GOVERNMENT OF ROMANIA

CONVERGENCE PROGRAMME

BUCHAREST

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1. INTRODUCTION

The coordination of the economic and budgetary surveillance policies is one of the European Commission's permanent concerns, as it represents a requirement for increasing the interdependence generated by the completion of the Internal Market and the Economic and Monetary Union. Moreover, according to the provisions stipulated in articles 99 and 104 of the EC's Stability and Growth Pact (the Council Regulation (EC)1466/97, amended by Regulation No. 1055/2005 and, respectively, Regulation No. 1467/1997, amended by Regulation No. 1056/2005), budgetary assistance in the EU is based on the in-depth and correlated analysis of the Stability or Convergence Programmes.

The Convergence Programme is a multi-annual program which supports and illustrates the quality and consistency of the macro-economic policies for economic and budgetary growth and stability, but also the perspectives for nominal and real convergence of the MS that have not adopted the Euro currency yet.

In accordance with the European Commission's requirements, the Convergence Programme, unlike other programmatic documents, is annually updated and submitted to the European Commission for review in November, but no later than December 1.

In this second edition of the Convergence Programme, the methodology regarding the contents and the format remained the same. However, a few changes occurred in the standard tables, especially for re-defining and introducing a number of new indicators which were only optional in the previous edition, such as: the private consumption deflator; the compensation per employee, the interest expenditures; the primary budgetary surplus; social payments instead of social transfers.

At the same time, there was underlined the requirement for all Member States to use the same assumptions regarding the external environment, as shown in the fall forecast of the European Commission, while for the ERM II members, the requirement to supply details concerning the implementation of ERM II commitments.

This second edition takes into consideration "The European Council's Opinion" regarding the first edition of Romania's Convergence Programme, as expressed in accordance with the provisions in article 9 of the EC Regulation Nr. 1466 of July 1997.

Essentially, the Opinion underlines the fact that macroeconomic and budgetary scenarios in the Convergence Programme are plausible, but, at the same time, there are risks related to meeting the budget objectives after 2008. As a global appreciation, the European Council shows that Romania has positive perspectives for a strong economic growth, but only with an increased foreign deficit and moderate progress in the fiscal sustainability, the MTO requirements being envisaged to be met only after the programming period.

The recommendations in the "European Council Opinion" refer to setting more restrictive budgetary targets for the following years and improving the quality of the public expenditure structure.

The second edition of the Convergence Programme presents – as an answer to these recommendations **–** Romania's capacity to bring the **structural deficit** down to less than 1% by 2011, thus ensuring a sufficient safety margin to avoid exceeding the 3% threshold of the budget deficit in the GDP.

Moreover, there is presented a medium term budgetary framework characterized by a restructuring of the expenditures with the aim of sustaining the economic sectors with a high value added, as well as the investment in knowledge, education and research in a move to improve the capacity of the Romanian economy to cope with global competition and to provide qualified labour supply for the services sector, under the circumstances of the labour force cost inevitably going up as a result of the convergence process.

The updated Convergence Programme took into account the latest developments of the internal and international economic environment and was based on the current legal framework as well as on the provisions stipulated in the 2008 budget draft currently under parliamentary approval procedure.

The current edition of the Convergence Programme was elaborated in correlation with the provisions in the National Reform Program 2007-2010, as drawn up and sent by Romania to Brussels in July 2007.

In preparing the Convergence Programme, efforts were made by all the involved institutions (National Bank of Romania, the Ministry of Labour, Family and Equal Opportunities, the Ministry of Interior and Administrative Reform, the Ministry of Development, Public Works and Housing, the Ministry of Public Health, the Ministry for Small and Medium-Sized Enterprises, Trade, Tourism and Liberal Professions, the Ministry of Education, Research and Youth, the National Commission for Prognosis, etc.), under the coordination of the Ministry of Economy and Finance, to supply the most eloquent and detailed data and information, in accordance with the requirements of the European Commission, aimed at supporting and illustrating the quality and the consistency of the macroeconomic policies for economic growth and budgetary stability, but also the perspectives for nominal and real convergence of the Romanian economy.

Given the fact that the Convergence Programme represents a broad and important document from the perspective of capitalizing on the benefits created by the accession to the European Union, with implications on the entire society, various non-governmental organizations were consulted during its preparation (including public seminars and debates), alongside trade unions and employers' associations, as well as some scientific personalities.

2. OVERALL POLICY FRAMEWORK AND OBJECTIVES

2.1 Government Objectives and Priorities

The fundamental objective of the Government's economic policy is to promote sustainable economic growth, in conditions of competitiveness, which will in turn ensure nominal and real convergence with the European Union. To guarantee the success of this strategy the Government will give top priority to investing in human capital and in infrastructure. The most important prerequisite for meeting the fundamental objective is the implementation of the right mix of macroeconomic policies to ensure **the continuation of the disinflation process and to preserve the external sustainability.** At the same time, meeting the economic and occupational performance, correlated with a sound social system represents the essence of the durable development oriented policies of Romania in 2007-2010.

As key elements comprised in the Government' medium-term economic strategy we highlight the following objectives, consistent with the goals of the European Community as set out in the re-launched Lisbon Strategy, the Broad Economic Policy Guidelines, and the EU Stability and Growth Pact:

(a) maintaining macroeconomic stability, continuing the disinflation process and containing the current account deficit;
(b) improving the medium term predictability and performance of the fiscal policy, including attracting and effective utilization of EU funds;
(c) continuing and deepening the structural reforms and delivering improved public services in health, education and professional formation, research and development as well as continuing the necessary reforms to enhance responsibility and efficiency;
(d) ensuring the long term sustainability of the public finances;
(e) improving the business environment, promoting entrepreneurial culture, increasing labor market participation and flexibility and a harmonious regional development;
(f) public administration reform.

2.1.1. The economic policy mix and macro-stability

Under the current circumstances, characterized by the simultaneous expression of many inflationary risk factors, as well as by persistent turbulence on the international financial markets, maintaining the macroeconomic stability and consolidating the progress in the nominal convergence require the direct approach of the higher inflation event by the overall macroeconomic policy and structural adjustment mix, as its consistency is more important than the focus on each of its individual components.

At the same time, it is necessary that the fiscal and revenue policies substantially support the disinflation, in order to facilitate the monetary policy mission, which is to anchor the inflationary expectations to the low inflation levels that have been reached so far. The implementation of this task has already been started by the central bank; however, the effectiveness of the monetary policy is limited by the existence of a significant external imbalance.

The economic policy mix consisting of a restrictive monetary policy (focused only on relatively high interest rates, translated in a slightly higher exchange rate), alongside a rapid revenue increase, exceeding by far the labour productivity dynamics, leads to unwanted consequences which may undermine the sustainability of the short run disinflation process: (i) a more deepened current account deficit of the balance of payments, persisting at levels which are difficult to sustain on a long term without a substantial increase of productive capital autonomous inflows; (ii) an increased risk of a sudden correction (in the sense of depreciation) of the exchange rate, resulting in a rise in inflation; (iii) a negative impact on the financial situation of the businesses and households which contracted foreign currency loans by **counting on** a continuous appreciation of the domestic currency, without taking adequate protection against the currency risk.

Hence, promoting a coherent economic policy mix is all the more necessary since: (i) the international financial turbulence will continue to persist, as shown by the developments of the *sub-prime* credits in the American real estate industry, their duration being difficult to anticipate. The probable consequence for Romania would be an increased aversion of the foreign investors to risk, which will lead to higher costs for accessing the foreign financing, leaving the room to significant spontaneous corrections of the exchange rate; (ii) the increase of the food prices on the international markets seem to be a lengthy phenomenon, reflecting both a higher pressure on the demand side (especially coming from a number of highly populated developing countries), but also supply side pressures (taking into account the new fuel-producing technologies using agricultural raw materials); (iii) the most significant increase in the oil price within the past 25 years occurred, due to a difficult geo-political context and against the background of shortfalls of the extraction and refining capacities relative to the rapid increase of the demand; (iv) Romania’s current account deficit reached a high level. Although this deficit does not represent a target-size for NBR, as its correction is the responsibility of the fiscal and revenue policies, there is a risk to be unevenly reflected on the price level and on the inflation rate, due to corrective depreciation as a result of an unsustainable appreciation. This risk goes up with the inflation targets becoming more and more ambitious, on a medium term.

The long term sustainable convergence process with EU living standards requires both the maintenance of the macroeconomic stability and the continuation of structural reforms. The main challenge is the convergence with the European living standards, simultaneously with maintaining the macroeconomic stability (in other words, with the evolution of the nominal parameters towards the levels stipulated in the Maastricht Treaty) while preserving, at the same time, the economy’s international competitiveness.

Given the above, in the next period of time, the economic policy mix needs to be conceived, as follows: (i) continue the structural reforms, so that the constraints on the aggregate supply could be eliminated, by stimulating the increase in productivity and foreign competitiveness of the Romanian products; (ii) maintain the monetary and fiscal policy in a relatively highly restrictive environment, alongside with a better coordination of such policies; (iii) a revenue policy which does not put additional pressure on the demand side.

2.2 Monetary and Exchange Rate Policy

In accordance with its statute[1], the National Bank of Romania has a primary objective to ensure and preserve the price stability. As of August 2005, the monetary policy has been implemented in the context of the inflation targeting strategy, co-existing with the managed floating exchange rate environment. This exchange rate regime is in compatible with the use of inflation targets as a nominal anchor for the monetary policy, allowing a flexible response of this policy to unexpected shocks which may affect the economy.

Considering the need to implement additional structural reforms that will increase the Romanian economy's capacity and flexibility to face asymmetric shocks, Romania will not be able to join the exchange rate mechanism (ERM 2) sooner than 2012.
Joining ERM 2, expected in 2012, will represent an important stage on the convergence

A higher degree of exchange rate stability can be ensured by increasing the credibility of the convergence process and by the stabilization of the long-term exchange rate expectations. In line with the expected productivity growth and the inflow of foreign direct investments, a gradual appreciation of the Leu versus the Euro is likely to continue, this adjustment supporting the nominal and real convergence of the Romanian economy.

With the Romanian economy still in disinflation process – the medium term sustainable inflation rhythm compatible with the quantitative definition of the price stability hasn't been reached yet – the inflation targets are annual (December/December) and set by NBR together with the Government for a two-year period. Consequently, the annual inflation targets set for 2008 and 2009 continue to show an descending trend, with levels of 3.8 per cent ±1 percentage point and 3.5 per cent ±1 percentage point, respectively.

These target values satisfy, on one hand, the requirement for attaining, according to the Euro joining schedule, an inflation rate level which is compatible with the inflation criterion stipulated in the Maastricht Treaty, as well as with the quantitative definition of price stability adopted by the European Central Bank.

On the other hand, the targets for 2008 and 2009 reflect the NBR's concern to consistently reach the set inflation objective, which is essential for strengthening the

[1] Law 312/2004.

central bank's credibility – in the context of the relatively short history of the direct targeting strategy in Romania – and eventually for effectively anchoring the inflation expectations on a medium term.

NBR's precaution – highlighted by this *pattern* of the inflation targets – is justified under the current circumstances by the anticipation of persistent inflationary factors outside of Central Bank control, the most important factors we can mention: (i) the influence on the price development by the continuation of the convergence process in the Romanian economy; (ii) the programming of administered price and indirect tax adjustments during this period of time; (iii) persistent asymmetrical nominal rigidities; (iv) the risk of manifesting of significant external shocks on the aggregate price level in Romania.

Maintaining the annual inflation rate on a trajectory compatible with attaining the medium term inflation targets has recently become a real challenge for the central bank, in the context of the consistent disinflation process started in 2000 being interrupted in the third quarter of the current year under the impact of the shocks occurred on the domestic as well as the foreign markets during this period of time; these triggered an increase of the annual inflation rate, in October, up to the level of 6.84 percent (3.7 percent in March this year) – which is incompatible with attaining the inflation target set for 2007 (4 percent ±1 percentage point).

During this interval, the major cause for the spike of the consumer price index was the inflation effect of the drought related lower agricultural output, whose level substantially exceeded the forecast; this effect was also intensified by the increase of the prices of the agricultural products on the foreign market. This was accompanied by the impact of the the exchange rate correction in nominal terms due to turbulences on the international financial markets.

Against this background, the inflation perspective on the monetary policy transmission horizon has deteriorated. Thus, according to the most recent forecast by the NBR, the projected annual inflation rate is in December at 5.7 percent, and at the end of 2008 at 4.3 percent, until the third quarter of 2008 its trend going beyond the upper limit of the variation interval which frames the central point of the inflation target.

At the same time, the complexity and the size of forecast-associated risks deepened, especially the one related to: (i) the revenue increase not sufficiently sustained by a boost of productivity, (ii) the potential deterioration of the public's inflationary expectations, mainly under the impact of adverse supply shocks and (iii) the uncertainty related to the investors' behaviour towards the emerging markets.

Under these circumstances, NBR responded promptly by strengthening the monetary policy, with the monetary authority increasing, on October 31, the monetary policy interest rate up to 7.5 percent, by 0.5 percentage points, after the central bank in September had pushed up the sterilized liquidity volumes in a move to bring the levels of the interest rates on the inter-bank monetary market closer to the monetary policy interest rate level, which was translated into an increase of the inter-bank interest rates on the short term by around 2 percentage points.

Moreover, in order to consolidate the restrictiveness of the monetary conditions in a broad sense and taking into account the rapid growth of credits granted to the private sector, in terms of all the components thereof and especially the credits in foreign currency, the Management Board of NBR decided to keep at the current levels the rates of the minimal obligatory reserves applicable to both liabilities in lei (20 percent) and in foreign currency (40 percent), respectively, of the credit institutions.

In this context, was reiterated the need to orient the monetary policy, alongside the other components of the macroeconomic policy mix, to anchor, in a firm and sustainable way, the inflationary expectations to the low inflation levels reached previously to the recent inflationary shocks, in order to keep the annual price increase on the medium term disinflation trend set in a joint effort with the Government and, in a broader horizon, to ensure the convergence of the aggregate price level in Romania to the price stability as defined in EU.

This orientation of the macroeconomic policies is considered to be all the more necessary since de foreign deficit is at levels which are difficult to sustain in the long run, in the context of deepened uncertainties which affect the international economic environment. From this perspective, through the increase of the monetary policy interest rate, NBR aims at ensuring an adequate level of the real interest margin, expected to stimulate savings and to improve the relationship thereof with investments, having as effect the gradual reduction of the foreign deficit in the future.

Putting the annual inflation rate back on the trajectory that is compatible with attaining the inflation targets is expected to happen in the last quarter of 2008; the main cause of this evolution is the action of a number of real monetary circumstances, the restrictiveness of which shall be ensured by the adequate calibration of the interest rate policy, correlated with the forecasted appreciation trend in real terms of the domestic currency in the longer term, under the impact of continuing productivity gains to be recorded in the Romanian economy and the persistence of sustainable productive capital inflows.

Hence, in the next period, the adequate restrictiveness degree of the monetary conditions shall be ensured through the monetary policy operational framework specific to the direct inflation targeting strategy. Including through an adequate management of the liquidity conditions on the monetary market, the central bank will seek to consolidate the role of the interest rate policy in transmitting the impulses of the monetary policy, as well as the signalling role of the monetary policy interest rate and implicitly the capacity thereof to anchor the inflationary expectations.

The minimal obligatory reserves mechanism will continue to be, at least on the short term, an important pillar of the liquidity management and control policy; a higher austerity of this instrument related to the ECB practice in the field is justified, on one hand by the persistence of a substantial structural liquidity surplus in the banking system and, on the other hand, by the still very high dynamics of the credits in foreign currency, based on the increasing level of foreign resources drawn by the credit institutions.

In exchange, the leveraging role of the monetary policy given to a number of prudential and administrative measures the central bank resorted to since 2005 in order to slow down the growth pace of the credits in lei and foreign currency granted to the private sector, has been in part cancelled by NBR in the first quarter of the current year. Hence, in early 2007, NBR cancelled the ceiling imposed to the credit institutions' exposure to the unhedged currency debtors, because of the limited and asymmetrical effects that this measure was generating in the context of the cross-border mobility of the financial service supply within EU.

At the same time, starting March, the regulation enabling NBR to imposed more severe loan granting conditions for natural persons has been adjusted subordinating it almost totally to the objective of preserving the financial stability; moreover, there was initiated a gradual process to remove the population indebtedness ceilings stipulated by the central bank in the above-mentioned regulation; alongside the proposal of the prudential internal norms of the credit institutions in terms of granting loans to the natural persons being validated by the national bank.

2.3 Fiscal policy

A top objective for the Government in the next years is the consolidation of the predictability, the stability and the transparency of the fiscal policy. The Government' fiscal policy is designed to support the convergence objectives, by maintaining the budgetary deficit at a prudent level in order to continue the disinflation process and maintain the external deficit within sustainable limits, by stimulating improved collection rates, by promoting measures for enlarging the tax base and increasing the quality of the public expenditures. Consolidating the quality of public finance in a coherent medium term budgetary framework represents the priority objective of the Government, and its success thereof is the main prerequisite for reaching the medium term budget objective and for promoting the efficient functioning of the automatic stabilizers.

Regarding the specific medium-term objective, we started from the premises that the cyclically adjusted budget deficit will be 0.9% of GDP by 2011. This level provides a satisfactory safety margin to prevent breaching the budget deficit ceiling of 3% of GDP in the context of possible future adverse shocks to the rate of economic growth.

The Government's efforts over the medium-term are directed towards the provision of improved public services, including a high-quality educational and vocational training system, a modern and reliable transport network and a responsive and efficient health service, through sustained increases of the net investments in the public sector, including the effective appropriation of the EU funds. Moreover, measures will be taken to create adequate conditions for maintaining the long-term sustainability of public finance.

Managing financial resources efficiently is central to this objective, with a view to allow sustained improvements of the fiscal policy performance in the long term. In this respect, the introduction of program budgeting, increasing the expenditure flexibility and the consolidation of the three year medium term budget framework in government financial planning will ensure the expected efficiency gains in public sector spending.

2.4. Structural reforms

The targets set by Romania, through the National Reform Program, are similar to the targets assumed at European level, but adjusted to the level of performance of the labour market and of other connected areas, with the purpose of ensuring economic stability and public finances sustainability, increasing productivity and economic competitiveness and improvement of the labour force market functioning.

In the **labour market** area, Romania assumed two priorities: improving the labour market activity rate and improving the quality of human resources. The objectives established for these two priorities aim at ensuring a favourable environment, from a legal and institutional point of view, for the creation of new jobs and attracting the highest number of persons to the labour market (reduce the inactivity rates within socially vulnerable groups).

2.4.1 Labour market

The labour market in Romania is characterized by a relatively low activity rate as compared to the EU average, high unemployment rates for the age groups of 15-19 years and 20-24 years, a high percentage of early retirement from the formal labour market and significant employment in the agriculture sector with work relationships that are not subject to taxation.

The Government aims at increasing on average by 1.1 percentage points annually of the activity rate for the active population in the age category 15-64 years. Reaching the total employment rate target of 62.1% and the ILO unemployment rate target of 6.6% before 2010 requires reforms on the labour market, to allow an increase of the competitiveness.

The Government will concentrate its efforts on the three priorities laid down in the Re-launched Lisbon Strategy: attract and uphold more people in the labour market improve adaptability and boost investments in human capital, correlated with the demographic problem and migration, social exclusion as well as the associated elements such as population’s health and sensitive aspects of poverty.

In the context of the ongoing adjustment of the labour market, the government focuses to ensure equal access and reinsertion for the youths, women, elderly people and the persons considered disadvantaged. Thus, special attention will be paid to the consolidation of the institutional capacity, especially at local level, with a view to efficiently use the grants of European Social Fund. The objectives set by the government regard the decrease in the long-term unemployment rate from 4.1% in 2006 to 3.4% in 2010, the ILO unemployment rate from 7.3% in 2006 to 6.6% in 2010 and the increase in the elderly employment rate from 41.7% in 2006 to 43.0% in 2010.

Quality training and the acquirement of new skills by the labour force facilitate the improved competitiveness of the labour market and to that extent becomes increasingly important in a knowledge-based economy and a global marketplace. As a significant requirement in developing the knowledge-based society is represented by the initial education and lifelong learning system, the government will give priority to the modernization of the national education system and the public service for employment. In this respect, through the National Reform Program, a complex set of objectives was set, regarding the stimulation of developing skills for digital economy and the promotion of employment mobility, the participation in initial and lifelong education, as well as the overall education reform.

