EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 7 April 2010
ECFIN/G3/Ares(2010)171654

ROMANIA: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE MARCH 2010 UPDATE OF THE CONVERGENCE PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called 'stability programme' for countries that have adopted the euro as their currency and 'convergence programme' for those that have not. The most recent update of Romania's convergence programme was submitted on 23 March 2010.

The attached technical analysis of the programme prepared by the staff and under the responsibility of the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission was finalised on 24 March 2010. Comments should be sent to Olivia Galgau (Olivia.Galgau@ec.europa.eu) and Adriaan Dierx (Adriaan.Dierx@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' autumn 2009 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 10 November 2009) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

Based on this analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 24 March 2010. The ECOFIN Council is expected to discuss the opinion on the programme on 16 April 2010.

* * *

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/sgp/index_en.htm

TABLE OF CONTENTS

1. INTRODUCTION

This document assesses the March 2010 update of the Romania's convergence programme, which was submitted on 23 March 2010 and covers the period 2009-2012. The programme builds on the 2010 budget adopted by Parliament in January 2010 and the medium term objective to bring the fiscal deficit below the 3%-of-GDP reference value by 2012.

This assessment is structured as follows. Section 2 discusses the key challenges for public finances in Romania. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the convergence programme against the background of the Commission services' economic forecasts[1]. Section 4 analyses budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy. It also assesses risks attached to the budgetary targets. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses institutional features of public finances. Finally, Section 7 concludes with an overall assessment of the programme. The annex provides a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme.

---

1 This assessment uses the Commission services' 2009 autumn forecast, as published on 3 November 2009, as a benchmark. However, more recent information that has become available has also been taken into account to assess the risks to the programme scenarios.

Table 1. Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012
Real GDP (% change)	**CP Mar 2010**	**7.3**	**-7.0**	**1.3**	**2.4**	**3.7**
	COM Nov 2009	6.2	-8.0	0.5	2.6	n.a.
	CP Jun 2009	*7.1*	*-4.0*	*0.1*	*2.4*	*n.a.*
HICP inflation (%)	**CP Mar 2010**	**7.9**	**5.6**	**3.7**	**3.2**	**2.8**
	COM Nov 2009	7.9	5.7	3.5	3.4	n.a.
	CP Jun 2009	*7.9*	*5.8*	*3.5*	*3.2*	*n.a.*
Output gap[1] (% of potential GDP)	**CP Mar 2010**	**9.5**	**-1.7**	**-3.3**	**-3.7**	**-2.7**
	COM Nov 2009[2]	10.0	-2.2	-4.4	-4.3	n.a.
	CP Jun 2009	*8.7*	*0.5*	*-2.5*	*-2.9*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**CP Mar 2010**	**-11.2**	**-3.9**	**-3.9**	**-3.9**	**-3.7**
	COM Nov 2009	-11.8	-5.0	-5.1	-5.2	n.a.
	CP Jun 2009	*-11.9*	*-6.3*	*-5.4*	*-5.2*	*n.a.*
General government revenue (% of GDP)	**CP Mar 2010**	**32.8**	**31.1**	**31.7**	**31.9**	**31.8**
	COM Nov 2009	32.8	31.6	31.8	32.0	n.a.
	CP Jun 2009	*33.1*	*33.2*	*33.7*	*34.2*	*n.a.*
General government expenditure (% of GDP)	**CP Mar 2010**	**38.4**	**39.1**	**38.1**	**36.4**	**34.8**
	COM Nov 2009	38.4	39.4	38.6	37.9	n.a.
	CP Jun 2009	*38.5*	*38.3*	*37.8*	*37.0*	*n.a.*
General government balance (% of GDP)	**CP Mar 2010**	**-5.5**	**-8.0**	**-6.3**	**-4.4**	**-3.0**
	COM Nov 2009	-5.5	-7.8	-6.8	-5.9	n.a.
	CP Jun 2009	*-5.4*	*-5.1*	*-4.1*	*-2.9*	*n.a.*
Primary balance (% of GDP)	**CP Mar 2010**	**-4.8**	**-6.5**	**-4.5**	**-2.6**	**-1.6**
	COM Nov 2009	-4.8	-6.2	-5.0	-3.9	n.a.
	CP Jun 2009	*-4.7*	*-3.6*	*-2.4*	*-1.4*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**CP Mar 2010**	**-8.5**	**-7.5**	**-5.2**	**-3.2**	**-2.1**
	COM Nov 2009	-8.5	-7.1	-5.5	-4.6	n.a.
	CP Jun 2009	*-8.2*	*-5.3*	*-3.3*	*-2.0*	*n.a.*
Structural balance[3] (% of GDP)	**CP Mar 2010**	**-8.5**	**-7.5**	**-5.2**	**-3.2**	**-2.1**
	COM Nov 2009	-8.5	-7.1	-5.5	-4.6	n.a.
	CP Jun 2009	*-8.2*	*-5.3*	*-3.3*	*-2.0*	*n.a.*
Government gross debt (% of GDP)	**CP Mar 2010**	**13.6**	**23.0**	**28.3**	**29.4**	**29.7**
	COM Nov 2009	13.6	21.8	27.4	31.3	n.a.
	CP Jun 2009	*13.6*	*18.0*	*20.8*	*22.0*	*n.a.*

Notes:

[1]Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2]Based on estimated potential growth of 5.1%, 3.4%, 2.9% and 2.5% respectively in the period 2008-2011

[3]Cyclically-adjusted balance excluding one-off and other temporary measures.

Source :
Convergence programme (CP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

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

This section describes recent economic and budgetary developments for Romania, which form the background against which the current programme assessment should be viewed, and outlines the key challenges to be addressed by future economic policies.

With an average annual GDP growth rate of 6.8% between 2004 and 2008, Romania was one of the fastest growing EU Member States. Growth was driven by a domestic demand boom for both consumption and investment, which was fuelled by a rapid expansion of credit and steadily increasing income expectations. This, together with high wage inflation, caused the sharp increase in the current account deficit to 12.3% of GDP in 2008. In addition, years of pro-cyclical budgetary policies led to a sizeable deterioration in the underlying fiscal position, with the structural deficit (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) rising to 8.5% of GDP in 2008. The sudden increase in risk aversion during the financial crisis caused markets to become increasingly concerned about these imbalances. Capital inflows plunged and pressures on the exchange rate increased, resulting in a cumulative depreciation by more than 30% of the RON against the EUR between August 2007 and January 2009. The drop in capital inflows, the balance-sheet effects of the currency depreciation and a sharp decline in export demand caused a severe recession in late 2008 and the first half of 2009, which was reflected in a 7.1% decline of GDP in 2009.

Under these conditions, the authorities decided to seek external financial support. The EU, the IMF, the World Bank, the EIB and the EBRD responded by making available to Romania medium-term financial assistance of up to EUR 20 billion. This assistance is conditional upon the implementation of a comprehensive economic policy programme which aims to address the external and fiscal imbalances described above. Fiscal consolidation is the cornerstone of this programme, which envisages a gradual, mainly expenditure-driven, reduction of the fiscal deficit. Moreover, the adoption of a fiscal responsibility law, which *inter alia* would require the adoption of a binding medium-term budgetary framework and the establishment of an independent fiscal council, should help improve fiscal governance. Finally, the economic policy programme envisages a number of structural reforms such as the introduction of a unified pay system for public sector employees and a reform of the pension system. Measures are also foreseen to improve financial sector regulation, increase the efficiency of public administration, enhance the business environment, tackle undeclared work and increase the absorption of EU funds.

The initial aim of the agreed economic policy programme was to bring the budget deficit down to 5.1% of GDP in 2009 and to 4.1% of GDP in 2010. However, a sharper-than-anticipated contraction in economic activity in the first half of 2009 led to a substantial deterioration in the fiscal position. It was decided to partially accommodate this deterioration in order to allow some room for automatic stabilisers to work. However, the need for fiscal consolidation left little room for manoeuvre in launching stimulus measures within the context of the European Economic Recovery Plan (EERP). Following discussions with the international financial institutions during the summer of 2009, Romania's deficit targets were revised upwards to 7.8% of GDP in 2009 and 6.4% of GDP in 2010.

The economic policy programme is broadly on track. The preliminary data in the convergence programme shows that the 7.8% of GDP deficit target for 2009 was slightly missed, by around 0.2 pp of GDP due to a build-up of payment arrears at the end of the year. Nevertheless, this can be considered a significant achievement given the uncertainty that surrounded this target just a few months ago. Looking forward, the Parliament adopted the 2010 budget in line with programme conditionality in January 2010. However, some of the fiscal consolidation measures (such as the cut in public sector employment) could be difficult to implement. This is why the Romanian government has agreed to take additional measures, including on the revenue side, in case the current measures are not on track to deliver the expected savings.

