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ROMANIA: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE JUNE 2009 UPDATE OF THE CONVERGENCE PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term budgetary programme, called "stability programme" for countries that have adopted the euro as their currency and "convergence programme" for those that have not.

The attached technical analysis of the programme, prepared by the staff of, and under the responsibility of, the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 24 June 2009. Comments should be sent to Lorena Ionita, Stefaan Pauwels and Corina Weidinger Sosdean (Lorena.Ionita@ec.europa.eu, Stefaan.Pauwels@ec.europa.eu, Corina.Weidinger-Sosdean@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' 2009 Spring forecast, (ii) the code of conduct ("Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. Technical issues are explained in an accompanying methodological paper prepared by DG ECFIN.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 24 June 2009. The ECOFIN Council adopted its opinion on the programme on 7 July 2009.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

1. INTRODUCTION

This document assesses the June 2009 update of the convergence programme of Romania. It takes into account all currently available information, notably the Commission services' 2009 Spring Forecast and the short-term fiscal stimulus measures adopted by the Romanian authorities in response to the economic downturn. The programme, which was submitted on 3 June 2009, covers the period 2008-2011 and builds on the 2009 budget as well as the April 2009 budgetary rectification. It was approved by the government on 27 May and sent for information to the Romanian parliament. The late submission of the convergence programme was due to the election of a new government at the end of 2008 and the update of budgetary projections in light of the commitments made under the EU balance of payment assistance.

2. MAIN CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

Between 2002 and 2008, the Romanian economy has experienced a strong expansion, with above potential real GDP growth rates averaging 6.3% year-on-year. Economic growth was primarily driven by domestic demand, as strong credit and wage developments boosted private consumption and investment. The boom, which was fuelled by foreign capital inflows, has also led to overheating and unsustainable external and fiscal imbalances. The current account deficit peaked at 13.5% of GDP in 2007 and decreased only marginally to 12.3% of GDP in 2008. Domestic demand pressures have also contributed to core inflation picking up in 2008, after several years of disinflation.

The high external borrowing was driven by a procyclical fiscal policy. During the demand boom between 2005-2008, headline deficits rose from 1.2% of GDP in 2005 to 5.4% of GDP in 2008, amidst high real GDP growth and against repeated advice given in the February 2008 Council Opinion on Romania's convergence programme and the June 2008 Commission Policy Advice. This was due to a large degree to an overall weak budgetary planning and execution and a lack of predictability of fiscal policy with frequent budgetary rectifications. This contributed to recurrent budgetary slippages, notably with respect to current spending. Public sector wage growth has become the driver of private sector wage increases, with wage levels higher in the public sector. Over the period 2005-2008, the public sector wage bill doubled in nominal terms.

The global economic downturn and an increased investor risk-aversion towards home-grown vulnerabilities have resulted in a significant tightening of capital flows to Romania. Pressures on the exchange rate have increased, resulting in a more than 30% cumulative depreciation of the RON since August 2007. In the fourth quarter of 2008, GDP growth dropped to 2.9% year-on-year, followed by a worse-than-expected 6¼% contraction in the first quarter of 2009. On the back of a 10% contraction of domestic demand in Q1-2009, the current account deficit shrank to 0.6% of the projected full-year's GDP, compared with 2.9% one year earlier, notwithstanding a significant decline in exports. The Commission services spring 2009 forecast projects GDP to contract by 4% in 2009, followed by about zero percent growth in 2010.

Estimates of the output gap indicate that the adjustment over the coming years will be significant, with the gap moving from strongly positive (8.5% of potential GDP in 2008) to close to zero in 2009 and negative (-3% of potential GDP) in 2010. Accordingly, the Romanian economy is assessed to have entered economic 'bad times' as from 2009 and to remain in bad times over the forecast horizon (see Figure 1 in Annex 1). This is also reflected in falling tax elasticities: the Commission forecasts elasticities of both VAT and direct taxes to drop significantly in 2009. Only the elasticity of social contributions is projected to increase, following a 3.3 percentage points hike in the pension contribution rate.

In order to cushion the effects of the sharp drop in private capital inflows and to facilitate an orderly adjustment of the external deficit, Romania has been granted[1] a large (EUR 20 billion) international financial assistance package from the EU (of up to €5bn) and the IMF (€12.95bn). Additional multilateral support will be provided by the World Bank (€1 billion) as well as by the European Investment Bank and the European Bank of Reconstruction and Development, which will contribute together with about €1 billion, on top of their general lending activities. This financial assistance is conditional upon the implementation by the Romanian authorities of a comprehensive economic adjustment programme, which aims to address the external and fiscal imbalances and to strengthen the financial sector regulation and supervision.

A cornerstone of the financing package's economic policy conditions is fiscal consolidation, targeting a gradual reduction of the public deficit from 5.4% of GDP in 2008 to 5.1% in 2009, 4.1% in 2010 and below 3% in 2011. Furthermore, the Romanian government has committed to undertake specific measures aimed at improving expenditure control and fiscal governance, among others the restructuring of the public compensation system, the introduction of a unified pay system for public employees, a reform of the public pension system, a binding medium-term budgetary framework and the establishment of an independent fiscal council. Measures will also be taken to improve financial sector regulation, among which increasing the remedial powers of the National Bank of Romania in case of bank distress. Furthermore, the pace of structural reforms will be stepped-up, among others by improving the efficiency of public administration, enhancing the business environment as well as tackling undeclared work.

Given the need for fiscal consolidation and in line with the European Economic Recovery Plan adopted in December 2008 by the European Council, Romania has adopted only a limited number of fiscal stimulus measures, amounting to roughly ¾% of GDP in 2009, aimed at supporting household income, the corporate sector as well as labour markets.

3. MACROECONOMIC SCENARIO

The programme projects GDP growth to contract by 4% in 2009 on the back of a strong reduction of domestic demand for both consumption and investment (see Table I). The contribution of net exports is expected to turn positive, notwithstanding a significant drop in external demand. In 2010, growth is forecasted around zero, followed by a recovery of about 2.4% in 2011, driven by domestic demand. Accordingly, the output gap, as recalculated by Commission services based on the information in the programme, using the commonly agreed

[1] On 6 May, two Council decisions were adopted: Council Decision 2009/458/EC granting mutual assistance to Romania and Council Decision 2009/459/EC providing Community medium-term financial assistance for Romania. In June, a Memorandum of Understanding was signed with the Romanian authorities, fixing the detailed policy conditionality per loan instalment.

methodology, will turn negative from 8.5% of potential GDP in 2008 to 0.5% in 2009 and -2.5% in 2010[2].

Net external borrowing needs are set to decline from 11.9% of GDP in 2008 to 6.3% of GDP in 2009 and 5.2% in 2001, following the reduction in the trade deficit. In line with the decline in excess demand, inflation is projected to ease from 7.9% in 2008 to 5.8% in 2009, i.e. entering the target band of the National Bank of Romania of 3.5 +/-1% by end-2009. Inflation is expected to further decrease to about 3.2% by 2011.

This scenario, which was finalised in May, is in line with the Commission services' spring 2009 forecasts. In view of the worse-than-expected GDP growth contraction in the first quarter of 2009 as well as the uncertainty related to the global economic downturn and the ongoing correction of economic imbalances in Romania, it now appears to be based on slightly favourable growth assumptions. Given potential growth estimates, this is true also for 2011. On inflation, the programme's projections appear realistic, as is the anticipated reduction of net external borrowing.