The quality of education, the professional training and lifelong acquiring of new knowledge and skills become more and more important competitiveness factors in a knowledge-based economy, which justifies the need to increase and improve the investment in the human capital. The actions envisaged by the Romanian Government aim at: modernizing the education and the initial professional training, ensuring the quality of the higher education and developing the lifelong education system.

The allocated budget to education has continuously increased since 2005, with the share in GDP of public expenditures for education increasing from 3.4% in 2005 to 4.3% in 2006, 5.5% in 2007, and an allocation of 6% of GDP provisioned for the year 2008. De-centralization in the education sector will contribute to the improvement of the capacity of both schools and local public administrations to take responsibility for the current management/administration requirements of schools and education processes.

The early education reform is a structural measure initiated in 2007 and sustained in two projects, namely the „early education reform project" and the „inclusive early education project", the implementation of which contribute to reducing educational disadvantages, ensuring equal access to education and fighting and preventing the early school leaving. Through the implementation of the announced measures, the Government planned to reduce, by 15% the school leaving rate in the compulsory education by the end of 2007; to increase by 10% the rate of access to the high secondary education for children/youths coming from disadvantaged categories; to increase by 15% the inclusion rate of the pupils in the special and normal schools and by 20% the rate of pupils re-integrated in the compulsory education system.

Regarding the vocational and technical education development, the objectives of increasing attractiveness and improving the capacity to respond to sectoral and regional requirements of the labour market were set for the initiation/extension of projects and actions aimed at improving the material base, ensuring the quality and the access conditions to the vocational and technical education, improving planning and adapting the vocational and technical education supply to the labour market requirement etc.

With regard to the higher education, as a key-element in the progress of the knowledge-based society, actions have continued in 2007 for the implementation of Bologna process. The implementation of the national qualification system in the higher education system is a measure which will lead to the improvement of the universities' capacity to provide adequate qualification as required on the labour market.

Labour market trends on the medium term

The Labour Code was updated in 2007 by the adoption of Law 94/2007; this will lead to a more flexible work relationship framework to the benefit of both employees and employers, with a number of consequences in the medium term: a more dynamic economic activity, the formalization of the work relationships from the grey area, the diminish of the corruption and bureaucracy. At the same time, the Government's actions in 2007 aimed at implementing the legal framework for changing all the provisions contrary to the equal treatment principle, improving the work conditions and promoting labour health and security.

The consolidation of economic performance in the production and services sectors is expected to lead to attracting the segment of population employed in subsistence agriculture to the non-agricultural activities' sector and alleviating the pressure already present in these sectors. In this context, against the background of the increase of the total employed population, the share of the population employed in the agricultural sector is expected to decrease by 6.9 percentage points compared to 2006 to 23.6%. At the same time, the rates of both active population and employment are expected to go up, by 2010, with the activity and employment rates reaching as far as 66.6% and 62.1%, respectively.

A raise of over 7% is expected in 2010 for the participation rate in education and professional formation for the age category 25 – 64 years, which represents an increase of 5.5 percentage points as compared to 2006.

A number of programs are expected to further contribute to the flexibility of the labour market, such as: supporting training and obtaining management qualifications intended to make the entrepreneurship a career option, a program supported by the European Social Fund; individually tailored assistance services for the unemployed, especially for the long-term unemployed, youth and vulnerable social groups; offering incentives for the employees to develop companies and careers, also aimed at enhancing the awareness of employers and employees as to the necessity of the life-long learning.

A significant dynamic was seen on the Romanian labour market regarding the domestic geographic and occupational mobility. Within the context of labour market diversification, it is necessary to continue the process of adapting training services to the employers' needs and the development of perspectives for new occupations, so that capable individuals could easily switch jobs through acquiring of new competences. *The implementation of a competences and partial qualifications certification system* is envisaged, allowing practicing one or more occupations and acquiring full qualifications, including the development of citizens' ability to involve in independent activities. At the same time, with a view to enhance the *domestic geographical mobility* the labour force deficit will be covered in such fields as required on the local and regional labour markets, through increasing the visibility of openings and facilities promoted by employers, providing incentives for the workers to change their jobs.

Regarding the external dimension of geographic mobility, adequate management of the economic migration will be required with a view to offsetting the labour force deficit in certain sectors. Special programs for the admission of foreign workforce will be drawn up, depending on the Romanian labour market demands. At the same time, incentives will be provided for attracting highly skilled foreign personnel required especially in R&D and management areas.

Fiscal incentives for employment

Alongside the tax cut and changes implemented in the labour legislation aimed at increasing the flexibility of the work relationships, in 2007 the Government undertook measures aimed at alleviating the administrative burden of the employers, related to the use of the labour force and the regulation of productive part-time activities.

Regarding the fiscal relaxation, the Government has continued in 2007 the process of reducing the social contribution quota payable by the employers; hence, in the case of social security the quotas decreased to 19.5%, while for the unemployment fund the contribution decreased to 2%. For 2008, the Government approved an additional three step cumulated decrease of the social contributions by 6 pp, with 4.5 pp for the employer and 1.5 pp for the employees.

On the medium term, the Government will continue with the process of updating the legislation aiming to encourage employment and providing social protection against unemployment, in order to obtain a better reflection of the changes occurred on the labour market.

2.4.2 Improving the Business Environment

For the implementation of the measures and activities necessary in the objective ”improvement and consolidation of the business environment”, an *Action Plan* was drawn up in order to develop and consolidate the Romanian business environment, the implementation of which led to a gradual reduction of the administrative barriers in the business environment, through the simplification of legal and administrative procedures necessary to start up and develop businesses, with a significant impact on the efficiency of the authorization and approval process.

World Bank -Doing Business 2008, alongside the progress in obtaining the credits, the payment of taxes and closure of business, lays down various aspects that need improvement, aiming at the procedures for starting a business, obtaining the licenses and protecting investors. Moreover, difficulties in finding available labour force are highlighted. However, ***the positive trend in the improvement of the business environment in Romania continues,*** *with our country having moved up from position 55 to 48, out of the 178 economies included in the analysis on the easiness of doing business.*

Building on the above assumptions and taking into consideration the signals coming from the business environment as well, the Government continues the implementation of reforms aimed at further improving the business environment and developing the liberal professions in Romania. The concrete measures and actions in this respect, as set for the next period, aim at: boosting the quality of regulations; further developing the administrative capacity required for a homogenous implementation of the legal provisions at a territorial level, modernizing procedures and laws regulating the intellectual property, improving the IT infrastructure of the public administration, reviewing the system of taxes and contributions representing own revenues and analyze the opportunity and efficiency thereof from an economic perspective, extending the one stop administrative offices for making various formalities and continuing the effort to internalize the document flow within the administration, improving the dialogue with the business environment and the civil society, etc.

The quality of regulations shall be improved through: a better justification for the necessity to adopt such regulations; an improved public consultation framework, previously to adopting the regulations; increasing the administrative capacity for analyzing the impact of regulations affecting the business and liberal professions development, creating a coherent institutional framework across agencies and authorities with regulating and control competencies, etc.

2.4.3 Regional development

Through the National Development Plan (NDP) and the National Strategic Reference Framework (NSRF) drawn up for the programming period 2007 - 2013, Romania intends to promote a regional policy in which the general objective is a balanced regional development of the country and the reduction of social and economic disparities between Romania and EU Member States, by improving the competitiveness of the regions and attaining an additional GDP growth of 15% by 2015 as a result of the absorption of the EU grants.

Table 2.1 Regional disparity indicators*)

	2003	2004	2007	2010
N-E Region	0. 723	0.693	0.673	0.679
S-E Region	0.857	0.908	0.867	0.872
South Muntenia Region	0.812	0.836	0.813	0.820
S-W Region	0. 847	0.835	0.830	0.832
W Region	1. 129	1.147	1.155	1.141
N-W Region	0.966	0.973	0.951	0.951
Centre Region	1.072	1.043	1.060	1.054
Bucharest-Ilfov Region	1.940	1. 906	2.027	2.007

Source: 2003 and 2004 NIS; 2007 and 2010, NCP forecasts

*) Calculated as ratio between the GDP per capita at region level and the national average

In order to consolidate the territorial cohesion component, the *Romania's Territorial Development Strategic Concept 2007–2030 (RTDSC)* was elaborated in 2007, which lays down, from an integrated territorial perspective, the ways to capitalize on the national potential, in order to recover the development gaps and encourage a balanced development in Romania. At the same time, the *8 Regional Territorial Planning Plans* are being developed, correlated with the measures aiming at economic, social and territorial cohesion, as well as the projects addressing various financing sources; at the same time the modification of the legislation on local and territorial planning is under preparation, both for territory planning and for authorizing the execution of construction works.

The priorities laid down in the *Regional Operational Program (ROP) 2007 – 2013* - supporting sustainable urban development – potential growth poles, improvement of the local and regional transport infrastructure, improvement of the social infrastructure, the consolidation of the local and regional business environment, the durable development and promoting tourism – are expected to contribute to reaching the ROP strategic objective. Supporting the economic, social and durable development of Romania's Regions, by focusing on the urban growth poles, improving the infrastructure and the business environment conditions, through reducing the disparities between Romania's regions, are only a few of the objectives laid down in the Regional Operational Programme.

2.4.4 Public administration reform

With the view to improve the public administration capacity to set and implement public policies, Romanian Government undertook actions regarding their management, increasing the quality of public services, as well as modernizing the public function and the management of the structural and cohesion funds. In this respect, *the Self-assessment Framework* was created in order to assess the functioning of the public administration at the level of the central and local authorities', with the view to help the assimilation of the management techniques and improvement of the performances. In addition, the training of central public administration specialists has begun during 2007, in the field of preliminary impact analysis and assessment techniques and the first draft of Strategy for a better regulation at central public administration level was made (2008-2012), which will be the subject for the inter-ministerial consultation process.

In order to ensure the quality of the communal public services regarding utilities the *Law on service of local public transportation, Law on establishing, organizing and functioning the landlords associations, Law on transport in taxi and renting regime* were adopted and *Law on administration service regarding the public and private patrimony of the administrative territorial units* is in the parliamentarian adoption procedure.

In the field of public policies management, Romanian Government started the implementation of an improved system of taking decisions, aiming at increasing the responsibility of public institutions against the results of the promoted public policies.

The main achievements estimated as a result of implementing this new system are as follows: training for 150 public administration specialists in the field of impact analysis and assessment techniques; the use in a proportion of 70 percent of performance indicators within the monitoring and assessment of the public policies by the end of 2008, followed by a 100% use of these indicators by 2010.

More modernization measures of the public function will be gradually applied by 2010 envisaging the public servants career, development of motivation policies and instruments and accomplishment of training requests. In this respect, training programs for public servants (including the Operational Sectoral Program the "Development of Administrative Capacity") will be organized while their remuneration law will be changed.

Regarding the simplification of the administrative procedures, an important factor of change consists in the implementation of one stop offices, which is a intermediating system of the relation between the solicitors of identity cards, elector cards, simple passports, driving licenses, vehicles certificates of registry and matriculation boards, on one hand and public authorities with competence in the issuance of above mentioned, on the other hand and has the role of facilitating the people access to corresponding public services by a single competent authority in receiving the applications and issuing the respective documents.

The process of cutting down the administrative burden will comprise two stages:

(a) cutting down the administrative duties as a result of the improvement of internal administrative procedures in three priority fields: finance, labour and health. This stage will comprise administrative measures of improving the management, possibly adopted by minister order or government decision at the most, without legislative changes;

(b) cutting down the administrative duties as a result of an analysis on the entire legislation, aiming at quantifying the administrative duties, removing the legislative overlapping, old provisions and redundant ones.

Public administration reform and carefully dimensioning of human resources in line with the real needs of providing qualitative services is crucial as regards promoting and sustaining an efficient labour market and avoiding the obstruction of resources potentially available on labour market in detriment of developing the private sector. Government is committed to support and accelerate the reform process of public administration aiming at improving the quality of public services, increasing the receptivity at citizen needs and improving the mechanism of making institutions responsible.

3. MACROECONOMIC SCENARIO

3.1 Assumptions on the International Economic Environment

As an open economy firmly integrated in the economy of the European Union, Romania is sensitive to changes in the external environment, especially to economic developments within the largest countries of the EU, which are our trade partners. In this respect, for the external environment, the macroeconomic scenario principally takes into consideration the European Commission’s forecasts.

According to usual practices, the European Commission drafted the Autumn Forecast, slightly revising the evolution of the main macroeconomic indicators for 2007, 2008 and 2009. Therefore, for the world growth rate in 2007 there are differences compared to the Spring Forecast, respectively a reduction by 0.3 percentage points, whereas for EU27 the GDP growth rates remained at the same level. It can be noticed that the revision of economic growth figures was not major, as the economic growth is still projected at high levels. For 2008, as compared to the Spring Forecast, the world GDP and EU27 growth rates went down by 0.1 and 0.3 percentage points, whereas the EU27 consumption and investment growth rates went down by 0.2, respectively 0.7 percentage points.

However, as a result of maintaining the GDP growth rate at an annual average of around 5%, in the interval 2008-2009 the world trade volume will remain high, up by approximately 7-7.5%. China and South Korea are currently the most dynamic countries in terms or exports, whereas a few years ago USA and EU countries were in top.

Table 3.1 Assumption on foreign environment

	2006	**2007**	**2008**	**2009**
GDP – World economy	5.4	5.1	4.7	4.8
GDP EU27, of which:	3.0	2.9	2.4	2.4
Consumption	2.2	2.3	2.4	2.2
Investment	5.9	5.6	3.5	3.4
GDP Euro zone	2.8	2.6	2.2	2.1
GDP Germany	2.9	2.5	2.1	2.2
GDP Italy	1.9	1.9	1.4	1.6
GDP France	2.0	1.9	2.0	1.8
GDP USA	2.9	2.1	1.7	2.6
GDP Japan	2.2	1.9	1.9	2.3
USD/€ Exchange rate	1.26	1.36	1.42	1.42
World imports of goods & services, excluding EU	8.0	7.8	7.1	7.7
EU export market growth	9.5	7.3	6.8	6.6
Oil price (Brent,USD/ barrel)	66.2	70.6	78.8	76.0
HICP, EU27	2.3	2.3	2.4	2.2

Source: DG ECFIN European Commission Autumn forecast

The estimates in the macroeconomic scenario are based on a slower growth rate of the global economy, expected to go down from 5.1% estimated for 2007, to 4.7% in 2008, followed by acceleration by 4.8% in 2009. Whereas USA is expected to see an economic growth rate on a descending trend, going from 2.1% in 2007 to 1.7% in 2008, with a revigoration in 2009 up to 2.6%, Japan will not be affected in 2008 and will keep the same growth rate as in 2007, followed by an increased rate up to 2.3% by 2009.

According to the European Commission forecast, the EU economic growth rate is expected to reach 2.9% in 2007, but will go down to 2.4% in 2008 and subsequently keep the same pace in 2009, despite the recession on the US real estate market.
For the Euro zone, the GDP growth rate is expected to go down from 2.8% in 2006 to 2.6% in 2007, 2.2% in 2008 and 2.1% in 2009 (in Italy it will go from 1.9% in 2007 down to 1.6% in 2009; in Germany from 2.5% to 2.2%; and in France from 1.9% to 1.8%).

The fact that the European economy is still led by domestic demand will be an important support for a robust development of the Romanian economy. The yearly growth in investment remains at a relatively high level and the descending trend of the overall EU investment growth rate, foreseen to go down from 5.6% in 2007 to 3.4% in 2009, is not expected to negatively affect the Romanian export. This is due to the fact that the share in the Romanian exports of the investment goods is still small, but also to the fact that the foreign market growth rate in 2008-2009 will record an ascending trend, going up to 7.0-7.5%.

In 2008 as against 2007 the price of Brent crude oil is expected to go up by 11.6%, reaching up to 78.8$/barrel, with a slight reduction to 76$/barrel expected in 2009.

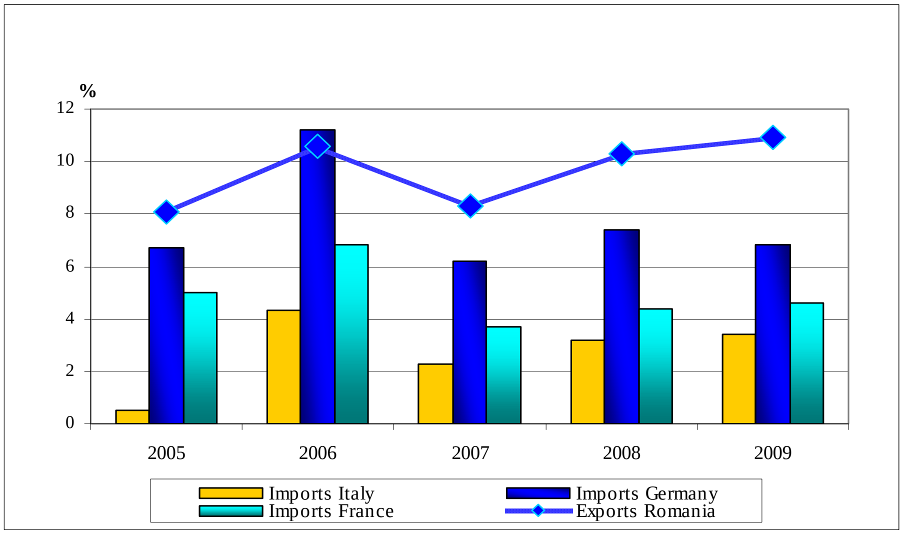
The prospects of economic growth for the main partner countries are very important, as for instance the share in the Romanian exports for **Italy**, our first foreign partner, increased from 17.9% at the end of 2006, to 18.1% in the first seven months of 2007. The expected evolution of the Italy's imports is also favourable to the Romanian foreign trade, as it will rise by 3.2% in 2008 and by 3.4% 2009.

In **Germany,** the economic growth rate is expected to slow down by 0.4 percentage points as compared to 2006, following the negative impact of VAT increase. With a 17% share in the Romanian export in the first seven months of 2007 compared to 15.7% in 2006, Germany ranked second in the top of Romania's main country partners. The increase in imports of goods & services is expected to be more significant than that in Italy, namely by 7.4% and 6.8% in 2008 and 2009, respectively.

France – Romania's third trade partner, with a share of 7.6% in total exports – is expected to post an increase in imports from 3.7% in 2007, to 4.4% in 2008 and 4.8% in 2009.

The evolution of the exports of Romanian goods and services, in terms of volumes, follows the trend of the import of goods and services in the main foreign partners, namely Italy, Germany and France, as shown in the next figure.
Thus, 2007 was the year with a decrease in the volume of the goods and services import and representing a decrease of the external demand for Romania leading to a decline in our exports volume index.

Figure 3.1 Volume indexes of the foreign trade



Source: Autumn forecast by DG ECFIN and by National Commission for Prognosis

We may conclude that for 2007-2009, we expect a positive development in the imports of Romanian´s main trade partners, thus sustaining the upward trend of the Romanian exports.

However, there are also noteworthy uncertainties regarding the impact of the international environment on Romanian economy, such as: a) the evolution of the crude oil price which is difficult to forecast under the current international background given its sensitivity to the political tensions and production crises; b) the deepening against the baseline of the negative consequences following the mortgage loan crisis in the US and the impact thereof on the global economy; c) the evolution above expectations of the emerging Asian economies such as China and India.

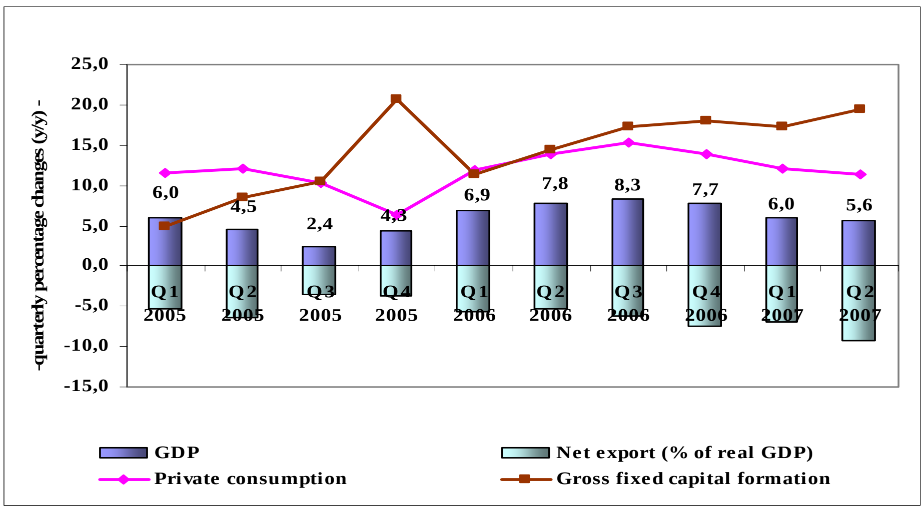
3.2 Recent macroeconomic developments

As regards the Romanian economy, after the robust economic growth by 7.7% in 2006, in the first half of 2007 the growth rate went down, to only 5.8%, as compared to the first half of 2006.