The adoption of the policy programme has contributed to an improvement in market sentiment and had a positive impact on the Romanian economy. After a period with renewed tensions due to the political uncertainties in the last part of 2009, financial market conditions have eased in 2010. The RON broadly stabilised over the fourth quarter of 2009 and then strengthened to its highest level since late 2008. Romanian money market rates remained elevated as compared to other New Member States (at around 10 percent for 3-month rates) over the fourth quarter 2009. They have declined progressively towards the NBR's key policy rate in early 2010.

In addition to fulfilling the conditions for receiving medium term financial assistance, Romania is bound by the Council's decision within the context of the Excessive Deficit Procedure (EDP) on 7 July 2009. The Council decided that an excessive deficit existed in Romania and issued recommendations to correct it by 2011. However, the sharper than anticipated recession had resulted in a significant worsening of the country's fiscal position despite the effective action taken by the authorities. In light of this, the Council issued new recommendations on 8 February 2010 extending the deadline for correction of the excessive deficit to 2012 (for more details on the EDP procedure, please see Box 1).

Overall, the following key challenges can be identified: (1) to restore macroeconomic stability allowing the country to emerge stronger from the crisis; (2) to continue the process of fiscal consolidation allowing the country to bring the deficit below the 3%-of-GDP reference value by 2012 and achieve a stabilisation of debt levels; (3) to implement the pension reform and in order to achieve sustainable public finances; and (4) to improve the efficiency and effectiveness of the public administration in support of real economic convergence.

3. MACROECONOMIC OUTLOOK

Against the background of the current macroeconomic situation and the main policy challenges set out in the previous section, this section makes an assessment of the plausibility of the macroeconomic scenario underpinning the public finance projections of the programme.

The main scenario in the programme estimates that in 2009 GDP contracted by 7% as a result of a sharp fall in domestic demand due to substantial contractions in both private consumption and investment expenditure. In 2010, GDP growth is expected to accelerate to 1.3% driven by a strong recovery in domestic demand and in particular in private consumption expenditure. This is in line with the latest GDP projection used within the context of the Balance of Payments (BoP) programme for Romania. GDP growth is then expected to continue accelerating in 2011 and 2012 driven by increases in domestic demand (both private consumption and investment expenditure) whereas the growth contribution of the external sector will remain slightly negative.

The real GDP growth projection for 2010 seems to be subject to moderate downside risks. The -1.5% qoq GDP growth rate for the fourth quarter of 2009 was worse than expected. This implies, amongst other things, that indirect tax revenue may come in lower than what is anticipated in the budget. The projections for 2011 and 2012 appear realistic and are in line with the Commission services' autumn 2009 forecasts and its estimates of potential GDP growth.

The programme assumes that the fiscal and external imbalances that contributed to the severity of the recession in Romania will remain in check over the projection period. This assumption is plausible. The fiscal consolidation measures taken within the context of the balance of payments programme are targeted at bringing the budget deficit below

3% of GDP by 2012. Moreover there has been a sharp correction in the current account deficit in 2009 as a result of the crisis and the associated increase in private sector savings.

The macroeconomic projections in the main scenario foresee a gradual reduction in consumer price inflation from an average of 5.6% in 2009 to an average of 2.8% in 2012. The reasons given for the reduction in the inflation rate during this period are prudent wage policies, the continuation of structural reforms, a monetary policy geared towards reducing the inflation rate and an appreciating trend of the RON/EUR exchange rate. Nevertheless, the inflation projections appear to be on the low side given the projected developments in private sector wage levels. Similarly, the expected reduction in the unemployment rate from 8.4% in 2009 to 7.7% in 2010 appears to be rather optimistic at this early stage of the economic recovery.

Overall, the macroeconomic scenario appears to be based on slightly favourable assumptions for 2010 in comparison with the Commission services' 2009 autumn economic forecast. The scenario for 2011 and 2012 appears plausible.

Table 2: Comparison of macroeconomic developments and forecasts

	2009		2010		2011		2012
	COM	**CP**	**COM**	**CP**	**COM**	**CP**	**CP**
Real GDP (% change)	-8.0	-7.0	0.5	1.3	2.6	2.4	3.7
Private consumption (% change)	-12.5	-10.6	2.2	3.8	3.6	2.8	3.8
Gross fixed capital formation (% change)	-12.3	-20.0	1.1	-1.0	5.8	5.0	6.7
Exports of goods and services (% change)	-8.9	-10.5	3.1	3.3	5.0	2.4	3.4
Imports of goods and services (% change)	-20.8	-24.8	5.0	3.6	7.5	3.3	5.5
Contributions to real GDP growth:							
- Final domestic demand	-12.8	-14.1	1.1	1.5	3.9	2.8	4.6
- Change in inventories	-1.5	-0.5	0.3	0.0	0.0	0.0	0.0
- Net exports	6.3	7.6	-0.9	-0.2	-1.3	-0.4	-0.9
Output gap[1]	-2.2	-1.7	-4.4	-3.3	-4.3	-3.7	-2.7
Employment (% change)	-3.3	-3.0	0.8	1.0	0.9	0.7	0.9
Unemployment rate (%)	9.0	8.4	8.7	7.7	8.5	7.5	7.0
Labour productivity (% change)	-4.9	-4.1	-0.3	0.3	1.7	1.7	2.8
HICP inflation (%)	5.7	5.6	3.5	3.7	3.4	3.2	2.8
GDP deflator (% change)	7.2	5.6	5.3	5.3	5.0	4.8	4.6
Comp. of employees (per head, % change)	4.8	1.6	5.5	5.2	6.0	6.0	6.9
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-5.0	-3.9	-5.1	-3.9	-5.2	-3.9	-3.7

Note:

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

Source:

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

4. General government balance

This section consists of four parts. The first three parts discuss the budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy in the programme. The final part analyses the risks attached to the budgetary targets.

4.1. Budgetary implementation in 2009

The programme estimates that the general government deficit in 2009 equalled 8.0% of GDP, which is slightly above target (7.8%) due to an increase in government payment arrears. The significant deterioration from the 5.5% of GDP deficit recorded in 2008 reflects to a large extent the impact of the crisis on government finances. In view of Romania's relatively difficult budgetary situation the policy focus in 2009 was on fiscal consolidation and the stimulus measures adopted in connection with the European Economic Recovery Programme (EERP) remained limited both in scope and size.

Table 3 compares the projected outcome for the general government balance, revenue and expenditure (as a percentage of GDP) in 2009 as presented in the new convergence programme with the targets from the previous update of the programme. Differences between outcomes and targets (excluding the impact of an unanticipated GDP developments which may have affected the ratio, referred to as the 'denominator effect') are decomposed in the impact of a different starting position (i.e. the outcome of 2008 may also have been different from what was anticipated in the previous programme update) and the impact of differences in the revenue / expenditure growth rate from the planned growth rates[2].

The revenue surprise excluding the denominator effect (-4.4%) confirms that the 2009 deterioration of the deficit was only due to an unexpected large shortfall in revenues, including VAT receipts and social security contributions. Moreover, absorption of EU funds and non-tax revenues were lower than anticipated. Similarly, the expenditure outturn excluding the denominator effect was 1.9 percentage points below baseline, which illustrates the substantial benefits from the government's fiscal consolidation efforts, which included a restructuring of state agencies and cuts in goods and services spending. However, the impact of the measures taken was lower than budgeted at the beginning of the year. As a result, one-off measures, such as the obligation of workers in the public sector to take ten days of non-paid leave, had to be taken to achieve the budgetary targets agreed within the context of the EU and IMF medium term financial assistance programme. A lower absorption of EU funds (reducing the co-financing needs) and lower-than-budgeted interest payments also helped meeting the expenditure target.

---

2 Mathematically, the difference in the revenue ratio in Table 3 can be expressed as:

$$\rho^{o}-\rho^{p}=\underbrace{\frac{1+r^{p}}{1+g^{p}}\Delta\rho_{-1}}_{\text{Base effect}}+\underbrace{\frac{\rho_{-1}^{o}}{(1+g^{o})(1+g^{p})}\Delta r}_{\text{Revenue growth effect}}-\underbrace{\frac{\rho_{-1}^{o}}{(1+g^{o})(1+g^{p})}\Delta g}_{\text{Denominator effect}}+\underbrace{\frac{\rho_{-1}^{o}\left(r^{o}g^{p}-r^{p}g^{o}\right)}{(1+g^{o})(1+g^{p})}}_{\text{Residual}}$$

where r is the growth rate of revenue and g is the growth rate of GDP. The subscript -1 refers to the previous year's value. Superscripts o and p refer to the outcome and the planned value respectively. Similar for the expenditure ratio.