Table I: Comparison of macroeconomic developments and forecasts

	2008		2009		2010		2011
	COM	**CP**	**COM**	**CP**	**COM**	**CP**	**CP**
Real GDP (% change)	7.1	7.1	-4.0	-4.0	0.0	0.1	2.4
Private consumption (% change)	9.1	9.1	-3.7	-4.1	-0.3	-0.6	2.0
Gross fixed capital formation (% change)	19.3	19.3	-6.5	-6.5	-0.5	-0.5	3.5
Exports of goods and services (% change)	19.4	19.4	-16.9	-13.7	0.6	1.7	2.8
Imports of goods and services (% change)	17.5	17.5	-17.3	-15.6	-0.5	-0.4	2.6
Contributions to real GDP growth:							
- Final domestic demand	12.5	12.5	-6.3	-6.6	-0.3	-0.5	2.5
- Change in inventories	-3.5	-3.5	0.0	0.0	0.0	0.0	0.0
- Net exports	-1.9	-1.9	2.3	2.6	0.3	0.6	-0.1
Output gap[1]	8.5	8.7	0.2	0.5	-3.0	-2.5	-2.9
Employment (% change)	0.3	0.2	-2.2	-2.1	0.6	0.5	0.7
Unemployment rate (%)	5.8	5.8	8.0	8.0	7.7	7.7	7.4
Labour productivity (% change)	6.8	6.9	-1.9	-1.9	-0.6	-0.4	1.7
HICP inflation (%)	7.9	7.9	5.8	5.8	3.5	3.5	3.2
GDP deflator (% change)	14.0	14.0	9.7	9.9	6.6	6.9	5.1
Comp. of employees (per head, % change)	22.0	20.5	8.5	6.0	7.5	3.0	3.6
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-11.8	-11.9	-6.4	-6.3	-5.1	-5.4	-5.2

<u>Note</u>:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

<u>*Source*</u> *:*

Commission services' Spring 2009 forecasts (COM); Convergence programme (CP)

Downside risks to the growth scenario of both the programme and the Commission forecast could be due to a slower-than-expected recovery of the world economy. However, risks are cushioned by the foreign financial assistance to Romania and the flanking policy reform

[2] It should be highlighted that potential GDP growth estimates should be interpreted cautiously especially in the context of the current economic downturn.

measures, which are expected to enhance stability of the domestic financial system and to ensure stable government financing. In this context, the credibility of the government's efforts to correct the fiscal deficit and stepping-up structural reform will play a key role in reducing vulnerabilities, shoring-up investor confidence and stimulating growth.

4. BUDGETARY STRATEGY

4.1. Budgetary implementation in 2008

For 2008, the programme update estimates the deficit outcome for 2008 at 5.4% of GDP[3], against a target of 2.9% of GDP set in the previous update of the convergence programme. The budgetary slippages accentuated in the remaining part of the year as three quarters of the 2008 deficit in cash terms have been created in the second half of 2008, notably in December (when the deficit increased by some 2 percentage points of GDP).

The significant deviation between the deficit target and the outturn is due to a combination of expenditure overruns and a revenue-shortfall mainly due to over-optimistic revenue assumptions. Expenditure increased by 28.6% rather than the planned rise of 19.8% in the previous programme. This is mainly due to weak budgetary planning and execution, which resulted in substantially higher-than-planned current spending, notably in public wages and social transfers. Budget revenue increased by 18.7% somewhat less than planned in the previous programme. This is due to a large extent to overly optimistic revenue projections, which did not materialise and, to a lesser extent, to a sudden drop in revenue collection in the last two months of the year owing to the economic slowdown.

4.2. Near-term budgetary strategy

The update of the convergence programme targets a deficit of 5.1% of GDP in 2009. The 2009 budget adopted in February 2009 contains several measures to lower the deficit, including a recruitment freeze and the reduction of various bonuses in the public sector, cuts in expenditure for goods and services and subsidies, a 3.3 percentage points rise in the pension contribution rate and a bringing forward of the schedule to increase excise taxes.

Under the balance of payment programme, the government has pledged to undertake additional expenditure-driven fiscal adjustment measures. These measures, reflected in a budget rectification approved in April 2009 include further cuts in the public sector wage bill, expenditure on goods and services, some capital spending and subsidies. On the revenue side, measures in the amended 2009 budget aim at eliminating certain tax deductions and allowances (in particular for company cars and depreciation of revalued assets). On the other hand, the government plans a substantial increase in public investment in 2009 compared with 2008, also as a means to sustain the economic recovery.

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3 In view of the reported breach of the Treaty reference value, the Commission prepared on 13 May 2009 a report under Article 104.3 of the Treaty. Taking into account the opinion of the EFC according to Article 104(4), the Commission is proceeding with the steps laid down in Article 104(5)-(7)

Given the need for fiscal consolidation, only a limited set of fiscal stimulus measures has been adopted amounting to some of ¾% of GDP. To support household income, the government decided to increase by 3 months the period for which unemployment benefits will be paid and to introduce a "minimum" social pension for low-income pensioners. The measures for supporting the corporate sector include the non-taxation of reinvested profits, an extension of the car-scrapping scheme as well as the allocation of funds for export promotion. The labour market measures are mainly targeted towards supporting professional training for both unemployed and employees.

Table II. Main budgetary measures for 2009

Revenue measures	Expenditure measures
Measures in response to the downturn	
	• Public investment (1% of GDP) • Instituting a minimum "social" pension (0.1% of GDP)
Other measures	
• Increasing social contribution rate (0.8% of GDP) • Bringing forward the schedule to increase excise duties (0.1% of GDP) • Updating the tax base for local property taxes, bringing it to the market value (0.1% of GDP)	• Lower expenditure on goods and services (-1.3% of GDP) • Cuts in personnel expenditure (-0.9% of GDP)
Source: Commission services and the Romanian Ministry of Finance	

Reflecting the above-mentioned fiscal adjustment measures, the structural deficit (i.e. “cyclically-adjusted net of one-off and other temporary measures”), according to the information provided in the programme and as recalculated by Commission services is planned to improve by some 3 percentage points of GDP in 2009, pointing to a strongly restrictive fiscal policy stance.

Table III: Composition of the budgetary adjustment

(% of GDP)	2007	2008		2009		2010		2011	Change: 2008-2011
	COM	COM	CP	COM	CP	COM[1]	CP	CP	CP
Revenue	**34.0**	**33.1**	**33.1**	**33.4**	**33.2**	**33.3**	**33.7**	**34.2**	**1.1**
of which:									
- Taxes on production and imports	12.7	12.3	12.3	11.7	11.0	11.5	11.6	11.7	-0.6
- Current taxes on income, wealth, etc.	6.8	6.9	6.9	6.5	6.4	6.5	6.4	6.8	-0.1
- Social contributions	10.6	10.3	10.3	10.9	11.0	10.7	10.7	10.8	0.5
- Other (residual)	4.0	3.6	3.6	4.3	4.8	4.5	5.0	4.9	1.3
Expenditure	**36.6**	**38.5**	**38.5**	**38.5**	**38.3**	**38.9**	**37.8**	**37.0**	**-1.5**
of which:									
- Primary expenditure	35.8	37.8	37.7	37.0	36.8	37.3	36.1	35.5	-2.2
of which:									
Compensation of employees	9.4	10.2	10.2	9.3	9.1	9.3	8.4	8.1	-2.1
Intermediate consumption	6.2	6.5	6.5	5.1	5.6	5.1	5.6	5.7	-0.8
Social payments	9.9	11.2	11.2	12.4	11.8	12.3	11.7	11.4	0.2
Subsidies	1.5	1.4	1.4	1.0	1.4	0.9	1.1	1.1	-0.3
Gross fixed capital formation	5.7	5.4	5.4	6.3	6.4	6.7	7.4	7.3	1.9
Other (residual)	3.2	3.1	3.1	3.0	2.5	3.0	2.0	1.9	-1.2
- Interest expenditure	0.8	0.8	0.8	1.5	1.5	1.6	1.7	1.5	0.7
General government balance (GGB)	**-2.5**	**-5.4**	**-5.4**	**-5.1**	**-5.1**	**-5.6**	**-4.1**	**-2.9**	**2.5**
Primary balance	**-1.8**	**-4.7**	**-4.7**	**-3.6**	**-3.6**	**-4.0**	**-2.4**	**-1.4**	**3.3**
One-off and other temporary measures	-0.1	0.0	n.a.	0.0	n.a.	0.0	n.a.	n.a.	n.a.
GGB excl. one-offs	**-2.5**	**-5.4**	**n.a.**	**-5.1**	**n.a.**	**-5.6**	**n.a.**	**n.a.**	**n.a.**
Output gap[2]	6.6	8.5	8.7	0.2	0.5	-3.0	-2.5	-2.9	-11.6
Cyclically-adjusted balance[2]	-4.5	-7.9	-8.2	-5.2	-5.3	-4.7	-3.3	-2.0	6.2
Structural balance[3]	**-4.4**	**-7.9**	**-8.2**	**-5.2**	**-5.3**	**-4.7**	**-3.3**	**-2.0**	**6.2**
Change in structural balance		*-3.5*	*-3.8*	*2.7*	*2.9*	*0.5*	*2.0*	*1.3*	
Structural primary balance[3]	-3.7	-7.2	-7.4	-3.7	-3.8	-3.1	-1.6	-0.5	6.9
Change in structural primary balance		*-3.5*	*-3.7*	*3.5*	*3.6*	*0.6*	*2.2*	*1.1*	