The positive evolution registered in 2006 – mainly in the second half of the year - for the new construction works and some industrial branches with a significant development potential, some of them fostered by the construction activities, continued in the first part of 2007.

An important feature of the economic growth in the first half of the year is the significant increase of the gross fixed capital formation contribution as compared to 2006, partially offset by the increased negative contribution of the net export. From a qualitative perspective, we may notice that the sustainability of the economic growth improved, on the background of continuing recovery in the growth factors as well. The dynamics of the gross fixed capital formation outpaced the final consumption dynamics, the latter slightly declining as compared to H1 2006. At the same time, the negative contribution of the net export went up to 8.2 %, as compared to only 5.5 percent in H1 2006.

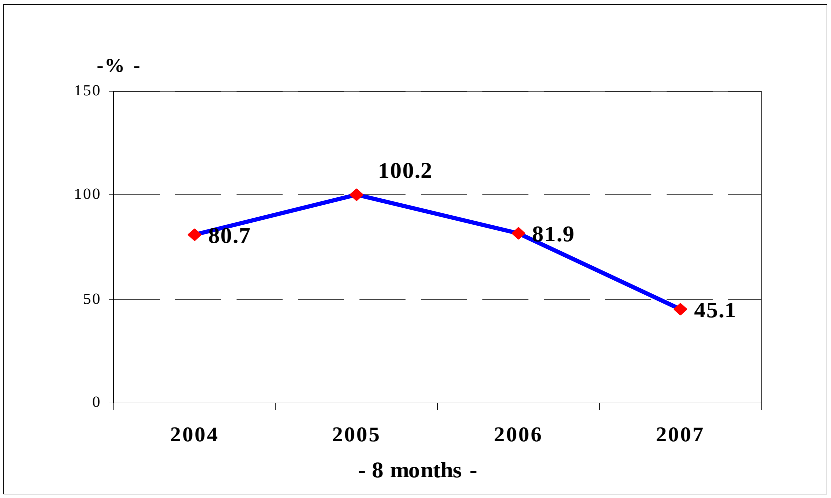
Figure 3.2 GDP and its main components developments



Source: National Institute of Statistics

Continuing the trend registered in H2 2006, in the first two quarters of 2007 the gross domestic product went up due to an increase in the domestic demand, mainly driven by the higher dynamics of the gross fixed capital formation. Hence, the gross fixed capital formation increased by 17.2% in Q1 and by 19.4% in Q2. In the first 8 months of 2007, the current account deficit enlarged by 86.4% as compared to the previous year, due to the widening in foreign trade deficit by 69% and the income deficit by 46.7%.

Figure 3.3 Current account deficit coverage from autonomous sources

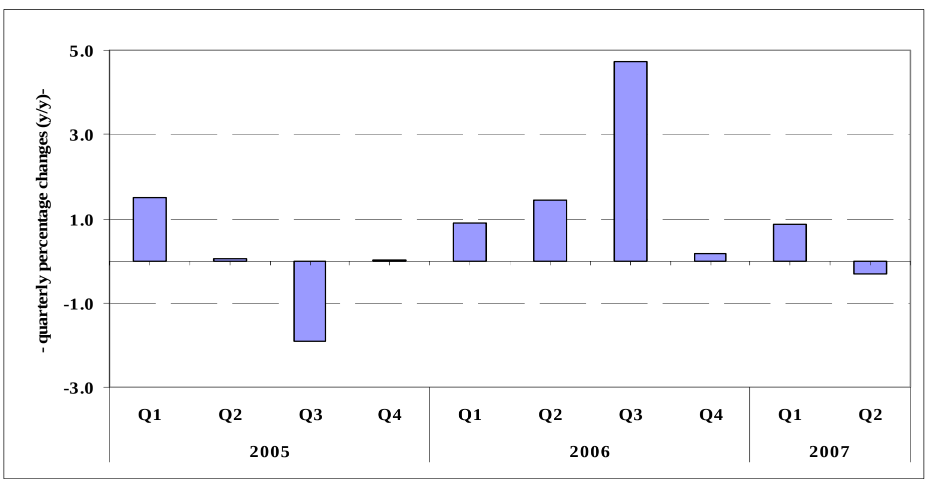


Source: NCP calculations based on data provided by NBR

A share of 39.7% of the current account deficit was covered through foreign direct investments, which accumulated to EUR 4.1 billion in January-August 2007, as against EUR 4.6 billion in the same interval of 2006.

The positive effects of the economic growth, especially as a result of the stronger increase of the investments, manifested in the improvement of the employment structure by activity sectors as well, but also in the increase of the employment by 1.8%* in 2006 as compared to 2005. The most significant increase was seen in the construction and services sectors. The share of agriculture employment in total employment went down to 30.5%, from 32.2% in 2005.

Figure 3.4 Employment



Source: National Institute of Statistics

* The labor force employment data is in accordance with the AMIGO methodology

The employment rate for the population at working age (15-64 years) went up in 2006 to 58.8%, which is higher by 1.1 percentage points as compared to the 2005 rate. In the first half of 2007 the employment rate at working age was 58.4%. The ILO unemployment rate declined to 6.5% in the second quarter of 2007, following the decrease in the first quarter of 2007 as compared to the fourth quarter of 2006 (7% as compared to 7.2%).

Romania's performance in **achieving disinflation**, although weaker than in other Central and Eastern European countries, acted continuously starting with 2000. A special role was played by the implementation of the direct inflation targeting strategy since 2005, which allowed anchoring the inflationary expectations to low levels.

In the first period of 2007 the annualized inflation rate followed the descending trend, reaching 3.8% in June. However, the past four months registered a change in the evolution trend, more obvious in September and October, as the inflation rate increased to 6.03%, and 6.84%, respectively, exceeding the accepted deviation band (3-5%).

Table 3.2 Inflation rate

	2005	**2006**	**2007*)**
Annual average	9.0	6.6	4.47
At the end of period/ Dec of previous year	8.6	4.87	4.91

*) 10 months

Source: National Institute of Statistics

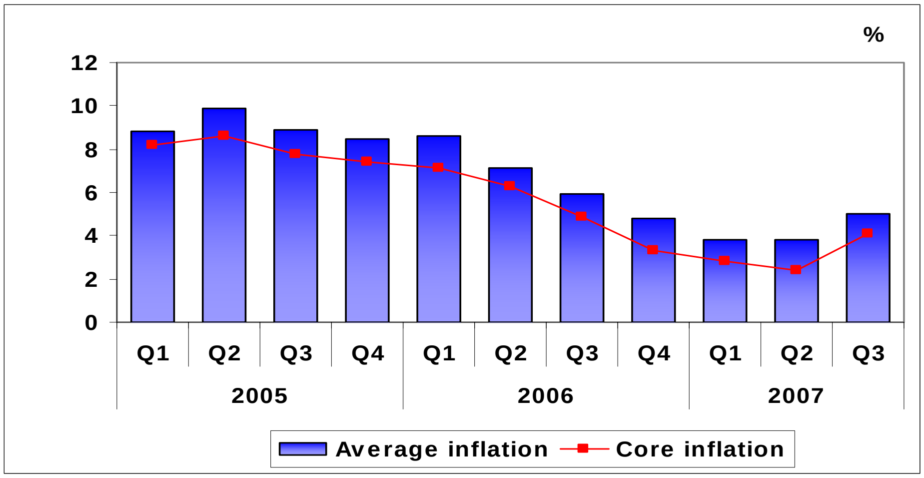
As against December 2006, the consumer prices went up by 4.91% within the first ten months of 2007, a level that is higher than the one attained in the similar period of the previous year (2.98%), with the average monthly rate at 0.5%.

This circumstantial evolution was caused by an increase in the food products' prices, which reached 6.90% in October, higher by 8.25 percentage points as compared to the similar period of the previous year; this group of products became the determinant contribution to the inflation rate increase. This is due to the large share of these products in the consumer basket (38.92%), the weather circumstances having affected the domestic production of both fruits & vegetables and grains, but also to a base effect entailed by the evolution of these products' prices in the previous year, namely a deflation process.

The 2.57% increase in the non-food product prices was lower by 3.52 percentage points as compared to the similar interval of the previous year, due to reduced adjustments of the administered prices. The prices of the non-food products decreased by the end of March, but as of April they switched to an ascending path, mainly on the background of the 4.16% increase in the electricity tariff occurred in April, and also of the 4.24% increase in the tobacco and cigarettes' prices occurred in July, in line with the higher excises schedule.

The service tariffs went up by 6.54% as against December, which is 1.23 percentage points higher than the tariffs in the similar period of the previous year.

Figure 3.5 Quarterly average inflation developments



Source: NCP calculations based on the NIS data

The slower upward trend of the administered prices (4.05%) in the interval January – October 2007, which is lower as compared to the total inflation, was primarily entailed by the nominal appreciation trend of the domestic currency in the first seven months, which was reflected especially by the products linked to the European currency, but also by the slower adjustments to the energy product category.

The evolution of the consumer prices in 2007 will reflect a stable year-end annual inflation. The consolidation of the disinflation process will be more visible in terms of annual average, which is in fact one of the important nominal convergence criteria, being expected to reach 4.8%. At the same time, the volatile prices, but also the prices of bakery products, will follow a trend distorted by the drought consequences expected to manifest especially toward the end of the year with a negative impact on the food prices.

Beside the negative base effect of the very high performance in the agriculture sector in 2006, the negative shock of the agricultural production supply caused by the long drought season in 2007 overlapped on both the significant increase in the agricultural products' prices on the international markets and the correction in nominal terms of the national currency in relation to the Euro, which occurred in August – November, which did not allow for the food imports to work against the inflation. Taking into account the share still high of the non-foods and non-alcoholic drinks in the consumer basket in Romania (over 36%, as against EU27 and Euro-zone average of about 15%), the inflation increase beyond the upper limit of the targeted interval (4% ± 1 percentage point) becomes explainable.

Hence, the "vegetables, fruits and eggs" category by itself is expected to add 1.8 percentage points to the year-end inflation, whereas the "no-excise duties core 2" (where the bread, edible oil, sugar and other foods have the major share but for which the demand is relatively inflexible) will contribute by approximately 2.7 percentage points.

Under these circumstances, the slowdown in the excise duties' increase (tobacco and alcohol) which will contribute by only 0.4 percent to the year-end inflation, and also in the administered prices (with a 0.6 percentage points contribution), was not enough to offset the significant depreciation of the food products inflation.
We also expect that the exchange rate depreciation trend observed in the last months will slow, to the extent it will not exert a negative influence on the import and administered prices.

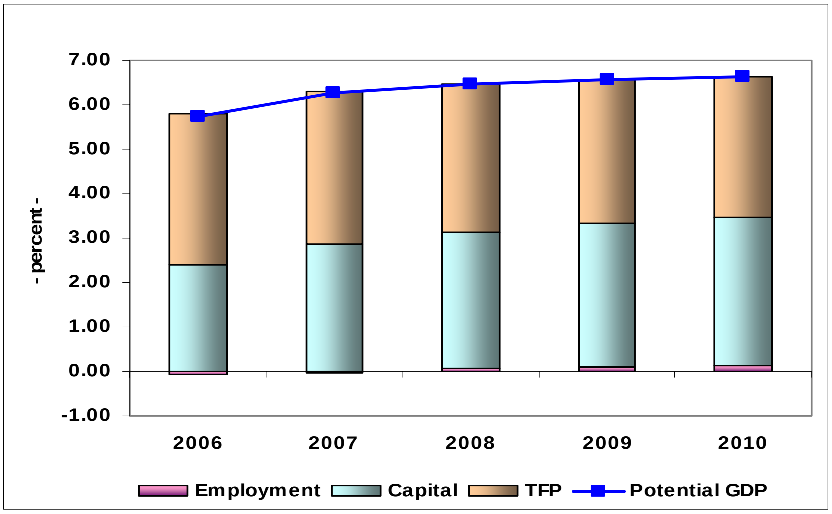
3.3 Medium Term Development Scenario and Cyclical Developments

3.3.1 Cyclical developments

According to the estimates based on the Cobb-Douglas production function, the average increase rate of the potential gross domestic product calculated for the interval 2008-2010 is 6.56%. Due to significant growth rates for investment, during this interval the capital stock is expected to go up entailing a higher capital contribution to the increase of the potential gross domestic product, which is expected to be of 3.2% annually, in average.

The potential employment at working age (15 - 64 years) is expected to record a moderate growth, in average by 0.1% annually. What is important is the expectation for the potential employment to have a positive contribution to the growth of the potential gross domestic product in the next period.
The total factor productivity (TFP) will continue to have a significant contribution, due to qualitative gains from a technological point of view, associated to the direct foreign investment inflows and due to business environment improvement.

Figure 3.6 Factor contributions towards potential GDP growth

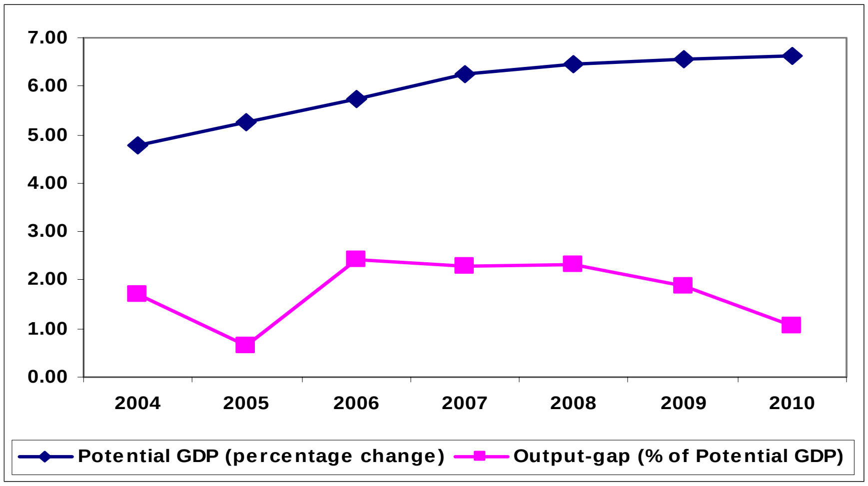


Source: Ministry of Economy and Finance, National Commission for Prognosis, DOFIN

The output gap stays positive in the next period, but is expected to decline after 2009, according to the proposed macroeconomic policy mix. The output gap will go down in

2009 by 0.4 percentage points as compared to 2007, to reach 1.1% of the potential gross domestic product in 2010.

Figure 3.7 Output gap development



Source: Ministry of Economy and Finance, National Commission for Prognosis, DOFIN

The economic growth forecasted for the interval 2008-2010 is inferior to the one forecasted for the potential gross domestic product, taking into account the envisaged overall mix of macroeconomic policies and various risks that may occur both internally and externally. Its trend represents the background of expectations regarding the acceleration of the real convergence process towards the average level of the EU.

3.3.2 The medium term development scenario

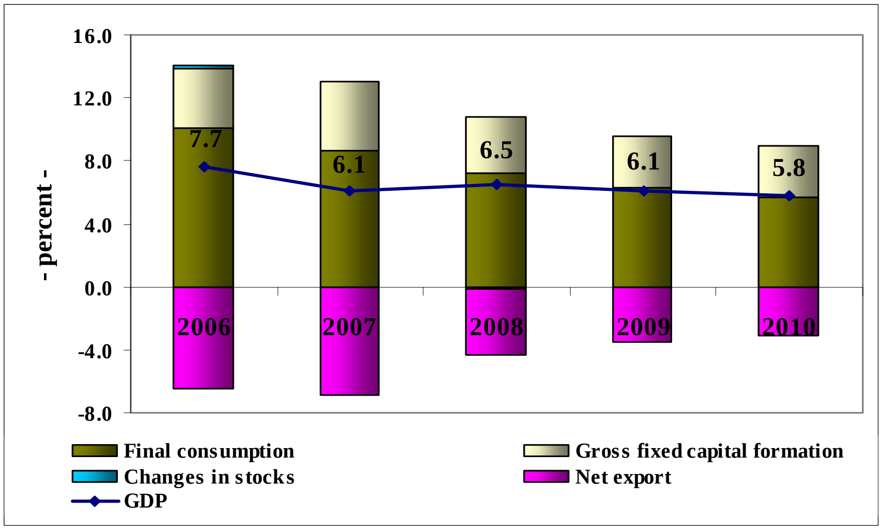
According to the development scenario projection, the GDP real growth will be, in average, of 6.1% annually, with a gradual reduction of the negative contribution to the gross domestic product of the net exports.

Table 3.3 Economic growth

	2006	2007	2008	2009	2010
Annual percentage changes					
Real GDP	7.7	6.1	6.5	6.1	5.8
Nominal GDP	18.9	14.1	13.1	11.5	10.5
Real GDP components					
Private consumption	13.9	10.9	9.2	8.2	7.3
Government consumption	2.5	5.4	4.3	2.8	2.6
Gross fixed capital formation	16.1	18.0	13.0	11.5	11.0
Exports of goods & services	10.6	8.3	10.3	10.9	10.7
Imports of goods & services	23.0	21.5	16.1	14.9	13.9
Contribution to GDP growth (per cent)					
Final domestic demand	13.8	12.9	10.8	9.6	8.9
Change in stocks	0.3	0.0	-0.1	0.0	0.0
Net exports	-6.4	-6.8	-4.2	-3.5	-3.1

Source: National Commission for Prognosis

Figure 3.8 Contribution to real GDP growth



Source: National Commission for Prognosis

Following a robust increase of the **private consumption** in 2007 by 10.9%, due to an increase of the population revenue, the year 2008 is expected to bring a gradual decline of this increase, as a result of the implementation of a number of measures aimed at limiting the credits expansion, through promoting real increased interest rates and maintaining a prudential wage policy in the public sector. The small increase of the nominal unit cost of labour as against the gross domestic product deflator will encourage the output increase against the background of increased enterprise profitability.

Continuing the acceleration seen in 2007, the **gross fixed capital formation** will record important growth rates in the following period as well, based on the announced public investments and the significant private investment inflows, both domestic and foreign, as a result of improved perception regarding the business environment.

The gross capital formation share in GDP will go up by about 2 pp in the interval 2008-2010, with a significant growth of the public sector (2.2 pp). The private sector will maintain this share for the next years of 19.2%. Weak savings in the private sector requires the need of foreign financing of over 10% of GDP. What is important is that part of this need is expected to be covered from foreign direct investments accounting for 5.1% of GDP, in average annually.

Table 3.4 Saving - Investment Balance

% of GDP	2006	2007	2008	2009	2010
Domestic saving	12.1	11.6	11.9	12.5	13.2
National saving	13.9	12.9	13.7	14.4	15.2
- private sector	10.9	8.8	8.4	8.7	8.4
- public sector	3.0	4.1	5.3	5.7	6.8
Gross capital formation	24.2	26.3	27.4	27.8	28.2
- private sector	19.3	19.3	19.2	19.2	19.2
- public sector	4.9	7.0	8.2	8.6	9.2
Savings-Investments balance	-10.3	-13.4	-13.6	-13.4	-13.0
- private sector	-8.4	-10.5	-10.7	-10.6	-10.6
- public sector	-1.9	-2.9	-2.9	-2.8	-2.4

Source: National Commission for Prognosis

The domestic savings will cover less than 50% of the investment that are forecast (gross capital formation), namely 44% in 2007 and 46% in 2010. At the same time, the level of financing through foreign capital transfers will increase by capital transfers from EU, leading to a decrease of the financing requirement by 1.8-2% of GDP.

From the point of view of the catching-up process, Romania still lags far behind most European countries. The gross domestic product per capita, expressed in euro at purchasing power standard (PPS), was 37% of the EU27 average in 2006. The gross domestic product per capita in PPS is expected to reach 42% of the EU27 average in 2010.