Table 3: Budgetary implementation in 2009

	2008		2009	
	Planned CP Jun 2009	Outcome CP Mar 2010	Planned CP Jun 2009	Outcome CP Mar 2010
Government balance (% of GDP)	-5.4	-5.5	-5.1	-8.0
Difference compared to target [1]	-0.1		-2.9	
Difference excluding denominator effect [1,2]			**-2.5**	
Of which : due to a different starting position end 2008			-0.2	
due to different revenue / expenditure growth in 2009			-2.2	
p.m. Residual [3]			-0.1	
p.m. Nominal GDP growth (planned and outcome)			*5.4*	*-1.8*
Revenue (% of GDP)	33.1	32.8	33.2	31.1
Revenue surprise compared to target [1]	-0.3		-2.1	
Revenue surprise excluding denominator effect [1,2]			**-4.4**	
Of which : due to a different starting position end 2008			-0.3	
due to different revenue growth in 2009			-4.0	
p.m. Residual [3]			-0.1	
p.m. Revenue growth rate (planned and outcome)			*5.7*	*-6.9*
Expenditure (% of GDP)	38.5	38.4	38.3	39.1
Expenditure surprise compared to target [1]	0.1		-0.8	
Expenditure surprise excluding denominator effect [1,2]			**1.9**	
Of which : due to different starting position end 2008			0.1	
due to different expenditure growth rate in 2009			1.8	
p.m. Residual [3]			0.0	
p.m. Expenditure growth rate (planned and outcome)			4.9	0.0

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 usually largely cancel against each other.

[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

Box 1: The excessive deficit procedure (EDP) for Romania

On 7 July 2009 the Council adopted a decision stating that Romania had an excessive deficit in accordance with Article 104(6) of the Treaty establishing the European Community (TEC). At the same time, the Council addressed a recommendation under Article 104(7) TEC specifying that the excessive deficit had to be corrected by 2011. On 16 February 2010 the Council, following a recommendation by the Commission, considered that action had been taken in accordance with the recommendations, but unexpected adverse economic events with major unfavourable consequences for government finances had occurred after the adoption of the recommendation, and issued new recommendations to correct the deficit by 2012.

In particular, Romania was recommended to bring the general government deficit below 3% of GDP by implementing the fiscal measures as planned in its 2010 budget and continuing consolidation in 2011 and 2012. To limit risks to the adjustment, Romania should also continue implementing the measures to improve fiscal governance agreed in the framework of the multilateral financial assistance programme[3], including in particular the adoption and implementation of the Fiscal Responsibility Law and the revised pension legislation. Finally, the Council established the deadline of 16 August 2010 for Romania to take effective action to implement the fiscal consolidation measures. Romania was asked to report on progress made in the implementation of these recommendations in a separate chapter in the updates of the convergence programmes to be prepared between 2010 and 2012.

[3] See discussion in Section 2 on the EU BoP loan assistance granted to Romania.

4.2. The programme's budgetary strategy for 2010

In line with the policy conditions under the balance-of-payments support programme, the planned adjustment is mainly expenditure driven: the measures imply expenditure cuts of around 2.2% of GDP. The main expenditure cuts are: a public sector wage freeze and cuts in public sector employment which contribute to a 0.8% of GDP reduction of the public wage bill; cuts in public spending on goods and services contributing to a 0.5% of GDP reduction in intermediate consumption by the general government sector; a pension freeze, which contributes to a 0.8% of GDP reduction in social payments; and a cut in subsidies equivalent to 0.2% of GDP. The impact of these measures is partially offset by expenditure increases elsewhere yielding a net reduction in the ratio of primary expenditure to GDP by 1.3% percentage points of GDP. In particular, investment spending should increase by 0.2% of GDP, also in view of the planned increase in the use of EU structural funds. The ratio of government revenue to GDP should increase by around 0.6% percentage points, including the (one-off) proceeds from the reimbursement of tax arrears (the Rompetrol bond) worth 0.5% of GDP. Increased revenues from the rise in excises tax rates equivalent to 0.4% of GDP are more than offset by declines in income taxes (-0.3% of GDP) and social contributions (-0.2% of GDP).

In view of Romania's relatively low public debt level, interest expenditures in 2010 remain relatively limited at 1.8% of GDP. The projected deficit of 6.3% of GDP in 2010 therefore corresponds to a primary deficit of 4.5% of GDP. Commission services' calculations on the basis of the information in the programme according to the commonly agreed methodology show a structural deficit of 5¼% of GDP in 2010. Here the structural government deficit is defined as the cyclically adjusted deficit net of one-off and other temporary measures (which are non-existent in the case of Romania). However, at a time of nascent recovery cyclically-adjusted and structural balances need to be interpreted with caution.

The achievement of the 2010 deficit target through a successful implementation of the planned consolidation measures would represent a fiscal consolidation effort of around 2.2% of GDP which is in line with the Council Recommendation under Article 126(7) of 16 February 2010. Taken at face value, the consolidation effort in 2010 is above the average annual fiscal effort of 1¾% of GDP recommended for the period 2010-2012 by the Council Recommendation.

Table 4. Main budgetary measures for 2010

Revenue measures[1]	Expenditure measures[2]
Reimbursement of tax arrears (Rompetrol bond) (0.5% of GDP) Increase in excise taxes (0.4% of GDP)	Public wage freeze (0.8% of GDP) Cuts in public spending on goods and services(0.5% of GDP) Pension freeze (0.7% of GDP)

Notes:

[1] Estimated impact on general government revenue
[2] Estimated impact on general government expenditure

Source: Commission services and Ministry of Public Finance of Romania

4.3. The programme's medium-term budgetary strategy

This section describes the medium-term budgetary strategy outlined in the programme - and how it compares with the one in the previous update - as well as the composition of the budgetary adjustment, including the broad measures envisaged.

The main goal of the programme's medium term strategy is to bring the ESA95 deficit below the 3%-of-GDP reference value by 2012 in line with the Council Recommendation under Article 126(7) of 16 February 2010, which extended the deadline for correction of the excessive deficit from 2011 to 2012. Achievement of this revised target would imply a reduction of the structural deficit from 7½% of GDP in 2009 to 2% of GDP in 2012, reflecting average annual fiscal effort of 1¾% of GDP over the programme period.

The programme sets out a gradual path from bringing down the ESA95 deficit from 8% of GDP in 2009 to the 3% of GDP 2012 target. The headline deficits for 2010 and 2011 are expected to equal 6.3% and 4.4% of GDP respectively. The primary balance is expected to remain in negative territory, as interest payments on government debt stay below 2% of GDP. The annual percentage point decline in the primary deficit should equal 2% between 2009 and 2011 and half that between 2011 and 2012. The structural balance calculated according to the commonly agreed methodology shows a similar pattern, with the adjustment being somewhat front-loaded.

Most of the adjustment is expenditure based, with primary expenditure being expected to gradually decline from 37.6% of GDP in 2009 to 33.3% of GDP in 2012. Government revenues will see an increase from 31.1% of GDP in 2009 to 31.7% of GDP in 2010 and level off thereafter. The consolidation measures taken to reach the 2010 budgetary target (see section 4.2 above) will, to a limited extent, also facilitate the achievement of the more medium term targets. However, the programme does not present the additional consolidation measures to be implemented in 2011 and 2012, which will be necessary to achieve the fiscal targets set. They should be included in the medium term budgetary framework though, which will be adopted by the government by end May 2010 as agreed in the Supplemental Memorandum of Understanding describing the conditions for EU medium-term financial assistance for Romania.

Box 2: The medium-term objective (MTO) for Romania

As noted in the Code of Conduct[4], the MTO aims to (a) provide a safety margin with respect to the 3% of GDP deficit limit; (b) ensure rapid progress towards fiscal sustainability; and (c) allow room for budgetary manoeuvre, in particular taking into account the needs for public investment. The MTO is defined in cyclically adjusted terms, net of one-off and other temporary measures. On 7 July 2009, the ECOFIN Council took note of a new methodology for setting MTOs, ensuring that implicit liabilities (costs related to ageing populations, in particular projected healthcare and pension expenditure) are also accounted for.

Specifically, the country-specific MTOs should take into account three components: (i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; (ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and (iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure. This implies a partial frontloading of the budgetary cost of ageing

[4] "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 on 10 November 2009, available at: http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm

irrespective of the current level of debt. In addition to these criteria, MTOs should provide a safety margin with respect to the 3% of GDP deficit reference value and, for euro area and ERM II Member States, in any case not exceed a deficit of 1% of GDP.

