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The Balance of Payments Programme for Romania First Review - Autumn 2011

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The Balance of Payments Programme for Romania

First Review - autumn 2011

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EXECUTIVE SUMMARY

1. **A joint EC/IMF/WB mission visited Bucharest from 25 October – 7 November 2011** to review implementation of the 2011-2013 precautionary follow-up programme. The mission also discussed policy changes ahead and an updated specification of the programme conditionality for future reviews (detailed in Annex 2: Programme Documents).The mission met with President Băsescu, Prime Minister Boc, Finance Minister Ialomiţianu, Central Bank Governor Isărescu, other senior officials, representatives of labour and business organisations, and financial institutions. This was the first formal review on the EU's side and the third review of the Stand-By Arrangement (2011-2013) with the IMF. The next quarterly review is scheduled for late January/early February 2012.

2. **The mission concluded that the programme remains on track.**[1] The IMF's Executive Board is scheduled to complete this review in its meeting provisionally scheduled for mid-December 2011, upon which a fourth tranche amounting to SDR 430 million (around EUR 490 million) would become available (in addition to the already available SDR 920 million). Under the 2011-2013 BOP precautionary programme assistance, the EU could provide up to EUR 1.4 billion. In line with the precautionary nature of the programme, the Romanian authorities do not intend to draw on the available resources and no disbursements are foreseen.

3. **This report provides a detailed assessment of compliance. The main findings of the mission can be summarised as follows.**

   - **Macroeconomic and financial situation and prospects**: After two years of negative growth, real GDP is expected to **grow** in 2011 by around 1½-2% slightly above previous projections. A further slight acceleration towards 1¾-2¼% is expected for 2012. This is, however, much lower than previous projections tabling on growth around of around 3¾%. **Inflation** which has been running high for a prolonged period (and was still above 8% in 2011 Q2), has come down sharply this summer (thanks to easing food prices and the base effects linked to last year's VAT hike) to the NBR's inflation target range of 3.0% ±1 percentage point. Inflation is expected to further decline in 2012 H1, before increasing again in 2012 H2 while staying within the target range. **Financial markets** performed solidly in early 2011, but strongly felt the effects of the rise in risk aversion and the deterioration in financial market sentiment since June. CDS spreads on Romanian government debt continue to hover around 400 basis points.

   - **Financial sector**: The still on-going deterioration in asset quality and increasing loan-loss provisions continue to weigh on the profitability of the banking sector. However, in spite of the negative return on equity (-3.4%) registered at the end of September, the capitalisation of the banking sector was kept at adequate levels at 13.4%. Continued pressures on solvency will have to be reckoned with going forward, necessitating either additional capital buffers or further deleveraging. As to the programme conditionality, the Romanian authorities adopted (ahead of the end-December 2011 deadline) the necessary prudential rules to ensure that national provisions on debt-for-equity swaps will not lead to a weakening of the financial positions of credit institutions. On the other hand, delays were incurred in finalizing consultations with the banking community on the prudential filters aimed at preserving prudent loan-loss provisions, solvency and reserves in the context of the envisaged changeover from the Romanian Accounting Standards to the International Financial Reporting Standards in 2012. There has also been some delay in aligning the legislation on the winding up of insurance undertakings to the general law on bankruptcy; the amended legislation was not ready by end-October as envisaged, but the authorities

[1] See http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/763

committed to send the law to Parliament before year end, so that the latter can confirm it by end-April 2012 as agreed to under the programme.

- **Public finance**: Public finance developments until end-September are consistent with the attainment of the 4.4% of GDP cash deficit target in 2011. For 2012, the Romanian authorities, based on growth of 2.1%, target a 1.9% of GDP cash deficit which should make it possible to comply with the below 3% ESA deficit target for 2012 with a comfortable margin. Public payment arrears continued to fall but still amounted to 0.5% of GDP at end-September. Further reforms and financing will be needed to durably balance the books in the health-care sector.

- **Structural reforms – Energy & Transport**: Limited progress was made in the energy area. The authorities missed the September 2011 programme deadline for the presentation of their roadmap for phasing out regulated prices in electricity and gas. The mission discussed the background to this and agreed on a new timetable in accordance with which the roadmap would be finalised during the next mission with the help of the Commission and the IMF. While deadlines for other programme conditionality in this area had not yet passed, progress would have to be stepped up to meet them.

- **Structural reforms – State-owned enterprises**: Corporate governance reforms for state-owned enterprises (SOEs) are being implemented. Restructuring plans for some 150 SOEs have been defined and first measures start being implemented. Progress is being made with cleaning up their arrears, and some progress was made with the preparations for the sale of majority and minority stakes in selected SOEs and the professionalization of management. The restructuring plan for the coal sector has been notified earlier this year to the Commission in line with programme conditionality.

- **Structural reforms – Public procurement**: Following several iterations and amendments to the law, the Commission (DG MARKT) ruled this autumn that the Romanian public procurement legislation (including provisions on public-private partnerships) has been brought into line with relevant EU Directives. Nevertheless, concerns remain about the institutional setup that was chosen in Romania in connection with the public private partnerships. It was agreed that the two bodies governing PPPs would produce a joint report on the implementation of their working arrangements in practice.

- **Structural reforms - Point of Single Contact**: The Point of Single Contact has been established, but is not yet fully operational as much of the economic content is still missing. Programme conditionality was amended to reflect this.

- **Administrative reforms**: While the action plans formulated in response to the findings of the functional reviews start to be implemented, there is scope for speeding up their implementation. To this end, a quarterly reporting and strengthened coordination within the Romanian government were agreed and reflected in updated conditionality.

- **EU funds absorption**: EU funds absorption remains low and has stalled since the summer. This autumn, Romania installed a new minister in charge of coordinating EU funds. Improvements in procedures on the Romanian side and measures to increase co-financing to up to 95% for programme countries should help improve absorption going forward. Absorption targets were adjusted to bring them into line with what could realistically be achieved.

I. INTRODUCTION AND BACKGROUND

4. **Following the successful completion of the first balance-of-payments assistance programme, a follow-up precautionary programme started this spring.** The follow-up programme provides precautionary financial assistance of nearly EUR 5 billion until the end of March 2013. The IMF's SBA entered into force on 31 March and provides assistance of up to SDR 3,090.6 million (300% of quota). Three tranches totalling SDR 920 million have been made available, but have not been drawn on by the Romanian authorities in line with the programme's precautionary nature. The EU can provide up to EUR 1.4 billion under the precautionary programme.

5. **The joint quarterly review mission visiting Bucharest from 25 October – 7 November concluded that the programme remains on track.**[2] On the EU's side, it was the first formal review of the commitments taken under the Memorandum of Understanding (MoU) concluded in June 2011.[3] On the IMF's side, it was the third formal review mission under their SBA, following up on the commitments taken by the Romanian authorities in their latest Letter of Intent.[4]

Box 1 - The Balance of Payments programme for Romania

On 6 March 2009, against a background of strongly increased risk aversion during the global economic crisis leading to reduced capital inflows, pressures on the exchange rate and an increasingly restricted access to the bond market for public borrowing, the Romanian authorities made a request for EU medium-term financial assistance and also approached the International Monetary Fund (IMF) and the World Bank for additional complementary assistance. On 9 March 2009, the European Commission (Commission) together with the Council Presidency declared that the EU was ready to participate with the IMF in a coordinated financing package to underpin the sustainability of Romania's balance of payments. However, it was stressed that the financial assistance would be contingent upon the implementation of a supportive policy programme; the programme was focused on cushioning the effects of the sharp drop in private capital inflows while implementing policy measures to address the external and fiscal imbalances and strengthening the financial sector. Against the background of the coordinated financing package underpinned by this programme, in the context of the European Bank Coordination Initiative (EBCI, also known as the "Vienna Initiative"), the parent institutions of the nine largest foreign-owned banks incorporated in Romania committed to maintain their overall exposure to Romania at a high level.

On 6 May 2009, in conjunction with an IMF Stand-by Agreement (SBA) in the amount of SDR 11.4 billion and additional support from the World Bank, EIB and EBRD of up to EUR 2 billion, the Council of the European Union decided to grant mutual assistance for Romania and to provide EU medium-term financial assistance of up to EUR 5 billion for Romania.* On 23 June 2009, a Memorandum of Understanding (MoU) between the European Union and Romania was concluded, specifying the concrete policy measures to be implemented over the programme period and ahead of each disbursement of the five instalments of the EU loan.

* Council Decision of 6 May 2009 granting mutual assistance for Romania (2009/458/EC) (OJ L 1150, 13.6.2009) and Council Decision of the same date providing EU medium-term financial assistance for Romania (2009/459/EC) (OJ L 150, 13.6.2011, p. 8). On 16 February 2010, the Council amended this Decision to address the impact on programme targets of the larger than expected recession (2010/183/EU) (OJ L 83, 30.3.2010, p. 19).

[2] The cut-off date for the information included in this report is 24 November 2011.
[3] http://ec.europa.eu/economy_finance/eu_borrower/mou/20110629-mou-romania_en.pdf
[4] http://www.imf.org/external/np/loi/2011/rou/091411.pdf

Box 1 - THE BALANCE OF PAYMENTS PROGRAMME FOR ROMANIA (CONT'D)

Between October 2009 and February 2011, Commission services carried out review missions to assess progress regarding conditions attached to the EU medium-term financial assistance. Based on the findings of these missions, the Commission concluded that the conditions for disbursement of the five instalments of the EU loan had been broadly fulfilled. Between the first and the fifth instalment, a total of four addendums were joined to the MoU, reflecting the effects of changes in the economic environment as well as additional structural reform measures. The first BoP programme was successfully completed in spring 2011.

On 17 February 2011, the Romanian authorities made a request for precautionary EU medium-term financial assistance of up to EUR 1.4 billion that would support the re-launch of the economic growth and would continue to support the government's economic reform programme, with a focus on structural reforms, while improving fiscal sustainability and consolidating financial stability. Similarly to the previous one, the new assistance was provided in conjunction with an IMF SBA in the amount of SDR 3.09 billion (about EUR 3.5 billion, 300% of Romania's IMF quota) that Romania would also treat as precautionary, and the World Bank continued providing earlier committed support of EUR 400 million to Romania under its development loan programme (DPL3) and of EUR 750 million of results based financing for social assistance and health reforms.

On 12 May 2011, the Council of the European Union adopted a decision to make available precautionary EU medium-term financial assistance of up to EUR 1.4 billion for Romania (2011/288/EU). This report presents the main findings of the first formal EU review mission of the new BoP programme and a detailed assessment of compliance with the measures set in the new MoU. A first supplemental MoU (enclosed in the Annex 2: Programme Documents), updating some of the conditionalities included in the original MoU, was negociated with, and approved by, the Romanian authorities on 14 December 2011.

II. MACROECONOMIC AND FINANCIAL DEVELOPMENTS AND OUTLOOK

II.1 Growth and Inflation

Growth

6. **Real GDP is forecasted to grow by around 1½-2% in 2011.** Following robust growth in the first quarter of 2011 (when GDP grew by 0.5% q/q, seasonally adjusted), economic growth tailed off in the second quarter to a meagre 0.15% q/q increase. The flash estimate for Q3 released on 15 November suggests that growth picked up markedly in Q3 (1.9% q/q s.a.).[5] Indeed, on the supply side, an exceptional agricultural harvest supported growth in Q3 and will positively impact exports in Q4 2011 too. Industrial production was also strong, responding to external demand, but has recently come down somewhat on account of the slowdown in export markets. Moreover, in Q3 2011, the construction volume index of production increased by 7% y/y, the first positive growth since Q1 2009. This recovery of the construction sector was mainly driven by the private sector with the non-residential construction output index growing by 20.4% y/y in Q3 2011 while the residential one grew by 11.6% y/y in the same quarter.

7. **On the demand side, net exports were the key driver for growth in the first half of 2011, but are likely to contribute less to growth in the second half of the year**, due to the expected slowdown in external demand in H2 2011. Private consumption did not really pick up as it was held back by still weak household balance sheets. Household consumption is expected to recover only modestly during the second half of 2011, being held back by constrained disposable incomes and pro-cyclical saving in the context of an on-going financial deleveraging process.[6] Following a comprehensive Labour Code reform, the labour market shows signs of improvement; while registered unemployment is coming down, the economically more significant indications coming out of the labour force survey point to a broadly stable unemployment rate of around 7% as job losses level off and wages begin to increase marginally. Public investment is assumed to increase towards the end of the year, as the authorities are moving ahead with various road construction projects. The still very low EU structural and cohesion funds absorption rate of 3.7% (as of end-September 2011) indicates that there is huge potential for higher public investment.

8. **Growth is expected to moderately accelerate in 2012** to around 1¾-2¼% in 2012 (Table II-1), but has been importantly revised downwards from levels around 3¾% that were projected in the spring of 2011. After the almost entirely export-led growth in 2011, growth is expected to become more broad-based in 2012 as the initial strong increase in exports spills over into domestic demand. External demand is expected to remain supportive, but to be less robust in 2012 due to the worsening economic outlook in Europe and other parts of the world. Although households and corporates are expected to continue to adjust their balance sheets during the first half of 2012, the projected increase in employment, coupled with lower inflation, would support real disposable income. This should contribute to a revival of private consumption during the second half of 2012. Government consumption is not expected to contribute much to growth in 2012 as it is constrained by the need for further fiscal consolidation and the continued reduction of public sector employment. Investment is expected to be an important driver next year given

[5] See http://www.insse.ro/cms/rw/news/item590.ro.do

[6] Many households continue to suffer from high debt-service-to-income ratios because of high interest rates and lower incomes, leaving little margin for more consumption. In fact, the non-performing loans still increased up to end-September 2011 and they are expected to peak only mid-next year. Gross wages have been improving only marginally while inflation continues to erode the purchasing power of consumers (although at a lower rate than before).

the country's high needs to modernise its public infrastructure, partly with the help of co-financing from EU structural funds. Private investment is, however, likely to be weaker on account of increased uncertainty due to the lagged effects of the turbulences in international financial markets during 2011. Therefore, some of the investments initially planned for 2011 and 2012 are likely to be delayed. Credit activity is expected to record a modest recovery in 2012, as credit institutions continue to repair their balance sheets after a long period of deteriorating asset quality.

Table II-1 - Romania: Macroeconomic Framework (Autumn 2011 Forecast)

	2010	2011	2012	2013
	(percentage change, unless otherwise indicated)			
Nominal GDP (bn RON)	513.6	548.0	579.8	628.7
Real GDP growth	-1.9	1.7	2.1	3.4
Total employment	-1.8	0.1	0.6	0.6
Unemployment rate (Eurostat definition)	8.3	8.2	7.8	7.3
HICP inflation (average)	6.1	5.9	3.4	3.4
HICP inflation (year-end)	7.8	3.7	3.9	3.3
Current account balance (% of GDP)	-4.0	-4.1	-5.0	-5.3
NIIP (% of GDP)	-62.4	-65.9	n.a.	n.a.