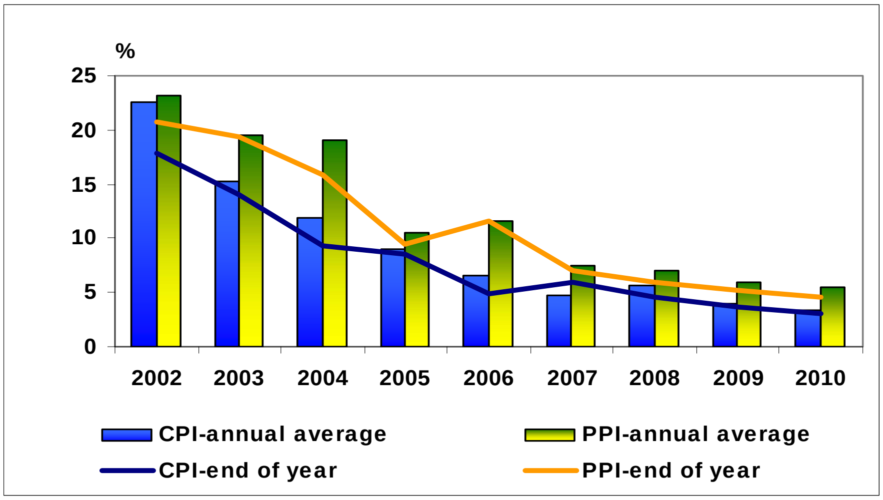
The **2008 inflation rate** will go down to around 4.5% at end-2007. In the disinflation process, the administered prices will have a significant influence, as they are expected to stay on the upward trend seen in 2007, which is inferior to the market established prices. Moreover, the inflation estimates for 2008 were based on the assumption of a normal year in agriculture, which means it would not be affected by severe shocks, although in the first part of the year the forecast took into account an increase of the agricultural food products triggered by the consequences of the previous year's lengthy drought.

In estimating the future evolution of inflation the possible increases of energy prices due to reduction of CO_2 emissions quota for Romania was taken into account.

At the same time, the estimates were based on the assumption that the international price of oil will keep on a relatively constant track during the forecast interval, which will lead to the assumption that the domestic prices for fuels will remain steady for this entire period of time. A possible increase of the international price of oil could be offset by the domestic oil production prices, and by a favourable evolution of the leu/euro and leu/dollar exchange rates as well.

The exchange rate is expected to continue its moderate appreciation trend, but nevertheless adding up to the decline of both import prices and the administered prices linked to the European currency.

Figure 3.9 Consumption and industrial product prices development



Source: National Commission for Prognosis

In the interval 2009-2010, **the disinflation process** is estimated to continue as a result of maintaining a firm monetary policy stance characterized by positive real rates of interest. Additionally, the gradual reduction of adjustments in administered prices, a prudent wage policy and the continuation of structural reforms will keep the disinflation process on a sustainable path. Hence, the inflation rate as annual average is to gradually go down to 3% in 2010.

Moreover, the continuation of the disinflation process will contribute to the further decline of inflationary anticipations. Another efficient way to anchor the inflationary anticipations will be to maintain the appreciation trend of the domestic currency against the European currency, in real terms. This will be possible if taking into account a more accelerated growth of the labour productivity in Romania as compared to its main foreign partners. The gross domestic product deflator will severely drop, but still it will stay above the consumer price index.

Table 3.5 Deflators evolution

Percentage changes	**2006**	**2007**	**2008**	**2009**	**2010**
GDP deflator	10.4	7.5	6.4	5.2	4.4
Consumer price index – average	6.6	4.8	5.7	4.0	3.3
Private consumption deflator	5.1	4.0	4.1	3.3	2.8
Public consumption deflator	14.8	6.8	5.0	4.2	3.5
Investment (GFCF) deflator	9.1	7.0	5.5	4.5	4.0

Source: National Commission for Prognosis

The benefits of the economic growth registered in the last years are considered at the real economy's level, in an improvement of **employment** expected in the next period, by increasing the active working age population (15-64 years) by 422 thousand persons and the working age employment by 460 thousand persons.

Both activity and employment rates will slightly recover after 2006. Between 2007 and 2010 we expect a growth of the activity rate by 3.9 percentage points, mainly due to higher foreign investments, a rise in competitiveness and last, but not least, to a rise in wages. The working age population's employment rate will increase by 3.3 percentage points due to fiscal policies, long-lasting and performing job creation and to the balance between job flexibility and security.

Continuing the trend seen over the recent years, the unemployment rate will still be on a descending trend, reaching a value of 6.6% in 2010. This decline will be possible by a more effective implementation of the active employment policies.

Table 3.6 Labour force evolution *

	2006	**2007**	**2008**	**2009**	**2010**
	- percentage changes -				
Total population	0.0	-0.1	-0.1	-0.1	-0.1
Active population	2.1	1.5	1.3	1.0	0.5
Employment	2.0	1.7	1.5	1.2	0.7
ILO unemployment	3.4	-1.2	-0.7	-1.4	-2.1
	- % -				
Participation rate	63.7	64.7	65.6	66.3	66.6
Employment rate	58.8	59.9	60.8	61.6	62.1
ILO unemployment rate	7.3	7.1	6.9	6.8	6.6

Source: National Commission for Prognosis

The **foreign deficit** will be high for the next interval as well, mainly due to the large investment process, required for the modernization of the productive apparatus and for the infrastructure development, which will attract increasing imports.

As a result of the previous period's investments and based on the assumption that the foreign environment will develop favourably, the Romanian exports are expected to significantly grow and contribute to the reduction of the commercial deficit share (FOB-FOB) in GDP from 15.7% in 2008 to 15.4% in 2010.

Along with the larger exports value, the improvement of the export structure is expected to continue, with the share of value added goods increasing further. This trend was seen for the first time in 2006, when the exports of the car industry exceeded the exports of the light industry.

* Working age population (15-64 years)

Still, the trade balance deficit is expected to remain the main contributor to the current account deficit. Moreover, the revenue balance deficit will go up as a natural result of the profit growth entailed by the direct investment increase; the flow of profits repatriated and reinvested by the foreign investors will go particularly up.

In the interval 2008-2010, the current transfer balance will see a constant nominal increase, thus contributing to the alleviation of the negative impact of the commercial balance deficit on the current account deficit.

Table 3.7 Foreign financing needs

% of GDP	**2006**	**2007**	**2008**	**2009**	**2010**
Current account deficit	10.3	13.4	13.6	13.4	13.0
Capital account balance	-0.04	0.7	3.1	3.3	2.8
Foreign financing need	10.3	12.7	10.5	10.1	10.2
Financing by loans	1.0	6.3	5.0	5.2	5.4
Financing by foreign investments	9.4	6.4	5.5	4.9	4.9
Of which Net FDI	9.3	6.0	4.7	3.8	3.8

Source: National Commission for Prognosis

The annual financing need, as percentage in GDP, will see a pick in 2007 of 12.7%, but it will go gradually declining afterwards, to reach 10.2% in 2010.

The foreign deficit financing will be covered to a significant extent from autonomous sources which do not generate foreign debt, but it will be on a downtrend due to the completion of the privatization process in economy, expected to go down to 61% at end-2010.

In the interval 2008-2010, alongside with the foreign investment level going steady, a downtrend is forecasted for the current account deficit coverage through direct investments, from 34.8% in 2008 to 26.7% in 2010. At the same time, a major increase of the capital transfer contribution is expected, mainly due to the assimilation of the EU funds to the coverage of the current account deficit (from 5.1% as estimated in 2007, to 21.3% in 2010).

3.3.3 Risks of forecast

In conclusion, the economic growth perspective for the next three years as laid down in the current scenario has a high predictability degree, being in accordance with the Romanian economy potential and in correlation with the available financing resources. Consequently, the aggregated demand will stay at a high level.

The risks are expected to be higher in the next two years and particularly in 2008. The European Commission autumn forecast shows that the uncertainty related to the economic environment are higher and originate mainly in the turbulence on the financial markets and the high volatility of the international prices (of the energy resources but also the food products).

At the same time, favourable economic factors still exist, such as: healthy balance sheets, high profitability in the industrial and services sectors, which will allow business to compensate the possibly more rigid credit requirements and the losses in competitiveness caused by the appreciation of the European currency.

As a consequence, although in 2008 the European Union growth pace is expected to slow down, the impact of financial markets' uncertainty and turbulence on the investment and employment will not be major.

Under these circumstances, it is important to say that the current basic macroeconomic scenario is in accordance with the foreign economic environment forecasted by the European Commission. However, it is necessary to mention that the projections may be affected by various **internal risks** associated in principal to the factors that could impact on the domestic supply's response to the demand, namely:

(a) a decrease in the competitiveness of certain activities, leading to a market loss for some products - both on the domestic and export markets;
(b) delayed restructuring or investments due to the requirements to observe quality standards (for example in the food industry), affecting some capacities;
(c) uncertainty related to the climate changes with impact on the agriculture output;
(d) a more rapid outsourcing of the lohn activities especially in the light industry, postponing the overall branch's revival.

If these risks will be accompanied by an economic evolution under EC estimates in the main EU countries that are Romania's partners (Germany, Italy, France), or by an unexpected evolution, in the negative sense, of the international prices, the economic growth process could be affected, in the first place by increased domestic and foreign deficits.

It is estimated that such factors can generate negative influences and may lead to the slowdown of the economic growth, on the average, by approximately 1 percentage point per year, due to the lower exports dynamics and an increased current account deficit for which the share in GDP could go up, on the average, by approximately 1.5 percentage points annually.

The shrinking activity will lead to a reduced economic competitiveness and an unemployment rate higher compared to the base scenario.

4. COMPARISON WITH THE PREVIOUS VERSION OF THE CONVERGENCE PROGRAMME

4.1 Comparison of the macroeconomic framework

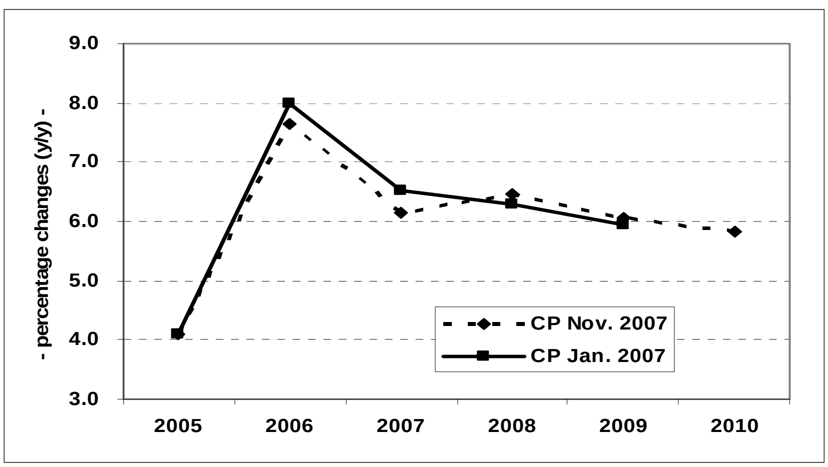
The macroeconomic development scenario on medium term laid down in the current programme is not substantially different from the one presented in the latest edition of the Convergence Programme.

The differences between the two programmes are mainly related to the following elements taken into account:

(a) the evolution of the economic context during 2007;
(b) the up-grading of the statistical data for 2006;
(c) the increasing estimation of the economic potential.

Thus, the real GDP growth achieved in 2006 was basically lower than estimated one in the previous version by 0.3 pp. The economic evolution in 2007 was characterised by two phenomena with a significant impact: an unprecedented increase in construction and a decline in agricultural output as result of the drought. The projections regarding the economic potential growth were upwardly revised by 0.5 pp, in average, based on an increase in the contribution of the stock of capital.

Figure 4.1 GDP growth

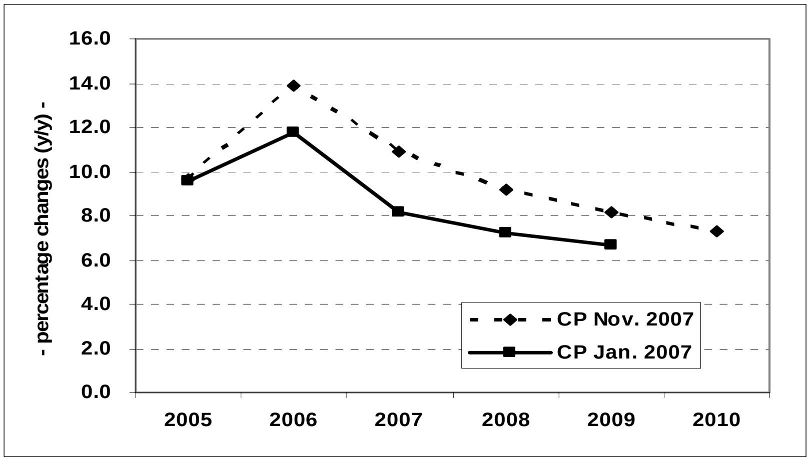


Source: National Commission for Prognosis
CP Nov 2007=Convergence Programme, November 2007 Edition
CP Jan 2007= Convergence Programme, January 2007 Edition

However, there are differences as against the latest Convergence Programme edition's projections, with regard to the composition of the domestic demand and the domestic supply's response to such demand. The difference comes, on one hand, from the trends showed by the recent progress and statistical updates, and – on the other hand – by the economic and budgetary policy changes.

Hence, the developments in 2007 show that the domestic need of goods, especially capital and intermediary goods (energy goods, but also raw material), relating to important foreign investments started in the last months of 2006, was reflected by the significant increase of the foreign deficits. Moreover, the domestic demand – both for consumption and investment – in fact, exceeded the forecast, according to the updated statistical data provided by the National Institute of Statistics. These developments led to an increase of the private consumption in the autumn forecast by the National Commission for Prognosis.

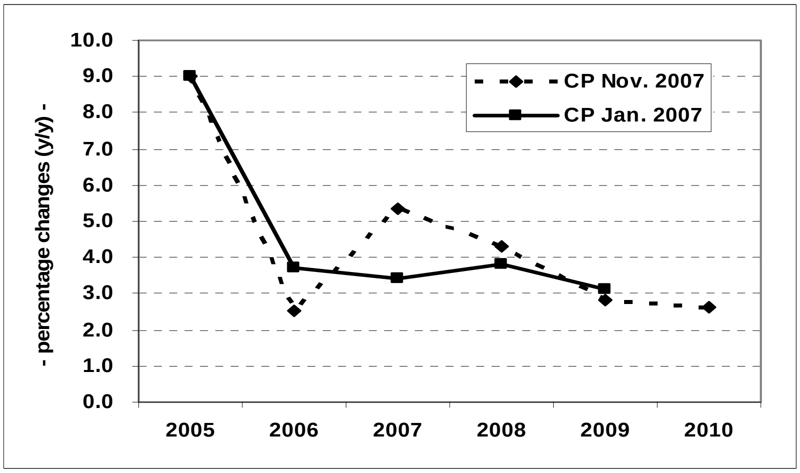
Figure 4.2 Private consumption expenditure



Source: National Commission for Prognosis

In the case of public consumption, the policy changes, materialized in a new structure of the budget expenditures, are based on the assumption of a substantial increase of the budget revenues, but also of the expenditures, with additional allocations for the public investment. The budget expenditures generated by the public consumption saw an important increase in 2007, following the supplementary financing of education and health systems. For the next period, the projection does not include major differences as compared to the previous version of the Convergence Programme.

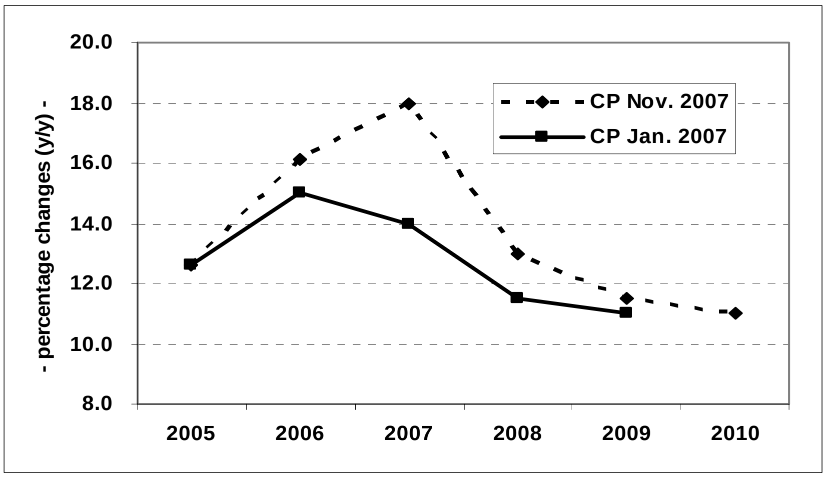
Figure 4.3 Public consumption expenditure



Source: National Commission for Prognosis

The dynamics of the gross fixed capital formation forecasted for 2007 was increased as a result of the recent developments, when the achieved investment registered acceleration by 17.8% in the first semester. For the next years, an evolution higher than the one in the previous programme is expected based on the infrastructure projects currently underway or scheduled to be run for many years.

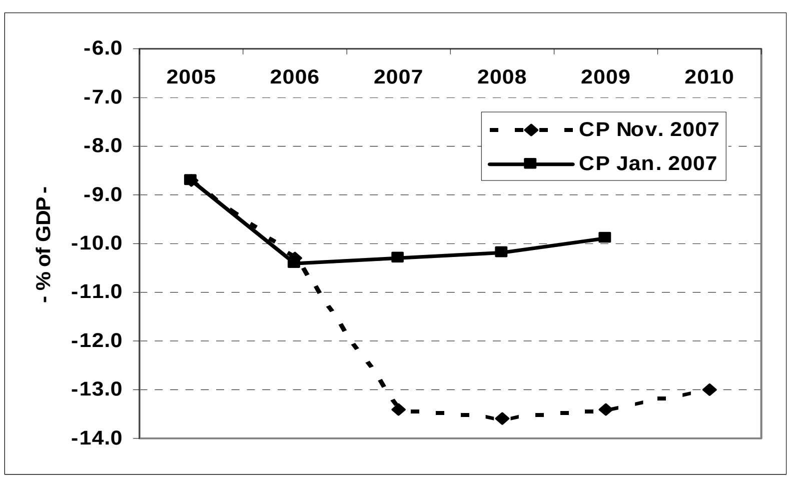
Figure 4.4 Gross fixed capital formation



Source: National Commission for Prognosis

As a result of this evolution of the domestic demand on a trend superior to the previous programme and in a more moderate perspective regarding the domestic supply's ability to meet the additional demand, the imports of goods are estimated with higher growths than exports of goods that will lead to deterioration of external balances compared to the previous one. Hence, the current account deficit was estimated at over 13% of GDP in the interval 2007-2009 and in slight decline in 2010.

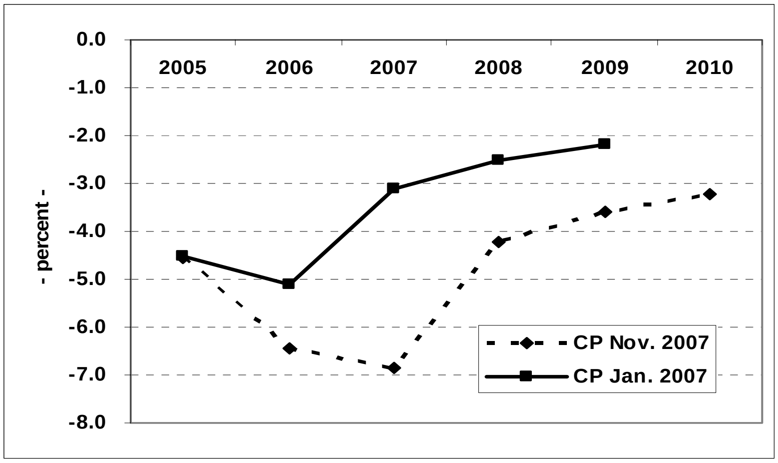
Figure 4.5 Current account deficit share in GDP



Source: National Commission for Prognosis

Consequently, the high foreign deficits although sustainable are reflected by the current development scenario in a higher negative contribution of the net exports to the gross domestic product growth, which was caused by the progress made in 2007 and by the future developments forecasted for the foreign markets, especially Romania's partners.