As communicated by the authorities, the medium term objective (MTO) for Romania is a structural deficit of 0.7% of GDP. In view of the new methodology and given the most recent projections and debt level, the MTO reflects the objectives of the Pact. The programme does not envisage achieving the MTO over the programme period.

Table 5: Composition of the budgetary adjustment

(% of GDP)	2008	2009		2010		2011		2012	Change: 2009-2012
	COM	COM	CP	COM	CP	COM[1]	CP	CP	CP
Revenue	**32.8**	**31.6**	**31.1**	**31.8**	**31.7**	**32.0**	**31.9**	**31.8**	**0.7**
of which:									
- Taxes on production and imports	12.0	10.9	10.6	11.0	10.9	11.0	10.9	10.8	0.2
- Current taxes on income, wealth, etc.	6.9	6.5	6.7	6.8	6.4	7.1	6.4	6.6	-0.1
- Social contributions	10.3	10.5	10.1	10.3	9.9	10.1	9.9	9.7	-0.4
- Other (residual)	3.7	3.7	3.7	3.7	4.5	3.8	4.7	4.7	1.0
Expenditure	**38.4**	**39.4**	**39.1**	**38.6**	**38.1**	**37.9**	**36.4**	**34.8**	**-4.3**
of which:									
- Primary expenditure	37.6	37.8	37.6	36.8	36.3	35.9	34.6	33.3	-4.3
of which:									
Compensation of employees	10.2	10.3	9.8	9.8	9.0	9.4	8.3	8.1	-1.7
Intermediate consumption	6.7	4.8	5.9	4.5	5.4	4.4	5.0	4.8	-1.1
Social payments	11.2	13.4	12.6	13.2	11.9	12.9	11.2	10.7	-1.9
Subsidies	1.1	0.9	1.0	0.9	0.8	0.8	0.7	0.6	-0.4
Gross fixed capital formation	5.6	5.7	6.4	5.7	6.6	5.7	6.5	6.6	0.2
Other (residual)	2.7	2.6	1.8	2.6	2.6	2.6	2.9	2.6	0.8
- Interest expenditure	0.8	1.6	1.5	1.8	1.8	2.0	1.8	1.5	0.0
General government balance (GGB)	**-5.5**	**-7.8**	**-8.0**	**-6.8**	**-6.3**	**-5.9**	**-4.4**	**-3.0**	**5.0**
Primary balance	**-4.8**	**-6.2**	**-6.5**	**-5.0**	**-4.5**	**-3.9**	**-2.6**	**-1.6**	**4.9**
One-off and other temporary measures	0.0	0.0	n.a.	0.0	n.a.	0.0	n.a.	n.a.	n.a.
GGB excl. one-offs	**-5.5**	**-7.8**	**n.a.**	**-6.8**	**n.a.**	**-5.9**	**n.a.**	**n.a.**	**n.a.**
Output gap[2]	10.0	-2.2	-1.7	-4.4	-3.3	-4.3	-3.7	-2.7	-1.0
Cyclically-adjusted balance[2]	-8.5	-7.1	-7.5	-5.5	-5.2	-4.6	-3.2	-2.1	5.3
Structural balance[3]	**-8.5**	**-7.1**	**-7.5**	**-5.5**	**-5.2**	**-4.6**	**-3.2**	**-2.1**	**5.3**
Change in structural balance		*1.4*	*1.0*	*1.7*	*2.2*	*0.8*	*2.0*	*1.1*	
Structural primary balance[3]	-7.8	-5.5	-6.0	-3.7	-3.4	-2.6	-1.4	-0.6	5.3
Change in structural primary balance		*2.2*	*1.8*	*1.9*	*2.5*	*1.0*	*2.0*	*0.8*	

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' autumn 2009 forecasts (COM); Commission services' calculations

4.4. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2011, Table 5 compares the detailed revenue and expenditure projections in the Commission services' autumn 2009 forecast, which are derived under a no-policy change scenario, with those in the updated programme. However, although the assessment uses the Commission services' forecast as a benchmark, it also takes explicitly into account all available information about more recent developments.

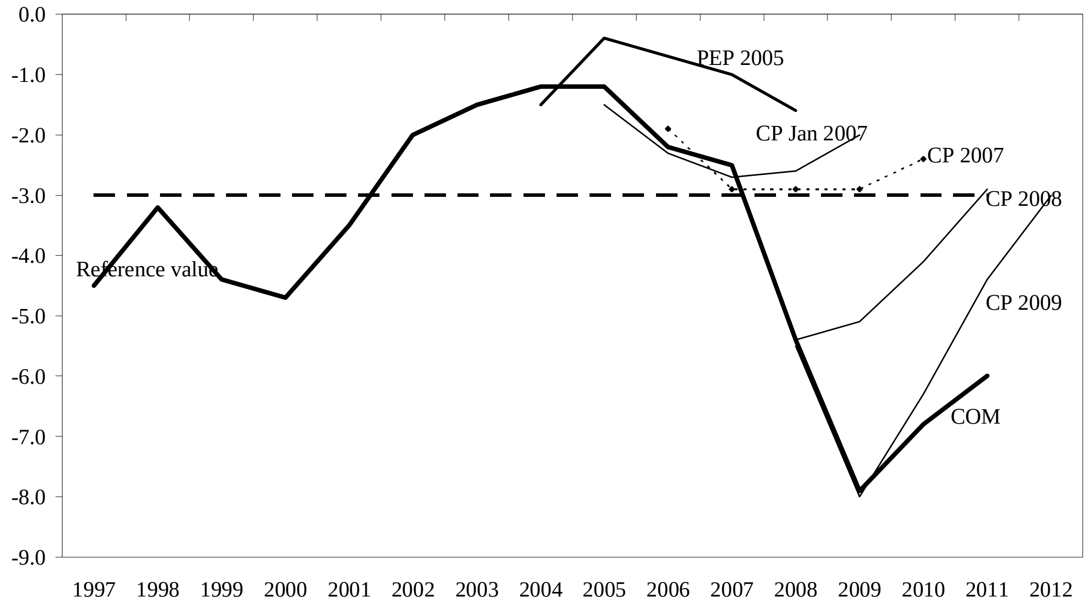
The budgetary outcome in the programme is subject to a number of downside risks. On the expenditure side, these risks include higher than projected personnel expenditure if the measures aimed at reorganizing the public sector or at controlling spending by local authorities are not implemented or only partly implemented. A lack of control on spending by local authorities can also lead to higher spending on goods and services. Finally, expenditure on subsidies may be higher than projected if no measures are implemented to restructure state-owned companies and their financial situation continues to deteriorate. On the revenue side, the main risk related to the 2010 budget is that the reimbursement of tax arrears by Rompetrol (the Rompetrol bond) does not materialise or materialises only partly. Another risk on the revenue side is related to the collection of tax revenue and fiscal fraud, which may increase in light of the sharp contraction of the economy in 2009.

More generally, there are significant implementation risks for the 2010 budget given that some of the measures aimed at reducing expenditure are socially and politically difficult to carry out. However, the Romanian government has committed itself within the framework of the multilateral financial assistance package to Romania to implement additional measures in case the measures currently agreed upon do not yield the necessary savings to achieve the budget deficit target for this year. Such measures are being prepared by the authorities and will be reviewed in the next balance of payments mission in April.

Risks are also present for the medium-term and are linked to the potential negative impact of the election cycle on public finances. Another potential medium-term risk is that measures aimed at restructuring and increasing the efficiency of state owned enterprises are not implemented, leading to a continuation of the accumulation of arrears by the latter. Should this happen, the government will be obliged to intervene at some stage, which will lead to a deterioration in public finances.

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 also increase by more than projected in the programme, but it would still remain below the Maastricht limit.

Figure 1: Government balance projections in successive programmes (% of GDP)



<u>Source</u>: Commission services' autumn 2009 forecast (COM) and successive convergence programmes. PEP=pre-accession economic programme.