Source : Commission services

9. **Risks to the growth forecast are balanced**. There is a downside risk to the 2011 forecast due to the economic uncertainties surrounding the euro area, the sovereign debt crisis and the financial markets. However, the very good growth result in Q3 (i.e. flash estimate of 4.4% y/y and 1.9% q/q s.a.) suggests that growth could also be somewhat higher than expected, thus counterbalancing the downside risk. For 2012 and beyond the downside risks include: (i) the additional needs for repairing household balance sheets, coupled with tighter credit standards for consumer lending may result in lower-than-expected private consumption; this in turn could affect the assumed transition to a more broad-based recovery driven by private household demand; (ii) the continuing uncertainties in financial markets and sovereign debt developments in the euro-area periphery and the global economic outlook in general may negatively affect Romania's future growth prospects; and (iii) an unfavourable base effect. Upside risks include: (i) a potentially stronger contribution of investment than foreseen in the baseline in case of a significant improvement in the absorption of EU funds in 2012; and (ii) a potentially stronger contribution of domestic demand linked to possible pre-electoral fiscal slippages, probably in the form of a combination of reductions in social security contributions, increases in public sector wages, and investment spending; although this would have a positive impact on short term growth, it would adversely impact fiscal consolidation in 2012.

Inflation

10. **Significant upside risks to the medium-term inflation outlook remain in place, although price pressures eased markedly in the course of the summer.** Inflation, which was consistently above the National Bank of Romania's (NBR[7]) end-year targets over past years, was still elevated in early 2011. Indeed, Romania was the Member State with the highest inflation in the EU (at 8.3%) in the second quarter of 2011. However, inflation dropped sharply in the third quarter of 2011 due to a base effect resulting from a VAT hike in July 2010 and a further easing of volatile food prices. Inflation has come down in September to 3.5% (lowest level in 21 years) and has thus moved into the NBR's target range of 3.0% ±1 percentage point inflation set for end-2011.[8] Inflation is expected to remain within the upper side of the NBR's target range during

[7] www.bnro.ro

[8] The NBR has set the end-year inflation targets at 3.0% ± 1 percentage point for both 2011 and 2012.

2011 Q4 and to decline to just below 3% in the first half of 2012 on the assumption of moderate increases in administered prices (Table II -1). Nonetheless, as the temporary downward pressure on headline price indices stemming from volatile food prices will likely reverse in the second half of 2012, inflation is projected to rebound to just below the upper end of the NBR's target range by end-2012.[9] The main upside risks to the inflation outlook relate to prospects for sizeable upward adjustments in administered prices (in particular of electricity, gas and other utilities). Conversely, a faster deterioration in global economic conditions (including lower commodity prices) than assumed in the forecast would have stronger disinflationary effects.

II.2 Monetary policy and exchange-rate developments

Monetary policy

11. **On 2 November 2011, the Romanian central bank lowered the policy rate by 25 basis points to 6.0%** amid a significantly improving near-term inflation outlook.[10] This was the first interest rate cut since spring 2010.[11] In the first half of 2011, money market rates fluctuated widely between the NBR's key policy and the deposit facility rate amid periods of abundant liquidity conditions.[12] Since the summer of 2011, nonetheless, tighter liquidity conditions have kept the interbank rates closer to the policy rate and, the NBR started to inject liquidity into the market (and since October 2011 these operations have been conducted on a regular basis). Credit growth to the private sector remains muted amid low credit demand and tightened bank-lending standards. Also, *ex post* real interest rates on leu-denominated loans increased markedly (due to a decline in inflation) since the summer and remain elevated in comparison with the rates on credit denominated in foreign currencies.

12. **Although short-term price pressures have eased, the medium-term inflation outlook may appear challenging for monetary policy.** The upside risks to inflation (including those stemming from upward adjustments in administered prices) call – together with volatile developments in the global economy – for continued prudence in the conduct of monetary policy, in order to ensure that the inflation target for end-2012 is met.

Exchange-rate developments

13. **The leu has depreciated in the third quarter of 2011 amid a sharp increase in global risk aversion, in the context of its managed floating exchange-rate regime.** While remaining within a relatively narrow range, the exchange rate vis-à-vis the euro strengthened markedly in April and May 2011, but it weakened since the summer and recorded a 16-month low in early November. Nonetheless, the leu's weakening against the euro was more moderate as compared to the regional peers. The real exchange rate, deflated by consumer prices and the unit labour cost (ULC), has weakened since the onset of the financial crisis.

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[9] In particular, annual inflation in the (unprocessed) food category may be pushed higher in the second half of 2012 and first half 2013 due to a base effect resulting from a good crop in summer 2011.

[10] As a result, the rate on the deposit facility was cut to 2.0% from 2.25% and the rate on the lending facility was cut to 10% from 10.25%.

[11] In April 2011, the NBR cut the required reserve ratio for forex liabilities by 5 percentage points to 20%. The reserve ratio for local currency liabilities remained at 15%.

[12] In some periods of abundant liquidity, short-end of money market rates fell to just above deposit facility rate. The environment of low interbank rates helped to deter short-term capital inflows, particularly during periods of strong global risk appetite.

II.3 Financial-market and banking-sector developments

Financial market developments

14. **The rise of global risk aversion in the second half of 2011 has weighed on Romanian markets.** The stock market BET lost about 20% between July and early November. CDS sovereign spreads hovered close to 230 basis points in April-May, but increased sharply on account of increased risk aversion (that also affected other regional peers) to just above 400 basis points in early November.

15. **Credit and money growth remain weak,** although annual growth in credit to the private sector recorded a modest increase in the course of the summer (up to 6.5% in September). Recently, new lending was driven primarily by corporate and mortgage lending. Foreign-denominated credit has remained the main source of lending to the household sector throughout the crisis, increasing its share to around 66% in total credit (i.e. up by around 6 percentage points since early 2009). The annual growth of broad money (M3) slightly recovered in September, from historical lows recorded in summer, pushed up notably by higher growth rates of currency in circulation and time deposits. Up until September 2011, the annual dynamics of M3 counterparts were shaped by a slightly higher contribution of both private sector loans and net foreign assets.

Banking sector developments

16. **After returning to profitability at the beginning of 2011, the banking sector registered losses by end-September, due to the still increasing loan-loss provisions.** Against the backdrop of the ongoing deterioration in asset quality, profitability declined since Q1 2011, with return on equity going down from 5% at the end of March 2011 to 0.6% at the end of June and declining even further to -3.4% in September 2011 (Table II-2). Notwithstanding these developments, with the exception of one small bank which had a solvency ratio just below 9%, all credit institutions maintained solvency ratios above 10% by the end of September 2011. The capital adequacy ratio of the system stood at 13.4% at the end of September 2011, i.e. roughly 0.8% lower than at the end of the end of June 2011. Meanwhile, the ratio of level 1 own funds (i.e. Tier 1 ratio) was 12.9% compared to 13.6% by end-June 2011. Going forward, banks may still have to reckon with mounting pressures on solvency ratios. Consequently, they may need to further strengthen their capital buffers or, in several cases, contemplate a reduction in risk-weighted assets.

Table II-2 - Romania: Banking sector – Financial soundness indicators

(%)	2009				2010				2011		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Capital Adequacy											
Capital Adequacy Ratio	13.2	13.5	13.7	14.7	15.0	14.3	14.6	15.0	14.9	14.2	13.4
Leverage Ratio	6.8	6.9	7.0	7.6	8.1	7.9	7.9	8.1	8.0	7.8	7.5
Ratio of level 1 own funds	11.4	11.9	12.0	13.4	14.2	13.4	13.8	14.2	14.5	13.6	12.9
Asset quality											
NPLs (90 days overdue)	4.0	4.7	6.5	7.9	9.1	10.2	11.7	11.9	12.7	13.4	14.2
NPLs (60 days overdue)	9.4	11.8	14.2	15.3	17.2	17.8	20.2	20.8	22.0	21.9	23.0
Profitability											
Return on assets (after tax)	-0.3	0.1	0.3	0.3	0.6	-0.2	-0.2	-0.2	0.5	0.1	-0.3
Return on equity (after tax)	-2.9	0.6	3.2	2.9	6.0	-1.6	-2.1	-1.7	5.0	0.6	-3.4
Liquidity											
Immediate liquidity	33.1	33.6	34.7	35.3	37.1	35.9	36.7	37.8	37.2	36.3	36.4

Source: NBR, Commission services. Notes: Data for Q3 2011 is preliminary; solvency data are measured in Romanian Accounting Standards terms.

17. **The NBR closely monitors developments in the euro area sovereign debt markets and guards for possible spill-overs on the Romanian banking sector.** The banks with majority Greek capital accounted for roughly 14.9% of the total assets of the banking sector by end-

September 2011. Notwithstanding the still on-going deterioration in asset quality, the Greek banks' subsidiaries have maintained a reassuring solvency situation and have continued to receive capital support from parent banks. Their average capital adequacy ratio stood at 15.6% at the end of September 2011 (i.e. roughly 2% higher than the capital adequacy ratio of the system). However, to continue to maintain their deposit base, these banks are competing for deposits.

II.4 Balance-of-payments

18. Barring negative external developments, Romania should be able to finance itself during 2011-2013 without having recourse to external financial assistance. The developments on the balance of payments' front are encouraging despite the recent decrease in demand from European partners. The current account deficit for 2011 is projected to amount to 4.1% of GDP. The trade deficit is forecast to reach RON 23.3 billion (-4.3% of GDP) in 2011 due to a slowdown in exports and imports in Q3 2011. Over 2011, the EC forecasts a 14.8% growth in exports (mainly from the machinery and agricultural sectors) and a 10.8% growth in imports. FDI inflows in 2011 are forecast to amount to EUR 2 billion after a disappointing realisation of EUR 1.1 billion as of end-August. There is scope to increase FDI and the measures implemented under the previous and current programmes to build a business-friendly environment should kick in and attract green-field investments. Scheduled sales in 2012 of shares held by Romanian investors to foreign investors – such as remaining state shares in PETROM[13] and the sale of minority interests in BCR[14] currently held by the SIFs (i.e. investment funds) – will help in this regard. Portfolio investment could amount to EUR 3.8 billion in 2011, from which EUR 2.5 billion on account of Eurobond issuances. As of end September-2011, EUR 300 million had been disbursed by the World Bank and EUR 1 billion by the EIB, EBRD and IFC. Finally, remittances from overseas remain stable at EUR 2.1 billion for 2011.

[13] www.petrom.com

[14] www.bcr.ro

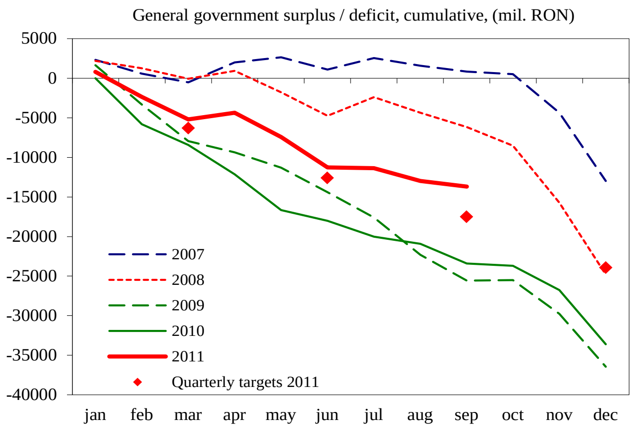
III. POLICY IMPLEMENTATION AND CONDITIONALITY

III.1 Fiscal Policy; consolidation and governance reforms

Consolidation

19. **Budget execution until end-September shows that Romania remains on track to reach the cash deficit target of 4.4% of GDP in 2011 (below 5% of GDP in ESA terms).** The budget deficit for the first nine months of the year, at RON 13.7 billion, was substantially below the quarterly target of RON 17.5 billion (Figure III-1). The over-performance is due to significant savings in spending, especially in personnel, capital and other transfers. The under-execution in personnel spending was the result of a faster-than-expected reduction in public sector employment as a result of the application of the 1-in-7 rule, as well as layoffs in the education sector at local government level and in the Interior Ministry. The lower-than-expected capital spending is due to an under-execution at local government level, while the savings in other transfers come from a lower-than-expected absorption of EU funds (i.e. less co-financing) and a smaller contribution to the EU budget. In contrast, total revenue has underperformed, particularly as regards excise and non-tax revenue. Lower excise revenue may be due to the sale by companies of existing stocks of cigarettes rather than new acquisitions following a hike in excises in July, but may also be due to some increase in tax evasion. Non-tax revenue underperformed because State-Owned Enterprises (SOEs) did not yet transfer their dividends to the budget, as a new law allows them to delay such payments for six months after the approval of their balance sheets (which was done in May).

Figure III-1 - General Government Surplus / Deficit

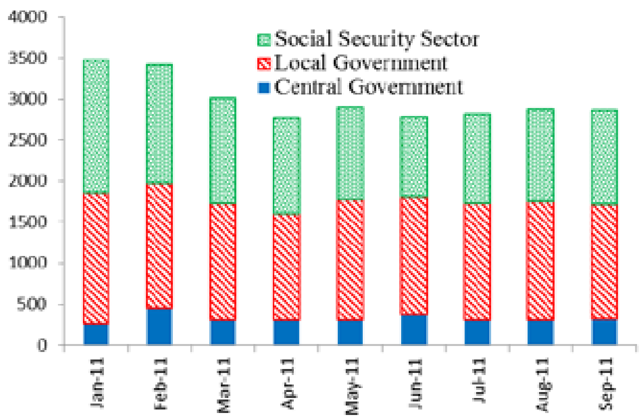


Source: Romanian authorities, Commission services

20. **Given the revenue underperformance, the authorities agreed to build buffers on the expenditure side in the November budget rectification to ensure that the deficit target is met.** In addition to the buffers, the final budget rectification for the year includes swaps worth 0.5% of GDP aimed at decreasing SOE arrears. They have a neutral effect on the budget deficit since they will increase both revenue and expenditure by the same amount. As agreed during the summer, the operation will take place within the Treasury accounts of the parties concerned and will not generate flows of funds outside the Treasury. Therefore, there is no risk that the operations have an impact on the budget. Moreover, an additional RON 750 million will be made available upfront to the health sector with, if needed, additional funds to be made available from the Reserve Fund in December in order to prevent a re-accumulation of arrears by the end of the year.

Figure III-2 - Stock of General Government Arrears

(0-360 days), mn RON



Source: Romanian authorities, Commission services

21. **Domestic payment arrears decreased from RON 3.5 billion at end-January 2011 to RON 2.9 billion RON at end-September.** Arrears at the level of local governments and the social security sector decreased, while those at the central government level increased slightly (Figure III-2). In the health sector, arrears over 90 days have been brought down to nearly zero and the authorities are currently working on paying the previously unregistered bills of RON 500 million uncovered during the stock-taking exercise. They have currently registered two thirds of the RON 500 million unpaid bills and are expected to register the remainder by the end of the year. Local government arrears stem mainly from hospitals that have been transferred to them, as well from utility and construction companies. While the main counties with arrears have continued to decrease their stock, other counties are starting to register arrears and it appears that arrears at the level of local hospitals have started to re-accumulate. The provisions of the local public finance law which entered into effect on January 1st 2011 should help contain any new accumulation of arrears at local government level. The law stipulates that forthcoming budgets should set cash aside to pay the preceding year's overdue bills and that no new budget commitments can be made until overdue bills have been cleared. Moreover, local governments are required to make quarterly budget revisions to make sure that the budget deficit remains within established targets and no new investment projects can be approved until their total cost is taken into account in multi-year budget forecasts. The local public finance law should also be applied to local hospitals where the authorities committed to take the necessary measures to prevent a re-accumulation of arrears in the future.

