](#footnote-ref-61)
62. () The indicators are: internet access for at least 50 % of employed people; recourse to ICT specialists; fast broadband (30 Mbps or above); mobile internet devices for at least 20 % of employed people; a website with sophisticated functions; social media; ERP; CRM; electronic sharing of supply chain management information; e-commerce turnover accounting for over 1 % of total turnover; business-to-consumer web sales of over 10 % of total web sales. [↑](#footnote-ref-62)
63. () Funds allocated to cogeneration/district heating were underused. From the total amount initially programmed, 15.9 % have actually been used. [↑](#footnote-ref-63)
64. () See European Commission, 2016a, Section 2.3 for background. [↑](#footnote-ref-64)
65. () In 2016, consultations and public debates were carried out systematically on the basis of templates and standard procedures developed by the Ministry of Civic Dialogue and Public Consultation to be followed by ministries at all stages – launching of debates, consolidating proposals, incorporating them in draft texts, and explaining rejections, if necessary. [↑](#footnote-ref-65)
66. () Romania performs worse than all but one OECD countries in terms of administrative data collection of number of staff, pay levels, functions, skills, mobility and turnover (OECD, 2016, p. 11). [↑](#footnote-ref-66)
67. () "There are sectors in public procurement where corruption is generalized. Many times, the awarding of contracts or the payments related to contracts are conditioned by receiving different sums of money disguised by fraudulent deals or fictitious agreements", DNA (2016). [↑](#footnote-ref-67)
68. () The analysis of the progress in the implementation of the public procurement Strategy is part of a wider Commission exercise in relation to ex-ante conditions for the implementation of EFSI funds in the 2014-2020 period. [↑](#footnote-ref-68)
69. () The following categories are used to assess progress in implementing the 2016 country-specific recommendations:
**No progress:** The Member State has not credibly announced nor adopted any measures to address the CSR. Below a number of non-exhaustive typical situations that could be covered under this, to be interpreted on a case by case basis taking into account country-specific conditions:

• no legal, administrative, or budgetary measures have been announced in the National Reform Programme or in other official communication to the national Parliament / relevant parliamentary committees, the European Commission, or announced in public (e.g. in a press statement, information on 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 that would need to be taken (unless the CSR explicitly asks for orientations or exploratory actions), while clearly-specified measure(s) to address the CSR has not been proposed.

**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 legislator body but these have not been adopted yet and substantial non-legislative further work is needed before the CSR will be implemented;

• presented non-legislative acts, yet with no further follow-up in terms of implementation which is needed to address the CSR.

**Some progress:** The Member State has adopted measures that partly address the CSR

and/or

the Member State has adopted measures that address the CSR, but a fair amount of work is still needed to fully address the CSR as only a few of the adopted measures have been implemented. For instance: adopted by national Parliament; by ministerial decision; but no implementing decisions are in place.

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

**Full implementation:** The Member State has implemented all measures needed to address the CSR appropriately. [↑](#footnote-ref-69)
70. () Renewable energy shares for 2015 are approximations and not official data, reflecting the available data (04.10.2016). See the Öko-Institut Report: Study on Technical Assistance in Realisation of the 2016 Report on Renewable Energy,  <http://ec.europa.eu/energy/en/studies> [↑](#footnote-ref-70)