5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

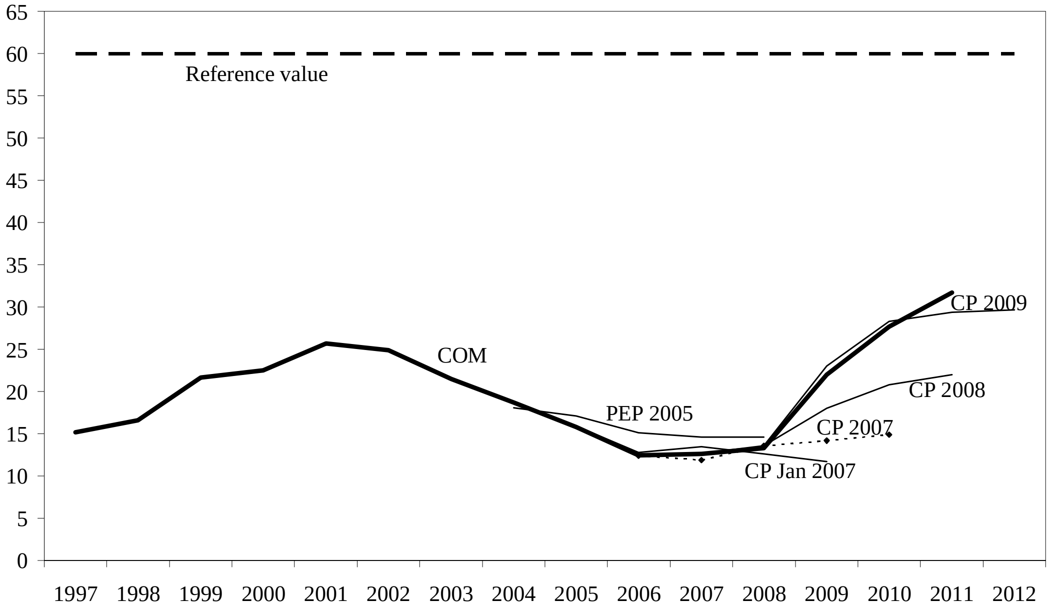
This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

5.1. Recent debt developments and medium-term prospects

5.1.1. Debt projections in the programme

Government gross debt is estimated at 23% of GDP in 2009, up from 13.6% the year before. The main drivers of the increase in the debt-to-GDP ratio were a sharp rise in the deficit, the decline in GDP growth, the rise in interest payments and the valuation effect stemming from the depreciation of the exchange rate. The debt ratio is projected to increase by a further 6.7 percentage points over the programme period, mainly driven by high government deficits.

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



Source: Commission services' autumn 2009 forecast (COM) and successive convergence programmes. PEP=pre-accession economic programme.

Table 6: Debt dynamics

(% of GDP)	average 2003-07	2008	2009		2010		2011		2012
			COM	CP	COM	CP	COM	CP	CP
Gross debt ratio[1]	**16.2**	**13.6**	**21.8**	**23.0**	**27.4**	**28.3**	**31.3**	**29.4**	**29.7**
Change in the ratio	-2.5	1.0	8.2	9.4	5.6	5.3	3.9	1.1	0.3
Contributions [2] :									
1. Primary balance	**0.6**	**4.8**	**6.2**	**6.5**	**5.0**	**4.5**	**3.9**	**2.6**	**1.6**
2. "Snow-ball" effect	**-2.2**	**-1.3**	**1.7**	**1.7**	**0.6**	**0.4**	**0.0**	**-0.1**	**-0.8**
Of which:									
Interest expenditure	1.1	0.8	1.6	1.5	1.8	1.8	2.0	1.8	1.4
Growth effect	-1.0	-0.6	1.1	1.0	-0.1	-0.3	-0.7	-0.6	-1.0
Inflation effect	-2.4	-1.5	-1.0	-0.8	-1.1	-1.1	-1.3	-1.3	-1.2
3. Stock-flow adjustment	**-0.7**	**-2.3**	**0.2**	**1.2**	**0.0**	**0.4**	**0.0**	**-1.4**	**-0.4**
Of which:									
Cash/accruals diff.	-0.4	-1.7		-0.2		-0.1		-0.1	0.0
Acc. financial assets	0.0	-1.6		0.0		0.0		0.0	0.0
Privatisation	-1.0	-0.5		0.0		0.0		0.0	0.0
Val. effect & residual	-0.2	1.0		14.6		8.1		7.3	1.5

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' autumn 2009 forecasts (COM); Commission services' calculations

The Commission services' 2009 autumn forecast estimated a slightly lower debt ratio in 2009 compared to the convergence programme mainly because it considered a significantly lower stock-flow adjustment. The latter is higher in the convergence programme because of the valuation effect that came from the significant depreciation of the exchange rate. The primary balance was also slightly higher compared to the Commission forecast. For 2010, the convergence programme projects a higher debt ratio compared to the Commission forecast, mainly because of a higher stock-flow adjustment. Finally, for 2011 the Commission 2009 autumn forecast foresees a higher debt ratio compared to the convergence programme due to a higher primary balance as well as slightly higher interest expenditures.

The risks to the projected evolution of the debt ratio appear to be on the upside in view of the negative risks to the budgetary targets. The Romanian authorities provide a number of State guarantees particularly for the "Prima casa" project in which banks are given guarantees by the State for making mortgages available for the purchase of a first home. State guarantees are also provided in order to ensure the co-financing of EU, BERD, BEI and other projects partly financed by funds from international organisations. However, the risks from these State guarantees for debt developments are relatively small given that within the multilateral financial assistance package given to Romania, the authorities are imposed strict ceilings on the amount of guarantees that can be given and the adherence to these ceilings are evaluated regularly by the IMF as part of its financial programme with Romania.

5.2. Long-term debt projections and the sustainability of public finances

5.2.1. Sustainability indicators and long-term debt projections

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[5].

Table 7 shows that the increase in age-related spending is projected to rise by 8.5 percentage points of GDP between 2010 and 2060, significantly above the EU average (4.6 pps.). Sustainability indicators for two scenarios are presented in Table 8. 'The 2009 scenario' is based on a no-policy-change assumption and the 2009 structural primary balance as a starting year, while 'the programme scenario' takes into account the consolidation planned in the programme up to 2012 and is based on the projected 2012 structural primary balance as a starting position. Including the increase of age-related expenditure and assuming that the structural primary balance remained at its 2009 level, the sustainability gap (S2)[6] would amount to 11.8% of GDP; about ½ percentage points less than in last year's assessment, due to a slightly improved estimated structural primary balance in the starting year. 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.

---

5 Economic Policy Committee and the European Commission (2009), '2009 Ageing Report: Economic and budgetary projections for the EU-27 Member States (2008-60)', *European Economy* No. 2/2009. European Commission (2009), 'Sustainability Report 2009, European Economy No. 9/2009. European Commission (2008), 'Public finances in EMU – 2008', *European Economy* No. 4/2008.

6 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.

In contrast to the '2009 scenario', 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 reduced, as shown by the sustainability gap (S2) reaching 6.4% of GDP.

Table 7: Long-term age-related expenditure: main projections

(% of GDP)	2007	2010	2020	2030	2040	2060	Change 2010-60
Total age-related spending	**13,1**	**14,7**	**15,1**	**17,0**	**19,3**	**23,2**	**8,5**
- Pensions	6,6	8,4	8,8	10,4	12,6	15,8	7,4
- Healthcare	3,5	3,6	3,8	4,1	4,4	4,9	1,3
- Long-term care	0,0	0,0	0,0	0,0	0,0	0,0	0,0
- Education and unemployment benefits	3,0	2,7	2,5	2,4	2,3	2,5	-0,2
Property income received	0,9	0,9	0,8	0,8	0,8	0,8	-0,1

Source: Economic Policy Committee and Commission services.

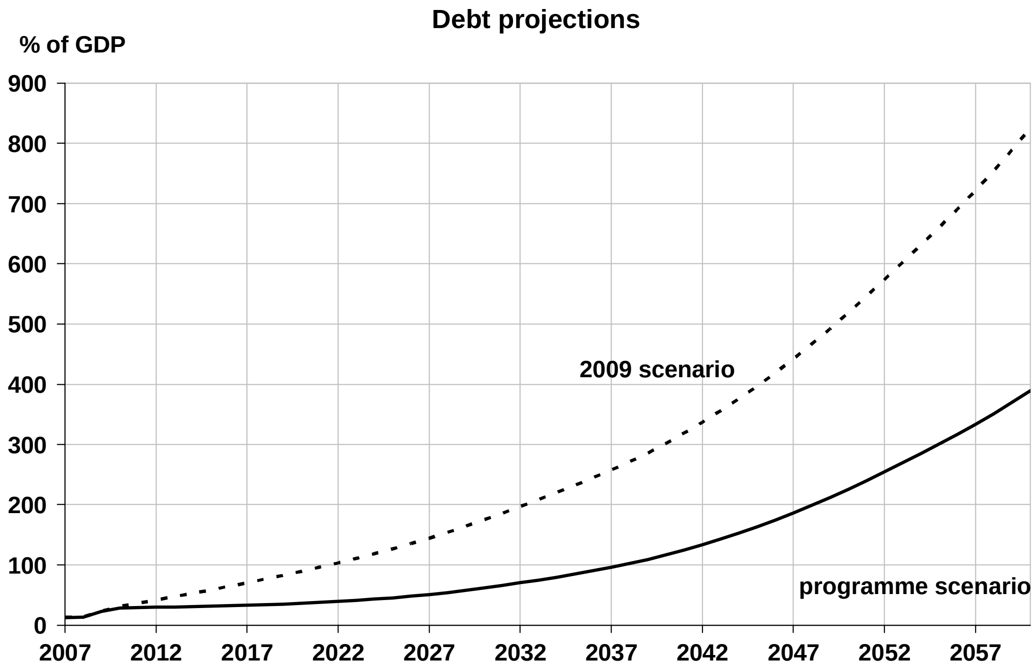
Table 8: Sustainability indicators and the required primary balance