22. **The authorities do not want to take risks with complying with the programme target of a general government deficit below 3% of GDP in 2012 and implicitly target a somewhat lower ESA (annual) deficit.** The budget for 2012 was built on a real GDP growth rate of 2.1% and targets a cash deficit of 1.9% of GDP. The measures taken to reach the deficit target (Table III-1)include: i) a freeze in wages and further employment cuts in the public sector, ii) a pension freeze, iii) the introduction of a new social assistance code which streamlines the number of social assistance programmes and targets them towards the most vulnerable, iv) the termination of pre-accession programmes following the end of the extension period for finishing them; and v) the reduction in national co-financing for EU funded projects following the expected decision that would provide for increasing the EU contribution from the usual maximum of 85% to 95% of the value of projects from structural and cohesion funds for programme countries. The cash deficit target monitored under the programme by the IMF will also include future spending under the National Infrastructure Development Programme (PNDI) estimated at 0.2% of GDP for next year thus bringing it to 2.1% of GDP. Expenses under the

PNDI programme are automatically included in the ESA definition of the budget deficit as they accrue according to ESA rules.[15]

Table III-1 - Impact of additional measures on the 2012 budget (% GDP)

Total impact of additional consolidation measures, of which:	**2.2**
Measures on the revenue side	**0.2**
Excise rate hikes for cigarettes and diesel	0.1
Increase in royalties for construction material	0.1
Measures on the expenditure side	**2.0**
Wage freeze and personnel cuts	0.5
Cuts in sibsidies	0.1
Reduction in cofinancing of EU funded projects (including VAT)	0.4
Application of EU regulation restricting investment transfers to SOEs	0.1
Termination of pre-accession programmes	0.2
Pension freeze	0.5
Removal of active measures on labour market	0.03
Introduction of new social assistance code	0.1
Rescheduling of compensation for people whose property has been expropriated	0.1
Cash deficit with consolidation measures	**1.9**
Cash deficit with consolidation measures and PNDI programme	**2.1**

Source: European Commission, IMF, Romanian authorities

23. **While the authorities adopted a prudent approach for 2012, they signalled that they would consider increasing wages and pensions if the fiscal space for this were to exist.** They have proposed to re-analyse the economic situation during the April/May 2012 review mission and if economic conditions turn out better than expected, they would analyse the opportunity of giving a modest wage and pension increases in the second half of 2012. However, they remain firmly committed to reaching the ESA deficit target of below 3% of GDP agreed under the programme and would not jeopardize it if they were to give these increases.

24. **The parliament passed a law dividing the payment of the 7.2 bn RON plus inflation won through court decisions into five yearly tranches.**[16] The law foresees that the government will

[15] The National Programme for Infrastructure Development (PNDI) consists of a series of infrastructure works mainly related to water and sewage systems that the authorities need to undertake in order to comply with an EU directive. The programme is scheduled to start in 2012 and finish in 2020. The total value of the programme is around RON 21 billion. The specificity of the programme is that private contractors would start works in 2012 but would only receive the payment related to these works in future years (from 2013 onwards with "big" payments starting from 2015).Given the way in which the programme was designed, there is no cash flow related to the PNDI in 2012 and therefore the cash deficit as such is not affected. However, according to ESA95 rules the recording of the PNDI should be made on an accrual basis (i.e. following the progress in construction) and not when the cash payment will be made. Moreover, the progress in construction should be valued on the basis of the costs incurred by the constructor, independently of any certification. The expenditure related to the PNDI programme, which is estimated at 0.2% of GDP for next year, is therefore included in the 2012 ESA definition of the budget. In order to adequately monitor the programme and not increase the discrepancy further between the cash and ESA definitions of the budget deficit, the expenditure related to the PNDI programme has also been included in the cash deficit target monitored under the EU/IMF programme.

[16] Individual courts in Romania ruled that the government's decision to reduce wages by 25% in the public sector as well as to cut bonuses and premia as part of the austerity package were illegal. They made this ruling despite the fact that the Constitutional Court had declared these measures as being constitutional. There have also been court decisions in individual cases condemning the government to pay compensation for not having applied a law passed in 2008 granting wage increases in the education sector. The total sum that has to be paid by the government as a result of these decisions amounts to RON 7.2 billion plus inflation.

make payments of 5% of the sum in 2012 (already included in the 2012 budget), 10% in 2013, 25% in 2014, 25% in 2015 and 35% in 2016.

Governance reforms

25. **The government has also been working on gradually moving to an accrual accounting system.** To this end, it has redesigned the reporting requirements for SOEs in order to be able to integrate their impact on the deficit on a monthly basis. SOEs at central government level are expected to start reporting under the new requirements in December. A trial run will be made in January and by spring 2012 the authorities will include an additional line in their cash budget execution reporting to show the impact of SOEs on the overall deficit of the general government. The aim of this measure is to move to a closer definition of the budget in cash and ESA terms. Moreover, the authorities are continuing their work on integrating the accounting reporting system with the treasury payment system in the Ministry of Finance, which would allow them to report budget data in accrual terms in a timely manner. The design of the system has been finalized and the contract with the software provider is expected to be signed by end-March 2012.

26. **The authorities are currently working on a comprehensive reform of the healthcare sector.** They are preparing a new health-sector framework law based on a reduction in the scope of the public benefits package through greater reliance on cost-sharing and private supplementary insurance, greater private sector involvement in health care provision and financing to enhance efficiency and quality of services and raise additional resources. In addition, they are revising the basic benefits package to exclude the coverage of nonessential health services, they will decrease the number of exemptions on co-payments for medical services, revise settlement prices and the list of compensated and free drugs, address shortcomings in the current version of the clawback tax by the end of the year and continue to monitor hospital budgets to ensure they are consistent with programmed expenditure.

27. **The major reform of introducing basic and supplementary insurance is yet to be defined in detail.** Its purpose is to generate additional revenue and to cover medical services beyond the basic benefits package. It will be based on the Dutch model. Sensitive issues include the coverage of children and possible exemptions from insurance for other vulnerable groups. Moreover, risk assessments have yet to be carried out with regard to: i) the achievable degree of competition among private insurers; ii) the correct design and regulation of the insurance market; and iii) the resulting administrative costs.

28. **The government has the intention of changing the legal status of public hospitals into not-for-profit and for-profit hospitals.** Further details are not known at this stage. Currently, hospitals work under historically allocated budgets. The financing is centralized, while management is decentralized at local level and, according to information from the health ministry, often based on political networks rather than professional qualifications. There is currently no system in place to monitor whether the budgets are allocated according to the patient-mix treated.

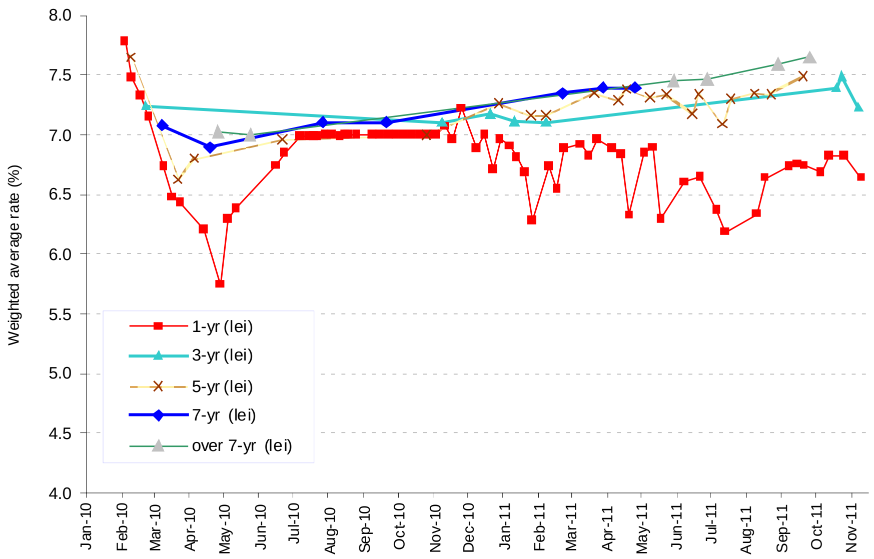
29. **Progress was made on prioritizing existing investment projects and improving the capital budgeting process.** The authorities have completed a review of the existing investment portfolio and have prepared a database of all central government investment projects. The latter will be used to prioritize investment projects and discontinue low priority and non-performing projects which cannot be financed over the medium term. The authorities will also give priority to investment projects financed from EU funds and to this end have raised the share of EU financed capital spending to 4% of GDP in the 2012 budget, compared with a share of 3.2% of GDP for entirely domestically financed capital spending. They have also strengthened the capacity of the capital monitoring unit in the Ministry of Finance. The latter is currently acting as a coordinator for all the investment departments in the line ministries. The authorities will continue to improve the expertise in this unit.

30. **Eurostat lifted the reservation on the quality of the Romanian EDP data after the October notification.** The authorities have closely collaborated with Eurostat to solve the outstanding methodological issues that led to the reservation on the quality of EDP data during the April notification. Sufficient progress was made for Eurostat to be able to lift the reservation. Hence, the authorities have fulfilled the specific condition under to programme in this regard. At the same time, the authorities have committed to continue improving the expertise in the National Statistics Institute (INSSE[17]) linked to the compiling of government financial statistics (GFS) data particularly by strengthening the role of the Statistics Institute in ensuring the quality of the data given by upstream providers and in deciding on the methods, standards and procedures used during the fiscal notification, updating and completing the data sources and the flow of data between the institutions responsible for the fiscal notification and creating a common IT platform to be used by all those responsible for compiling GFS data. The National Statistical Institute committed to submit semi-annual progress reports.

III.2 Financing Situation and Requirements

31. **The Romanian Debt Management Office is improving its debt management;** it has broadened the range and lengthened maturities of its debt instruments (Figure III-3). These actions are consistent with its debt management strategy.[18] The average maturity of government public debt at end-September 2011 was 4 years, out of which the domestic debt maturity averaged 2 years and the external debt 7 years. Further progress in extending the maturity of bond issues and in optimising the currency composition of public debt are priorities, taking due account of risk management issues. The treasury is building up a cash buffer to cover 4 months of financing needs.

Figure III-3 - Romania: Government Bond Auctions



Source: Bloomberg

17 http://www.insse.ro/cms/rw/pages/about.en.do

18 http://discutii.mfinante.ro/static/10/Mfp/buletin/executii/Strategy2011_2013.pdf

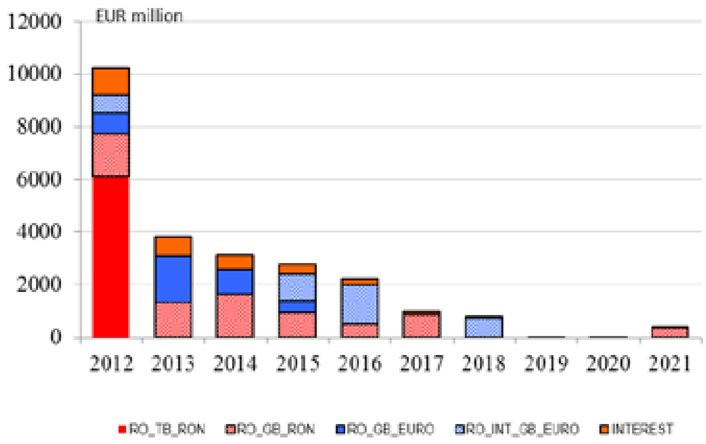
32. **The upcoming yearly review of the debt management strategy will be slightly delayed.** The publication of the updated Debt Management Strategy (2012-2014) will be postponed until 2012-Q1 to give more time for technical assistance to be provided by the World Bank. The Romanian authorities are also seeking to learn from the experience and expertise of other Member States by conducting informal peer reviews through the EFC subcommittee on bonds.

33. **While financing operations seemed to be well on track to cover financing needs until this summer, they seem to be falling behind as of late.** Since August, investors have been asking for higher yields. The treasury chose to fail a number of auctions so as not to give in to the pressure of rising yields and cash in on the better inflation and fiscal deficit prospects. As in the last quarter of 2010, this year again due to challenging international market conditions, the treasury will have a difficult task. The mission argued for frontloading the yearly issuance pattern so as to be in a better bargaining position next year. The treasury pointed out two major challenges that should be overcome: (i) the already high sovereign exposure of banks; and (ii) the relatively low liquidity level on the domestic market.

34. **The NBR 25 basis points interest rate cut of 2 November may translate, as a side effect, into more affordable financing costs.** In early November, 1-year and 2-year auctions were met with higher demand from the banks and lower yields (6.69% and 7.23% respectively).

35. **In 2012, total government financing needs are projected to amount to some RON 70 billion.** Financing needs in 2012 comprise about RON 11 billion on account of the targeted 1.9% of GDP cash deficit, and some RON 53 billion of refinancing needs for debt falling due (Figure III-4). Given the already high level of exposure to the sovereign of the domestic investors, the treasury will target increasingly external markets for its debt issuance (EUR 2.3 billion are targeted for 2012 under the EMTN programme).

Figure III-4 - Romania: Maturing Government Debt and Interest



Source: Bloomberg

36. **Future repayments of international financial assistance – particularly linked to the previous IMF SBA – imply a sizeable amortisation effort and consequently a substantial drawdown of reserves.** Repayments peak in the period 2013-2015 (i.e. just after the end of the current programme), reaching about EUR 4.5 billion or about 2½% of GDP annually (Table III-

2). As of end-October, the NBR's foreign exchange reserves stood at EUR 32.2 billion.. In terms of adequacy ratios, this represents 107% of short-term external debt at remaining maturities (at end-2010), or about 7 months of imports taking S1 2011 figures as a benchmark.[19] Since the current level of foreign-exchange reserves presents good coverage ratios, repayments can be carried out smoothly. In addition, the increase in the treasury's cash buffer to 4 months of financing needs foreseen in the public debt management strategy should help sovereign liquidity. All in all, no major problems with respect to the repayment capacity are foreseen as long as the authorities stick to a sound economic and fiscal policy strategy and as long as this commitment remains credible to investors. However the deterioration in international markets, the growth slowdown in Romania's export markets and the situation in Greece pose additional challenges to Romania.

Table III-2 - Romania, financial assistance repayment obligations

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
EU (bn EUR)										
principal	0.0	0.0	0.0	0.0	1.5	0.0	1.2	1.4	1.0	0.0
interest	0.1	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.0	0.0
total	**0.1**	**0.2**	**0.2**	**0.2**	**1.7**	**0.1**	**1.3**	**1.5**	**1.0**	**0.0**
IMF (bn EUR)										
principal	0.0	1.5	4.6	4.7	1.4	0.1	0.0	0.0	0.0	0.0
interest	0.3	0.3	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
total	**0.3**	**1.8**	**4.9**	**4.8**	**1.4**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**
TOTAL										
bn EUR	**0.4**	**2.0**	**5.1**	**5.0**	**3.1**	**0.2**	**1.3**	**1.5**	**1.0**	**0.0**
% of GDP	**0.4**	**1.3**	**3.2**	**2.7**	**1.6**	**0.1**	**0.6**	**0.5**	**0.4**	**0.0**
Forex reserves (bn EUR)	**32.0**	**34.5**	**33.8**	**32.7**						
Gross international reserve	**36.0**	**38.5**	**37.8**	**36.7**		-	-	-	-	-

Source: Commission services calculations, IMF

III.3 Financial sector policies

37. **Authorities are currently finalizing the preparations for the introduction of International Financial Reporting Standards as the accounting basis for the banking sector at the beginning of 2012.** Under the programme, the NBR committed to complete by end-November the consultation with the banking community to reach a common agreement on the calibration of prudential filters for solvency, reserves and loan-loss provisions. The latter are necessary to ensure that the transition from the Romanian Accounting Standards (RAS) to International Financial Reporting Standards (IFRS) will not lead to a significant release in provisions and a consequent weakening of prudential indicators of credit institutions. Although consultations with the banking community on the calibration of these filters have started in June 2011, a final agreement on calibration issues was still outstanding at the moment of the review mission. The NBR will ensure that, if prudential provisions exceed IFRS provisions, the calibration of prudential filters for provisions and solvency will substantively preserve the current approach, and not result in a reduction in solvency ratios compared to the present provisioning regime. As regards the tax treatment, authorities will ensure that the net amounts arising at the beginning of 2012 from the release of provisions due to the new accounting treatment and which are treated as retained earnings from specific provisions to support regulatory capital will not be taxed as long as they remain in the corresponding retained earnings account. On an on-going basis, the authorities will ensure that the IFRS provisions, and any additional prudential filters applied by the NBR, are tax deductible when they are made and taxable when they are released.