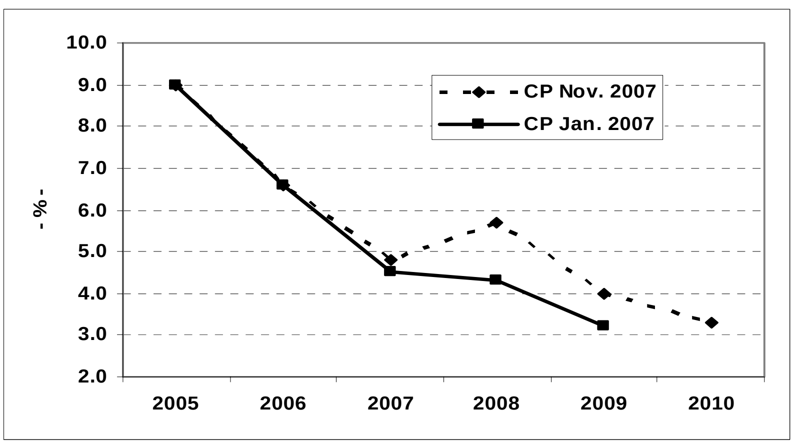
Figure 4.6 Net export contribution to the real GDP growth



Source: National Commission for Prognosis

The evolution of the consumer prices in 2007 was different from what had been predicted in the previous edition of the programme. The initial inflation target set up by the central bank at the beginning of the year at 4% plus/minus 1 percentage point was overshoot. Consequently, the forecasted evolution of the annual average inflation is significantly different, meaning that in 2008 we will witness an increase as compared to 2007, under the circumstances of higher agricultural products prices both on internal and external market during the first part of year and the base effect stemmed by the 2007 evolution. Afterwards, the annual average inflation rate is expected to start declining again.

Figure 4.7 Annual average inflation



Source: National Commission for Prognosis

4.2 Comparison of the budget deficit

The previous edition of the Convergence Programme predicted a budget deficit of 2.3% of GDP in 2006, calculation based on the approved budget. Based on the execution data, the actual budget deficit was 1.9% of GDP.

Table 4.1 Budget deficit

% of GDP

	2006	2007	2008	2009	2010
1. CP January 2007	2.3	2.7	2.6	2.0	
2. CP November 2007	1.9	2.9	2.9	2.9	2.4
3. Difference (2-1)	-0.4	0.2	0.3	0.9	

Source: Ministry of Economy and Finance

On the medium term, the forecasted deficit is 2.9% of GDP, higher as compared to the previous Convergence Programme. This adjustment is justified by the need to ensure the funds necessary to start up various infrastructure projects in the priority areas: transport, environment, education, health, in parallel with sustaining the national contribution to the eligible investment programs to be financed from European funds.

5. GOVERNMENT FINANCES - DEFICIT AND DEBT

5.1 Fiscal and budgetary policy objectives and strategy

Maintaining **macroeconomic stability** by promoting a combination of coherent macroeconomic policies, a conservative fiscal stance and cautious wage policies in order to support the disinflation process and limit the external imbalances, remained the main objective set by Romanian Government to facilitate the process of sustainable economic growth and real convergence.

The private sector represents the main driver of growth and convergence and promoting a favourable business environment and a flexible labour market will stimulate both domestic and foreign direct investments, thus encouraging the employment and also sustaining consistent gains in productivity and competitiveness.

The purpose of the government's **budgetary policy** is to sustain the real and nominal convergence process while ensuring the long term sustainability of public finances. To this end, the budget*ary* policy comes alongside structural reforms sustained through budgetary programs in education, health, research & development and pension system, aiming at stimulating the potential gross domestic product growth.

One of the main budgetary challenges on medium and long term is the necessity to eliminate the structural disparities which were identified in infrastructure, education, health and R&D areas, while keeping simultaneously the budgetary stance characterized by cautious levels of the budgetary deficit.

The Government will sustain this balance by improving the administration of revenue and increasing the efficiency of budgetary expenditure. Substantial measures related to collection process improvement were already implemented by accelerating the forced collection process, facilitated by the reform of the bankruptcy procedures and the strengthening of the budget constraints for both public and private enterprises. This process will be continued in parallel with additional measures aimed at enlarging the tax base in fields such as environment, state-owned enterprises and agriculture.

Although the level of the government expenditure will grow on medium term, drastic measures are needed to improve the efficient public funds spending, mostly by setting clear priorities, especially for the investment projects, through horizontal coordination of the economic policies, continuous improvement of the medium term budget programming and by increasing the transparency of this process.

Implementation of the aforementioned structural reforms is crucial for increasing efficiency and accountability, also including the increased share of the prophylactic and medical care in total sector spending, the consolidation of the decentralization process in education area by defining and implementing per capita financing, the promotion of long-life learning schemes and professional training, and improving the link between R&D and the corporate sector, especially the relationship with small and medium sized enterprises

Government's vision regarding **fiscal policy** focuses on ensuring a stimulating and non-discriminatory environment, while relying on measures to consolidate its stability, transparency and predictability. Further reductions in social security contribution rates is justified by the intent to diminish the economic players' propensity towards maintaining their activities in the grey economy, in order to give a positive impulse to labour market developments while contributing to achieve the goals laid down in the re-launched Lisbon Strategy.

At the same time, the objective of fiscal policy is the consolidation of public finances with a view to increase its stabilizing role by reducing structural deficits and improving the conditions for symmetrical functioning of the automatic stabilizers.

The structural budget deficit will reach a level of 0.9 percent of GDP in 2011, complying with the provisions in the revised Stability and Growth Pact, and ensuring an adequate safety margin in order to avoid the overshooting of the 3 percent of GDP budget deficit ceiling, as a result of a possible slowdown of the gross domestic product growth pace.

5.2 Public finances development over 2006 and 2007

Despite of 2007 budget program anticipating a general consolidated budget deficit of 2.7% of GDP – based on the execution in the first 9 months of the year, the latest rectification revised it down to 2.4 percent of GDP, in order to avoid the public resources spending pattern observed in previous years and to correlate the overall mix of macroeconomic policies with the latest international developments.

In the first 9 months of 2007, the general consolidated budget execution shows a **surplus of** 0.19% of GDP, as compared to the 1.7% GDP in the similar interval of 2006. The fiscal revenue went up by 0.6 percentage points to 13.8% of GDP in the first 9 months of 2007. This was made possible by the improvement of performance in the case of income, profits and capital gain taxes (which increased by 0.9 percentage points up to 4.8% of GDP) but also by the slower VAT dynamics (lower by 0.2 percentage points to 5.6% in 2007); moreover, revenues from social security and health contributions increased by 0.3 percentage points, while non-fiscal revenues increased by 0.4 percentage points.

The increased collections from income tax – higher by 44% as against the collections in the first 9 months of 2006 – can be explained mostly by the increased employment with 2.81% and the developments in the economy gross average salary by 23.5%, as compared to the similar interval of the previous year. The same above mentioned factors´ are explaining the developments of the revenues from social security and health contributions by 21.7% and 20.4%, respectively, as compared to the first 9 months of 2006, even if the employers' contribution rate was reduced by 2 percentage points.

The revenue from corporate income tax registered a nominal increase of 34% in the first 9 months of the year 2007[2] as compared to similar period of the previous year, especially due to a robust growth in industry, constructions and retail trade.

[2] Not adjusted to the transfers between months regarding the collection of profit tax at the end of the previous year

The indirect taxes (VAT, excise and customs duties) had a slower increase (10.25% nominal increase in VAT collections and 8.69% in excise duties) as compared to the collections in the first nine months of 2006; this is due to changes in legislation on VAT and the intra-Community acquisitions of goods, on one hand, and to structural collection issues for excise duties and the decline in cigarette consumption, on the other hand.

The local own revenue show a remarkable performance in the first nine months of 2007, amounting to RON 4.6 billion and registering a nominal increase of 42%, as compared to the first nine month of 2006. This higher performance is explained by the update of tax rates for residence buildings and for transportation means implemented in January 2007, and improvement in tax management capabilities.

At the end of September, the general consolidated budget expenditure amounted to 23.4% of GDP, accounting for 59% of the annual provisions. Under these circumstances, there is an acceleration of the capital expenditure growth rate, while the goods and services expenditure are registering growth rates under the overall increase of the public expenditure, and the subsidies are nominally reduced. Hence, during the first nine months, the capital expenditure went up to 2.1% of GDP, higher by 66.4% as compared to the same period of 2006 (the capital expenditure provisioned in 2007 account for 5.5% of GDP as compared to 3.7% of GDP in 2006 execution).

Moreover, the transfers registered a significant increase by 36.4% in nominal terms and by 1.7 percentage points as share in the gross domestic product in the first nine month of 2007 as compared to the same period of the previous year, one of the main triggering factors being the payment of Romania’s contribution to the European budget (0.6% of the gross domestic product, i.e. RON 2,296.2 million).

The personnel expenditure went up by 26.9%, while the expenditure with the goods and services noticed a nominal increase of 17.7% in the first nine months of 2007, as compared to the same interval of the previous year.

The subsidies in the first nine months of the year are lower than the one granted during the same period of the previous year, with a nominal cut of 12.5% or 0.3 percentage points as share in GDP, an evolution which is in accordance with the downward trend of subsidies as a result of diminishing state’s role in the national economy.

Globally, even though wage policy relaxed in 2006, the overall execution of general consolidated budget shows an improvement of public finance quality, by speeding up the pace of capital expenditure, continuation of reducing subsidies and a higher control over the evolution of the goods and services expenditure.

5.3 The medium term development of the public finances

The Government's medium term fiscal policy was centred on the objective of ensuring sustainability and improvement of public finance quality, in parallel with consolidating economic growth, and sustaining the nominal and real convergence process with European Union. Consolidation of revenue tax base continues to be essential for ensuring the resources needed for economic development and meeting Romania's commitments as an EU Member State.

The budget revenue will further go up in the medium term, as a result of both favourable economic cyclical position and continuation of tax administration reforms and improving revenue collection. For 2008, revenues of the general consolidated budget are estimated[3] to amount to RON 175,071.7 million (39.8% of the Gross Domestic Product), higher by 2.4 percentage points, as compared to 2007).

The wage and income tax revenue are expected to grow by 0.5 percentage points (from 3.5% of GDP in 2007 to 4.0% in 2008, with this level to be maintained on a medium term as well). This development is mainly due to increases in gross average wage and employment during the forecast period.

Although in nominal terms the profit tax revenue is expected to grow, its share in gross domestic product will be the same in 2008 as compared to 2007 (2.9%). However, on medium term, we estimate a slight increase in collections, on one hand because of cutting down the social security contribution rates, and on the other hand because of the previous years' economic arrears recovery and maintenance of a high degree of profitability of enterprises due to hidden efficiency reserves.

The cuts in the social security contribution rates in 2008 will lead to a positive budgetary impact regarding the revenue from the profit tax estimated at RON 174 million in 2008, RON 456 million in 2009 and RON 555 million in 2010. Moreover, the Government decided to postpone until 2010 the implementation of annual profit tax payment system through anticipated payments.

In the field of income tax, the following provisions have been adopted and are to become effective as of January 1, 2008: (i) increase in monthly ceiling of non-taxable pension benefits from RON 900 to RON 1000; (ii) implementation of tax on farming revenue (2%), as of January 1, 2009; (iii) implementation of tax imposed on transfer of the real estate assets of non-residents from the personal property.

[3] Projection of the General consolidated budget revenues is based on macroeconomic indicators estimated on 2008 and in tax provisions in force as of January 1st 2008.

Table 5.1 Estimated budgetary impact of income tax-related measures

Million RON

Measure	Budgetary impact		
	2008	2009	2010
Increase of the monthly ceiling of the non-taxable pension benefits from 900 lei to 1000 lei;	-63	-186	-201
Tax on farming revenue introduced as of January 1, 2009	-	+29.7	+30.6
Tax imposed on transfer of the real estate assets of non-residents from the personal property	+8.4	+9.2	+10.3

We estimate *VAT revenue* will go slightly up by 0.2 percentage points in 2008 as against 2007. On medium term, the level of this revenue will come closer to the values in the Member States of the European Union, in agreement with the overall economic policy mix presented for the forecast interval and with the amendment proposals of the Fiscal Code.

The legislative changes regarding VAT which will enter into force as of January 1, 2008, are as follows: (i) transposition in national legislation of changes introduced in the Community legislation, through Directive 112/2006 on the common VAT system, the modification of provisions regarding the chargeability of intra-Community deliveries and acquisitions; (ii) modification of provisions regarding the taxable base of intra-Community acquisition; (iii) implementation, in the national legislation, of the conditions enforced through Directive 112/2006 on tax exemption for the deliveries of goods that are carried in personal luggage of passengers who are not established in the Community; (iv) extension – until December 31, 2011 – of the application period of the system of paying the VAT directly to the customs authorities, for the goods imported from third countries, which is applicable as of April 15, 2007, with simplified payment arrangements for VAT to be resumed in 2012 for all importers, when Romania would have already strengthened its VAT control system; (v) remove the simplification measures for construction-installation works, because of the delayed collection to the state budget, as well as for the deliveries of buildings, building parts and plots of land; (vi) the tax adjustment for the capital goods used to other purposes than the economic ones shall be done only at once for the entire adjustment period remained, regardless of its duration (5 or 20 years).

The table below shows the calculation of the budget impact triggered by the measures implemented in this area.

Table 5.2 Budgetary impact of the fiscal measures adopted in VAT field

Million RON

Measure	**Budgetary impact**		
	2008	**2009**	**2010**
Remove reverse taxation for construction-installation works	+1500.0	+1743.0	+2012.0
Remove reverse taxation for deliveries of buildings, building parts and plots of land of any nature	+992.2	+1010.2	+1031.4
VAT paid at the customs point for imports from outside EU	+1793.0	+2171.0	+2433.0

Source: Ministry of Economy and Finance

The *excise duties* level will register a slight decrease by 0.2 against the background of continuing legislation harmonisation with European legislation, appreciation of the exchange rate and reduction in alcohol and tobacco consumption.

The legislative changes regarding the revenue from excise duties, which are to come into effect as of January 2008, are as follows: (i) clarification of the date for application of excise duty rates for the processed tobacco, laid down in annex 1 to Title VII of the Fiscal Code, in accordance with the date provisioned in the position paper related to Chapter 10 – Taxation; (ii) revision of excise duty arrangements for soluble coffee mixtures from intra-Community acquisitions or import operations, aimed at implementing similar arrangements with those applied in the case of mixtures coming from domestic production; (iii) implementation of excise restitution arrangements in the case of green coffee or coffee products purchased outside Romania, where such products are consequently delivered to other Member States, in order to apply a system similar to the one applied for export operations; (iv) the revision of the taxable base for the non-approximated excise duties in the case of products from domestic production, in a move to align it up to the taxable base applicable to similar products from intra-Community acquisitions.

The revenue from social security contributions will continue to have the highest share in the gross domestic product, with a growth of 1.3 percentage points (from 10.3% in 2007, to 11.6% in 2008). In 2008 the social security contributions will notice a cumulated three step cut by 6 percentage points (for both employers and employees), as follows: 1.5 percentage points to the social security budget; 2.0 percentage points to the unemployment budget; 1.8 percentage points to the health budget; 0.7 percentage points to the budget for insurance against work accidents and professional diseases.

This increase is due to the developments of the main macroeconomic indicators(number of employees and average wage) and to the measures aimed at enlarging the taxable base that have already been approved by the Government and are to become effective as of January 1, 2008.

Hence, the constraint of maximum 5 gross salaries for the payment of social security contribution will be eliminated and new revenue categories (censorship, management boards, incentives, hourly rates, clinical indemnity for teaching doctors) will be included in taxable base. Moreover, the remuneration for managers will be assimilated to wage revenue and the single partner may be at the same time an employee of the limited liability company, which will lead to an enlarged taxpayer basis.

Regarding the **expenditures of the general consolidated budget** the Government proposes, for 2008, a 42.7% level of the GDP for all these, with 2.4% higher than the level registered in the previous year, an increase which takes into account a significant input of the funds allocated by EU.

The interest payments will be maintained approximately at the same level registered in 2007 (0.9% of the Gross Domestic Product). *Subsidies* will account for 1.4% of GDP in 2008, and their sloping trend will continue down to 1.0% in 2010, in parallel with the gradual state withdrawal from the economy and with more robust market mechanisms. *The transfers* will continue to hold the highest share in the gross domestic product (18.5% of GDP), up by 1.7 percentage points as compared to 2007, due to increases of pension benefits.

Moreover, the Government commits to significantly improve the spending policy by re-channelling the public funds to sustain the economic growth. Hence, for 2008, we estimate an increase of *capital expenditure* from 7% in 2007 to 8.2% of GDP in 2008. Thus, the most substantial increase of the capital expenditure share over the past years is forecasted for 2008, given the fact that the economic growth pattern has changed to favour the accumulation, with a positive long term impact on the sustainable development of the Romanian society.

5.4 The impact of EU accession on public finance

Romania's objective is to keep a budgetary position of net recipient of Community funds. Thus, Romania's accession to the European Union is expected to have a positive impact on both the public budget and the country's economic development. European Union allotted to Romania – for the interval 2007-2013 – a total of 19,667.647 million Euro in Structural Instruments. The table below shows the breakdown of amounts allotted to Romania under the EU Cohesion Policy for the interval 2008-2010.

Table 5.3 EU Funds allocated to Romania

Million euro

	2008	2009	2010
Structural funds (ERDF, ESF)	1,277.26	1,717.81	2,061.84
Cohesion Fund (CF)	638.42	62.96	64.83
TOTAL	1,915.68	1,780.77	2,126.67

Source: Ministry of Economy and Finance

On the other hand, starting on the accession date, Romania has the obligation to contribute its own share to the Community budget. The table below shows the estimated contributions of Romania to the Community own resources system in 2008 and the projection for 2009-2010.

Table 5.4 Romania's contribution to the EU budget

Million euro

	2008	2009	2010
Romanian contribution to the EU budget	1,363.3	1,187.4	1,309.4
% of GDP	0.96	0.85	0.85

Source: Ministry of Economy and Finance

In addition to the contribution to the Community budget, Romania will have to incur other expenditure, as follows: a) co-financing the agricultural and rural development projects; b) co-financing the projects funded with structural and cohesion funds; c) continuing the co-financing of ISPA projects (in transportation and environment fields) which started in the previous years; d) continuing the co-financing of the PHARE programs started in the previous years.

The table below shows the **net balance** between Romania's contributions to EU own resources in the interval 2007 – 2009 and the funds allocated for the same interval (both pre-accession and post-accession funds).

Table 5.5 Net budgetary position against EU budget

% of GDP	**2008**	**2009**	**2010**
Total EU funds	2.59	2.74	3.43
Romanian contribution to the EU budget	0.96	0.85	0.85
Balance	1.63	1.89	2.58

Source: Ministry of Economy and Finance

Romania's accession to the European Union will have a positive impact on both the public budget and the country's economic development, with the net benefits going up in 2009 as compared to 2008 by 0.26% of GDP, and by 0.69% in 2010 as against 2009. According to the evaluations made based on the HEROM model (a HERMIN-type of model), **the effect of the total absorption** of EU funds generates an additional growth of 15% of GDP until 2015, compared to a scenario where Romania would not receive these funds.

5.5 Computation of the structural and cyclical deficit

In order to estimate the elasticity of taxes and fees, as well as the expenditure elasticity, we applied the OECD and EC methodology as described by van den Noord (2000) and Girouard (2005). This methodology relies on the decomposition of each elasticity in components which can be estimated by using the existing data and the specific econometric techniques. The elasticity of revenue (income tax, profit tax, social security contribution and indirect taxes) and expenditure is shown in the table below.