	2009 scenario			Programme scenario		
	S1	S2	RPB	S1	S2	RPB
Value	9,7	11,8	5,7	4,2	6,4	5,5
of which:						
Initial budgetary position (IBP)	6,5	6,7	-	1,2	1,3	-
Debt requirement in 2060 (DR)	-0,2	-	-	-0,4	-	-
Long-term change in the primary balance (LTC)	3,4	5,1	-	3,4	5,1	-

Source: Commission services.

Based on the assumptions used in the projection of age-related expenditure and the calculation of the sustainability indicators, Figure 3 displays the projected debt-to-GDP ratio over the long-term.

Figure 3: Long-term projections for the government debt ratio

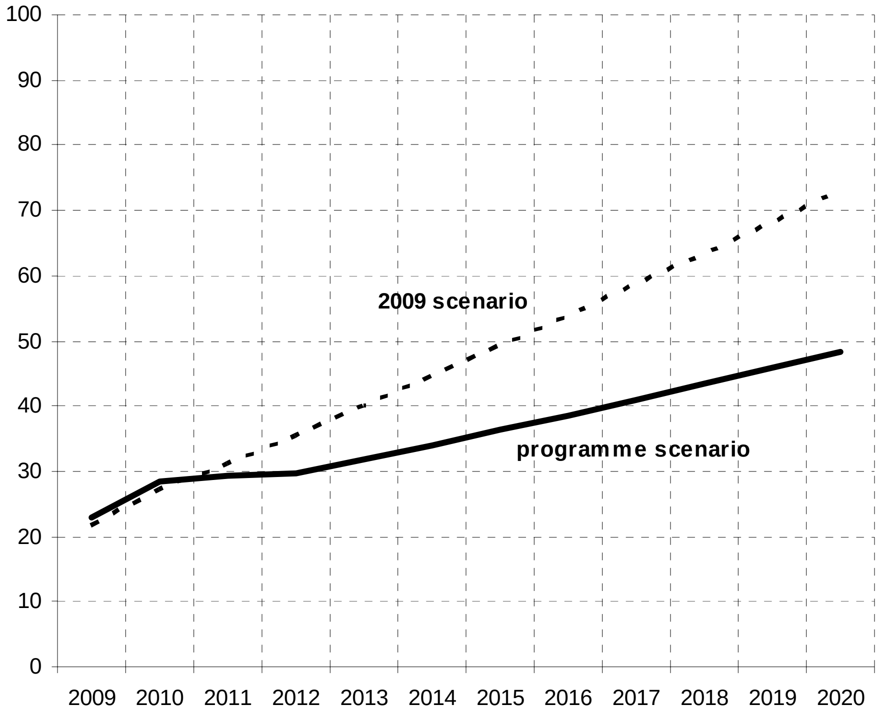


Note: Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication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

Based on the alternative assumptions of economic developments presented in the Commission services' autumn 2009 forecast publication[7], Figure 4 shows projected medium-term trajectory of the debt/GDP ratio. Taking into account the latest economic development (below) debt is increasing to around 50% of GDP in the programme scenario by 2020 while in the baseline (above) the increase is slower in the same period.

[7] Section 3.5 in European Commission (2009), 'European Economic Forecast – autumn 2009', European Economy No. 10/2009. This economic scenario assumes that the output gap caused by the crisis will be closed by 2017.

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



<u>Source</u>: Commission services' calculations

5.2.2. Additional factors

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account. As indicated in Table 9 none of these factors have an impact on the overall long-term sustainability assessment. Nevertheless, as mentioned in the programme, a draft pension reform has been sent to Parliament for adoption. The reform strikes a good balance between fiscal affordability and maintaining sufficiently high replacement rates. It also increases the retirement age for men and women to 65 years of age and moves gradually to an indexation of existing pensions entirely on inflation by 2030. If implemented, this reform would curb the projected increase in age-related expenditure and thus diminish the risks to the long-term sustainability of public finances.

Table 9: Additional factors for the assessment of long-term sustainability risks

	Impact on risk
Debt and pension assets	na
Decline in structural balance until 2011 in COM Autumn 2009 forecast	na
Alternative projection of cost of ageing	na
Strong decline in benefit ratio	na
High tax burden	na
Difference between S1 and S2	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. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unofficial".

An explanation on these factors can be found in chapter V of: European Commission (2009), Sustainability Report 2009, European Economy No. 9/2009.

Source: Commission services.

5.2.3. Assessment

The long-term budgetary impact of ageing is clearly above the EU average, mainly due to a high projected increase in pension expenditure. The budgetary position in 2009, as estimated in the programme, compounds the budgetary impact of population ageing on the sustainability gap. Reducing the primary deficit over the medium term, as foreseen in the programme, and implementing the draft pension reform agreed together with the international financial institutions in the context of the balance-of-payments assistance programme for Romania, which is aimed at curbing the substantial increase in age-related expenditures, would contribute to reducing the risks to the sustainability of public finances which were assessed in the Commission 2009 Sustainability Report as high.

Medium-term debt projections until 2020 assume that GDP growth rates and tax ratios will only gradually recover to the values projected before the crisis. This would imply that the budgetary strategy envisaged in the programme, taken at face value and with no further policy change, is not sufficient to stabilise the debt ratio by 2020.

6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES

This section is subdivided into two elements: the fiscal framework and the quality of public finances in a broader sense.

6.1. Fiscal framework

The fiscal deficits and pro-cyclicality of the fiscal policy in Romania in past years can be partly explained by a weak budgetary planning and execution as well as by a lack of fiscal discipline. Initial budgets have suffered from an over-estimation of revenue and there have been several in-year budgetary rectifications, increasing expenditure levels and changes in the composition of spending (by shifting capital to current spending). Furthermore, there is a high degree of uncertainty as large expenditure outlays are executed in the last few months of the year. While 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 payments assistance to adopt measures aimed at strengthening fiscal governance. A fiscal responsibility law has been submitted to Parliament for approval, based on EC/IMF/World Bank technical assistance. The draft law sets up a binding medium-term budgetary framework, establishes limits on budget revisions during the year, introduces sound fiscal rules and creates the fiscal council which will provide independent scrutiny on public finance issues. While this reform remains to be adopted by Parliament and implemented, there has been progress in controlling expenditure overruns in the 2009 budget, although there was still some build-up of arrears at the end of last year.

6.2. Quality of public finances

An overarching priority and challenge for the Government is to improve the effectiveness and efficiency of public administration, both at the central and local level. Problem analysis, conceptual development, budget planning and execution as well as the enforcement of policies are improving within the context of multilateral assistance form international financial institutions. However, further progress needs to be made in order to avoid a deterioration of the access to and quality of the public services as well as the business environment more generally. Such progress would also contribute to raise the low rate of absorption of EU funds.

In order to address the specific performance challenges in individual ministries as well as the systemic problems requiring a government wide approach, a functional review of the public administration is about to be launched. In addition, specific measures are envisaged to improve the efficiency of tax management and to strengthen central government control over spending by local authorities and state owned enterprises.

Moreover, a unified wage law was adopted by Parliament in October 2009. It enhances the transparency in the public wage system and foresees a gradual reduction of the wage bill by setting annual ceilings on the total wage bill and by introducing limits to bonus payments. However, further improvements in the law are necessary such as a further strengthening of the link between pay and responsibility and the incorporation in the system a of non-wage payments which are currently excluded. Follow-up legislation on the unified wage law will be drafted in the coming months. The authorities have also adopted a plan to tackle undeclared work, which focuses on measures to increase the efficiency of the labour inspection.

Agreement has been reached on the objectives and recommendations of the national R&D strategy 2007-2013 with a view to improving the effectiveness and efficiency of public R&D spending. A more detailed plan of action is being prepared, which aims to concentrate public R&D spending in niche areas where Romania has particular strengths.