[19] As regards Romania's external debt, year-end estimates for 2011 of short-term external debt amounts to EUR 22 billion (up by 15% in 2011). Medium- and long term external debt has reached EUR 76 billion, but its growth rate (4.7% this year) has slowed down considerably. The total external debt (EUR 98 billion) thus amounts to about 77.6% of GDP.

38. **Good progress has been made to align the legislation on the winding up of insurance undertakings to the general law on bankruptcy.** Authorities committed to amend the Law 503/2004 on the winding up on insurance undertakings to ensure the consistency between the provisions of the law on the bankruptcy of insurance undertakings with the general law on insolvency and the law on the insurance business and insurance supervision. Furthermore, the Insurance Supervisory Commission (CSA) prepared amendments aimed at filling the legislative gaps on the liquidation of re-insurance undertakings and insurance brokers. These amendments were submitted to the Ministry of Finance at the end of September 2011. However, the initial deadline on the adoption of these amendments (i.e. through an emergency ordinance) by end-October 2011 was not met. Under the programme, authorities committed to send the law amending the Law 503/2004 to Parliament before year end. Subsequently, it shall be enacted by end-April 2012.

39. **Authorities have committed to continue to strengthen the bank resolution framework by introducing bridge-bank powers and other stabilization measures.** The NBR board approved at the end of October the proposals for amending the Ordinance 99/2006 aiming at introducing bridge-bank powers and other stabilization measures. According to the new provisions, any bridge bank should be owned by the Deposit Guarantee Fund (DGF) and operate for a limited period of time (i.e. for two years with the possibility of further prolongation depending on market conditions). The DGF would contribute to the financing of the transfer of assets and liabilities from the credit institution under resolution to the bridge bank. The bridge bank would be managed in a prudent manner and sold following a transparent and competitive bidding process. Furthermore, the NBR committed to strengthen the financial safety net by year end. In this respect, the following measures are envisaged: (i) the DGF will join the National Committee on Financial Stability as full member; (ii) the NBR and the DGF will sign a MoU which includes the appropriate procedures to enhance information sharing, warrant the early identification of problematic credit institutions and prepare contingency plans to deal with such institutions; and (iii) under the guidance of the Supervision Department, the NBR will set up a bilateral working group of the NBR and the DGF aiming at, *inter alia*, preparing contingency plans and finalizing intra- and inter institutional operational procedures.

40. **To address the vulnerabilities associated with foreign-currency denominated lending, the NBR board approved measures aimed at further discouraging un-hedged consumer borrowing.** To curb foreign-currency lending to households, the NBR approved the amendments aiming at limiting foreign-currency credit to households for consumption purposes, without a significant impact on mortgage loans. These new provisions include, inter alia, measures such as: (i) the reduction of the allowed debt-to-income ratios for consumer loans; (ii) the introduction of explicit maximum levels of loan-to-value ratios (LTVs) for loans for real estate investments, differentiated by currency; and (iii) maturity caps for foreign currency denominated consumer loans to un-hedged household borrowers. The proposed measures will enter into force after the publication in the official journal.

III.4 Structural issues and reforms

Functional reviews

41. **Action plans in response to the findings of the functional review have been adopted.** Twelve functional reviews of various parts of the Romanian public administration were carried out by the World Bank and financed by the European Commission. Following the conclusion of these reviews, the government has adopted the actions plans[20] to respond to the findings.

42. **Measures were agreed that should foster a timely and effective implementation of the action plans.** The Romanian authorities have committed in the latest LoI/MEFP to appoint an inter-ministerial group to coordinate and monitor the implementation of these plans and to start by focusing first on the "quick-win" measures requiring no additional financing. Moreover, they have also committed to produce quarterly implementation reports and the first set of reports should be submitted by mid-January 2012.

Product market reforms and state-owned enterprises

43. **In the field of energy,** limited progress has been made and this assessment was confirmed during the technical meetings held with the Ministry of Economics, the Regulator and some stakeholders. During the discussions, the Romanian authorities committed to notify the energy laws transposing the Third Energy Package as soon as possible and it was agreed that they would meet DG ENER in order to discuss the remaining technical issues. The most sensitive issue relates to the price deregulation and the establishment of a roadmap identifying the main steps. During the discussions, it was made clear that the market could not bear a full deregulation in one shot, in particular in the gas market where domestic gas prices are disconnected from international gas prices. It was agreed that a roadmap on price deregulation would be submitted early 2012. The roadmap would include the timeline of deregulation (2013 for non-domestic consumers and 2015 for domestic consumers, i.e. households) and the intermediary steps. To ensure the success of this process, particular attention was drawn to the need to preserve competition, in particular in the gas market where two producers account for a large share of the market. It was proposed to closely involve the Competition Council and to develop a trading exchange in the gas market (as it already exists in the electricity market). Wholesale gas markets improve transparency and allow prices to reflect market conditions. Another related issue is to remove the physical barriers to gas trade. These conditions are crucial to ensure the success of price deregulation and for Romania to be part of the EU internal market. Here again, limited progress was made. Finally, the independence of the regulator as well as unbundling will need to be tackled in the context of the transposition of the Third Energy Package. Regarding the barriers to gas export, no progress has been made. Barriers to gas trade should be removed as soon as possible, in particular in the context of the phasing out of the regulatory prices in gas and electricity. This was stressed by the EC/IMF team during the mission.

44. **On railway transport,** the July mission had assessed progress made in the field of the closure of unprofitable lines and the independence of the regulator. During this mission, the discussions focussed on the other conditions included in the programme. As regards the multiannual contract, the Ministry of Transport is preparing a new multiannual contract (the current one ends in 2011). Based on this update, a new condition was included in the programme, highlighting the items that should be included in the contract - stability (duration of contract extended to 5 years), clarification of the financing sources (in order to ensure the financial viability of CFR Infrastructure), incentives to be cost effective. The multiannual contract between the State and the Infrastructure Manager (CFR Infrastructure) should contribute to ensuring financial and economic viability, which is crucial for the company as well as for the whole efficiency of the

[20] The action plans typically include measures to clarify and streamline responsibilities and existing structures within the ministries, and to support decision-making by evidence-based analysis. In addition, they aim to improve recruitment procedures and human resource management by making them more competence based.

railways market. This Contract should be in line with the business plan of CFR Infrastructure. This is why the programme includes a condition on the need for CFR Infrastructure to submit a business plan. As regards performance schemes, the Romanian authorities said that these schemes were implemented. The mission advised the authorities to notify the schemes to the Commission (DG MOVE), but did not change the conditions related to them.

45. **On SOEs,** arrears reducing mechanisms are put in place and steps are taken to improve corporate governance and the quality of management. The Government has already produced and is now working on the approval of a new corporate governance reform legislation of state-owned enterprises (by end November).[21] In general, the discussions focused on the ways to reduce SOEs arrears and ensure the viability of assets while complying with EU state aid rules. As further efforts are needed, a number of measures were discussed during the mission with DG COMP; both the transport and economy ministries are making progress in their arrears reduction and restructuring plans implementation. So far, specific plans/schemes have been identified for a number of large SOEs to obtain a reduction in arrears of nearly 1% of GDP and the authorities will also have to continue the SOEs restructuring to prevent the accumulation of new arrears. Other discussions focused on bringing in competent private management in key state-owned enterprises and on preparations for opening up their capital.

Public Procurement

46. **On public-private partnerships,** discussions focused on the need to improve the functioning of the institutional framework and the ultimate right of ANRMAP to ask the courts for the annulment of the PPP contracts. In this context, several stakeholders involved in the process raised concerns about the insufficient information flows received by the competent authorities needed to take decisions. The mission proposed that the bodies in charge of overseeing PPP (ANRMAP and UCPPP) would jointly prepare a report by April 2012 with the aim to assess the working arrangements, in particular regarding access to relevant documents to take decisions.

Point of Single Contact

47. **While the technical design of the Point of Single Contact (PSC) portal is completed, its economic content has yet to be established.** Limited progress has been made in the field of the Single Point of Contact (provided for in the Services Directive) as there is a lack of leadership and ownership of the implementation. The revised conditionality stresses the need to appoint a new coordinating institution endowed with an appropriate mandate and resources and set complementary obligations on all the competent authorities in order to ensure their cooperation in the completion of this project.

Retail trade restrictions

48. **Progress with the removal of restrictions in setting up retail shops is slow.** The legal provisions requiring economic needs tests and the involvement of the competitors in the authorization procedure of opening of large surface retail shops were not removed by the end of September 2011 as initially foreseen under the programme. This legal amendment would facilitate the compliance of the relevant legislation with the Services Directive and improve the overall business environment by increasing competition, efficiency and innovation in a key economic sector for the Romanian economy. The discussions during the mission focused on the technical options available to the authorities to fulfil the conditionality and the need to extend the deadline to end-January 2012.

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[21] The new legislation requires regular independent external audits, quarterly publication of financial data, reinforcement of OECD principles on corporate governance and strengthening the rights of minority shareholders.

Labour market and social policy issues

49. **The recently implemented Labour Code appears to have produced the desired effects on the labour market.** Since the implementation of the Labour Code (May 1, 2011) almost 1.2 million new labour contracts have been registered, more than 50% of them in manufacturing, wholesale and retail trade and construction. About 34% of these new contracts are fixed-term contracts, which is possibly the result of less restrictive conditions for this type of contracts introduced with the new Labour Code. Despite these positive developments, the content of the new Labour Code is not fully satisfactory in some respects. The regulation of fixed-term labour contracts and overtime arrangements remains relatively rigid compared to other EU countries. Following the enactment of the new Labour Code, the government is not planning further reforms in this area before next year's elections. Nevertheless, the authorities will continue monitoring closely the impact of the new Labour Code on labour market outcomes, notably on the share of newly created fixed term contracts.

50. **The implementation of the Social Dialogue Code remains challenging.** Although the Social Dialogue Code entered into force on May 10, 2011, its implementation will effectively take place once the consultation process with social partners on the definition of sectors relevant for conclusion of sectoral labour contracts will be closed. At present, social partners remain divided on what would be the best possible solution; still the government aims to close the consultation process by the end of November, seven months after its start. The Social Dialogue Code is potentially conducive to wage developments being more in line with productivity, with beneficial knock-on effects on job creation and competitiveness. However, the legislation was not adopted in agreement with social partners, which could lead to a difficult implementation and increased conflict, and potentially raises an issue with the respect of core ILO conventions. The Romanian authorities expressed their willingness to discuss with the ILO any possible violations of core labour standards, although no concrete steps to proceed have been presented. The mission encouraged the authorities to engage in constructive discussions with the social partners in order to achieve a satisfactory implementation of the Code.

Absorption of EU funds

51. Continued efforts are needed to improve the absorption of EU funds which remains very low. As already reported previously, the first interim absorption target (EUR 900 million) for structural and cohesion funds for end-June 2011 was not attained.[22] Out of a total of EUR 19.2 billion made available to Romania for the 2007-2013 period, only 3.7% have been actually certified and accepted by the Commission until the end of October 2011. Currently a number of initiatives are put in place by the authorities and some in cooperation with the European Commission (DG REGIO and EMPL) to encourage Romania to speed up things and to increase the absorption rate. It is to be hoped that the newly appointed minister for European Affairs, Mr Orban (former Commissioner), will be able to improve the situation.[23] The implementation of the Barroso-initiative of 1 August 2011 could provide for increased co-financing rates (up to 95%) and earlier reimbursement and should thus further enhance the possibilities for Romania to increase its absorption rate.[24] Moreover, as recommended by the Commission, a list of 100 priority projects[25] financed with EU funds has already been approved by the Government and the Government is also planning to include the non-recoverable VAT in the eligible amount. Continued efforts are needed to implement the Government's Priority Action Plan (PAP) for Increasing the Capacity to

[22] As of end-June 2011, around EUR 740 million have been certified.

[23] The Romanian authorities have just set up this new ministry to speed up the absorption of the EU funds. Its main objective is to eliminate obstacles (including the bureaucratic ones), to co-ordinate all the programmes financed from the EU budget and to put in place reforms to accelerate the overall process.

[24] The final Council Decision is expected to be taken in December 2011.

[25] http://www.maeur.gov.ro/admin/files/Lista%20100.pdf

Absorb Structural and Cohesion Funds.[26] Under the impulse of the Commission, the Romanian authorities defined in April 2011 a Priority Action Plan which contains 7 priority actions and about 100 measures to be taken in this context. The Commission (REGIO, EMPL) is closely following up on the action plan's implementation. The EU funds absorption targets were adjusted to reflect the realities on the ground. It was decided to include all the EU funds (including the agricultural funds) in the absorption targets. On this basis, the end-2011 EU funds absorption target (i.e. EUR 2.1 billion) is likely to be met. However, significant efforts are required to meet the end-2012 conditionality as an additional EUR 6 billion are to be absorbed next year.