Table 5.6 The elasticity of budget revenues and expenditures as compared to GDP

	Revenues				Expenditures
	Elasticity of income tax	Elasticity of social security contributions	Elasticity of income tax	Elasticity of social security contributions	Elasticity of income tax
Method Van der Noord (2000)	1.0358	0.7506	1.2040	0.9700	-0.1010

Source: Ministry of Economy and Finance; National Commission for Prognosis, DOFIN

The budget's structural components are obtained by subtracting the cyclical component from the current budget component, by using the formula below:

$$CAB_t = B_t - B_t^C = B_t - \sum_j B_{t\ j}^C$$

The cyclical component of each category of revenues and expenditures ($B_{t\ j}^C$) is calculated by using the output gap and the estimated elasticity as against the gross domestic product (α_j^{PIB}). The formula used to calculate the cyclical component is as follows

$$B_{t\ j}^C = B_{t\ j} \times \alpha_j^{PIB} \times output\_gap_t$$

Table 5.7 Cyclical component and cyclical adjusted deficit (% of GDP)

% in GDP	2006	2007	2008	2009	2010
1. Real GDP growth	7.7	6.1	6.5	6.1	5.8
2. Current balance	-1.9	-2.9	-2.9	-2.9	-2.4
3. Net interest payments	0.8	0.9	0.9	0.8	0.8
4. Output gap	2.44	2.29	2.32	1.86	1.07
5. Cyclical component of the budget	0.69	0.74	0.80	0.66	0.39
6. Adjusted cyclical balance	-2.59	-3.64	-3.7	-3.56	-2.79
7. Adjusted primary balance	-1.79	-2.74	-2.8	-2.76	-1.99

Source: Ministry of Economy and Finance, National Commission for Prognosis, DOFIN

The computation for 2006-2010 is based on the assumption regarding the real gross domestic product and the output gap showed in the table above. Hence, taking into account these assumptions, the cyclically adjusted primary deficit is obviously increasing from 1.79% of GDP in 2006 to 2.74% in 2007, but it will go down until 2010 to 1.99% of GDP

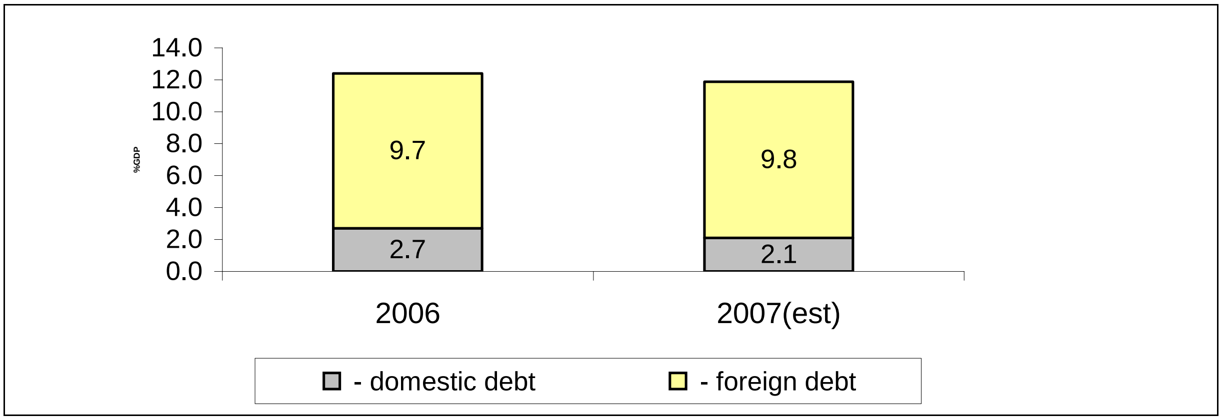
5.6 Public Debt and Debt Strategy

5.6.1 Government debt management and budgetary deficit financing

The public debt management legal framework is the Emergency Ordinance issued by the Government in 2007. According to this ordinance, the Ministry of Economy and Finance has the responsibility to contract and manage the government debt. The main changes brought by this ordinance are the removal of the possibility for the Ministry of Economy and Finance to contract loans for on-lending to the line ministries, the state guarantees and the on-lending by the Ministry of Economy and Finance to the various beneficiaries being allowed only for projects of major importance approved by law.

Romania's indebtedness stays under 20% of GDP, which is by far under the threshold of 60% of GDP set in the Maastricht Treaty. Hence, against the background of a sustained economic growth, at the end of 2006 the government debt calculated according to the EU methodology (ESA95) was 12.4% of GDP, out of which the domestic debt was 2.7% and the foreign debt 9.7%. At end 2007, this index is estimated to reach the level of 11.9% of GDP.

Figure 5.1 Public debt structure



Source: Ministry of Public Finance

The structure of the government debt as at 31.12.2006 on debt instruments shows that the government securities issues account for 28.4% of the total debt, with the difference covered by loans. Regarding the initial maturity of the government debt, 9.5% of the debt was short-term and 90.5% medium and long term, whereas the average maturity of the debt balance at the end of 2006 was 5.1 years. At the same time, it is worth mentioning that 33.4% of the debt was floating interest rate debt. The local currency debt at end-2006 was 21.5% of the total debt, while in the foreign currency debt the highest share was represented by the debt in Euro, namely 63.2%.

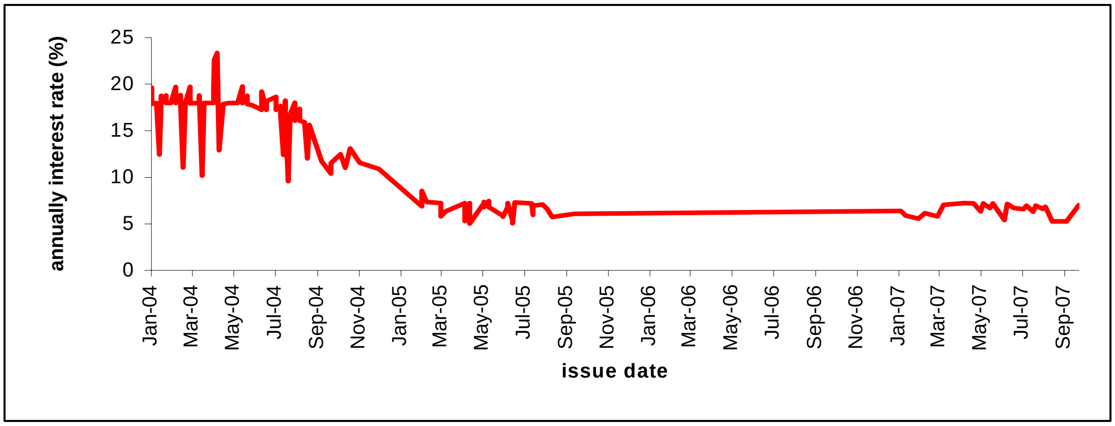
5.6.2 Government securities market

Aiming at improving the predictability and transparency, the schedule of government securities issuances was published for the first time in 2006, announcing the issuances of government bonds with 3, 5 and 10 years of maturity and short term government securities with maturities of 6 and 12 months, respectively

However, as a result of the developments in budget expenditure and revenue, the financing of the budget deficit from domestic sources was limited to temporary financing from the funds available in the state treasury general current account, as these available funds were significant in 2006 coming from surpluses of the local budget and various other budgets (social security budget or the unemployment budget).

In 2007, considering the specific objectives of the government public debt management, which are the development of the government securities market and reducing the currency and interest rate risk in the public debt portfolio, the financing strategy was planned in such way to use mainly the domestic financing resources. Hence, the annual government securities calendar was published, announcing an indicative volume of government securities amounting to 12 billion lei, in 6-month and 12-month T-bills and 3, 5 and 10-year Benchmark Bonds, with government securities of 9.0 billion lei issued before September 30, 2007.

Figure 5.2 Government Securities Market



Source: Ministry of Public Finance

It is important to mention that in accordance with the Emergency Ordinance 64/2007 the state guarantees will be issued by Ministry of Economy and Finance only based on a special law adopted to this purpose, with the state guarantees to be issued only for the major projects and based on an approval by the Competition Council to ensure the observance of Romania's commitments regarding the state aid.

Table 5.8 State guarantees issuances

-million euro-

	2005	2006	2007
State guarantees issued for foreign loans undertaken:	410.5	7.2	0
- by ministries	0.0	0.0	0
- by local public authorities	20.0	7.2	0
- by companies	390.0	0.0	0

Source: Ministry of Public Finance

In 2006 a share of 84.3% of budget deficit was covered from domestic sources, and in 2007 the budget deficit is still to be mainly covered using domestic sources.

Due to prudential fiscal policies and reduced borrowing costs as a result of successive improvements of the sovereign rating[4], the government debt servicing burden went gradually down and will be evenly distributed over the following years.

[4] Romania was upgraded to investment grade in 2006 by all rating agencies. Moody's Investors Service was the last to upgrade Romania's sovereign rating from Ba1 to Baa3 (equivalent to BBB- on the rating scales of S&P and Fitch). Moreover, the rating ceilings for Romania were substantially improved to A2 (5 steps) by Moody's and to BBB+ (2 steps) by Fitch.

Moreover, in June 2007, the public debt department was reorganized according to a modern debt agency organization structure, including the contracting activity (Front Office), the analysis activity (Middle Office) and public debt payments (Back Office)

5.6.3 Objectives of the government debt management for 2007-2009

The main objective of the government debt management is maintaining the debt in sustainable limits and ensuring necessary sources to finance the budget deficits and pay the debt service with reduced costs and acceptable risk.

In fact, the government debt management strategy for 2008-2010 will be promoted in December 2007, laying down the objectives set by the Ministry of Economy and Finance for the government debt management, as well as the instruments to be used in order to achieve the stated objectives.

In order to ensure the financing of the budget deficit and re-financing the public debt, the domestic sources will be mainly considered, for both reducing the public debt costs and reducing the currency risk in the government debt portfolio.

Moreover, one stated objective is the development of the government securities market and to this purpose, for financing the budget deficit using domestic sources, medium and long term benchmarks will be issued, with the possibility to be re-opened in order to increase their liquidity. The development of the secondary market by creating references (benchmarks) is essential from the point of view of reducing the state financing costs, gaining a liquidity premium in trading on the secondary market, including for the municipal and corporate bonds related to these benchmarks. The development of the government securities market takes into account the significant increase of the government securities demand, after the liberalization of the capital account and the implementation of the private pension funds through the pension reform in 2007.

At the same time, regular meetings have been organized with the representatives of the National Bank of Romania, for coordinating the fiscal and monetary policy and with the primary dealers and investors in order to discuss market developments and investment requirements specific to the domestic financial market.

One of the key objectives in managing government debt is represented by the gradual reduction of project financing (due especially to the contracting of loans from international financial institutions), and increasing the share of negotiable debt, contracted by issuing government securities mainly on the internal market; but also by accessing the international capital markets so as to maintain a constant presence of Romania in the context of the continuous improvements of the sovereign ratings.

Regarding the financing in foreign currency, the Government intends to consolidate the euro denominated exposure, aiming to reduce the currency risk in view of the perspective of adopting the single European currency.

From an institutional point of view, the Ministry of Economy and Finance plans to improve the domestic infrastructure by implementing a public debt management system that will include incentives for risk management capacity building in the government debt portfolio, alongside an electronic system for the government securities auctions.

Moreover, the legal framework of the public debt management is to be improved, with the main changes referring to the removal of the possibility for the Ministry of Economy and Finance to contract loans for on-lending to the line ministries, and the state guarantees and the on-lending by the Ministry of Economy and Finance to the various beneficiaries to be allowed only for projects of major importance approved by law. The main objective from the standpoint of public debt management is to keep the government debt level within sustainable limits and ensuring the necessary sources for financing the budget deficits at a minimal cost and by assuming a reasonable risk level.

5.7 Sensitivity Analysis

5.7.1 Budget analysis

On the revenue's side, the collection of taxes and levies is obviously influenced by the nominal consumption and the wage fund. Against the macroeconomic baseline scenario, we have assessed for 2008 the impact of the lower growth in the economy wide average gross wage of 11.3 compared to 12.3 percent, a lower growth in employment of 1 compared to 2 percent and a marginal decline in the nominal GDP growth rate from 12.87% to 11.87%.

The table below describes the impact triggered by the changes in the above mentioned macroeconomic variables on the general government revenue. As expected, the impact is negative, and particularly in the case of the social security contributions, as a slower increase in employment yields a decline by 0.12 % of GDP whereas a lower growth in economy wide average gross wage results in a decline by 0.09 % of GDP in budget revenues.

Table 5.9 Sensitivity of the general consolidated budget revenue against changes in macroeconomic variables

Tax and levies category (revenue share in GDP)	**Macroeconomic base**	**Change in macroeconomic base (percentage points)**	**Change in general government revenues (% GDP)**
1. Personal Income Tax (3.4%)	average gross wage	lower by 1	-0.023
	employment	lower by 1	-0.0289
2. Social Security Fund (9.5%)	average gross wage	lower by 1	-0.0522
	employment	lower by 1	-0.1045

Tax and levies category (revenue share in GDP)	Macroeconomic base	Change in macroeconomic base (percentage points)	Change in general government revenues (% GDP)
3. Health Fund (3,8%)	average gross wage	lower by 1	-0.049
	employment	lower by 1	-0.024
4. Corporate Income Tax (2.7%)	average gross wage	lower by 1	0.03
	employment	lower by 1	0.04
	GDP	lower by 1	-0.01
5. Value Added Tax (9.3%)	average gross wage	lower by 1	
	employment	lower by 1	
	GDP	lower by 1	-0.017
Total	**average gross wage**	lower by 1	**-0.094**
	employment	lower by 1	**-0.117**
	GDP	lower by 1	-0.017

Source: Ministry of Economy and Finance

5.7.2 Public debt

This sub-chapter discusses the economic growth influence on the government debt share in GDP, the influence of the national currency's appreciation/depreciation against euro on the interest payments related to the government debt and the influence of the increased interest rates on the interest payments related to the government debt.

The analysis of the economic growth influence – Two scenarios were used in the analysis of the influence exerted on the public debt developments of a more reduced pace of economic growth. The first scenario is based on the projections laid down in the macroeconomic framework on the medium term, and the second scenario (the alternative scenario) was built on the assumption the economic growth would be lower by approximately 1% as compared to the baseline scenario. In the baseline scenario, the share of government debt in GDP is expected to go up by 2.5% in 2010 as compared to 2006 (from 12.4% in 2006 to 14.9%), whereas in the alternative scenario the government debt share in GDP is to increase by 2.7% (from 12.4% in 2006 to 15.1% in 2010).

The analysis of the influence of the national currency's appreciation/depreciation against the euro – For this analysis, one baseline scenario and two alternative scenarios were used, with the latter built on the assumption that, on medium term, the national currency will depreciate/ appreciate by 1% as compared to the euro. While in the baseline scenario the share of interest payments in GDP is expected to go down from 0.79% in 2006 to 0.78% in 2010, in the first alternative scenario the share of interest payment in GDP would keep the same level of 0.79% in this interval, and in the second alternative scenario the interest payments' share in GDP is to drop to 0.78%.

The analysis of the increased interest rate – This analysis is based on a baseline scenario and on an alternative scenario built on the assumption that the interest rates will go up (both EURIBOR and LIBOR) by 1% as compared to the baseline scenario. In the baseline scenario, the interest payments' share in GDP will go down from 0.79% in 2006 to 0.78% in 2010, while in the alternative scenario the share of interest payments is expected to go up to 0.84% in 2010.

5.8 Budgetary consequences of major structural reforms

In the context of problems related to ageing population and related costs, the implementation of the mandatory **private pension system** (pillar II) represented a fundamental re-launch of the public expenditure reform in Romania. Although in the short run this measure will have an impact on the budget deficit, on a longer term the social security reform should rationalize the public expenditure and improve efficiency in service supply.

Pensions system

The pension system in Romania was affected by many reforms in the previous years, aiming at improving the sustainability of the system that faces structural demographic changes due to the increasing share of aged population. The second Pillar - compulsory pension system privately managed will be implemented starting with January 1st, 2008, when 2% of the individual social security contributions calculated from the gross income of all taxpayers up to 35 years old and optional of those of age between 35-45 years, will be directed towards the compulsory pensions funds privately managed. This rate will increase by 0.5% every year until it will reach 6% in 2016.

On long term, the introduction of the 2nd Pillar has a positive impact on the sustainability of the system by ensuring the possibility to obtain at the retirement age a private pension besides the one received from the public pension system. The reduction of the individual contribution rate paid by the taxpayers to the public pensions system in favour of the 2nd Pillar, would have lead during the first years of application to the reduction of the public pensions system revenues, but this consequence was offset by legislative actions aimed to broaden the income tax base as well as attracting new categories of taxpayers.
In this regard, starting from 2008 the tax base will consist of the monthly gross income, instead of monthly gross salary. Thus, new income categories were included by extending the tax base: auditing activities, administration councils, incentives, payment by hour, and clinical indemnity for doctors. Also, the ceiling of 5 average gross salaries for the value of social security contribution paid on an annual basis for individual contributions, is eliminated.
An important positive influence will be generated in the following period by improved macroeconomic indicators, respectively the increase of the gross average wage, higher number of employees and a better collection of current liabilities and arrears due by employers.

For assessing the budgetary impact of the contributions to the 2nd Pillar the following assumptions were used:

(a) 2008 was considered the first year of the assessment,
(b) the number of taxpayers with age below 35 represents 41.4% of the total number of taxpayers,
(c) a share of 28.5% of the number of taxpayers is represented by persons with the age between 35-45 years from which 20% will opt to contribute to the system,
(d) the average gross income, average number of employees and their age distribution were forecasted by the National Forecast Commission and National Institute of Statistics, taking into account the demographic perspectives.

Table 5.10 Contribution to the pensions system

	2008	**2009**	**2010**
Total contribution to the 2nd Pillar - mil. lei	835	1208	1809
- mil.euro	262	392	603
out of which:			
1. Contribution of insured persons and assimilated persons below 35 years old	734	1001	1346
2. Contribution of insured persons and assimilated persons between 35-45 years old	101	207	463
Share of the 2nd Pillar in GDP	0.19	0.25	0.33

Source: Ministry of Economy and Finance

The analysis shows that the budgetary impact following the implementation of the 2nd Pillar is not substantial. The amount of individual contributions directed to the 2nd Pillar will represent 0.19% of the GDP in 2008 and will increase up to 0.33% of GDP in 2010, achieving 1% of the GDP in 2016, when the value of the redirected rate from the pas-as-you-go system (traditional system) will reach its maximum of 6%. The Government intends to finance the deficit through domestic issuance of long term state bonds, in order to build up the yield curve of the state bonds and to deepen the development degree of the national market.

6. QUALITY OF PUBLIC FINANCES

6.1 General Framework of Public Finances

Both in theory and in economic practice, the quality of spending and not the level of public expenditures become decisive to national economy growth. The main priority of the Government for the next period is to consolidate the quality of public finances by improving efficiency, transparency and accountability of the public resources utilization.

With the view to observe these objectives, the Government is set to maintain and consolidate the tax policy principles set out in 2005, which in turn will render an international competitive position and an attractive business environment in Romania, as prerequisites for sustainable economic growth.

Alongside with the revenues budget policy, improving the efficiency of the public spending adds quality to the utilization of financial resources. The budgetary policy on medium term has been designed in the context of ongoing reform process by means of horizontal consolidation of the economic policies, improvement of the budget programming by moving away from the costs based budget to the budget founded on objectives, outcomes and performance.

Moreover, the reform of the budget philosophy is pursued by supporting the economic sectors with large value added as education, R&D, health with a view to enhance the capacity to face global competition and provide the qualified work force needed to sustain services development on the background of increasing wage costs as real convergence advances.

Public policies financing is undertaken by ensuring coherence and complimentarily with the strategic framework already in force (National Development Plan 2007-2013, National Reform Plan 2007-2010, Strategic National Framework 2007-2013). The strategic planning concept development strengthens the connection between public policies design, budget development and improved efficiency and coherence in spending public funds.

Beginning with the 2008 budget, strategic planning becomes instrumental at the first stage in annual budget drafting process. In this vein, the public policies eligible for financing from the budget are the priorities set in the Government Program, National Development Plan or other programmatic documents related to the EU status as a state member of Romania. A major advantage of the strategic planning stage lays in the relationship established at the outset of the budget development process between the public policies priorities, their objectives and the medium term budgetary resources employed.

The expected outcome of the strategic planning stage is the development and consolidation of the program based budgeting. Hence, the 2008 state budget comprises 236 programs against 194 programs in 2007, accounting for 76.2% of total budget outlays. Out of the 50 main budget credit holders, 25 of them submitted entirely program based budgets.

As regards the tax administration improvement, the reform objectives refer to increasing the efficiency in budget revenues administration with a view to improve services to taxpayers, enhance transparency, simplify administration procedures and ultimately reduce voluntary tax compliance costs.

6.2 Budget revenue

In January 2005 Romania has launched a fundamental tax reform. The profit tax has been scaled down from 25 percent to 16 percent and a single personal income tax rate of 16 percent replaced a progressive five-bracket scale with rates ranging between 18% and 40%.