Notes:

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Convergence programme (CP); Commission services' Spring 2009 forecasts (COM); Commission services' calculations

4.3. Medium-term budgetary strategy

The main goal of the medium-term budgetary strategy in the programme is to achieve the medium-term objective (MTO) of a structural deficit of 0.9% of GDP, by 2012 (i.e. beyond the programme period). The programme foresees that the MTO to be achieved one year later that foreseen in the December 2007 convergence programme, i.e. 2012 instead of 2011. The general government headline deficit is projected to be gradually reduced from 5.1% of GDP in 2009 to 4.1% of GDP in 2010 and 2.9% of GDP in 2011. The primary balance follows a similar trend.

The adjustment path is based on expenditure reduction, by 1.5 percentage point of GDP notably due to substantial cuts in compensation of employees and intermediate consumption. Lower subsidies also contribute to the expenditure reduction. These cuts partly offset a significant increase in public investment as a share of GDP as well as a significant increase in interest payments. After 2009, the programme does not sufficiently specify the concrete measures underlying the planned expenditure reduction, in particular with respect to the significant decrease in compensation of employees.

Revenues are also expected to increase by 1.1 percentage point of GDP over the programme period. The increase results from an assumed increase in EU funds absorption and the increase in social security contributions in 2009. Between 2009 and 2011, the programme foresees an increase in the direct and indirect tax revenue as a share of GDP. Regarding indirect taxes, the programme describes several revenue-increasing measures, including the removal of the VAT deductibility for acquisition of company cars and a front loading of the increase in excises for cigarettes as well as some foreseen increases in excises for certain alcohol products. With respect to the direct taxes, some measures with a positive budgetary impact are envisaged as well, i.e. the taxation of reserves from the revaluation of certain fixed assets and the introduction of a minimum tax for all tax payers, including the microenterprises which declare a profit less than the minimum legally required level. These measures are partly offset by the removal of the corporate tax on reinvested profit. However, the programme does not provide information on the budgetary impact of these revenue-increasing measures and does not fully substantiate the rather significant increase in indirect and direct tax revenues over 2009-2011.

4.4. Risks to the budgetary targets

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors.

Given the worse-than-anticipated growth in Q1 2009 and in view of the uncertainty related to the global financial crisis and the ongoing correction of economic imbalances in Romania, the macroeconomic scenario of the programme now appears to be based on slightly favourable growth assumptions. Lower economic growth could lead to lower-than-expected budget revenues and thus to a higher-than-planned budget deficit.

Besides the underperformance of revenue due to a possible worse-than-expected macroeconomic outlook, there are risks to the achievement of the 2009 fiscal target also stemming from the implementation of the planned expenditure reduction. In particular, risks concern the implementation of the measures in the area of public sector wage bill - an area where in the past recurrent budgetary slippages occurred. This can be seen from the budgetary execution so far, i.e. a nominal increase of the public sector wage bill by 16% over January-April 2009 compared to the same period of the last year. This compares to a planned nominal reduction of some 4% in the public sector wage bill envisaged in the April 2009 amended budget compared to 2008.

In 2010 and 2011, the achievement of the budgetary targets still needs to be underpinned by concrete measures. In particular, on the expenditure side, the adjustment relies to a large extent on the cuts in compensation of employees as a share of GDP. The programme mentions some measures to achieve this, e.g. a prudent wage increases policy in line with consumer prices, freezing of the hiring and the introduction of a unitary pay system. However, the detailed measures and their expected budgetary impact are not spelled out.

Furthermore, public expenditure could come under additional pressure given the electoral context (presidential elections are foreseen in the autumn 2009).

Finally, with respect to planning, Romania has a dismal track record as the deficit has been systematically revised upwards in successive programme (see Figure 2 in Annex 1). This is due to weaknesses in budgetary planning and execution, a lack fiscal discipline and frequent budgetary revisions. The effective implementation of the envisaged measures to improve budgetary management and fiscal governance (notably by introducing a medium-term budgetary framework) agreed upon by the Romanian authorities under the balance of payments assistance (see section 7 below) is crucial to restore the credibility and to improve the observance of the planned deficit targets.

To sum up, the budgetary outcomes are subject to downside risks. In view of the negative risks to the budgetary targets, the debt ratio could increase more than projected in the programme (see next section).

5. DEBT DEVELOPMENTS AND LONG-TERM SUSTAINABILITY

5.1. Debt developments

The government gross debt-to-GDP ratio has been on an increasing path since 2006. The convergence programme expects a steep increase in government debt from 13.6% in 2008 to 22.0% in 2011, driven by increasing interest expenditure on government debt and by high primary balance deficits, especially in 2009 and 2010.

Table IV: Debt dynamics

(% of GDP)	average 2002-06	2007	2008		2009		2010		2011
			COM	CP	COM	CP	COM	CP	CP
Gross debt ratio[1]	**18.6**	**12.7**	**13.6**	**13.6**	**18.2**	**18.0**	**22.7**	**20.8**	**22.0**
Change in the ratio	-2.7	0.3	0.9	0.9	4.6	4.4	4.5	2.8	1.2
Contributions [2] *:*									
1. Primary balance	**0.1**	**1.8**	**4.7**	**4.7**	**3.6**	**3.6**	**4.0**	**2.4**	**1.4**
2. "Snow-ball" effect	**-2.6**	**-1.2**	**-1.4**	**-1.5**	**0.8**	**0.8**	**0.5**	**0.5**	**0.0**
Of which:									
Interest expenditure	1.5	0.8	0.8	0.7	1.5	1.5	1.6	1.7	1.5
Growth effect	-1.0	-0.6	-0.7	-0.7	0.5	0.5	0.0	0.0	-0.5
Inflation effect	-3.0	-1.3	-1.5	-1.5	-1.3	-1.3	-1.1	-1.2	-1.0
3. Stock-flow adjustment	**-0.1**	**-0.2**	**-2.2**	**-2.2**	**0.2**	**0.0**	**0.0**	**-0.1**	**-0.2**
Of which:									
Cash/accruals diff.	-0.5	0.2		0.0		0.0		0.0	0.0
Acc. financial assets	0.2	-0.5		0.1		0.1		0.1	0.1
Privatisation	-1.0	-0.4		0.1		0.0		0.0	0.0
Val. effect & residual	0.2	0.1		4.7		6.5		3.5	1.1

Notes:

[1]End of period.

[2]The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Convergence programme (CP); Commission services' Spring 2009 forecasts (COM); Commission services' calculations

While the Commission services' 2009 spring forecast and the convergence programme provide similar debt projections for 2009, the Commission forecast expects a more significant increase in government debt in 2010 than envisaged in the convergence programme. The difference between the debt projections for 2010 stems from a higher primary balance deficit projection in the Commission forecast compared to the convergence programme. The convergence programme foresees a negligible impact of the stock-flow adjustment on government debt throughout the programme period.