[26] http://www.fonduri-ue.ro/-263

LIST OF ABBREVIATIONS

BCR	Banca Comercială Română
BET	Bucharest Exchange Trading
BoP	Balance of Payments
CAR	Capital Adequacy Ratio
CDS	Credit Default Swap
CSA	Insurance Supervisory Commission
DGF	Deposit Guarantee Fund
EBCI	European Bank Coordination "Vienna" Initiative
EC	European Commission
EBRD	European Bank for Reconstruction and Development
EDP	Excessive Deficit Procedure
EIB	European Investment Bank
ESA	European System of Accounts
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
GFS	Government Financial Statistics
HICP	Harmonised Index of Consumer Prices
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
ILO	International Labour Organisation
IMF	International Monetary Fund
LFS	Labour Force Survey
LoI	Letter of Intent
LTV	Loan To Value
MEFP	Memorandum of Economic and Financial Policies
MoPF	Ministry of Public Finance

MoU	Memorandum of Understanding
NBR	National Bank of Romania
NIIP	Net International Investment Position
NPL	Non-Performing Loans
PAP	Priority Action Plan
PNDI	National Infrastructure Development Programme
PPP	Public-Private Partnership
PSC	Point of Single Contact
RAS	Romanian Accounting System
REER	Real Effective Exchange Rate
ROA	Return on Assets
ROBOR	Romanian Interbank Offered Rate
ROE	Return on Equity
RON	Romanian Currency (LEU)
SBA	Stand-by Agreement
SDR	Special Drawing Rights
SIF	Societate de Investitii Financiare/ Financial Investment Fund
SMoU	Supplemental Memorandum of Understanding
SOE	State Owned Enterprise
TMU	Technical Memorandum of Understanding
ULC	Unit Labour Cost
WB	World Bank

Annex 1: Key Economic Indicators

Table A1 - Overview, 2007-2013

	2007	2008	2009	2010	2011*	2012*	2013*
Gross Domestic Product	*(annual percentage change, unless otherwise indicated)*						
Nominal GDP (in bn RON)	416	515	501	514	548	580	629
Real GDP	6.3	7.3	-6.6	-1.9	1.7	2.1	3.4
Private Consumption	11.9	9.0	-10.1	-1.6	0.7	1.9	3.4
Public Consumption	-0.1	7.2	3.1	-5.8	-1.5	1.5	3.5
Gross fixed capital formation	30.3	15.6	-28.1	-7.3	2.4	2.6	6.5
Exports	7.8	8.3	-6.4	13.1	7.3	4.3	5.9
Imports	27.3	7.9	-20.5	11.6	4.7	4.5	8.5
Contribution to GDP growth							
Domestic demand	15.9	11.9	-15.0	-3.9	0.7	2.0	4.1
Inventories	0.0	-3.5	1.4	2.3	0.3	0.3	0.6
Net exports	-9.6	-1.0	7.0	-0.2	0.7	-0.3	-1.4
Prices							
HICP inflation (average)	4.9	7.9	5.6	6.1	5.9	3.4	3.4
HICP inflation (year-end)	6.8	6.9	4.7	7.8	3.7	3.9	3.3
NBR target	n.a.	4.0	3.5	3.5	3.0	3.0	2.5
Labour market							
Total employment	0.4	0.0	-1.7	-1.8	0.1	0.6	0.6
Unemployment rate (registered, year-end)	4.1	4.4	7.8	6.9	*4.9*	n.a.	n.a.
Unemployment rate (LFS, year-end)	6.2	5.8	7.5	7.3	*7.2*	n.a.	n.a.
General Government Accounts	*(in percent of GDP, cash)*						
Total revenues	30.6	32.2	31.4	32.8	33.3	33.9	34.0
Total expenditures	32.8	37.0	38.7	39.4	37.7	35.9	36.0
Current	29.4	32.1	34.8	35.7	33.9	32.0	32.0
Capital	3.5	5.0	4.4	3.8	3.7	3.9	4.0
Govn deficit, cash definition	-2.3	-4.8	-7.3	-6.5	-4.4	-1.9	-2.0
Govn deficit, ESA95 definition	-2.9	-5.7	-9.0	-6.9	-4.9	-2.6	-2.5
Gross debt, general govn, ESA95 definition	12.8	13.4	23.6	31	34	35	35.2
Balance of payments	*(in percent of GDP)*						
Current account balance	-13.5	-11.5	-4.2	-4.0	-4.1	-5.0	-5.3
Trade balance	-14	-13.1	-6.1	-5.3	-4.3	-4.5	-4.4
Capital and financial account balance	14.1	13.1	5.3	4.9	4.4	7.9	8.6
FDI balance	5.7	6.7	3.0	1.8	2.0	2.3	2.4
Net international investment position	-43.5	-49.6	-62.4	-64.2	-65.9	n.a.	n.a.
Foreign exchange reserves (in bn Euro)	25.3	26.2	28.3	32.4	32.0	34.5	33.8
Gross external debt	47.1	51.8	68.7	75.8	76.6	n.a.	n.a.
Monetary and exchange rate developments							
Broad money M3 (annual % change, end of the period)	33.7	17.5	9	6.9	*6.8*	n.a.	n.a.
NBR policy rate (in %, end of period)	7.50	10.25	8.00	6.25	*6.00*	n.a.	n.a.
Exchange rate (lei/euro, end of period)	3.60	4.06	4.22	4.28	*4.35*	n.a.	n.a.
REER (Unit Labour Costs deflator, % change)	19.40	8.00	-16.40	-0.40	*0.8*	n.a.	n.a.
Financial market & banking sector developments							
Private credit growth (y-o-y)	60.4	33.7	0.9	4.7	*6.5*	n.a.	n.a.
Capital Adequacy							
CAR	13.8	13.8	14.7	15.0	*13.4*	n.a.	n.a.
Leverage ratio	7.3	8.1	7.6	8.1	*7.5*	n.a.	n.a.
Ratio of level 1 own funds	10.7	11.8	13.4	14.2	*12.9*	n.a.	n.a.
Asset quality							
NPLs (90 dpd)	-	2.8	7.9	11.9	*14.2*	n.a.	n.a.
NPLs (60 dpd)	4.0	6.5	15.3	20.8	*23.0*	n.a.	n.a.
Profitability							
ROA (after tax)	1.0	1.6	0.3	-0.2	*-0.3*	n.a.	n.a.
ROE (after tax)	9.4	17.0	2.9	-1.7	*-3.4*	n.a.	n.a.
Liquidity							
Immediate liquidity	38.7	34.4	35.3	37.8	*36.4*	n.a.	n.a.

Note: * Forecasts or *latest values*

Source : Commission services, Eurostat, National authorities

Table A2 - Romania: General Government Accounts, 2007-2012

	2007 Final	2008 Final	2009 Final	2010 Final	2011 Proj	2012 Proj
	(in percent of GDP, cash projection)					
TOTAL REVENUES	30.6	32.2	31.4	32.8	33.3	33.9
Profit tax	2.5	2.5	2.4	2.0	2.0	2.0
Income and wage tax	3.5	3.6	3.7	3.5	3.4	3.4
VAT	7.5	7.9	6.8	7.6	8.7	8.7
Excises	3.0	2.7	3.1	3.4	3.6	3.7
Social insurance contributions	9.3	9.5	9.6	8.9	9.0	8.9
Non fiscal revenue	1.9	3.1	3.1	3.9	3.3	3.3
Other fiscal taxes	1.9	2.0	2.0	2.7	1.4	1.4
Revenue from capital	0.9	0.8	0.8	0.9	1.8	2.6
TOTAL EXPENDITURES	32.8	37.0	38.7	39.4	37.7	35.9
Current expenditures	29.4	32.1	34.8	35.7	33.9	32.0
Personnel expenditures	6.2	8.9	9.3	8.3	7.4	6.9
Goods and services	6.2	6.3	5.7	5.8	5.5	5.5
Interest	0.7	0.7	1.2	1.4	1.7	1.8
Subsidies	1.7	1.5	1.4	1.3	1.2	0.9
Transfers	14.7	14.7	16.7	18.5	17.7	16.5
Social Assistance	9.2	10.5	12.8	13.4	12.5	11.7
Other transfers	5.5	4.1	3.9	5.1	5.2	4.7
Other	0.0	0.0	0.4	0.3	0.4	0.4
Capital expenditures	3.5	5.0	4.4	3.8	3.7	3.9
Other expenditure (net lending)	0.0	-0.1	-0.5	-0.1	0.0	0.0
Government deficit, cash definition	-2.3	-4.8	-7.3	-6.5	-4.4	-1.9
Government deficit, cash definition including PNDI						-2.1
Government deficit, ESA95 definition	-2.9	-5.7	-9.0	-6.9	-4.9	-2.6
Gross debt, general government, ESA95 definitior	12.8	13.4	23.6	31.0	34.0	35.0

Source: Romanian authorities, European Commission

Table A3 - Romania: Monetary Indicators, 2007-2012

(in millions of lei (RON), unless otherwise indicated; end of period)

	2007	2008	2009	2010	Sep-11	2011	2012
Broad money (M3)	**148,116**	**174,028**	**189,630**	**202,763**	**209,135**	…	…
Intermediate money (M2)	148,044	173,629	188,013	199,586	204,772	…	…
Money market instruments	72	399	1,617	3,177	4,363	…	…
Narrow money (M1)	79,914	92,549	79,361	81,605	83,966	…	…
Currency in circulation	21,442	25,287	23,968	26,793	29,406	…	…
Overnight deposits	58,473	67,262	55,394	54,812	54,560	…	…
Time deposits**	68,129	81,080	108,652	117,982	120,806	…	…
Money and credit (Annual percentage change, eop)							
Broad money (M3)	33.7	17.5	9.0	6.9	6.8	…	…
- *NFA contribution*	…	-10.7	5.0	0.7	0.6	…	…
- *NDA contribution*	…	18.2	4.0	6.2	6.2	…	…
Intermediate money (M2)	…	17.3	8.3	6.2	6.3	…	…
Narrow money (M1)	…	15.8	-14.2	2.8	3.0	…	…
Currency in circulation	…	17.9	-5.2	11.8	9.8	…	…
Overnight deposits	…	15.0	-17.6	-1.1	-0.3	…	…
Time deposits***	…	19.0	34.0	8.6	8.7	…	…
p.m. Credit to private sector	60.4	33.7	0.9	4.7	6.5	…	…
Interest rates (In percent, eop)							
ROBOR, 3 m*	8.3	15.6	10.4	6.3	6.0	5.9	5.7
ROBOR, o/n	7.6	12.1	10.2	3.0	4.9	…	…
NBR policy rate**	7.5	10.3	8.0	6.3	6.0	…	…
NBR credit facility rate**	12.0	14.3	12.0	10.3	10.0	…	…
NBR deposit facility rate**	2.0	6.3	4.0	2.3	2.0	…	…
Exchange rates							
Lei per euro (end of period)*	3.6	4.0	4.2	4.2	4.4	4.3	4.3
Lei per euro (average)*	3.3	3.7	4.2	4.2	4.2	4.2	4.3
Real effective exchange rate (percentage change)							
HICP based	8.4	-4.9	-7.6	2.2	2.0	…	…
ULC deflator based	19.4	8.0	-16.4	-0.4	0.1	…	…

Source: www.nbro.ro, Commission services

Note: * Data for 2011 and 2012 based on technical assumptions of the Commission services Autumn 2011 forecast

** Includes cut in the NBR's policy rates on 2 November 2011.

*** Maturity of up to two years.

Table A4 - Romania: Gross External Financing Requirements and Sources, 2010-2012

Romania Gross External Financing Requirements

(In billions of euros, unless otherwise indicated)

	2010 Q1 Act	Q2 Act	Q3 Act	Q4 Act	Year Act	2011 Q1 ACT	Q2 ACT	Q3 Proj	Q4 Proj	Year Proj.	2012 Q1 Proj.
I. Total financing requirements	9.7	8.0	11.2	8.7	37.5	8.9	8.9	9.3	11.7	38.7	8.6
I.A. Current account deficit	1.2	2.2	0.8	0.7	4.9	0.8	2.0	1.6	1.7	6.0	1.7
I.B. Short-term debt	5.1	4.5	5.8	5.7	21.1	5.9	4.3	5.0	5.8	21.0	5.5
Public sector	1.4	0.8	1.4	1.0	4.6	1.9	0.8	1.1	1.1	4.9	1.2
Banks	2.6	2.9	2.7	3.1	11.2	2.9	2.6	2.7	3.3	11.5	2.8
Corporates	1.1	0.8	1.6	1.6	5.2	1.1	0.9	1.2	1.4	4.6	1.6
I.C. Maturing medium- and long-term debt	2.9	1.9	4.2	2.3	11.3	1.8	2.5	3.5	3.3	11.2	1.9
Public sector	0.2	0.3	0.9	0.3	1.7	0.2	0.6	0.7	0.2	1.8	0.2
Banks	1.1	0.5	1.1	0.6	3.2	0.2	0.8	1.7	0.7	3.4	0.8
Corporates	1.7	1.1	2.1	1.4	6.4	1.4	1.1	1.1	2.5	6.0	0.9
I.D. Other net capital outflows	0.4	-0.7	0.4	0.1	0.3	0.4	0.1	-0.8	0.9	0.5	-0.5
II. Total financing sources	8.9	7.4	9.3	8.3	33.9	8.5	10.1	6.8	11.4	36.8	9.1
II.A. Foreign direct investment, net	0.3	1.0	1.2	-0.2	2.2	0.5	0.8	0.1	0.6	2.0	0.9
II.B. Capital account inflows	0.1	0.0	0.1	0.1	0.2	0.1	0.1	0.1	0.2	0.4	0.2
II.C. Short-term debt	6.1	4.7	6.0	6.4	23.2	6.7	6.4	4.8	6.3	24.2	6.3
Public sector	1.8	0.7	1.7	1.2	5.4	2.5	1.7	0.8	1.0	6.0	1.2
Banks	3.0	2.5	3.1	3.8	12.5	2.6	3.3	2.8	3.3	12.0	3.0
Corporates	1.3	1.4	1.2	1.4	5.3	1.6	1.4	1.2	2.0	6.2	2.1
II.D. Medium- and long-term debt	2.4	1.7	2.0	2.0	8.2	1.1	2.9	1.8	4.3	10.1	1.6
Public sector	1.2	0.2	0.5	0.4	2.2	0.3	1.7	0.4	1.5	3.8	0.1
Banks	0.2	0.9	0.2	0.9	2.3	0.6	0.5	0.9	0.6	2.5	0.7
Corporates	1.1	0.6	1.3	0.7	3.7	0.2	0.7	0.6	2.2	3.8	0.8
III.Primary external balance (II-I)	-0.8	-0.6	-1.9	-0.4	-3.7	-0.4	1.3	-2.5	-0.3	-1.9	0.4
IV. Change in gross reserves	3.1	-1.3	2.1	-0.4	3.5	1.1	1.8	-1.4	0.2	1.8	1.2
V. Errors and omissions	-0.2	-0.9	0.5	-0.3	-0.9	-0.9	-0.2	0.7	0.0	-0.4	0.0
V. Financing gap	4.1	0.2	3.5	0.3	8.0	2.4	0.7	0.4	0.5	4.1	0.8
VI. Programme financing	4.1	0.2	3.5	0.3	8.0	2.4	0.7	0.4	0.5	4.1	0.8
IMF	2.5	0.0	1.9	0.0	4.3	0.9	0.0	0.0	0.0	0.9	0.0
Purchases	2.5	0.0	1.9	0.0	4.3	0.9	0.0	0.0	0.0	0.9	0.0
Repurchases											0.0
Others	1.6	0.2	1.6	0.3	3.7	1.5	0.7	0.4	0.5	3.2	0.8
European Commission	1.0	0.0	1.2	0.0	2.2	1.2	0.2	0.0	0.0	1.4	0.0
World Bank	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.0	0.0	0.3	0.4
EIB/EBRD/IFC	0.6	0.2	0.4	0.3	1.5	0.3	0.3	0.4	0.5	1.5	0.4
Memorandum items:											
Foreign exchange reserves	33.7	33.6	33.0	32.4	32.4	32.7	34.4	32.9	34.3	34.3	
Gold	3.5	3.3	3.5	3.5	3.5	3.3	3.5	3.5	3.4	3.4	
Coverage of gross international reserves											
- Months of imports of GFNS (next year)	…	…	…	…	5.9	…	…	7.0	…		
- Short-term external debt at remaining maturity (in percent)	…	…	…	…	118.5	…	…	105.5	…	…	