Finally, the Government intends to take concrete measures to increase the low rate of absorption of EU Structural Funds. These measures include a strengthening of the administrative capacity of the services directly concerned, an increased efficiency of public procurement procedures and the integration of Structural funds' expenditures in the MTBF.

7. OVERALL ASSESSMENT

Taking into account risks attached to the budgetary targets discussed above, this section assesses the appropriateness of the fiscal strategy in relation to the Council Recommendations under Article 126(7) of 16 February 2010 with a view to correcting the excessive deficit and the budgetary objectives of the Stability and Growth Pact, against the background of the current economic situation, the debt and long-term sustainability position of the country, and the institutional features of its public finances.

The budgetary strategy presented in the programme for 2010 implies a fiscal consolidation effort of around 2.2% of GDP which is in line with the Council Recommendation under Article 126(7) of 16 February 2010. However, it remains uncertain whether the 2010 budget deficit target will be achieved, particularly in light of the macroeconomic growth performance which is likely to be somewhat worse than projected, as well as implementation risks related to some of the measures given the social and political difficulty of carrying out some of the reforms (e.g. reorganization of the public sector, job cuts, tighter control on spending by local authorities). Given these uncertainties, the Romanian authorities have committed themselves to implement additional contingency measures if the current reforms do not yield the expected savings. It will therefore be important that the Romanian government rigorously implements the budgetary measures agreed upon within the framework of the balance of payments programme and identify additional contingency measures to be implemented if the risks mentioned above materialise.

For 2011-2012, the aim of the budgetary strategy is to gradually bring down the budget deficit to the 3%-of-GDP reference value by 2012, in line with the Council Recommendation under Article 126(7) of 16 February 2010. Achieving this target implies an annual fiscal adjustment effort of 1 ¾% of GDP over the programme period. The fiscal governance reforms being implemented as part of the BoP programme as well as the other structural consolidation measures being implemented as part of the 2010 budget should contribute to achieve the fiscal targets over the medium-term. However, the Romanian government needs to present more specific fiscal consolidation measures for these two years which should be included in the Medium Term Budgetary Framework (MTBF). The latter should be adopted by the government by end-May 2010 as agreed in the Supplemental Memorandum of Understanding describing the conditions for EU medium-term financial assistance to Romania. Furthermore, the Fiscal Council which will be set up in April as part of the Fiscal Responsibility Law should contribute to the elaboration of the MTBF.

Overall, it can be concluded that the budgetary strategy for 2010-2012 is broadly consistent with the Council Recommendations.

Over the long-term, there is a high risk to the sustainability of public finances due to the substantial increase in pension expenditure. It will therefore be important for the Romanian authorities to adopt and implement the pension reform agreed in the BoP programme to Romania. This would significantly contribute to curb the increase in age-related expenditure and thereby reduce the high risks related to the sustainability of public finances most notably by equalizing the retirement age between men and women and by gradually moving to a full indexation of pensions based on inflation rather than on wage growth as has been the case in the past.

Finally, given the weak budgetary planning and execution that have characterized fiscal policy in the past, the government should continue working towards increasing the predictability of public finances by improving its fiscal framework. The adoption of the fiscal governance reforms foreseen in the BoP programme (fiscal responsibility law and unified wage law) should make a substantial contribution towards achieving this goal. In addition, taking measures to improve the efficiency of tax management and strengthen the control of public spending by local authorities should enhance the effectiveness and efficiency of public finances.

* * *

ANNEX. COMPLIANCE WITH THE FORMAT AND CONTENT REQUIREMENTS FOR STABILITY AND CONVERGENCE PROGRAMMES

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct); and (iii) other information requirements is concerned. It also assesses to what extent Country followed up on the Council's recommendation to report on progress made in the correction of the excessive deficit, in a separate chapter of the programme.

(i) Model structure

The 2009-2012 update of the convergence programme largely adheres to the code of conduct as far as its table of contents is concerned. However, contrary to the model structure in Annex 1 of the code of conduct the chapters describing the macroeconomic scenario and comparing the current update with the previous one precede the chapter on the government deficit and debt. Moreover, the sensitivity analysis of budgetary projection to different scenarios and assumptions is integrated in the chapter on the government deficit and debt, and not in the chapter providing a comparison of the current update with the previous one.

(ii) Data requirements

The 2009-2012 update of the convergence programme largely adheres to the code of conduct as far as data requirements are concerned. However, it does not provide tables on general government expenditure by function and on the basic assumptions underlying the programme. The tables on the divergence from the previous update and on the long-term sustainability of public finances are only partially filled out. Moreover, no data appear to be available on employment in terms of hours worked and labour productivity per hour worked. In the table on sectoral balances, no information is provided on net lending/borrowing of the private sector and general government. In the table on general government budgetary prospects, no information is provided on the budgetary impact of one-off and other temporary measures and on capital tax revenues.

The tables on the following pages show the data presented in the March2010 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.

(iii) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

In its recommendations under Article 126(7) of 16 February 2010 with a view to bring the excessive deficit situation to an end, the Council also invited Romania to report on progress made in the implementation of the Council's recommendations in a separate chapter in the updates of the convergence programmes. Romania did not comply with this recommendation.

* * *

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

The SCP…	Yes	No	Comments
a. Involvement of parliament			
… mentions status vis-à-vis national parliament.		X	
… indicates whether Council opinion on previous programme has been presented to national parliament.		X	

The SCP…	Yes	No	Comments
b. Economic outlook			
… (for euro area and ERM II Member States) uses "common external assumptions" on main extra-EU variables.			Not applicable
… explains significant divergences with Commission services' forecasts[1].		X	
… bears out possible upside/downside risks to economic outlook.		X	
… analyses outlook for sectoral balances and, especially for countries with high external deficit, external balance.	X		
c. Monetary/exchange rate policy			
… (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.	X		
d. Budgetary strategy			
… presents budgetary targets for general government balance in relation to MTO and projected path for debt ratio.	X		
… (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.	X		
… (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).	X		
… backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance.			Yes for 2010, but no for 2011 and 2012
… specifies state of implementation of measures.	X		
e. "Major structural reforms"			
… (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible 'major structural reforms' over time.	X		
… includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.		X	
f. Sensitivity analysis			
… includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of: a) changes in main economic assumptions b) different interest rate assumptions c) (for CP only) different exchange rate assumptions d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.		X	But contains a sensitivity analysis on the evolution of debt
… (in case of "major structural reforms") analyses how changes in assumptions would affect budget and potential growth.		X	
g. Broad economic policy guidelines			
… provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.		X	
h. Quality of public finances			
… describes measures to improve quality of public finances, both revenue and expenditure sides.	X		
i. Long-term sustainability			
… outlines strategies to ensure sustainability.	X		
… includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).	X		
j. Other information (optional)			
… includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		

Notes: SCP = stability/convergence programme; CP = convergence programme
[1]To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme.

Source:
Commission services

Tables from Annex 2 of the code of conduct

Table 1a. Macroeconomic prospects

	ESA Code	2008 Level	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change	2012 rate of change
1. Real GDP	B1*g	*446.6*	7.3	-7.0	1.3	2.4	3.7
2. Nominal GDP	B1*g	*514.7*	23.7	-1.8	6.6	7.4	8.4
Components of real GDP							
3. Private consumption expenditure	P.3	*304.9*	9.5	-10.6	3.8	2.8	3.8
4. Government consumption expenditure	P.3	*71.3*	7.1	-2.7	-3.5	-1.3	1.9
5. Gross fixed capital formation	P.51	*145.9*	16.2	-20.0	-1.0	5.0	6.7
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*-14.4*	-4.2	-0.5	0.0	0.0	0.0
7. Exports of goods and services	P.6	*132.5*	8.7	-10.5	3.3	2.4	3.4
8. Imports of goods and services	P.7	*193.7*	7.8	-24.8	3.6	3.3	5.5
Contributions to real GDP growth							
9. Final domestic demand		-	12.3	-14.1	1.5	2.8	4.6
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	-4.2	-0.5	0.0	0.0	0.0
11. External balance of goods and services	B.11	-	-0.8	7.6	-0.2	-0.4	-0.9