The risks related to the debt projections stem mainly from the likelihood of a higher-than-expected GDP contraction in 2009. The risks to the debt scenario presented in convergence programme are, therefore, on the upside.

5.2. Long-term sustainability

This section presents sustainability indicators based on the long-term age-related government spending as projected by the Member States and the EPC in 2009 according to an agreed methodology.[4]

Table 4 in the Annex 1 shows that the projected increase in age-related spending is raising by 8.5% of GDP between 2010 and 2060, which is above the EU average. Sustainability indicators for two scenarios (i.e. the 2008 scenario and the programme scenario) are presented in Table 5 in the Annex 1. Taking into account the increase of age-related expenditure and assuming that the structural primary balance remained at its 2008 level, the sustainability gap (S2)[5] would amount to 12.2% of GDP. This is about 10 percentage points more than in last year's assessment, which is due to a lower estimated structural primary balance in the starting year and a higher cost of ageing. The starting budgetary position is not sufficient to stabilize the debt ratio over the long-term and entails a risk of unsustainable public finances even before considering the long-term budgetary impact of ageing.

While the "2008 scenario" already reflects the weakening of the budgetary position as a response to the current economic crisis, the "programme scenario", which is based on the end-of-programme structural primary balance, shows a smaller gap. If the budgetary consolidation planned in the programme was achieved, risks to long-term sustainability of public finances would be substantially mitigated.

Based on the assumptions used for the calculation of the sustainability indicators, Figure 4 in the Annex 1 displays the projected debt/GDP ratio over the long-term.

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account. They are summarized in Table 6 in the Annex 1. Notably, the programme presents a projection of pension expenditure that includes recently adopted measures. The

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4 Economic Policy Committee and the European Commission (2009), 'The impact of ageing on public expenditure: projections for the EU-27 Member States on pensions, health care, long-term care, education and unemployment transfers (2008-60)', *European Economy* No. 2/2009. European Commission (2006), The long-term sustainability of public finances in the European Union, European Economy No. 4/2006. European Commission (2008), *Public finances in EMU – 2008*, *European Economy* No. 4/2008.

5 The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

impact of these measures seems though very limited as pension expenditure is still projected to increase by 6.5 % of GDP between 2010 and 2060. However, as the projections in the programme are not validated by the EPC, they can only be considered as "national projections".

Romania appears to be at high risk with regard to the sustainability of public finances. The long-term budgetary impact of ageing is well above the EU average, mainly as a result of a relatively high increase in pension expenditure as a share of GDP over the coming decades. The budgetary position in 2008, as estimated in the programme, which is worse than the starting position of the previous programme, compounds the budgetary impact of population ageing on the sustainability gap. Reducing the primary deficit over the medium term, as already foreseen in the programme, and further reforming the pension and health care systems to curb the substantial increase in age-related expenditures would contribute to reducing risks to the sustainability of public finances.

6. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

The fiscal deficits and the pro-cyclicality of the fiscal policy in Romania can be partly explained by a weak budgetary planning and execution as well as by a lack of financial discipline. Although, Romania has started in 2006 to implement a medium-term expenditure framework, the improvements in the area of budgetary planning and execution have been modest. Initial budgets have suffered from an over-estimation of revenue and there have been several in-year budgetary rectifications, increasing current expenditure levels and changes in the composition of spending (i.e by shifting capital to current spending). Furthermore, there is a high degree of uncertainty as large expenditure outlays are operated in the last few months of the year. The primary current spending overruns coupled with a suboptimal composition of spending have put increasing strain on public resources and have reduced the scope for growth-enhancing capital spending. While the current spending overruns reflect the absence of a long-term strategy for public sector wages and pensions, the underperformance in terms of capital spending can be partly attributed to the weak administrative capacity to plan and execute public investment projects.

To increase the predictability of public finances and the soundness of fiscal policy planning, the Romanian authorities have committed under the EU balance of payment assistance to adopt measures aimed at strengthening fiscal governance. These measures foresee the implementation of a medium-term budgetary framework, covering the general government and including budgetary rules on both revenue and expenditure and the establishment of an independent fiscal council. However, the convergence programme fails to specify concrete steps towards the implementation of the envisaged measures.

In the area of tax administration, the convergence programme foresees the improvement in the efficiency of revenue collection and a broadening of the tax base in sectors such as environment and agriculture. To improve revenue collection, the programme specifies measures aimed at preventing and combating tax evasion (i.e. setting-up of a unitary control cell and harmonizing the control plans of the different structures within the National Agency for Fiscal Administration, developing a fiscal intelligence service) as well as reducing arrears (i.e. by monthly monitoring the arrears and solvency situation of companies). Moreover, the programme emphasises measures in the parafiscal area, such as the reduction in the number of current parafiscal taxes.

7. ASSESSMENT

This section assesses the budgetary strategy, taking into account risks, in the light of (i) the adequacy of the fiscal stimulus package in response to the Commission Communication of 26 November 2008 on the European Economic Recovery Plan (EERP) as endorsed by the European Council conclusions on the European Economic Recovery Plan (EERP) on 16 December 2008 and the overall fiscal stance; (ii) the criteria for short-term action laid down in the above mentioned Commission Communication and (iii) the objectives of the Stability and Growth Pact. It also assesses the budgetary strategy in the light of the economic programme committed to by the Romanian authorities under the EU balance of payment assistance.

During the demand boom in the period 2005 - 2008, Romania pursued a pro-cyclical fiscal policy with headline deficits rising from 1.2% of GDP in 2005 to 5.4% of GDP in 2008, amidst an average real GDP growth of 6.5%. This was due to a large degree to overall weak budgetary planning and execution which result in recurrent budgetary slippages.

In view of the large domestic and external imbalances and the adverse effect of the global financial turmoil on the economic and financial situation in Romania, the authorities requested multilateral financial assistance in March 2009. This assistance is conditional upon the implementation by the Romanian authorities of a comprehensive economic adjustment programme. In line with the aim of reducing external and internal imbalances, fiscal consolidation is one of the cornerstones of this economic programme.