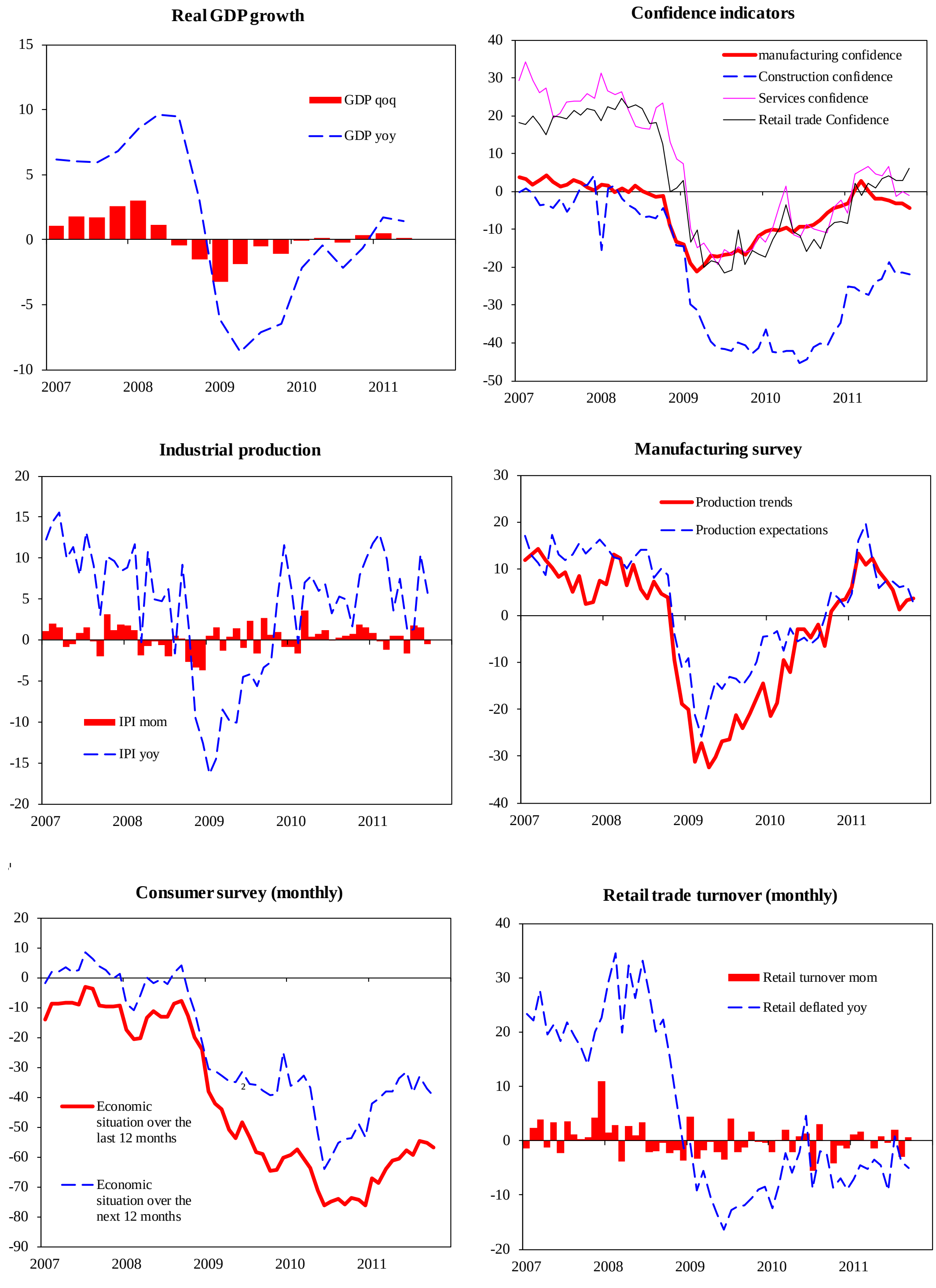
Source: IMF/EC/NBR staff estimates.

Table A5 - Romania: Key Labour Market Indicators

Updated: 13/12/11 16:40

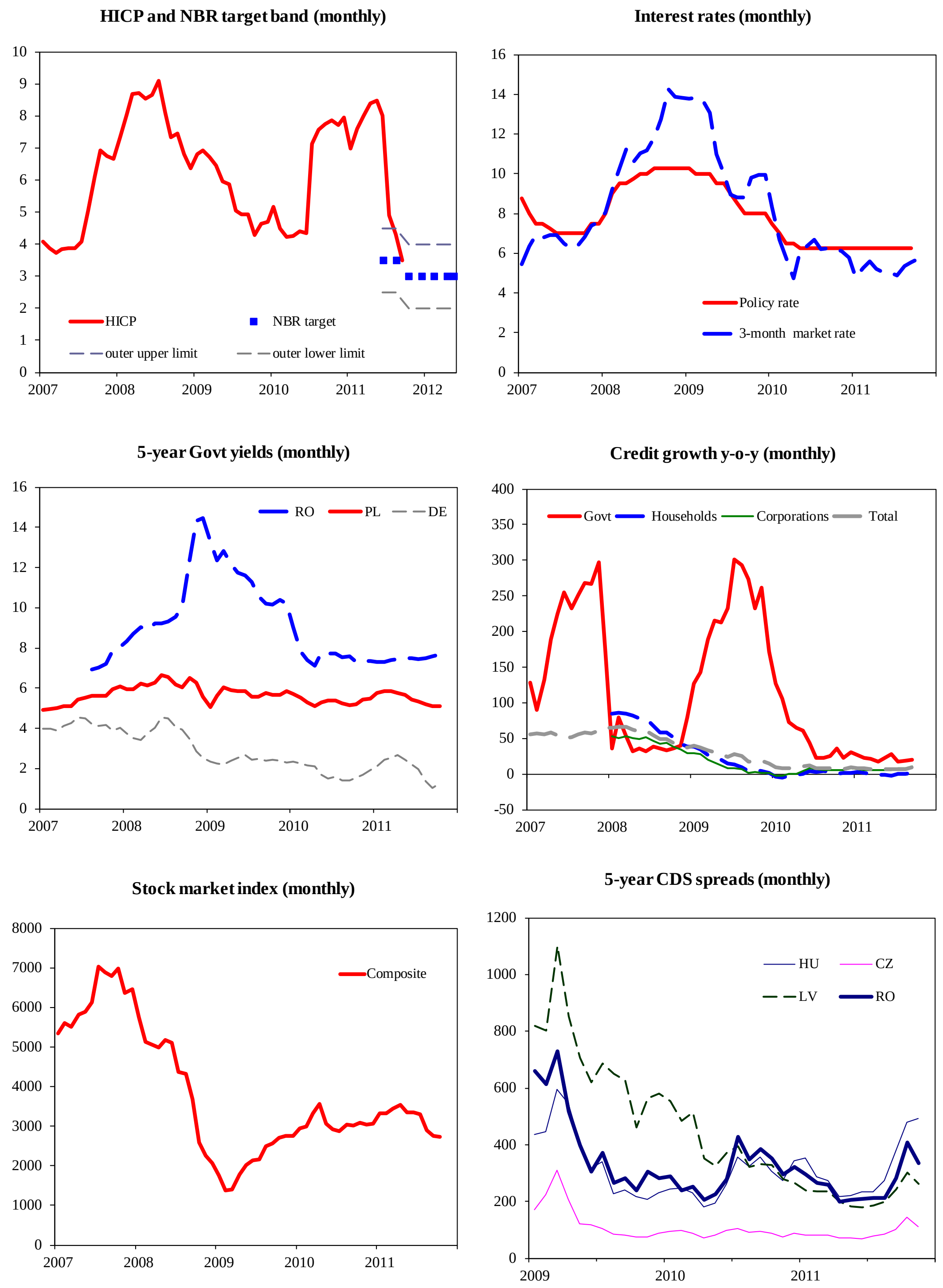
Romania	2007	2008	2009	2010	2011	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2010-2009
1 **- Population** (total, 1000 pers.)	**21551**	**21517**	**21484**	**21447**	**:**	**21462**	**21462**	**21431**	**21431**	**21413.8**	**21413.8**	**:**	**-0.2 %**
2 **- Population** (working age:15-64, 1000 pers.)	15046	15042	15028	14999	:	15004	15004	14995	14995	14988.9	14988.9	:	-0.2 %
3 **- Labour force** (15-64, 1000 pers.)	**9483**	**9457**	**9485**	**9547**	**:**	**9341**	**9721**	**9736**	**9389**	**9437.7**	**9520.6**	**:**	**0.6 %**
4 **- Activity rate** (% of population 15-64)	**63.0**	**62.9**	**63.1**	**63.6**	**:**	**62.3**	**64.8**	**64.9**	**62.6**	**63.0**	**63.5**	**:**	**0.5 pps**
Young (15-24)	30.5	30.4	30.9	31.2	:	30.3	32.4	33.0	29.2	30.2	31.1	:	0.3 pps
Prime age (25-54)	79.0	78.3	78.5	79.5	:	78.1	80.5	80.4	78.9	78.9	79.3	:	1.0 pps
Older (55-64)	42.4	44.2	43.9	42.5	:	40.7	44.1	44.5	40.7	41.6	42.2	:	-1.5 pps
Male	70.1	70.6	70.9	71.5	:	70.5	72.6	72.5	70.5	70.5	70.5	:	0.7 pps
Female	56.0	55.2	55.4	55.8	:	54.1	57.0	57.4	54.7	55.4	56.6	:	0.4 pps
5 **- Employment rate** (% of population 15-64)	**58.8**	**59.0**	**58.6**	**58.8**	**:**	**57.0**	**60.1**	**60.2**	**57.9**	**58.0**	**58.8**	**:**	**0.2 pps**
Young (15-24)	24.4	24.8	24.5	24.3	:	23.6	25.8	25.5	22.5	23.1	24.3	:	-0.2 pps
Prime age (25-54)	74.6	74.4	73.7	74.4	:	72.3	75.6	75.7	73.9	73.7	74.3	:	0.6 pps
Older (55-64)	41.4	43.1	42.6	41.1	:	39.3	42.8	43.1	39.1	40.0	40.5	:	-1.6 pps
Low-skilled (15-64)	40.3	41.0	42.0	43.0	:	39.8	45.1	46.2	40.9	39.8	40.7	:	1.0 pps
Medium-skilled (15-64)	63.9	63.5	62.2	62.2	:	61.0	63.3	63.1	61.5	62.1	62.9	:	0.0 pps
High-skilled (15-64)	85.8	85.7	84.1	82.4	:	82.0	84.7	81.5	81.6	82.9	82.9	:	-1.7 pps
Male	64.8	65.7	65.2	65.7	:	64.0	67.1	67.0	64.7	64.6	65.1	:	0.5 pps
Female	52.8	52.5	52.0	52.0	:	50.0	53.2	53.6	51.0	51.5	52.5	:	0.0 pps
6 **- Employed persons** (15-64, 1000 pers.)	**8842.5**	**8882.2**	**8804.7**	**8822.0**	**:**	**8553.8**	**9024.0**	**9034.4**	**8675.8**	**8697.1**	**8809.7**	**:**	**0.2 %**
7 **- Self employed** (% of total employment)	18.6	18.2	18.4	19.5	:	18.7	19.9	20.6	18.7	17.8	17.8	:	1.1 pps
8 **- Temporary employment** (% of total employment)	1.6	1.3	1.0	1.1	:	1.0	1.1	1.2	1.2	1.4	1.9	:	0.1 pps
9 **- Part-time** (% of total employment)	8.6	8.6	8.5	9.7	:	8.8	10.5	10.3	9.3	9.4	9.4	:	1.2 pps
10 **- Unemployment rate** (harmonised:15-74)	**6.4**	**5.8**	**6.9**	**7.3**	**:**	**8.1**	**6.8**	**6.9**	**7.3**	**7.6**	**7.2**	**7.2**	**0.4 pps**
Young (15-24)	20.1	18.6	20.8	22.1	:	22.2	20.5	22.9	22.8	23.6	21.8	:	1.3 pps
Prime age (25-49)	5.8	5.1	6.1	6.6	:	7.6	6.2	5.9	6.5	6.7	6.4	:	0.5 pps
Older (55-64)	2.3	2.5	3.0	3.3	:	3.4	2.8	3.1	4.0	3.9	4.0	:	0.3 pps
Low-skilled (15-64)	8.6	8.6	8.9	7.2	:	7.5	6.7	6.9	7.6	8.7	8.4	:	-1.7 pps
Medium-skilled (15-64)	6.9	6.0	7.3	8.3	:	9.3	8.1	7.8	8.2	8.5	7.9	:	1.0 pps
High-skilled (15-64)	3.0	2.7	4.4	5.4	:	6.3	4.2	5.4	5.6	4.5	4.6	:	1.0 pps
Male	7.2	6.7	7.7	7.9	:	8.8	7.3	7.4	7.9	8.2	7.5	7.8	0.2 pps
Female	5.4	4.7	5.8	6.5	:	7.1	6.2	6.3	6.5	6.8	6.8	6.6	0.7 pps
11 **- LT unemployment rate** (% of total unemployment)	**50.0**	**41.3**	**31.6**	**34.9**	**:**	**31.7**	**34.9**	**37.9**	**35.7**	**39.8**	**41.7**	**:**	**3.3 pps**
12 **- Worked hours** (average actual weekly hours)	**41.1**	**41.0**	**40.7**	**40.7**	**:**	**39.9**	**41.2**	**41.4**	**40.5**	**39.9**	**41.2**	**:**	**0.0 %**
13 **- Indicator board on wage developments** (% change)													
Compensation per employee	22.0	31.9	-6.8	1.6	-68.9	5.6	8.3	-2.9	-2.8	3.2	14.5	19.6	8.4 pps
Hourly labour costs (Eurostat labour cost index)	21.0	20.6	11.8	6.0	6.0	7.4	5.0	6.2	5.4	4.5	7.1	:	-5.8 pps
Labour productivity (GDP/person employed)	5.9	7.3	-4.9	-0.1	-0.1	-0.8	1.6	-0.2	1.2	4.5	4.7	9.4	4.8 pps
Nominal unit labour costs	15.2	22.9	-1.3	0.8		6.4	6.6	-2.7	-3.9	-1.3	:	:	2.1 pps

Figure A1 – Romania: Key Economic Indicators, 2007-2011



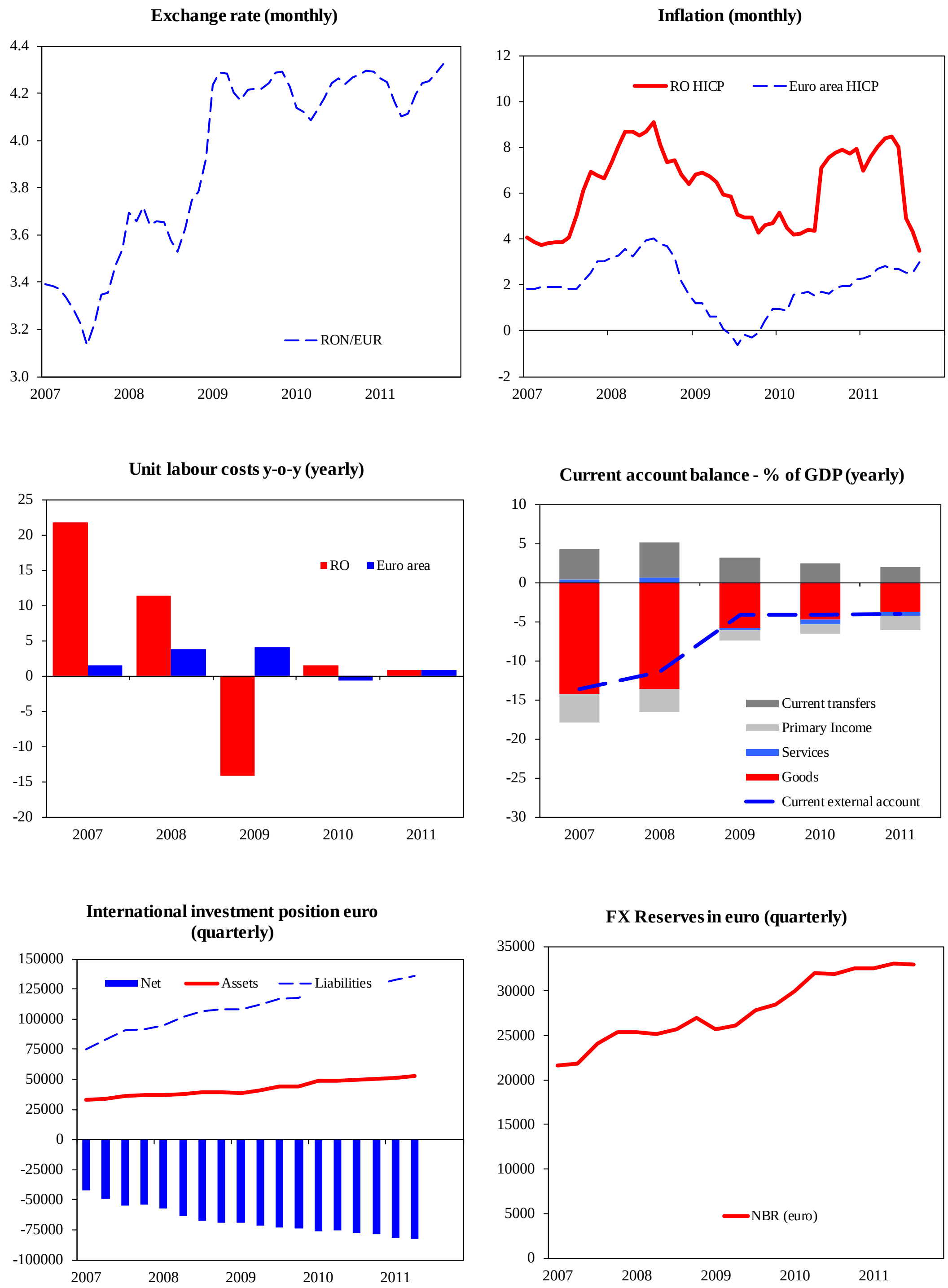
Source: European Commission, Romanian authorities