Table 1b. Price developments

	ESA Code	2008 Level	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change	2012 rate of change
1. GDP deflator		*n.a.*	15.2	5.6	5.3	4.8	4.6
2. Private consumption deflator		*n.a.*	9.5	5.5	4.1	3.8	3.5
3. HICP[1]		*n.a.*	7.9	5.6	3.7	3.2	2.8
4. Public consumption deflator		*n.a.*	22.2	6.6	4.6	6.1	5.6
5. Investment deflator		*n.a.*	12.6	5.0	4.8	4.5	4.2
6. Export price deflator (goods and services)		*n.a.*	18.2	5.0	1.2	0.8	1.3
7. Import price deflator (goods and services)		*n.a.*	15.5	3.9	0.5	0.1	0.5

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2008	2008	2009	2010	2011	2012
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[1]		*9369*	0.2	-3.0	1.0	0.7	0.9
2. Employment, hours worked[2]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
3. Unemployment rate (%)[3]		*n.a.*	5.8	8.4	7.7	7.5	7.0
4. Labour productivity, persons[4]		*n.a.*	7.1	-4.1	0.3	1.7	2.8
5. Labour productivity, hours worked[5]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
6. Compensation of employees	D.1	*198290*	25.0	-2.4	6.0	6.6	7.6
7. Compensation per employee		*30640*	24.3	1.6	5.2	6.0	6.9

[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	2008	2009	2010	2011	2012
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-11.2	-3.9	-3.9	-3.9	-3.7
of which :						
- Balance on goods and services		-13.2	-5.9	-5.6	-5.4	-5.7
- Balance of primary incomes and transfers		1.6	1.6	0.5	0.3	0.7
- Capital account		0.4	0.4	1.2	1.2	1.3
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		n.a.	n.a.	n.a.	n.a.	n.a.

Table 2. General government budgetary prospects

	ESA Code	2008 Level	2008 % of GDP	2009 % of GDP	2010 % of GDP	2011 % of GDP	2012 % of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	*-27941.3*	-5.5	-8.0	-6.3	-4.4	-3.0
2. Central government	S.1311	*-22784.9*	-4.5	-6.2	-5.3	-3.9	-2.6
3. State government	S.1312	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	*-4619.6*	-0.9	-0.6	-0.5	-0.3	-0.3
5. Social security funds	S.1314	*-536.8*	-0.1	-1.2	-0.5	-0.2	-0.1
General government (S13)							
6. Total revenue	TR	*165421.9*	32.8	31.1	31.7	31.9	31.8
7. Total expenditure	TE[1]	*193363.2*	38.4	39.1	38.1	36.4	34.8
8. Net lending/borrowing	EDP B.9	*-27941.3*	-5.5	-8.0	-6.3	-4.4	-3.0
9. Interest expenditure	EDP D.41	*3825.3*	0.8	1.5	1.8	1.8	1.5
10. Primary balance[2]		*-24116*	-4.8	-6.5	-4.5	-2.6	-1.6
11. One-off and other temporary measures[3]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		*94865.3*	18.8	17.3	17.3	17.3	17.4
12a. Taxes on production and imports	D.2	*60291.8*	12.0	10.6	10.9	10.9	10.8
12b. Current taxes on income, wealth, etc	D.5	*34573.5*	6.9	6.7	6.4	6.4	6.6
12c. Capital taxes	D.91	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
13. Social contributions	D.61	*51988.1*	10.3	10.1	9.9	9.9	9.7
14. Property income	D.4	*4407.8*	0.9	0.9	1.4	1.3	1.3
15. Other[4]		*14160.7*	2.8	2.8	3.2	3.4	3.4
16=6. Total revenue	TR	*165421.9*	32.8	31.1	31.7	31.9	31.8
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.	n.a.
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	*85145.2*	16.9	15.7	14.4	13.3	12.9
17a. Compensation of employees	D.1	*51446.6*	10.2	9.8	9.0	8.3	8.1
17b. Intermediate consumption	P.2	*33698.6*	6.7	5.9	5.4	5.0	4.8
18. Social payments (18=18a+18b)		*56381.1*	11.2	12.6	11.9	11.2	10.7
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*3058.1*	0.6	0.6	0.5	0.5	0.5
18b. Social transfers other than in kind	D.62	*53323*	10.6	12.0	11.4	10.7	10.2
19=9. Interest expenditure	EDP D.41	*3825.3*	0.8	1.5	1.8	1.8	1.5
20. Subsidies	D.3	*5764.8*	1.1	1.0	0.8	0.7	0.6
21. Gross fixed capital formation	P.51	*28452.3*	5.6	6.4	6.6	6.5	6.6
22. Other[6]		*13794.5*	2.7	1.8	2.6	2.9	2.6
23=7. Total expenditure	TE[1]	*193363.2*	38.4	39.1	38.1	36.4	34.8
p.m.: Government consumption (nominal)	P.3	*87123.9*	17.3	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	**2007**	**2012**
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	**2008**	**2009**	**2010**	**2011**	**2012**
1. Gross debt[1]		13.6	23.0	28.3	29.4	29.7
2. Change in gross debt ratio		0.9	9.4	5.3	6.4	1.4
Contributions to changes in gross debt						
3. Primary balance[2]		-4.8	-6.5	-4.5	-2.6	-1.6
4. Interest expenditure[3]	EDP D.41	0.8	1.5	1.8	1.8	1.5
5. Stock-flow adjustment		4.9	14.4	8.0	7.2	1.5
of which:						
- Differences between cash and accruals[4]		0.0	-0.2	-0.1	-0.1	0.0
- Net accumulation of financial assets[5]		0.1	0.0	0.0	0.0	0.0
of which:						
- privatisation proceeds		0.1	0.0	0.0	0.0	0.0
- Valuation effects and other[6]		4.8	14.6	8.1	7.3	1.5
p.m.: Implicit interest rate on debt[7]		6.4	6.6	6.9	7.1	5.4
Other relevant variables						
6. Liquid financial assets[8]		0.0	0.0	0.0	0.0	0.0
7. Net financial debt (7=1-6)		13.6	23.0	28.3	29.4	29.7

[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	2008	2009	2010	2011	2012
1. Real GDP growth (%)		7.1	-4.0	0.1	2.4	3.7
2. Net lending of general government	EDP B.9	-5.5	-8	-6.3	-4.4	-3
3. Interest expenditure	EDP D.41	0.8	1.5	1.8	1.8	1.5
4. One-off and other temporary measures[1]		n.a.	n.a.	n.a.	n.a.	n.a.
5. Potential GDP growth (%)		3.2	1.9	1.4	1.6	1.9
contributions:						
- labour		1.1	-3.5	0.5	0.9	1.1
- capital		3.8	3.4	2.4	2.4	2.4
- total factor productivity		-1.7	2.1	-1.5	-1.7	-1.6
6. Output gap		6.1	-2.2	-3.1	-2.3	-0.6
7. Cyclical budgetary component		1.8	-0.6	-0.8	-0.6	-0.2
8. Cyclically-adjusted balance (2 - 7)		-7.3	-7.4	-5.5	-3.8	-2.9
9. Cyclically-adjusted primary balance (8 + 3)		-6.5	-5.9	-3.7	-2.0	-1.4
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	2008	2009	2010	2011	2012
Real GDP growth (%)						
Previous update		7.1	-4.0	0.1	2.4	n.a.
Current update		7.3	-7.0	1.3	2.4	3.7
Difference		0.2	-3.0	1.2	0.0	n.a.
General government net lending (% of GDP)	EDP B.9					
Previous update		-5.4	-5.1	-4.1	-2.9	n.a.
Current update		-5.5	-8.0	-6.3	-4.4	-3.0
Difference		-0.1	-2.9	-2.2	-1.5	n.a.
General government gross debt (% of GDP)						
Previous update		13.6	18.0	20.8	22.0	n.a.
Current update		13.6	23.0	28.3	29.4	29.7
Difference		0.0	-5.0	-7.5	-7.4	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2000	2007	2020	2030	2040	2060
Total expenditure	33.6	35	39	43.5	42.5	42
Of which: age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension expenditure	6.7	6.6	8.5	9.8	11.7	14.1
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	3.8	4.1	4.4	4.9
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	2.8	2.3	2.2	2.1	2.3
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	34.5	40.5	39.5	39
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	2.5	5.9	3.4	2.7	2.7	1.7
Real GDP growth	2.4	6.3	3.2	2.1	1.6	1.2
Participation rate males (aged 20-64)	75.4	70.1	70.9	68	66.1	66.3
Participation rates females (aged 20-64)	61.8	56	58.8	56.6	55.5	56.1
Total participation rates (aged 20-64)	68.7	63	64.8	62.4	60.8	61.3
Unemployment rate	6.9	6.4	6.0	6.0	6.0	6.0
Population aged 65+ over total population	13.6	14.9	17.4	20.3	25.5	35

Table 8. Basic assumptions

	2008	2009	2010	2011	2012
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.