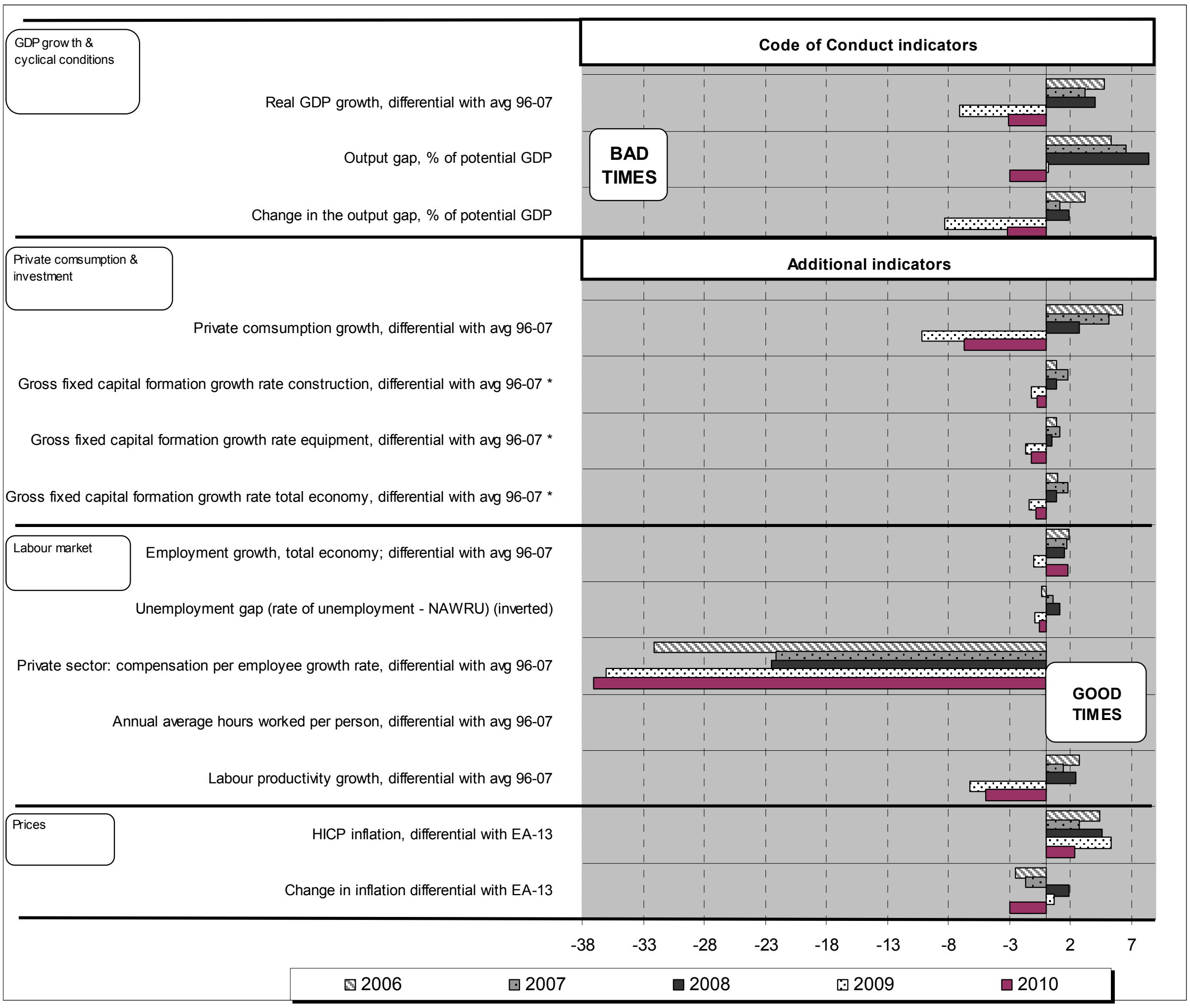
The budgetary targets in the convergence programme are in line with the commitments made in the context of multilateral financial assistance. However, taking into account risks related to the macroeconomic scenario in 2009, to the effective implementation of the planned expenditure measures and the lack of information on concrete measures needed to underpin fiscal consolidation after 2009, the budgetary outcomes in the programme are subject to downside risks. In addition, the convergence programme does not reflect in a clear manner the commitments in terms of additional fiscal measures agreed under the balance of payments programme, notably with respect to the foregoing of public sector wage increases or equivalent further cuts in employment, and further reductions in subsidies to public entities. Furthermore, the updated programme does not reflect the commitments to reform key parameters of the pension system (e.g. indexation of public pensions and the retirement age), which is crucial for improving long-term sustainability of public finances. Finally, it does not provide sufficiently detailed information on the concrete measures and their budgetary impact, needed to achieve the deficit targets in 2010 and 2011.

The update programme foresees a breach of the 3% of GDP deficit reference value until 2011. This is consistent with the deadline for correction of the excessive deficit set in the recommendations addressed to Romania to correct the excessive deficit under Article 104(7) of the Treaty. The safety margin against breaching the reference value (estimated at 1.75% of GDP) would not be restored before the end of the programme period.

According to the convergence programme, the fiscal stance as measured by the change in the structural balance recalculated by the Commission services using the commonly agreed methodology based on the information provided in the programme is estimated to be restrictive over the programme period. In addition, given the need for fiscal consolidation and in line with the EERP, only a limited set of fiscal stimulus measures has been adopted, aimed at supporting household income, the corporate sector and labour markets. Considering the absence of room for fiscal manoeuvre and the need to correct economic imbalances, the restrictive fiscal stance appears appropriate.

ANNEX 1. ADDITIONAL TABLES AND FIGURES

Figure 1: Good and bad economic times



Source: Commission services' Spring 2009 forecast (COM) and successive convergence programmes

Note: * these variables have been divided by the standard deviation of the period 2003-2010. This procedure allows reducing (increase) the variability of the underlying series when the standard deviation is greater (smaller) than 1.

Table 1: Budgetary implementation in 2008

	2007		2008	
	Planned CP Dec 2007	Outcome COM	Planned CP Dec 2007	Outcome COM
Government balance (% of GDP)	-2.9	-2.5	-2.9	-5.4
Difference compared to target	**0.4**		**-2.5**	
Of which : due to a different starting position end 2007			0.4	
due to different revenue / expenditure growth in 2008			-2.7	
p.m. Denominator effect and residual [2,3]			-0.2	
p.m. Nominal GDP growth (planned and outcome)			13.1	22.1
Revenue (% of GDP)	37.4	34.0	39.8	33.1
Revenue surprise compared to target [1]	**-3.4**		**-6.7**	
Of which : due to a different starting position end 2007			-3.6	
due to different revenue growth in 2008			-0.4	
p.m. Denominator effect [2]			-2.2	
p.m. Residual [3]			-0.5	
p.m. Revenue growth rate (planned and outcome)			20.4	18.7
Expenditure (% of GDP)	40.3	36.6	42.7	38.5
Expenditure surprise compared to target [1]	**3.7**		**4.2**	
Of which : due to different starting position end 2007			3.9	
due to different expenditure growth rate in 2008			-2.3	
p.m. Denominator effect [2]			2.4	
p.m. Residual [3]			0.2	
p.m. Expenditure growth rate (planned and outcome)			19.8	28.6

Notes:

[1] A positive number implies that the outcome was better (in terms of government balance) than planned.

[2] The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue and expenditure separately, on the balance they

[3] The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.

Source : Commission services

Table 2: Evolution of budgetary targets in successive programmes

		2007	2008	2009	2010	2011
General government balance (% of GDP)	**CP June 2009**	**-2.5**	**-5.4**	**-5.1**	**-4.1**	**-2.9**
	CP Dec 2007	*-2.9*	*-2.9*	*-2.9*	*-2.4*	*n.a.*
	COM Jan 2009	-2.5	-5.4	-5.1	-5.6	n.a.
General government expenditure (% of GDP)	**CP June 2009**	**36.6**	**38.5**	**38.3**	**37.8**	**37.0**
	CP Dec 2007	*40.3*	*42.7*	*42.8*	*43.2*	*n.a.*
	COM Jan 2009	36.6	38.5	38.5	38.9	n.a.
General government revenue (% of GDP)	**CP June 2009**	**34.0**	**33.1**	**33.2**	**33.7**	**34.2**
	CP Dec 2007	*37.4*	*39.8*	*39.9*	*40.8*	*n.a.*
	COM Jan 2009	34.0	33.1	33.4	33.3	n.a.
Structural balance[1] (% of GDP)	**CP June 2009**	**-4.5**	**-8.2**	**-5.3**	**-3.3**	**-2.0**
	CP Dec 2007	*-3.4*	*-3.4*	*-3.4*	*-2.7*	*n.a.*
	COM Jan 2009	-4.4	-7.9	-5.2	-4.7	n.a.
Real GDP (% change)	**CP June 2009**	**6.2**	**7.1**	**-4.0**	**0.1**	**2.4**
	CP Dec 2007	*6.1*	*6.5*	*6.1*	*5.8*	*n.a.*
	COM Jan 2009	6.2	7.1	-4.0	0.0	n.a.

Note:

[1]Cyclically-adjusted balance excluding one-off and other temporary measures. Cyclically-adjusted balances according to the programmes as recalculated by the Commission services on the basis of the information in the programmes. One-off and other temporary measures are 0.2% of GDP in 2007 deficit-reducing and 0% over the period 2008-2011 according to the most recent convergence programme and 0.2% of GDP in 2007 deficit-reducing and 0% over the period 2008-2010 according to the Commission services' spring 2009 forecast.