Figure A2 - Romania: Monetary and Financial Market Indicators, 2007-2011



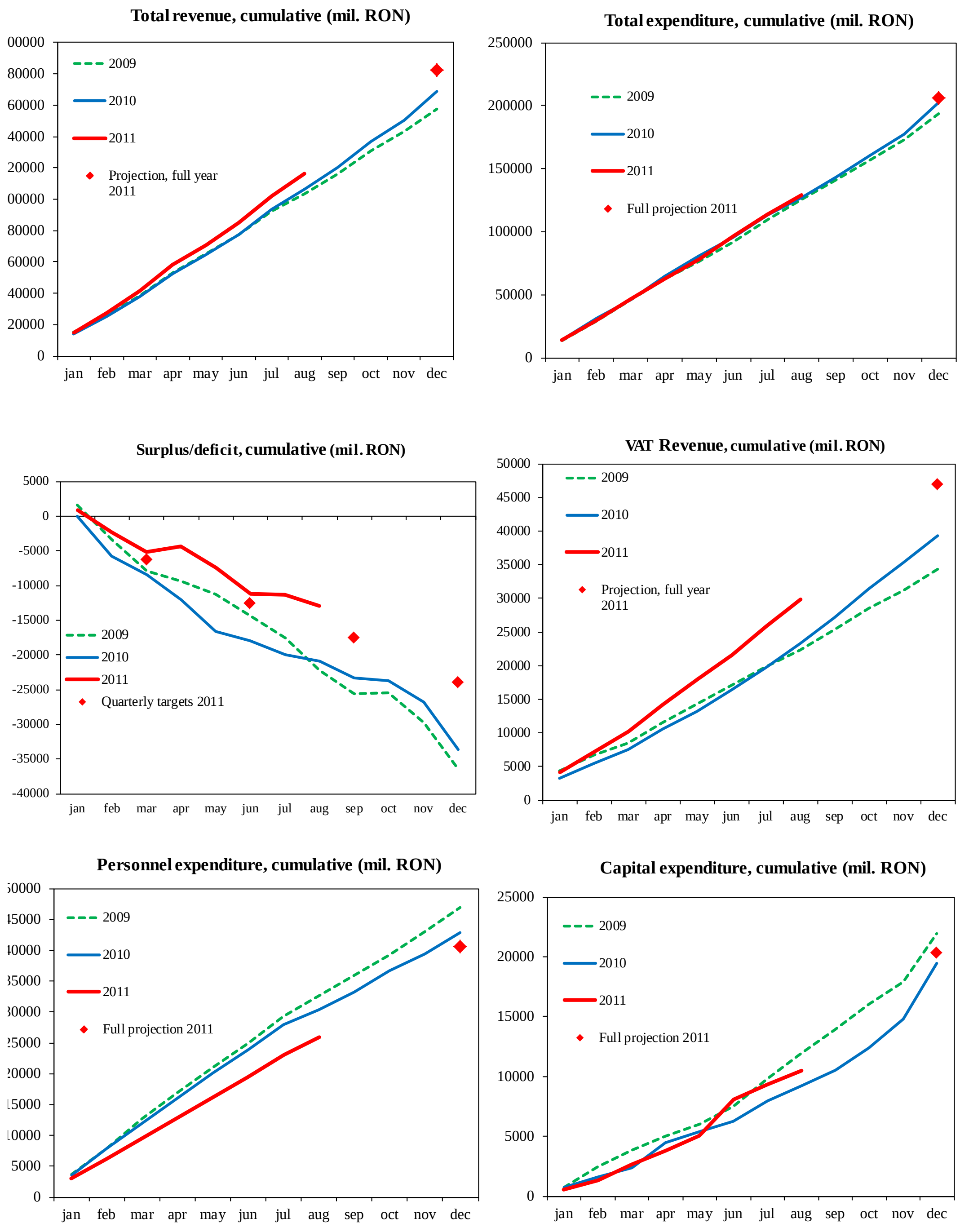
Source: European Commission, Romanian authorities

Figure A3 - Romania: Price and Competitiveness Indicators, 2007-2011



Source: European Commission, Romanian authorities

Figure A4 - Romania: Budgetary Execution, 2009-2011



Source: European Commission, Romanian authorities

ANNEX 2: PROGRAMME DOCUMENTS

Letter of Intent

Bucharest, December 14, 2011

Mr. Olli Rehn
Vice-President of the European Commission
responsible for Economic and Monetary Affairs and the Euro
European Commission
BERL 10/299
B-1049 Brussels
Belgium

Mr Jan Vincent Rostowski
Minister of Finance
U1 Swietokrzyska 12
PL-00-916 WARSZAWA
Poland

Dear Mr Rehn and Mr Rostowski,

1. The Council of the European Union (Council Decision 2011/288/EU of 12 May 2011) decided to make precautionary medium-term financial assistance of up to EUR 1.4 billion available to Romania to support the continuation of the economic, fiscal and financial system reforms started under the previous Balance-of-Payments program (2009-2011) as well as necessary structural reforms to increase the resilience and growth potential of Romania's economy.

2. We reaffirm our commitment to the economic adjustment program supported by the International Monetary Fund (IMF), the European Union (EU), and the World Bank (WB). Our track record to date is strong. We continue our efforts on a large structural agenda, though further progress is needed in some areas, as described in the attached Memorandum of Economic and Financial Policies (MEFP), the Technical Memorandum of Understanding (TMU) and the first supplemental Memorandum of Understanding (MoU). Our achievements in economic stabilization and reforms are beginning to bear fruit, as economic growth has turned positive this year after two years of decline. Continued firm policy implementation and maintaining fiscal, monetary and financial buffers are required to safeguard against risks, as the recovery remains vulnerable to adverse developments in international financial markets and pronounced downside risks to euro area recovery.

3. Policy implementation for the first EU formal review (and third IMF review) has been determined. In the MEFP, we set out our plans to further advance towards meeting the objectives laid out in our macroeconomic program. In view of our strong performance under the program supported by the IMF and the EU, the Government of Romania and the National Bank of Romania (NBR) request completion of the first EU review. We intend to continue to treat the arrangement as precautionary.

4. We believe that the policies set forth in this Letter and its attachments are adequate to achieve the objectives of our economic program. We stand ready to take additional measures as appropriate to ensure achievement of its objectives. We will consult with the IMF and European Commission (EC) before modifying measures contained in this Letter and the attached programme documents or adopting new measures that would deviate from the goals of the program, and will provide the IMF and the EC with the necessary information for program monitoring.

5. We authorize the IMF and the EC to publish the Letter of Intent, its attachments, and the related staff reports. This letter is being copied to Mme Lagarde.

Sincerely,

[Signed]	[Signed]
Gheorghe Ialomiţianu	Mugur Isarescu
Minister of Public Finance	Governor of the National Bank of Romania

Attached: Memorandum of Economic and Financial Policies (MEFP); Technical Memorandum of Understanding (TMU); the first supplemental Memorandum of Understanding (MoU).

Romania: Memorandum of Economic and Financial Policies (MEFP)

Recent Economic Developments and Outlook

1. Romania's growth is now resuming, but severe headwinds from the regional economic slowdown and financial turbulence are making the recovery fragile. We continue to forecast growth of around 1½-2 percent in 2011, rising modestly to about 1¾-2¼ percent in 2012. The favorable agricultural harvest will likely boost farm incomes and offset slowing external demand in the short run. This has also reduced significantly the inflationary pressures that were evident earlier in the year due to high global food and energy prices. We now expect inflation to remain within the inflation target range despite some increases in administered prices. Amidst signs of a gradually improving labor market and the anticipated absorption of EU funds, growth is expected to be mainly driven by domestic demand in 2012. The current account deficit is projected to remain below 5 percent of GDP in 2011-12 on the back of improved trade performance. Continued firm policy implementation is required to safeguard against downside risks, as there remain significant vulnerabilities to adverse developments in international financial markets and the euro area recovery.

Fiscal Policy

2. For 2011, we remain committed to the previously agreed cash deficit target of 4.4 percent of GDP or below 5 percent in ESA terms. In the third quarter, revenues were below expectations, but tight control on current spending allowed us to meet the fiscal balance target with a comfortable margin. We have continued to reduce public employment by another 20,000 positions in the third quarter, in line with our commitment to keeping the wage bill below 7.5 percent of GDP in 2011. In August, we eliminated central government heating subsidies and improved the legislation to provide heating allowances for the most vulnerable population. Local governments are also required to fully budget and fund their heating subsidies. To safeguard the deficit target, we will continue our prudent management of expenditures to ensure that there will be room to counteract any continued revenue underperformance. The November budget rectification will allocate the necessary funds to avoid the accumulation of new arrears in the health sector.

3. In order to bring closer the cash and ESA measures of the fiscal balance, we will start monitoring selected state-owned enterprises (SOEs) as defined in the attached TMU on a monthly basis beginning in November; once this system is fully functional, we will request that the performance criterion on the general government cash overall balance be amended to include the operating balance of these entities. This system will—as far as possible—include the SOEs that are to be added to the ESA definition of the general government, and with the technical assistance of Eurostat, enhance our ability to measure the fiscal deficit on an accrual basis.

4. For 2012, we remain committed to bringing the fiscal deficit in ESA terms below 3 percent of GDP. To achieve this with ample margin for unforeseen shocks, we will approve a budgetary cash deficit of 1.9 percent of GDP, although our deficit target as measured under the IMF program will be 2.1 percent of GDP due to off-budget spending under the National Development and Infrastructure Program (PNDI). Achieving this ambitious fiscal deficit will require sustained expenditure restraint. We will initially freeze wages in the public sector as well as pensions (by postponing this element of the implementation of the pension law until 2013). However, if economic conditions permit we will consider prudent wage and pension increases later in the year. We will make savings in the capital budget by eliminating the non-performing projects identified during the prioritization exercise and by

reducing the national co-financing of EU-funded projects. A new EU regulation will allow us to temporarily reduce the co-financing rate by 10 percentage points (as long as Romania is covered by this current IMF/EU program) and a national regulatory framework renders non-recoverable VAT from projects financed by EU structural funds eligible for reimbursement. We will also replace budget subsidies given to the agricultural sector with funds received from the EU. Implementation of health sector reforms and restructuring of public enterprises included in the general government will also be crucial to achieve the 2012 target. Means-testing of social benefits programs is also expected to generate savings.

5. We intend to bring the wage bill below 7.2 percent of GDP in 2012. Public employment reductions will continue with the policy of replacing only 1 out of 7 employees; however, we will implement it with more flexibility, by applying the rule at a sectoral or higher level rather than for each institutional unit. This flexible approach will allow elimination of some bottlenecks in sectors where problems with staff shortages are becoming acute, as identified by the recently conducted functional reviews.

6. In the medium-term, we remain committed to continued responsible fiscal policy, consistent with our fiscal strategy and Fiscal Responsibility Law (FRL). We will continue to support the independent Fiscal Council, by providing it with adequate information and funding. We will ask the Fiscal Council to recommend improvements to the FRL to increase flexibility while strengthen the commitment to transparency and responsible fiscal policy. We will strictly limit further ad hoc changes to the tax system to ensure predictability and stability. We will close tax loopholes and improve the efficiency of the tax system, while ensuring its revenue neutrality, taking stock of the recommendations of the technical assistance of the IMF. The government will appoint an interministerial group to implement the functional review action plans. We will begin implementation of the action plans by focusing on “quick-win” measures requiring no additional financing. By mid-January 2012, we will ensure that a central coordinating entity is operational and will submit to the EU, WB, and IMF the first quarterly implementation reports.

7. Arrears and unpaid bills of the general government (excluding SOEs) have been declining since the beginning of the year. Arrears now stand below 0.2 percent of GDP (almost entirely in local governments). In SOEs monitored under the program, arrears have fallen in the third quarter of 2011 by some 0.2 percent of GDP to 3.4 percent of GDP. Overall, central government SOE arrears fell some 0.3 percent of GDP to 3.8 percent of GDP. With the assistance of Fund and EC staff, we are implementing our action plan to deal with arrears as follows:

- In the ***health sector***, arrears in registered bills have now been completely eliminated and we will pay the unregistered bills revealed during the stocktaking exercise by end-2011. We have registered about two thirds of the RON 500 million unpaid bills uncovered in the stocktaking exercise. We will register the remaining bills by the end of the year, and will specify in the 2012 budget that all new bills must be registered within 60 days of delivery of the relevant good or service. Additional budget allocations to the health sector were made in July and RON 750 million will be included in the November supplementary budget to avoid new arrears, but new allocations will be conditioned on progress on systemic reforms.
- At the ***local government level***, arrears have leveled off since the second quarter. The new amendments to the local government public finance law (LGPFL) are effective in preventing the accumulation of new arrears, but we need to better enforce its provisions and explore possibilities to further reduce the stock of existing arrears. In particular, we will ensure adequate financing, within line ministries’ budget ceilings, of local government projects co-financed by the state budget. Medium-term financing of these projects will be guaranteed through multi-year contracts signed between line ministries and local governments, according to the provisions of the LGPFL. These projects shall be included in the capital

investment database to ensure that line ministries can prioritize and adequately fund these projects.

- For ***SOEs***, we are making progress in the process of reducing arrears in monitored companies through swap operations, payments, and other financial operations. Together, we anticipate that these measures will permit arrears of companies under monitoring to be reduced by RON 5 to 6 billion (1 percent of GDP) by early 2012. As part of this process, any overperformance against the 2011 cash fiscal deficit target (after central government and social security) will be used to help fund arrears clearance in CFR Infrastructure, conditional upon the subsequent viability of the firm and on negotiation of elimination of payment penalties with suppliers.

- The next phase in the integration of the accounting reporting system with the ***Treasury payment system*** is underway, including the commitment control and reporting module for all levels of government. The design of the system has been finalized and the contract with the software provider will be signed by end-March 2012. This system will help control spending commitments to avoid accumulating future arrears.

- Over the next two years the ***period for paying bills submitted*** to the central government and social security system will be gradually reduced. The EU directive 7 in this area will be transposed into Romanian law on a timely basis. Towards this end, we will seek to use revenues from the clawback tax to begin shortening the period for paying bills submitted for pharmaceuticals.