Essentially, the reform aimed at removing the various exceptions, exemptions and discretionary special regimes, which accounted in the past for the building up of tax arrears both in public and private sectors. As regards the enlargement of the tax base, many of the exemptions and deductions granted by the previous legislation were eliminated, including the possibility to deduct the amortization expenditures up to 20 percent from the value of the fixed asset, the deductibility of the private health insurances and the deductibility of the positive value of the participation shares. Additionally, the statutory tax rates on the dividends, interest and capital gains were increased toward the flat tax level of 16 percent, thus contributing to an increased transparency and a non-discriminatory business environment.

The Government will keep unchanged the main coordinates of the tax policy on medium term with a view to enhance the predictability and the stability of the business environment. Except for the ongoing decline in the social insurance rates, the main taxes will not be modified. Moreover, the taxes which account for own revenues will be thoroughly reviewed from the perspective of financial opportunity and efficiency. Alongside, additional measures to enlarge the tax base and improve tax administration will be pursued in order to support the upward trend of budget revenues.

6.3 Budget outlays

The key objectives of the budgetary policy, presented also in the first edition of the Convergence Program, are reasserting the public policies in the areas related to the human capital, as education, research and development, health and social cohesion, while supporting the public share to investment programs eligible for EU financing and the national contribution to the EU budget.

One of the main budget challenges on the medium and long run is the need to remove the structural disparities identified in infrastructure, education, health, research and development, while running prudent budget deficits. Efficiency in financial resources management is instrumental for improving fiscal policy outcome over the long term. In this context, consolidating the program based budget, increasing expenditures flexibility and enhancing budget programming on the medium term will generate the expected efficiency gains in public spending. In setting the coordinates for budget expenditures over the medium term, we have tracked the following components of public intervention:

6.3.1 Public education expenditures

Education remains a priority for the Government, as the public spending level is set at 6,0% of GDP for the entire forecasting period 2008-2011, the resources being earmarked to continue and build up the multi-annual programs.

Under the equal access to education program, 950 thousand students from low-income households will be granted handbooks in 2008; more than 2007 with 100 thousand children; also financial support to acquire computers will be provided to 41 thousand students and 18 thousand students will benefit from bus transportation. Under the infrastructure development program for pre-university and university education, the proposed funds will increase by 260% as compared to 2007, 180 investment objectives at university education level will be continued and 82 new investments started, including endowment with school furniture, laboratories and sports equipment.

6.3.2 Public R&D expenditures

Research will benefit from a higher budgetary allotment in order to lessen the disparities that are inconsistent with the provisions of the Lisbon strategy. In this vein, R&D outlays will increase sharply from 0.5% of GDP in 2007 to 0.7% of GDP in 2008, reaching 1% of GDP in 2010. The public policies in R&D will mainly target the development of the human capital and the technology base, with a view to attain a critical accumulation and necessary facilities for an increased contribution to the competitive economy, in line with the European research coordinates.

Hence, we expect to reach the following targets by 2009: increase both the overall staff employed in R&D and the number of researchers by 15%, increase to 80% of total the share of R&D institutes and the universities endowed with hi-tech equipment.

6.3.3 Public health expenditures

Public health sector will be granted over 4% of GDP on the entire reference period. A substantial share of the funds granted to the Ministry of Public Health will be targeted to the rehabilitation of the hospital infrastructure under the program of improving emergency medical services (conclude the ongoing investments, build 8 type I regional hospitals and another 20 county hospitals, refurbish 15 type II hospitals, endow hospitals with high performance medical equipment and ambulances).

With a view to rein in the number of patients in hospitals, outpatient and prevention care will be granted supplementary financing to accommodate a larger number of patients receiving drugs treatment (50% increase as compared to 2004 and 11% increase as compared to 2007) and 2 million more consultations in primary care.

6.3.4 Public infrastructure expenditures

Public infrastructure will be granted on average 4.0% of GDP in the reference period, as the sector presents a significant absorption potential for both national and EU funds. The earmarked resources will finance 71 investment objectives in transport infrastructure under the Sectoral Operational Program-Transport, with a view to:

(a) promote international transport and transit for people and goods in Romania by linking Constanta Port, and also Greece, Turkey, Bulgaria to the rest of EU and developing the priority transport networks TEN-T;
(b) promote efficient transport for people and goods between Romania's regions and to the priority transport networks by rehabilitating national network and TEN-T;
(c) promote the development of a balanced transport network for all means of transport, while adding emphasis on railways, shipping and inter-modal;
(d) promote sustainable development by minimizing the adverse impact of transport on environment and improving its safety.

6.3.5 Public expenditures on environment

On **environment protection**, the public finances are oriented towards the lessening of the gap between EU and Romania regarding environment infrastructure both from a quantitative and a qualitative perspective. The funds will follow an upward trend reaching 0.6% of GDP by the end of the forecasting period. The main programs include:

(a) monitoring the enforcement of the legal framework, standards and best practices in environment safeguard, norms on improving environment and quality of life, integration with the sub-regional, regional and global cooperation issues related to environment and development;
(b) protecting and conserving nature, its biological diversity and exploiting in a sustainable manner its resources, proper management and development of the national net of protected areas in line with the European and international strategies, policies and practices;
(c) multi-annual priority programs on environment and water management to be implemented over 2006-2009 at the local authorities level;
(a) floods prevention, water resources protection, sustainable management, hydrological surveillance, meeting the water needs for people and economy.

6.3.6 Public expenditures for agriculture

Public spending in **agriculture** will target on average 2.5% of GDP, the main investments eligible to both national and EU funds financing include:

(a) „The Farmer" – national program of investment in new and established farms 420 processing units, 2,700 vegetable producing farms, 2,900 livestock farms.

(b) Life renting program providing an amount of Euro 100 per year per ha of land sold by an older than 62 years owner, or an amount of Euro 50 per ha respectively, rented to an incorporated exploitation;

(c) Subsidies program for agricultural producers in livestock farms;

(d) Incentives program for subsistence farms to develop in agricultural farms and consolidation of the middle class in rural areas;

(e) Maintenance and investment programs on land improvement. 56 investments in rehabilitation infrastructure in agriculture (37 ongoing investments, 19 new investments in irrigation, draining, water pumping stations and forestation).

7. LONG–TERM SUSTAINABILITY OF PUBLIC FINANCES

Over the next decades, Romania will face major challenges related to the consequences of population ageing. Life expectancy is increasing to a level close to the average in European Union, but the fertility rate is still small, among the lowest in EU.
The main objective factors, exerting a direct impact on the public finances' sustainability, mainly on the pension and health systems are the demographic evolution and the participation rate in the labour market.

7.1 Demographic developments

7.1.1 Fertility and mortality indicators evolution

Currently, the fertility rate is 1.32 children per woman (1.26 in 2002), much below the optimal reproduction level. In the future we expect an improvement – firstly, at a lower pace (reaching 1.36 children per woman in 2015), but at a higher speed afterwards (reaching 1.93 children per woman in 2030); then, during the second interval of the forecasting period (2030-2050), the rate is expected to slow down again, tending towards the reproduction level at the end of the period.

Until 2050, the mortality rate is estimated to decline for both genders, as life expectancy at birth is expected to go upward by the end of the forecasting period with 6.7 years for men and 6.4 years for women.

Table 7.1 Life expectancy

(average number of years expected at a certain age)

	2010	2020	2030	2040	2050
Men					
Life expectancy at:					
Birth	69	70.3	71.8	73.4	74.9
Age of 20	52	51.8	53.1	54.5	55.9
Age of 60	16.9	16.7	17.7	18.7	19.7
Age of 65	13.6	13.4	14.2	15.1	16.0
Retirement age	13.9	13.4	14.2	15.1	16.0
Women					
Life expectancy at:					
Birth	76.2	77.8	79.1	80.6	81.9
Age of 20	57.8	58.9	60	61.3	62.5
Age of 60	20.9	21.4	22.4	23.4	24.4
Age of 65	16.5	17.4	18.2	19.2	20.1
Retirement age	21.4	21.4	22.4	23.4	24.4

Source: World Bank and Ministry of Labour, Social Solidarity and Family

Total population will register a downward trend from 21.6 million in 2007 to approximately 19.2 million in 2050. The main explanation is the low level of fertility, which, even if improving, will remain below the optimal reproduction level over the entire forecasting period.

Table 7.2 Projection of the population number and the rate of dependence

	2010	2020	2030	2040	2050
Total population (thousands people)	21.191	20.395	19.638	19.326	19.228
			percentage (%)		
0-14 years old	15.2	14.8	13.2	12.4	12.8
+15 up to retirement age	69.8	67.0	65.0	60.4	55.8
after retirement age	15	18.2	21.8	27.2	31.4
Dependency rate (percent)	21.6	27.2	33.6	45.0	56.3

Source: EUROSTAT (Europop2007) and National Statistics Institute

The number of contributors to the pension system is expected to decline from a weight of 69.8 percent in 2010 to about 56 percent in 2050 due to the diminishing trend of the total population. The share of the people aged over 65 years old in the total population is forecasted to increase from 15 percent in 2010 to 31.4 percent in 2050.

7.2 Development of the labour participation rates

The demographic challenges are amplified by the employment rate. In 2006, the employment rate for the population recording an age between 15 and 64 was 58.8 percent, as against the target of 62.1 percent set for 2010.

The employment rate for the population between 55 and 64 years old was approximately 40 percent in 2006, below the 50 percent target set in the Lisbon Strategy.

Prolonging the active life is a priority having in view the negative trend of the demographic evolution and the quantitative and qualitative deficits recorded in the labour market.

In order to reduce the pressure on the public pension system, the Government presently designed additional measures to restrict early retirement by limiting eligibility criteria and incentive measures aimed at developing the services addressed to old unemployed persons in order to re-enter in the labour market.

Under these circumstances we expect that the participation rate for male will be over 80 percent, and for female at about 71 percent in 2050. Also, we estimate a diminishing ILO unemployment rate from a current 7.3 percent to 4.5 percent at the end of the forecasting period.

7.3 Development of the pension system

In order to evaluate the dynamics of the pension system, supplementary to the demographic assumptions we assumed an indexation of the pensions' benefits accordingly to the evolution of the average wage.

This assumption is a realistic one, considering recent government's decisions of increasing these benefits as in 2006 the pension’s benefits registered a minimum economic and legally allowed level.

Table 7.3 Development of the pension’s system deficit

percent in GDP	2010	2020	2030	2040	2050
Pension´s system deficit–pessimistic scenario	0.02	0.36	1.28	2.19	2.76
Pension´s system –baseline scenario	0.02	0.36	0.70	1.21	1.32
Pension´s system–baseline scenario – excluding second pillar	0.36	0.96	1.50	2.01	2.12

Source: Ministry of Economy and Finance

The table above shows the evolution the deficit of the pension’s system taking into account the demographic assumptions. As is showed, in a pessimistic scenario the level of the deficit will raise from 0.02 percent in GDP in 2010 to 2.76 percent in GDP in 2050. However it has to be mentioned that Romania has reserves for increasing the tax base through certain means as increasing the activity rate and restructuring the agricultural sector. Thus, in the baseline scenario we assume an increase in the participation rate, the level of the deficit rising from 0.02 percent of GDP in 2010 to 1.32 percent of GDP in 2050. The system’s balance in the baseline scenario will further deteriorate when part of the contributions to the public pension system will be re-directed towards the private- administered compulsory pensions (2 percentage points in 2008, followed by a gradual increase up to 6 percentage points in 2016). In this case the deficit of the pension’s system is expected to increase from 0.36 percent in GDP in 2010 to 2.12 percent in GDP in 2050.

7.4 Health system’s development

Population’s health indicators improved significantly during the last years, but they are still lagging from a comparative perspective with the European Union member states.

As observed in the below table, the continuous improving level of the indicators shows a positive evolution of the health status. Life expectancy enhanced and mortality rate has notably decreased. Infant mortality is currently under the average of the states with a similar average income as Romania, but maternal mortality is to some extent above the average.

Table 7.4 Selected Health Indicators

	2000	2001	2002	2003	2004	2005	2006
Female life expectancy at birth	74.2	74.8	74.9	74.8	75.1	75.5	75.8
Male life expectancy at birth	67.0	67.7	67.6	67.4	67.7	68.2	68.7
SDR ischemic heart disease 0-64 per 100,000 males	688.6	701.2	755.9	749.8	721.9	732.4	…
SDR all causes and ages	11.4	11.6	12.4	12.3	11.9	12.1	12.0
Infant mortality rate (per 1,000 live births)	18.6	18.4	17.3	16.7	16.8	15.0	13.9
Maternal mortality (per 100,000 live births)	0.33	0.34	0.22	0.30	0.24	0.17	0.15

Source: Ministry of Public Health- Statistical Annual Book; National Statistics Institute – Demographic Annual Book; Romanian Government – the Second Report on the Development Objectives of the Millennium

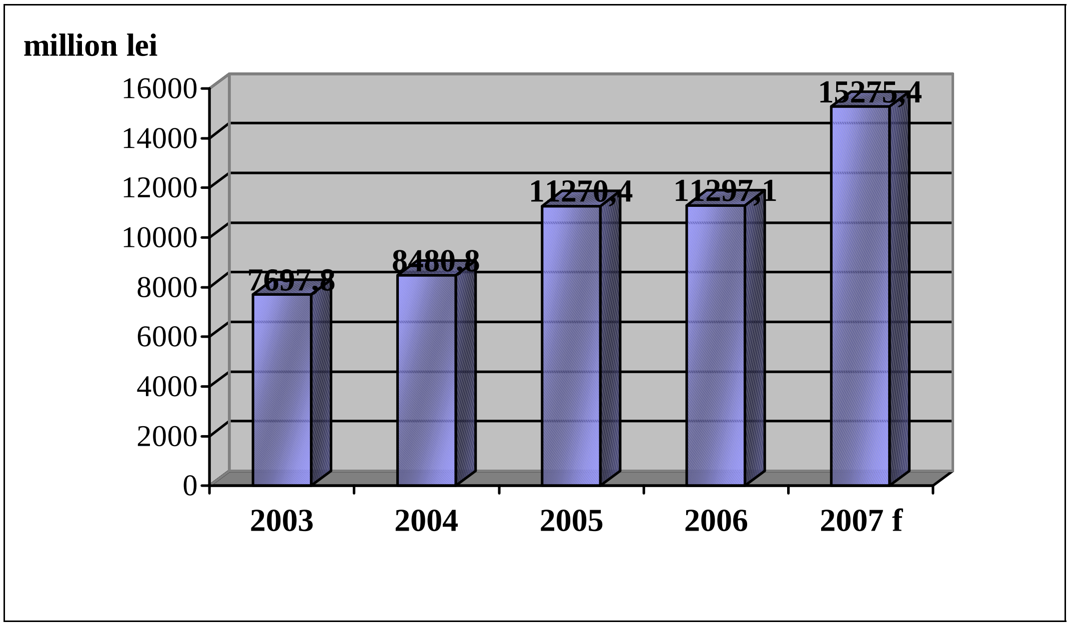
Besides, the deterioration trend of some other health indicators was not yet inverted. For instance, the standard death rates (SDR) indicates that the diseases of the circulatory system represent one of the leading causes of death in Romania and there has been made little progress in reducing the number of ischemic heart diseases. The decrease of these rates is very modest and their levels are still well above those registered in the European Union. Regarding the standard death rates in the case of tuberculosis, the evidence shows that in the last years the incidence of tuberculosis was decreasing. In the mean time, the new cases of HIV/AIDS registered a diminishing trend.

With the purpose of taking the appropriate actions for improving the health status to a level close to EU member states, starting July, 1st the National Health Status Evaluation was launched.

Health expenditure increased in real terms over time and expressed as weight in GDP fluctuated around 3.4 and 4 percent, in line with the level registered in other countries with the same level of development, but lower compared to the majority of the EU countries.

Even so, a number of factors hinder the satisfactory functioning of the system and creates pressure for increasing the level of the financial resources, mainly: the higher share of about 60 percent of the resources from the health budget absorbed by the hospital system (compared with an average level of 35-40 percent in the EU member states); the technological and therapeutically progress registered in the medical field, triggering higher costs; the increasing expectations of the population and the inadequate financial discipline within the system.

Figure 7.1 Health expenditure evolution



Source: Ministry of Economy and Finance

Note: the flows between budgets were eliminated

7.5 Measures to improve public finances' sustainability

7.5.1 Pensions Sector

The pension's reform was launched on the occasion of the enactment of the Law no 19/2000 regarding the public pension system and other social rights that include measures aiming to decrease the long-term fiscal imbalances of the social security budget, such as:

(a) rising the standard retirement age from 57 to 60 years for women and from 62 to 65 years for men, in a gradual approach until 2014;
(b) granting additional pension points in order to stimulate participation in the labour market even after meeting the cumulative criteria for retirement;
(c) increasing the minimum contribution period for both genders from 10 to 15 years until 2014;
(d) introducing a new formula for computing pensions, thus improving the correlation between the contributions to the system and the level of benefits.

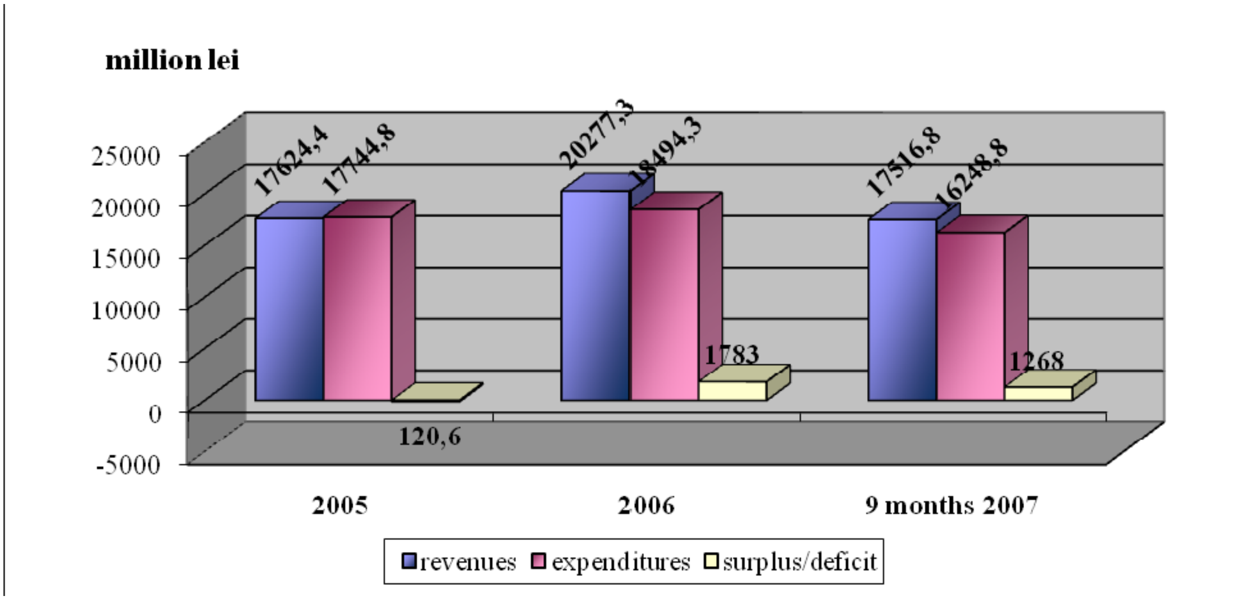
A key element in consolidating the public pension system (first pillar) was the externalization of the non-contributive services. In this respect, a number of benefits were excluded from the social security budget, such as:

(a) payment of the farmers' pensions was transferred to the state budget, starting 2005;
(b) payment of the child-raising allowances and medical allowances were transferred to the state budget, respectively to the health social insurance fund, starting 2006.

Pension's benefits in the pay as you go system increased by 5 percent from September, 1st. and as compared to December 2004 the nominal increase was of 60 percent.

Accordingly to the Law no 250/2007 the rate between the pension point and the average gross wage used for the assessment of the Social Insurance Budget increased from 31.2 percent up to 37.5 percent starting November, 1st.

Figure 7.2 Development of the Social Insurance Budget



Source: Ministry of Economy and Finance

As shown in the above graph, the positive value of the balance of the Social Security Budget registered in the first 9 months 2007 (a surplus accounting for RON 1268 million) created the favourable pre-requisites for the increase in the pension point value.