Source :
Convergence programmes (CP); Commission services' Spring 2009 forecasts (COM)

Table 3: Assessment of tax projections

	2009			2010			2011
	CP	**COM**	**OECD[3]**	**CP**	**COM[1]**	**OECD[3]**	**CP**
Change in tax-to-GDP ratio (total taxes)	-1.2	-0.4	0.1	0.3	-0.3	0.1	0.6
Difference (CP – COM)	-0.7		/	-0.7		/	/
of which [2] :							
- discretionary and elasticity component	*0.3*		*/*	*0.3*		*/*	*/*
- composition component	*-0.2*		*/*	*-0.6*		*/*	*/*
Difference (COM - OECD)	/	-0.5		/	-0.4		/
of which [2] :							
- discretionary and elasticity component	*/*	*-0.7*		*/*	*-0.1*		*/*
- composition component	*/*	*-0.2*		*/*	*0.2*		*/*
p.m.: Elasticity to GDP	0.3	0.7	1.1	1.2	0.8	1.1	1.3

Notes:

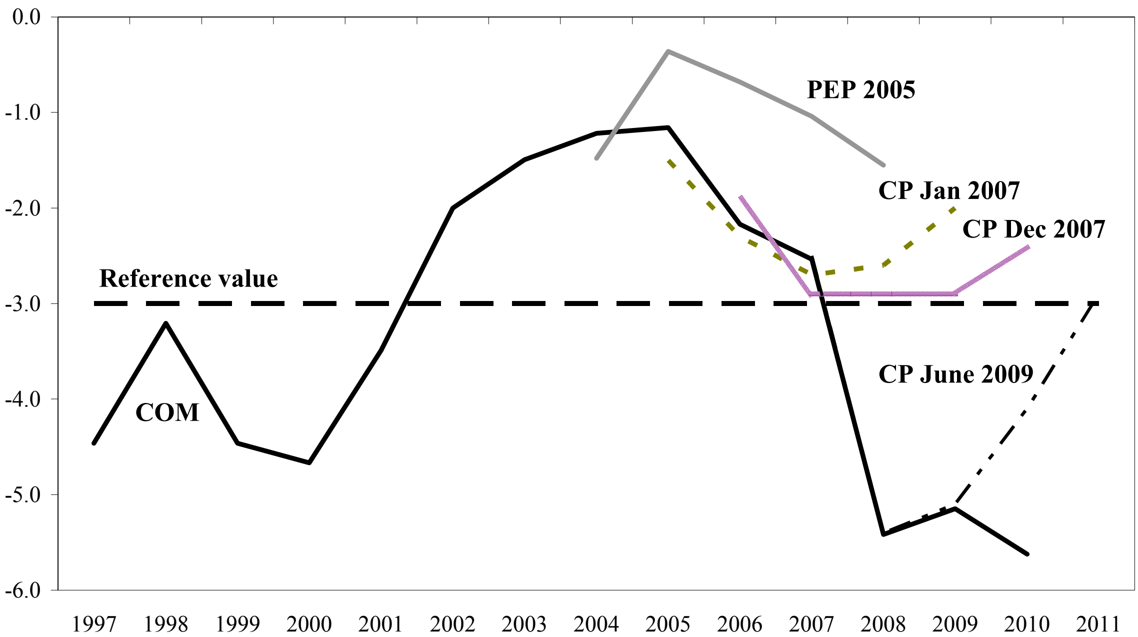
[1]On a no-policy change basis.

[2]The composition component captures the effect of differences in the composition of aggregate demand (more tax rich or more tax poor components). The discretionary and elasticity component captures the effect of discretionary fiscal policy measures as well as variations of the yield of the tax system that may result from factors such as time lags and variations of taxable income that do not necessarily move in line with GDP, e.g. capital gains. The two components may not add up to the total difference because of a residual component, which is generally small.

[3]OECD ex-ante elasticity relative to GDP.

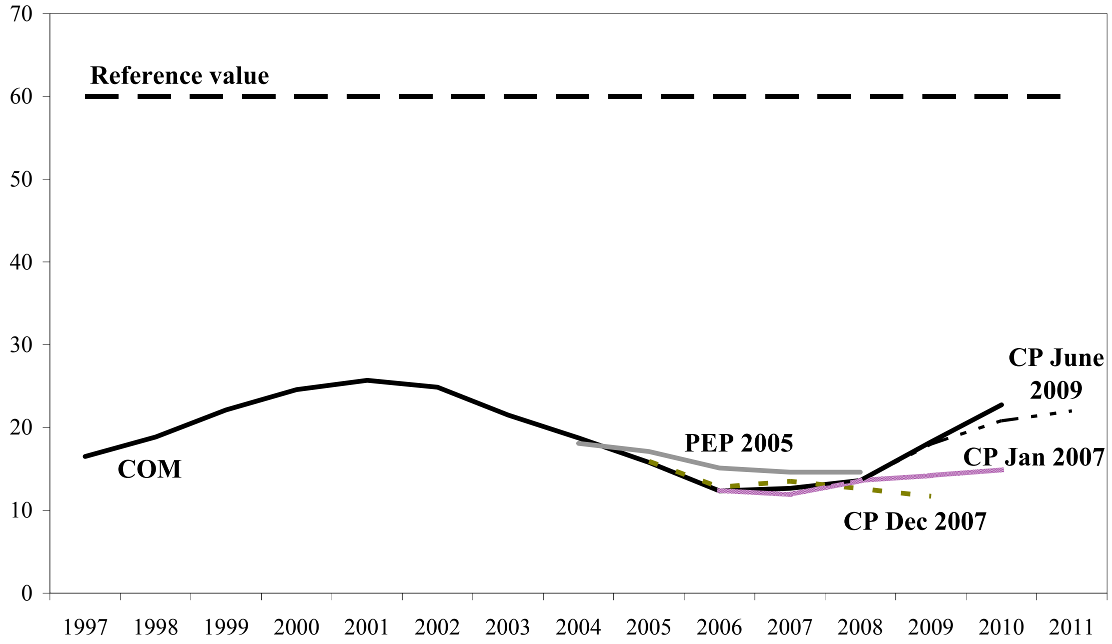
Source :
Commission services' Spring 2009 forecasts (COM); Convergence programme (CP); Commission services' calculations; OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434).

Figure 2: Government balance projections in successive programmes (% of GDP)



Source: Commission services' Spring 2009 forecast (COM) and successive convergence programmes

Figure 3: Debt projections in successive programmes (% of GDP)



Source: Commission services' Spring 2009 forecast (COM) and successive convergence programmes

Table 4: Long-term age-related expenditure: main projections

(% of GDP)	2007	2010	2020	2040	2060	Change 2010- 60
Total age-related spending	**13.1**	**14.7**	**15.1**	**19.3**	**23.2**	**8.5**
- Pensions	6.6	8.4	8.8	12.6	15.8	7.4
- Healthcare	3.5	3.6	3.8	4.4	4.9	1.3
- Long-term care	0.0	0.0	0.0	0.0	0.0	0.0
- Education	2.8	2.5	2.3	2.1	2.3	-0.2
- Unemployment benefits	0.2	0.2	0.2	0.2	0.2	0.0
Property income received	**0.9**	**0.9**	**0.8**	**0.8**	**0.8**	**-0.1**

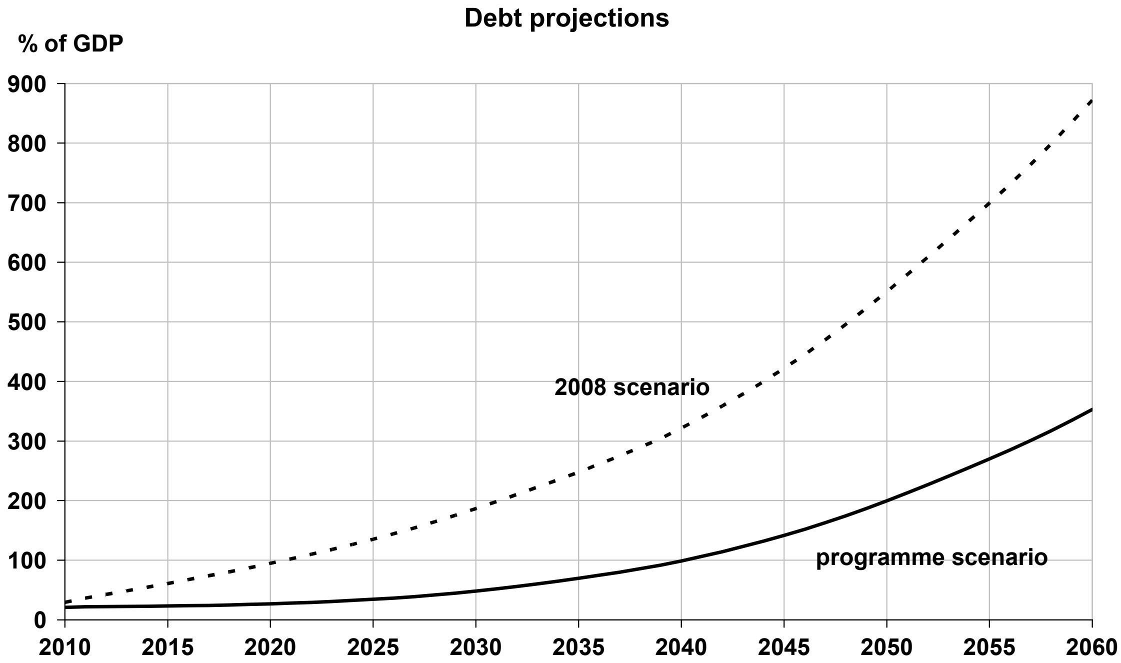
Source: Economic Policy Committee and Commission services.

Table 5: Sustainability indicators and the required primary balance

	2008 scenario			Programme scenario		
	S1	**S2**	**RPB**	**S1**	**S2**	**RPB**
Value	10.1	12.2	5.6	3.6	5.9	5.3
of which:						
Initial budgetary position (IBP)	7.0	7.2	-	0.8	0.9	-
Debt requirement in 2050 (DR)	-0.3	-	-	-0.3	-	-
Long-term change in the primary balance (LTC)	3.3	5.0	-	3.3	5.0	-

Source: Commission services.

Figure 4: Long-term projections for the government debt ratio



Note: Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.
Source: Commission services.

Table 6: Additional factors

	Impact on risk
Debt and pension assets	na
Decline in structural balance until 2010 in COM Spring 2009 forecast	na
Significant revenues from pension taxation	na
Alternative projection of cost of ageing	+
Strong decline in benefit ratio	na
High tax burden	na
Non-age related budgetary measures with inter-temporal effect	na

Note: '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability.
'na': not applicable.
Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method.
Source: Commission services.

ANNEX 2. COMPLIANCE WITH THE CODE OF CONDUCT AND TABLES FROM THE PROGRAMME

The update broadly adheres to the code of conduct as far as its table of contents is concerned. As regards data requirements, the programme has some gaps in the required and optional data. In particular, in table 1c (labour market developments), compulsory data on hours worked of employed population is missing, as well as labour productivity per hour. In the same table, optional data on compensation per employee in 2010 and 2011 is also missing. In table 1d, compulsory data on the sectoral breakdown of net lending/borrowing is missing. Furthermore, no data was provided on general government expenditure by function (compulsory, table 3). In table 5 (cyclical developments), compulsory data is missing on one-offs and the structural balance. Finally, several compulsory items were missing in table 8 on long-term sustainability of public finances.

The tables on the following pages show the data presented in the June 2009 update of convergence programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

Table 1a. Macroeconomic prospects

	ESA Code	2007 Level	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change
1. Real GDP	B1*g	*366.2*	6.2	7.1	-4.0	0.1	2.4
2. Nominal GDP	B1*g	*412.8*	19.8	22.1	5.4	7.0	7.7
Components of real GDP							
3. Private consumption expenditure	P.3	*265*	11.6	9.1	-4.1	-0.6	2.0
4. Government consumption expenditure	P.3	*58.3*	1.6	3.2	-11.0	0.1	1.2
5. Gross fixed capital formation	P.51	*113.8*	29.0	19.3	-6.5	-0.5	3.5
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*n.a.*	0.1	-3.5	0.0	0.0	0.0
7. Exports of goods and services	P.6	*120.1*	7.9	19.4	-13.7	1.7	2.8
8. Imports of goods and services	P.7	*194.2*	27.2	17.5	-15.6	-0.4	2.6
Contributions to real GDP growth							
9. Final domestic demand		-	15.6	12.5	-6.6	-0.5	2.5
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.1	-3.5	0.0	0.0	0.0
11. External balance of goods and services	B.11	-	-9.5	-1.9	2.6	0.6	-0.1

Table 1b. Price developments

	ESA Code	2007 Level	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change
1. GDP deflator		*n.a.*	12.7	14.0	9.9	6.9	5.1
2. Private consumption deflator		*n.a.*	4.9	9.0	6.1	3.8	3.3
3. HICP[1]		*n.a.*	4.5	7.9	5.8	3.5	3.2
4. Public consumption deflator		*n.a.*	10.3	18.8	9.2	8.2	6.1
5. Investment deflator		*n.a.*	10.4	12.1	7.0	6.0	4.8
6. Export price deflator (goods and services)		*n.a.*	1.5	7.0	11.9	2.5	2.6
7. Import price deflator (goods and services)		*n.a.*	-7.5	3.9	2.0	2.0	1.8

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2007	2007	2008	2009	2010	2011
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[1]		*9353*	0.4	0.2	-2.1	0.5	0.7
2. Employment, hours worked[2]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
3. Unemployment rate (%)[3]		*n.a.*	6.4	5.8	8.0	7.7	7.4
4. Labour productivity, persons[4]		*n.a.*	5.8	6.9	-1.9	-0.4	1.7
5. Labour productivity, hours worked[5]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
6. Compensation of employees	D.1	*157970*	19.5	22.0	2.6	3.5	4.4
7. Compensation per employee		*25490*	18.9	20.5	6.0	3.0	3.6

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	2007	2008	2009	2010	2011
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-12.9	-11.9	-6.3	-5.4	-5.2
of which : - Balance on goods and services		-14.0	-12.8	-7.4	-6.3	-5.8
- Balance of primary incomes and transfers		0.5	0.5	-0.2	-0.2	-0.5
- Capital account		0.6	0.4	1.2	1.1	1.1
2. Net lending/borrowing of the private sector	B.9	n.a.	n.a.	n.a.	n.a.	n.a.
3. Net lending/borrowing of general government	EDP B.9	n.a.	n.a.	n.a.	n.a.	n.a.
4. Statistical discrepancy		-	optional	optional	optional	optional