With a view to ensure the resources needed for supporting the financial effort due to the increase in pension's benefits in parallel with the implementation of the second pillar and the reduction in taxation level, the following measures were already approved for 2008 (Emergency Ordinance no 91/2007):

(a) removal of the ceiling of 5 average gross wages for the individual contributions and enlarging the tax base in order to include the average gross earnings (instead of the average gross salary in present) which is estimated to bring a surplus of RON 2163.6 million (0.49 percent in GDP); the obligatorily inclusion of new taxpayers categories (sole associates, managers, directors) represent a supplementary revenue estimated at RON 1037.2 million (0.23 percent in GDP).

(b) enhancing the efficiency of the fiscal administration will facilitate the collection process with an estimated surplus of RON 1995.4 million (0.45 percent in GDP);

(c) in addition, subsidies from the State Budget summing to RON 1379.56 million (0.31 percent in GDP) will be granted to finance the remaining deficit.

The **second pillar** - the private-managed compulsory pensions - will be implemented starting January 1, 2008 according to Law no 411/2004. The provisions comprised by the law stipulate the compulsory redirection of a certain part of the contribution from the pay-as-you-go system (up to 2 percent of the wage fund for the first year with the share gradually increasing by 0.5 percent per year, during the next eight years, up to 6 percent at the end of the period).

The contribution to these private-managed funds will be obligatory for the population under 35 years and voluntary for those aged between 36 and 45. Each pension fund should assist minimum 50,000 participants and will function under the supervision of a newly established body named the Pension Funds Supervisory Commission (established by Emergency Ordinance no 50/2005, approved by Law no 313/2005). The persons, who will not accomplish in opting for a certain fund, will be directed ex officio towards a fund administrator.

To subscribe to one of the private pension fund represent either the participant's own decision or the result of the ex officio assignment of the National Office for Pensions and Social Insurance.

The procedure for initial assignment to the private pension funds started at September 17, 2007. Until September 30, 2007 a number of 17 fund administrators and 17 private pension's funds were authorized.

The third pillar – private-managed voluntary pension's schemes – was implemented in 2007 (Law no 204/2006 regarding optional pensions). At the end of September, 6 fund administrators and 7 optional pension's funds were authorized summing up 14543 participants. Total contributions are estimated to be around EUR 100 million at the end of the second implementation year.

7.5.2 Health Sector

By adopting Law number 95/2006, the reform of the health sector was launched, in order to increase the access of the population to medical services, improving the quality and the efficiency of the health services.

The government is fully committed to implement this package and to deepen the overall reform process in order to improve the public finance sustainability within the sector.

The priorities of the reform are the following:

(a) ensuring an appropriate financing in accordance with the population needs;
(b) reducing the medical assistance costs in hospitals while improving accountability and efficiency in the hospital sector by introducing a more professional management as the hospital units are functioning on financial autonomy basis;
(c) enhancement of the ambulatory medical assistance in order to improve the medical services, including supplying IT and communication network for family medical units;
(d) development and reorganization of the emergency services network;
(e) a better acknowledge of the population health status and associated risk's factors by organizing and financing the national Program for evaluation of health status;

(f) improving the managerial capacity in the health sector by monitoring and redefining the status of the hospital's manager;

In the view of improving and raising the level of the financial flows to the system the subsequent measures were introduced:

(a) amplifying the level of resources by increasing the number of contributors to the system;
(b) attracting financial resources from the private sector;
(c) regulating the private insurance health system (complementary system) for diversifying the resource base, raising the level of the competition in the system with positive consequences evident on a better cost control and the provision of services with improved quality;
(d) launching and concluding the concept of co-payment and that of minimal health services package.

We have to stress that a further involvement of the private sector in supplying medical assistance is essential for reducing the pressure exerted on public resources and improving the quality of the medical services.

A supplementary financial source for investments is represented by the vice tax that was introduced aiming at reducing the excessive tobacco and alcohol consumption and also improving the health sector's infrastructure.

The revenues coming from the vice tax accounted for RON 645 million in 2006 (the effective collection started in September) and for RON 947.8 million in the first 9 month 2007.

A part of this sum is directed towards the national Program for evaluation the health status (launched at July 1st this year) and the rest of the money for the acquisition of vehicles and ambulances.

The National House for Health Insurance became certainty autonomous, as the public control over its activity and the use of funds is exerted by the Parliament. In the mean time some expenses that are not related to the sanitary system were transferred to the budget, such as expenditures for the social-medical units and work accidents.

With the view to enhance the efficiency of managing the National Fund for Health Social Insurance a standard framework for paying off was set and special fees were introduced to validate the most costly treatments under special criteria, being supervised by the National House for Health Insurance.

The development of the primary medical assistance was appointed in the General Contract and in the methodological standards, as the following measures would be undertaken:

(a) a greater fund will be allocated to the primary medical assistance starting this year;
(b) for the doctors working in less developed areas some bonuses will be granted;
(c) introducing new medical services in the standard medical service's packages;

(d) granting financial incentives to the family's care doctors who deliver separate lists with insured patients and patients benefiting the minimal health package, the final number taken into account being the sum of the patients belonging to those lists.

7.5.3. Measures to Enhance Fertility Rates

In this area, the Government adopted the Law 396/2006, granting a financial support of 200 euro per family, with the condition that both partners are at the first marriage. In addition, striving for boosting the birth rate, the government adopted the Emergency Decision no 148/2005, stipulating the child care holiday right (up to 2 years for normal child and up to 3 years for handicapped persons) for the people having realized professional revenues for at least 12 month. Moreover, these persons are benefiting of a monthly indemnity of RON 600 and an additional RON 100 incentive, starting by January 1, 2007.

From the same date, the amount of the child allowance is about RON 200 for each child with an age below 2 years (3 years respectively for the handicapped children).

Adopting Law no 263/2007 regarding the setting up and organisation of crèches, created the appropriate legal framework to organize crèches as structures offering specialized social services dedicated to raise, guard and educate the children under 3 years old. In the same time under the provisions of this law the Program for supplying the crèche tickets was introduced.

8. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

8.1 The medium term strategy of the National Agency for Fiscal Administration

The main objectives governing the tax administration activity over the next five years, comprised in the strategy of the National Agency for Fiscal Administration are the following:

a) Encourage voluntary compliance through the implementation and improvement of the taxpayer assistance services (including measures concerning the fiscal education of taxpayers), as well as through modernization and simplification of fiscal procedures;
b) Prevent and fight tax evasion and financial indiscipline, by improving the quality of tax inspections and the forced execution, insolvency and joint liability procedures; under this objective, strengthening cooperation with similar authorities from other EU Member States will play a central role;
c) Modernize and improve the functioning of the tax administration, by improving the revenue collection planning process, strengthening the capacity to assess the taxpayers' and contributors' compliance rates, as well as building institutional relationship with those bodies holding information on taxpayers.

The main priorities laid down in the strategy aim at:

1. Simplifying and improving the fiscal procedures:

(a) Build a database including questions/answers for explaining the tax legislation;
(b) Efficiently manage the taxpayers' complaints;
(c) Adjust VAT management procedures in line with the EU requirements in the tax administration field;
(d) Provide taxpayers with more diversified means to assist them to comply with the tax stating obligations (including on-line submission of tax statements by the large tax payers, system to be extended from 2008 to all the tax payers);
(e) Establish procedures to update and consolidate the Taxpayer Register, and the redesign of the computer system;
(f) Harmonize the contributions tax base for the social insurance funds, introduce the single statement and improve of the information exchange with the insurance offices.

2. Fighting tax evasion and financial indiscipline:

(a) Implement risk analysis;
(b) Develop the research & study component in the tax field;
(c) Develop electronic control in 2008;
(d) Adopt the best international practices regarding price transfer, expected to become effective as of 2009.

3. Boosting the budget revenues collection rate:
   (a) Gradually reduce arrears in the economy and prevent new arrears from accumulating;
   (b) Follow-up of insolvency procedures against taxpayers, in case the enforcement measures failed;
   (c) Monitor the arrears reduction in large and medium-sized taxpayers;
   (d) Monitor on a monthly basis, the budget revenues administrated by NAFA;
   (e) Monitor the recovery of illegal/forbidden state aid.

Improving the domestic functioning
   (a) Routine the management procedures on tax statements and payments, activity to be extended in the next two years;
   (b) Implement the centralized database containing comprehensive information on taxpayers;
   (c) Continue the management transfer of excisable products movement to National Customs Authority;
   (d) Continue the efforts to improve the financial discipline with a view to carry on the restructuring process at a microeconomic level and provide efficient use of resources.

8.2 The elaboration and implementation of public policies

The process of drafting and implementing public policies remains a priority area, and Romanian authorities continued their efforts to improve the economic and social impact assessment of public policies and to systematically monitor the efficiency in using public funds.

The Government approved in 2007 the procedures enabling a new mechanism for assessing the justification of all acts and public policy papers, before they are submitted to the Parliament. This procedure document is based on the Strategy to improve the public policy elaboration, coordination and planning within the central public administration. The main objective of the Strategy is to develop a simplified and efficient system to formulate, coordinate and plan the public policies, aimed at adding up to the significant improvement of the government action quality, the quality of legislation and the overall development of the institutional capacity of the central public administration.

The rationale behind the new legal framework is to streamline the procedures of elaboration, approval and submitting of legal acts and public policy documents for adoption/approval, in the context of the following objectives:
   (a) establish a public policy document system;
   (b) elaborate clear procedures for carrying out consultations with public institutions and interested partners from civil society, during the stage of drafting the normative acts;
   (c) stress the importance of consultation period, as compared to the approval period, by cultivating the communication concept within the public administration;

(d) elaborate procedures for correlating public policy planning and implementation of legal acts with budget planning process.

On a long term, the new Regulation aims at increasing the coherence of government policies, contributing to the establishment of a stable framework for the elaboration of public policies and legal acts, assessing the budgetary impact, improving the correlation with the medium term budget framework, and deepening the civil society's involvement in the Government's initiatives.

ANNEXES

Table 1a. Macroeconomic prospects

	ESA Code	2006	2006	2007	2008	2009	2010
		Level [1)]Bn.Lei	Rate of change				
1. Real GDP	B1*g	310.1	7.7	6.1	6.5	6.1	5.8
2. Nominal GDP	B1*g	342.4	18.9	14.1	13.1	11.5	10.5
Components of real GDP							
3. Private consumption expenditure	P3	227.8	13.9	10.9	9.2	8.2	7.3
4. Government consumption expenditure	P3	53.7	2.5	5.4	4.3	2.8	2.6
5. Gross fixed capital formation	P51	77.2	16.1	18.0	13.0	11.5	11.0
6. Changes in inventories (% of GDP)	P52	0.3	0.3	0.0	-0.1	0.0	0.0
7. Exports of goods and services	P6	104.9	10.6	8.3	10.3	10.9	10.7
8. Imports of goods and services	P7	153.3	23.0	21.5	16.1	14.9	13.9
Contributions to real GDP growth							
9. Final domestic demand		-	13.8	12.9	10.8	9.6	8.9
10. Changes in inventories	P52	-	0.3	0.0	-0.1	0.0	0.0
11. Trade balance	B11	-	-6.4	-6.8	-4.2	-3.5	-3.1

1) Levels of real GDP and its components expressed in 2005 prices.

Table 1b. Price developments

	2006	2007	2008	2009	2010
	Rate of change				
1. GDP deflator	10.4	7.5	6.4	5.2	4.4
2. Private consumption deflator	5.1	4.0	4.1	3.3	2.8
3. HICP	6.6	4.8	5.7	4.0	3.3
4. Public consumption deflator	14.8	6.8	5.0	4.2	3.5
5. Investment deflator	9.1	7.0	5.5	4.5	4.0
6. Export price deflator (goods and services)	5.7	1.1	3.3	2.1	1.7
7. Import price deflator (goods and services)	-0.6	-3.3	-1.6	-2.6	-3.0

Table 1c. Labour market developments

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	Rate of change				
1. Employment, thou. persons		9,313	1.8	1.5	1.4	1.1	0.6
2. Employment, hours worked			-	-	-	-	-
3. Unemployment rate (%) - ILO			7.3	7.1	6.9	6.8	6.6
4. Labour productivity[1]			5.8	4.5	5.0	4.9	5.2
5. Labour productivity, hours worked			-	-	-	-	-
6. Compensation of employees –mill.lei	D1	85,690	19.6	22.1	14.6	11.6	10.8
7. Compensation per employee- lei		18,360	16.8	19.5	optional	optional	Optional

[1] Real GDP per person employed.

Table 1d. Sectoral balances

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Net lending/borrowing vis-à-vis the rest of the world	B9	-10.3	-12.6	-10.5	-10.1	-10.2
of which:						
- Balance on goods and services		-12.1	-14.7	-15.4	-15.3	-15.0
- Balance of primary incomes and transfers		1.8	1.4	1.8	1.9	2.0
- Capital account		-0.04	0.7	3.1	3.3	2.8

Table 2. General government budgetary prospects

	ESA Code	2006	2006	2007	2008	2009	2010
		Level Mill.lei	% of GDP				
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-6,378.5	-1.9	-2.9	-2.9	-2.9	-2.4
2. Central government	S.1311	-9,949.1	-2.9	-3.3	-3.1	-3.2	-2.6
3. State government	S.1312						
4. Local government	S.1313	-82.4	0.0	0.0	0.1	0.1	0.1
3. Net lending/borrowing of general government	S.1314	3,653.0	1.1	0.4	0.1	0.2	0.2
General government (S13)							
6. Total revenue	TR	113,512.4	33.2	37.4	39.8	39.9	40.8
7. Total expenditure	TE	119,890.9	35.0	40.3	42.7	42.8	43.2
8. Net lending/borrowing	EDP B.9	-6,378.5	-1.9	-2.9	-2.9	-2.9	-2.4
9. Interest expenditure	EDPD.41	2,806.9	0.8	0.9	0.9	0.8	0.8
10. Primary balance		-3,571.6	-1.0	-2.0	-2.1	-2.1	-1.6
11. One-off and other temporary measures[1]		-1,446.4	-0.4	-0.2	-0.2	-0.1	-0.1
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		64,877.0	18.9	21.6	21.9	22.5	23
12a. Taxes on production and imports	D.2	43,911.3	12.8	14.0	14.0	14.5	15
12b. Current taxes on income, wealth, etc	D.5	20,965.7	6.1	7.6	7.9	8	8
12c. Capital taxes	D.91	0.0	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	35,604.2	10.4	10.3	11.6	11.2	11.0
14. Property income	D.4	3,324.1	1.0	1.3	1.6	1.4	1.3
15. Other		9,707.1	2.8	4.2	4.7	4.8	5.5
16=6. Total revenue	TR	113,512.4	33.2	37.4	39.8	39.9	40.8
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		100,481.2	29.3	31.9	33.5	33.7	34.0
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	**52,963.6**	**15.5**	**16.9**	**16.7**	**16.0**	**15.8**
17a. Compensation of employees	D.1	31,268.1	9.1	9.1	8.6	7.8	7.3
17b. Intermediate consumption	P.2	21,695.5	6.3	7.8	8.2	8.2	8.5
18. Social payments (18=18a+18b)		33,017.9	9.6	10.0	11.5	12.0	11.9
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	2,659.5	0.8	0.2	0.3	0.3	0.3
18b. Social transfers other than in kind	D.62	30,358.4	8.9	9.8	11.2	11.7	11.7
19=9. Interest expenditure [2]	EDP D.41	2,806.9	0.8	0.9	0.9	0.8	0.8
20. Subsidies	D.3	6,302.5	1.8	1.7	1.4	1.2	0.9
21. Gross fixed capital formation	P.51	16,930.0	4.9	7.0	8.2	8.6	9.2
22. Other		7,870.0	2.3	3.9	4.0	4.2	4.5
23=7. Total expenditure	TE	119,890.9	35.0	40.3	42.7	42.8	43.2
p.m.: Government consumption (nominal)	P.3	57,215.3	16.7	L	L	L	L

1) Compensations titles issue by government as a result of restitutions law
2) For the period 2007 - 2010 interest expenditure are cash basis

Table 3. General government debt developments

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Gross debt (according to ESA)		12.4	11.9	13.6	14.2	14.9
2. Change in gross debt ratio		-3.4	-0.5	1.7	0.6	0.7
Contributions to changes in gross debt						
3. Primary balance		-1.0	-2.0	-2.1	-2.1	-1.6
4. Interest expenditure (incl. FISIM)	EDP D.41	0.8	0.9	0.9	0.8	0.8
5. Stock-flow adjustment		-3.2	0.6	2.9	1.9	1.5
Of which: - Differences between cash and accruals		-0.02	-0.01	-0.01	-0.02	-0.01
- Net accumulation of financial assets		2.69	0.06	0.15	0.10	0.10
Of which : privatisation proceeds		2.61	0.04	0.01	0.01	0.01
- Valuation effects and others		-5.9	0.6	2.8	1.8	1.4
p.m.: Implicit interest rate on debt		6.2	7.3	7.1	6.3	5.8
Other relevant variables						
6. Liquid financial assets*		3.9	2.8	2.6	2.3	2.1
7. Net financial debt (7=1-6)		8.5	9.1	11.0	11.9	12.8

*) stands for the cash holdings of MEF in hard currency account and in Ron account including receipts from banking assets recovery and privatization proceeds.

Table 4. Cyclical developments

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Real GDP growth (%)		7.7	6.1	6.5	6.1	5.8
2. Net lending of general government	EDP B9	-1.9	-2.9	-2.9	-2.9	-2.4
3. Interest expenditure (incl. FISIM)	EDP D41+ FISIM	0.8	0.9	0.9	0.8	0.8
4. Potential GDP growth (%)		5.72	6.26	6.47	6.57	6.63
contributions:						
- labour		-0.07	-0.04	0.05	0.09	0.12
- capital		2.40	2.86	3.09	3.24	3.34
- total factor productivity		3.39	3.43	3.32	3.25	3.16
5. Output gap		2.44	2.29	2.32	1.86	1.07
6. Cyclical budgetary component		0.69	0.74	0.80	0.66	0.39
7. Cyclically-adjusted balance (2 - 6)		-2.59	-3.64	-3.7	-3.56	-2.79
8. Cyclically-adjusted primary balance (7 + 3)		-1.79	-2.74	-2.8	-2.76	-1.99

Table 5. Divergence from previous update

	ESA Code	2006	2007	2008	2009	2010
Real GDP growth (%)						
Previous update		8.0	6.5	6.3	5.9	
Current update		7.7	6.1	6.5	6.1	5.8
Difference		-0.3	-0.4	0.2	0.2	
General government net lending (% of GDP)						
Previous update		-2.3	-2.7	-2.6	-2.0	
Current update		-1.9	-2.9	-2.9	-2.9	-2.4
Difference		0.4	-0.2	-0.3	-0.9	
General government gross debt (% of GDP)						
Previous update		12.8	13.5	12.6	11.7	
Current update		12.4	11.9	13.6	14.2	14.9
Difference		-0.4	-1.6	1.0	2.5	

Table 6. Long-term sustainability of public finances

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure	33.6	35.0	43.2	41.0	39.0	37.0
Pension expenditure	6.7	6.8				
Health care	3.5	3.3				
Education expenditure	3.4	4.3				
Total revenue	32.1	33.2	40.8	40.5	38.5	37.0
		- Average rate -				
Labour productivity growth	2.2	8.6	5.0	5.1	4.4	3.6
Real GDP growth	2.1	5.7	6.4	5.5	4.6	3.7
	- % -					
Participation rate males (aged 15-64)	75.4	69.5	72.6	75.1	78.1	80.5
Participation rates females (aged 15-64)	61.8	55.3	60.7	63.1	64.9	70.8
Total participation rates (aged 15-64)	68.7	62.4	66.6	69.1	71.5	75.7
Unemployment rate - ILO	6.9	7.2	6.6	4.8	4.6	4.5
Population aged 65+ over total population	13.6	14.7	15.5	17.0	18.5	22.0

Table 7. Basic assumptions

	2006	2007	2008	2009
World GDP growth	5.4	5.1	4.7	4.8
EU27 GDP growth, *of which:*	3.0	2.9	2.4	2.4
• Consumption	2.2	2.3	2.4	2.2
• Investment	5.9	5.6	3.5	3.4
Euro area GDP growth	2.8	2.6	2.2	2.1
USD/€ exchange rate (annual average)	1.26	1.36	1.42	1.42
World import of goods&sercices volumes, excluding EU	8.0	7.8	7.1	7.7
Growth of relevant foreign markets	9.5	7.3	6.8	6.6
Oil prices (Brent, USD/barrel)	66.2	70.6	78.8	76.0