Table 2. General government budgetary prospects

	ESA Code	2007	2007	2008	2009	2010	2011
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	*-10,465.7*	-2.5	-5.4	-5.1	-4.1	-2.9
2. Central government	S.1311	*-13,837.4*	-3.4	-4.4	-4.9	-3.7	-2.9
3. State government	S.1312	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	*-926.4*	-0.2	-0.9	-0.2	-0.4	-0.3
5. Social security funds	S.1314	*4298.1*	1.0	-0.1	0.0	0.1	0.3
General government (S13)							
6. Total revenue	TR	*140499.4*	34.0	33.1	33.2	33.7	34.2
7. Total expenditure	TE[1]	*150965.1*	36.6	38.5	38.3	37.8	37.0
8. Net lending/borrowing	EDP B.9	*-10465.7*	-2.5	-5.4	-5.1	-4.1	-2.9
9. Interest expenditure	EDP D.41	*3142.1*	0.8	0.8	1.5	1.7	1.5
10. Primary balance[2]		*-7323.6*	-1.8	-4.7	-3.6	-2.4	-1.4
11. One-off and other temporary measures[3]		*-759.8*	-0.2	n.a.	n.a.	n.a.	n.a.
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		*80562.8*	19.5	19.1	17.4	18.0	18.5
12a. Taxes on production and imports	D.2	*52675.7*	12.8	12.3	11.0	11.6	11.7
12b. Current taxes on income, wealth, etc	D.5	*27887.1*	6.8	6.9	6.4	6.4	6.8
12c. Capital taxes	D.91	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
13. Social contributions	D.61	*43639.1*	10.6	10.3	11.0	10.7	10.8
14. Property income	D.4	*3918.6*	0.9	0.8	0.8	0.8	0.9
15. Other [4]		*12378.9*	3.0	2.8	4.1	4.3	4.0
16=6. Total revenue	TR	*140499.4*	34.0	33.1	33.2	33.7	34.2
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]			n.a.	n.a.	n.a.	n.a.	n.a.
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	*64379.4*	15.6	16.7	14.6	14.0	13.8
17a. Compensation of employees	D.1	*38637.6*	9.4	10.2	9.1	8.4	8.1
17b. Intermediate consumption	P.2	*25741.8*	6.2	6.5	5.6	5.6	5.7
18. Social payments (18=18a+18b)		*40716*	9.9	11.2	11.8	11.7	11.4
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*2370*	0.6	0.6	0.3	0.3	0.3
18b. Social transfers other than in kind	D.62	*38346*	9.3	10.6	11.5	11.4	11.2
19=9. Interest expenditure	EDP D.41	*3142.1*	0.8	0.8	1.5	1.7	1.5
20. Subsidies	D.3	*6220.2*	1.5	1.4	1.4	1.1	1.1
21. Gross fixed capital formation	P.51	*23231.1*	5.6	5.4	6.4	7.4	7.3
22. Other[6]		*13276.3*	3.2	3.1	2.5	2.0	1.9
23=7. Total expenditure	TE[1]	*150965.1*	36.6	38.5	38.3	37.8	37.0
p.m.: Government consumption (nominal)	P.3	*66690.8*	16.2	n.a.	n.a.	n.a.	n.a.

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	2006	2011
1. General public services	1	n.a.	n.a.
2. Defence	2	n.a.	n.a.
3. Public order and safety	3	n.a.	n.a.
4. Economic affairs	4	n.a.	n.a.
5. Environmental protection	5	n.a.	n.a.
6. Housing and community amenities	6	n.a.	n.a.
7. Health	7	n.a.	n.a.
8. Recreation, culture and religion	8	n.a.	n.a.
9. Education	9	n.a.	n.a.
10. Social protection	10	n.a.	n.a.
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	n.a.	n.a.

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	2007	2008	2009	2010	2011
1. Gross debt[1]		12.7	13.6	18.0	20.8	22.0
2. Change in gross debt ratio		-3.1	0.9	4.4	2.8	1.2
Contributions to changes in gross debt						
3. Primary balance[2]		-1.8	-4.7	-3.6	-2.4	-1.4
4. Interest expenditure[3]	EDP D.41	0.8	0.8	1.5	1.7	1.5
5. Stock-flow adjustment		-2.1	4.8	6.5	3.5	1.1
of which:						
- Differences between cash and accruals[4]		0.0	0.0	0.0	0.0	0.0
- Net accumulation of financial assets[5]		0.1	0.1	0.1	0.1	0.1
of which:						
- privatisation proceeds		0.0	0.1	0.0	0.0	0.0
- Valuation effects and other[6]		-2.2	4.7	6.5	3.5	1.1
p.m.: Implicit interest rate on debt[7]		7.3	6.4	9.6	8.9	7.3
Other relevant variables						
6. Liquid financial assets[8]		1.7	0.0	0.0	0.0	0.0
7. Net financial debt (7=1-6)		11.0	13.6	18.0	20.8	22.0

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	**2007**	**2008**	**2009**	**2010**	**2011**
1. Real GDP growth (%)		6.2	7.1	-4.0	0.1	2.4
2. Net lending of general government	EDP B.9	-2.5	-5.4	-5.1	-4.1	-2.9
3. Interest expenditure	EDP D.41	0.8	0.8	1.5	1.7	1.5
4. One-off and other temporary measures[1]		-	-	-	-	-
5. Potential GDP growth (%)		5.3	5.0	3.3	2.6	2.3
contributions:						
- labour		0.3	0.3	0.3	0.2	0.2
- capital		3.5	3.9	3.0	2.7	2.5
- total factor productivity		1.6	0.7	0.0	-0.3	-0.5
6. Output gap		4.3	6.4	-1.1	-3.5	-3.4
7. Cyclical budgetary component		1.2	1.8	-0.3	-1.0	-1.0
8. Cyclically-adjusted balance (2 - 7)		-3.7	-7.2	-4.8	-3.1	-1.9
9. Cyclically-adjusted primary balance (8 + 3)		-2.9	-6.4	-3.3	-1.4	-0.4
10. Structural balance (8 - 4)		n.a.	n.a.	n.a.	n.a.	n.a.

[1]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	**2007**	**2008**	**2009**	**2010**	**2011**
Real GDP growth (%)						
Previous update		6.1	6.5	6.1	5.8	n.a.
Current update		6.2	7.1	-4.0	0.1	2.4
Difference		0.1	0.6	-10.1	-5.7	n.a.
General government net lending (% of GDP)	EDP B.9					
Previous update		-2.9	-2.9	-2.9	-2.4	n.a.
Current update		-2.5	-5.4	-5.1	-4.1	-2.9
Difference		0.4	-2.5	-2.2	-1.7	n.a.
General government gross debt (% of GDP)						
Previous update		11.9	13.6	14.2	14.9	n.a.
Current update		12.7	13.6	18.0	20.8	22.0
Difference		0.8	0.0	3.8	5.9	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure	33.6	35.0	35.4	41.0	39.0	37.0
Of which: age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension expenditure	6.7	6.8	8.3	6.6	5.7	5.4
Social security pension	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Old-age and early pensions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other pensions (disability, survivors)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health care	3.5	3.3	3.6	3.7	4.0	4.7
Long-term care *(this was earlier included in the health care)*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Education expenditure	3.4	4.3	n.a.	n.a.	n.a.	n.a.
Other age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Interest expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total revenue	32.1	33.2	33.4	40.5	38.5	37.0
Of which: property income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : from pensions contributions (or social contributions if appropriate)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension reserve fund assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions						
Labour productivity growth	2.2	8.6	3.1	3.9	4.2	3.6
Real GDP growth	2.1	5.7	3.3	4.7	4.4	3.7
Participation rate males (aged 20-64)	75.4	69.5	69.0	73.2	75.8	78.3
Participation rates females (aged 20-64)	61.8	55.3	57.7	61.3	63.1	69.0
Total participation rates (aged 20-64)	68.7	62.4	63.3	67.2	69.5	73.6
Unemployment rate	6.9	7.2	7.7	4.4	4.2	3.9
Population aged 65+ over total population	13.6	14.7	15.3	16.9	18.6	22.3

Table 8. Basic assumptions

	2007	2008	2009	2010	2011
Short-term interest rate[1] (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.
Long-term interest rate (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.
USD/€ exchange rate (annual average) (euro area and ERM II countries)	n.a.	n.a.	n.a.	n.a.	n.a.
Nominal effective exchange rate	n.a.	n.a.	n.a.	n.a.	n.a.
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.
World excluding EU, GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.
EU GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.
Growth of relevant foreign markets	n.a.	n.a.	n.a.	n.a.	n.a.
World import volumes, excluding EU	n.a.	n.a.	n.a.	n.a.	n.a.
Oil prices (Brent, USD/barrel)	n.a.	n.a.	n.a.	n.a.	n.a.

[1]If necessary, purely technical assumptions.

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