- To prevent possible future arrears due to unfunded contracts, we will ensure that any commitments made at the **central government** level for multiannual capital projects are appropriately reflected in the fiscal accounts and new guarantees issued for bank financing of these projects are transparently recorded within the program guarantee ceiling of RON 14 billion.

8. We have improved our financing strategy and will continue to focus on building the yield curve and consolidating the financial buffers. We launched our euro medium-term notes program with a June issue for €1.5 billion. We will continue regular external bond issuance 1-2 times per year at a range of maturities. We remain committed to consolidating our financial buffer (including WB DPL-DDO financing) to around four months of financing needs to protect government finances against unforeseen external shocks. Less favorable external market conditions have led us to temporarily reconsider further extension of the maturity of our domestic debt issuances, but we will continue to issue a range of maturities at market interest rates. We are conducting a formal review of our debt management strategy with the assistance of IMF, EC, and WB experts by Q1 2012; in August and October 2011, we received training on a debt management system in order to strengthen our capacity to optimize debt portfolios. We will also further improve treasury information technology (IT) systems and increase senior staffing.

9. Improving the absorption of EU funds remains a difficult challenge, and further efforts are needed. We have moved the EU structural funds coordination unit to a newly created Ministry of European Affairs. In order to significantly boost absorption next year, we have undertaken measures for identification of high priority projects, strengthen capacity of management authorities, and reduce procedural bottlenecks. We have approved a list of 100 priority projects and will strictly monitor their implementation. In addition, we will negotiate with the EC a reallocation of EU funding between operational programs and funds in order to finance additional needs that occurred and were not envisaged for financing within the current programming period 2007-13. We have increased accountability of public procurement agencies in the tendering process and have made progress in developing standard bidding documents in four key subsectors and standardized procurement

procedures, where possible, which we expect to complete by end-2011. We are also seeking to simplify procedures, increase staffing and technical expertise of managing authorities, and improve transparency regarding project implementation and payment claim status.

10. We are focusing on prioritizing investment to assure sufficient financing for key projects. We have completed a comprehensive review of the existing investment portfolio and have prepared a database of all government projects. This database will be used to prioritize and evaluate projects to focus on those where funding can be fully secured within a medium-term horizon (e.g., 3–5 years), and to discontinue low priority and non-performing projects that cannot be fully financed within this horizon. In particular, we will strictly prioritize EU funded projects in 2012. The prioritization of investment projects should be based on feasibility studies, and take account of criteria such as cost benefit analysis, estimated share of completion, how well the project implementation has been managed to date by the ministry, their matching to the strategic priorities of the government, as well as on the analysis produced by the capital monitoring unit of the Ministry of Public Finance (MOPF). The Ministry of Regional Development and Tourism (MRDT) and the Ministry of Environment and Forest (MEF) will ensure that this spending does not exceed RON 1.0 billion in 2012 (RON 820 million for MRDT and RON 180 million for MEF). In addition, the authorities overseeing public private partnerships (PPPs) commit to joint reporting by mid-April 2012 on the functioning of their working arrangements.

11. To address the persistent budgetary shortfalls in the healthcare system and enhance service quality, we are preparing a comprehensive reform of the system. Over the medium-term, given that public healthcare spending in Romania is among the lowest in the EU as a share of GDP, we will ensure adequate financing in line with the recommendation of the 2008 Presidential Commission on health care policy while factoring in the challenge of population aging into spending needs. The reform will also ensure that spending commitments remain within the allocated budget. To contain the growth of spending, we will seek to reduce the scope of the public benefits package through greater reliance on cost-sharing and private supplementary insurance. We are also exploring options for greater private sector involvement in health care provision and financing to enhance efficiency and quality of services, and to raise additional resources. We are preparing a framework law based on these principles, which will be finalized by end-2011 (structural benchmark), and approved by end-March 2012.

12. In 2012, budget allocations to the health sector will be consistent with a realistic spending program, while incorporating savings from reforms already underway, including:

· ***Basic benefits package.*** With the technical assistance of the National Institute for Health and Clinical Excellence under the WB financed project, we are assessing and revising the package of benefits insured by the government to exclude coverage of costly nonessential health services and drugs. A negative list of services and revised list of reimbursed drugs will be prepared by the end of the year.

· ***Pharmaceutical expenditures.*** In September, we included generics in the C2 list, and changed references prices accordingly. In the context of the revision of the basic benefits package, we will also revise settlement prices and the list of compensated and free drugs.

· ***Expenditure controls.*** We will continue to monitor aggregate hospital budgets to ensure that they are consistent with the expenditure programmed in the general government budget, and will take all necessary actions to avoid new arrears, including at the level of hospitals under the responsibility of local governments.

· ***Revenue enhancements.*** The copayment law for medical services has already received a positive recommendation from the expert commission of the Chamber of Deputies and is expected to be implemented during the first half of 2012. The current version of the claw-back tax for pharmaceuticals, introduced in October, presents some shortcomings that we will address by the end of the year. A revised law, agreed with IMF, EU, and WB staff, will be approved by end-2011. Enactment of the copayment and of the revised clawback legislation will be prior actions for conclusion of the third review.

· Progress continues on implementing new ***healthcare IT systems***. The auditing of patient registries is underway and will be completed by end-2011. In 2012, we will begin rolling out new health cards for all participants, which will help control fraud and abuse in the system and better monitor spending commitments. We will also introduce a new electronic prescription module for the National Health Information System in the second half of 2012. We will internalize the National Health Accounts System and will initiate the development of the Health Technology Assessment System by end-2011. These mechanisms will help ensure that future spending remains within allocations.

13. Improving tax administration and fighting tax evasion are crucial elements of our strategy to increase revenue. We are making progress on a comprehensive reform of ANAF. However, sustained improvements in tax collections have not yet been achieved and we hope that our continued efforts will bring such results in the future. Among the key developments are the following:

· We have reconsidered our previous plans to introduce ***simplified taxation for smaller taxpayers.*** We now plan to use administrative means to cancel the registration for VAT purposes of the low contributors, who constitute 60 percent of firms registered but contribute only 1 percent to the fiscal revenues of the budget. In consultation with EU and IMF experts, we will agree on measures to reduce VAT registrants by 20 percent by end-September 2012 (compared to end-September 2011) (modified structural benchmark, end-December 2011). This system will help reduce fraud, and allow us to redirect tax administration resources towards large taxpayer compliance control.

· We have started implementing the ***indirect audit method*** strategy, with a view to starting audits of individuals in 2012. To access third party information, we concluded agreements with most of the institutions providing such data, including the Land Registry.

· We passed the government decision on ***ANAF restructuring*** and have closed 141 regional offices to reduce collection costs. ANAF staff has been reduced by 8 percent since end-2010. We have also initiated a regionalization reform, with long-term benefits for efficient administration, commencing with the large taxpayer directorate.

· We will decrease the number of large taxpayers under the supervision of the ***large taxpayer directorate***, to around 2000 starting with 2012.

· We have adopted a ***compliance risk strategy*** in accordance with best practices in September. As a first step, we have already established a department in charge of risk assessment and work is under way to collect information for risk analysis purposes. A risk analysis procedure has been adopted in September, and selection of individual taxpayers for auditing will be based on this procedure.

· We are planning expansion of ***e-filing*** and further simplification of tax forms and the number of payments required with a view to providing a ***one-stop shop*** for tax declaration and payments. Between January and September 2011, 40 percent of all tax returns filed to ANAF were using e-filing facilities.

· We will also review ***VAT refund processes*** to streamline the timeframe for issuance and address difficulties from the expiration of the temporary reverse VAT scheme. Recently, the large taxpayers directorate abandoned its practice of requesting supplementary documents to examine VAT refund requests.

· To reduce ***tax arrears,*** which have increased sharply with the economic crisis, a new scheme for agreed installment arrangements was approved in March. In October, we introduced another scheme allowing penalties to be partially or fully cleared for arrears prior to August 2011. We will consider other options if the situation does not improve materially in the next months.

Financial Sector

14. The tensions in euro area sovereign debt markets weighed upon the economic and financial market conditions in Romania during the third quarter. The Romanian banking sector as a whole recorded a loss in the quarter, due to rising provisions. Non-performing loans ratio (loans that are past due over 90 days and/or for which legal proceedings have been initiated) rose to 14.2 percent in September. Lending aggregates are picking up, with an increase in corporate lending more than offsetting a slight decline in household lending, but credit growth remains weak in real terms. The banking system remains well-capitalized, with an average capital adequacy ratio of 13.4 percent and a tier one capital ratio of 12.9 percent at end-September.

15. The final amendments to bank resolution legislation to introduce bridge bank powers are due to be completed by end-November. In light of the adverse developments in the external environment, we will take further steps to buttress the operational preparedness and strengthen the institutional underpinnings of the financial safety net by the end of the year. Specifically: (i) the Deposit Guarantee Fund (DGF) will join the National Committee for Financial Stability as a full member; (ii) the NBR and the DGF will sign a memorandum of understanding, which includes the appropriate procedures to enhance information sharing, warrant the early identification of problematic credit institutions and prepare contingency plans to deal with such institutions; (iii) under the guidance of the supervision department, the NBR will set up a joint working group of the NBR and DGF aiming at, *inter alia*, preparing contingency plans, finalizing intra- and inter-institutional operational procedures and undertaking practice runs and simulations. This working group will be given adequate expertise and resources to meet these objectives on a priority basis. The additional funding needed to fulfill the DGF's obligations (including for bridge banks and purchase and assumption transactions) will be available within five working days from the MOPF on the ("cost recovery") terms and conditions agreed by the MOPF and will no longer be capped by the balance in the privatization account, and legislative amendments will allow for it to be financed via the MOPF's treasury operations.

16. In meeting our commitment to introduce International Financial Reporting Standards (IFRS) for the banking sector at the beginning of 2012, the NBR will ensure that, if prudential provisions exceed IFRS provisions, the calibration of prudential filters for provisions and solvency will substantively preserve the current approach, and not result in a reduction in banks' solvency ratios compared to the present provisioning regime. The NBR will urgently complete consultations with the banking community to reach a common agreement on the calibration issues by end-November 2011. Net amounts arising at the start of 2012 from the release of provisions due to the new accounting treatment and which are treated as retained earnings from specific provisions to support regulatory capital will not be taxed as long as they remain in the corresponding retained earnings account. On an ongoing basis, the authorities will ensure that the IFRS provisions, and any additional prudential filters applied by the NBR, are tax deductible when they are made and taxable when they are released. To maintain its current capacity to effectively supervise the banking sector, the NBR will strengthen its expertise on IFRS, including via consultations with international experts.

17. The NBR will closely monitor the impact of the recent regulations on foreign currency lending to households and recalibrate the limits as necessary going forward to ensure that foreign currency lending to households, including for mortgages, remains prudently priced to reflect the risks to households. As preserving credit discipline and avoiding moral hazard among debtors contributes significantly towards enhancing financial stability, we will continue to refrain from adopting legislative initiatives (such as the personal insolvency law or proposals on the debt collecting law), which would undermine credit discipline. The NBR will ensure that any future consolidation process in the banking sector would lead to the emergence of well-capitalized credit institutions backed by a strong private shareholder base. We will amend the legislation on the bankruptcy of insurance undertakings, which will be enacted by end-April 2012.

Monetary Policy

18. Headline inflation has dropped more than previously forecasted since July, on the back of food price deflation and the disappearance of the first-round effect of VAT hike. The NBR is now seen to meet its 2011 inflation target, as we now expect inflation to continue declining to around 3.3 percent by the end of the year. Barring significant supply shocks and exchange rate depreciation, 2012 inflation is also likely to be within the central bank's target band. However, risks to inflation remain, particularly from additional needed adjustments in administered prices and a rebound in wage cost dynamics. These pressures, together with the ongoing instability in international financial markets and the attendant risk of exchange rate pressures and volatile capital flows, mean that a continued prudent monetary policy stance is required. We will maintain banks' reserve requirements ratios unchanged in the coming months and will act judiciously on the monetary policy rate.

Structural Reforms

Regulatory and Strategic Reforms in Transport and Energy

19. We remain convinced that comprehensive reforms in the energy and transport sectors are crucial for improving public sector efficiency, enhancing medium-term growth prospects, and increasing the absorption of EU structural funds. In the transport sector, in the coming months we will develop a new general transport strategy and master plan for Romania, balancing the increasing demand, ensuring the complementarities between the different transport modes in an efficient way, and the available fiscal means while defining priorities for medium- and long-term investment. We continue to implement measures to cut expenditures and raise revenues, in line with those specified in our letters of June 9 and September 14, 2011. Renegotiations of existing contracts and applying standard costs will substantially reduce costs in the road, urban transport, and rail industries. We have been able to reduce arrears of the passenger and infrastructure rail companies via specific schemes and are considering additional steps, conditional on the post-reform financial viability of these firms and EU regulations on state aid. In order to bring the rail sector closer to economic viability, we will continue the process of closing 1000 underutilized line kilometers. In addition, we will tender out the remaining 1600 line kilometers agreed and, in case the tendering fails, close them. Finally, we will develop by end-March 2012 ways to improve revenue generation and management of the real estate of the various transport sector SOEs, possibly through the establishment of a special real estate company.

20. For the energy sector we envisage major reforms. We have changed our national energy strategy with a view to attract more private capital and allowing for more transparent, flexible, and

competitive energy production and supply. To enhance the pricing and regulatory framework we will undertake the following steps:[27]

- The government will approve and submit legislation to Parliament by mid-December ensuring a complete transposition of the 3rd Energy Package as agreed with the EC, including the functional and financial independence of the energy regulator (ANRE), an appropriate unbundling regime, and the definition of vulnerable consumers.

- We will approve by end-January 2012, a government memorandum (after agreement with the IMF and EC), a roadmap for phasing out regulated prices in gas and electricity specifying the timetable and intermediary steps, as defined in the EU Supplemental Memorandum of Understanding. We will also submit to Parliament the corresponding legislation by the same date. In order to ensure the good functioning of the price deregulation process, we will remove all legal, regulatory and physical barriers to cross-border trade of electricity and gas. We will also ensure that competition on energy markets is maintained, in particular in the gas market.

- We have already undertaken action to ensure that existing bilateral energy contracts of SOEs are not extended and that their prices are adjusted to prevailing market prices as quickly as legally permissible and that new bilateral contracts are made transparently and non-discriminately through OPCOM (electricity) and other competitive procedures, including the possibility to develop a platform of exchange (gas) and are published.

- To better align the CUG with actual costs, we will issue a decision to increase the CUG for non-households by another 5 percent as of January 1, 2012 (prior action).

State-Owned Enterprises

21. We maintain our ambitions reform agenda for SOEs, though additional action is needed to realize it. Our efforts contributed to achieving the third quarter indicative targets on the operating balance and arrears in key companies. We have also enhanced our monitoring of central government SOEs and made progress with a similar database for local SOEs. Restructuring of central government SOEs is advancing. Restructuring plans of all 154 companies specified in the LOI of June have been finalized. The process of implementing and sharpening these plans has started. For remaining central government SOEs in our database, we will develop plans by end-December 2011 in line with guidance given by staff concerning aim and content of these plans.

22. Our privatization efforts have not progressed as quickly as we had anticipated, but we remain committed to offering minority and majority stakes in a series of companies over the coming months. The structural benchmark on the appointment of privatization advisors was not met, but we intend to rectify this by the time of the IMF Board meeting (prior action). Privatization of these companies will be done in a market-friendly process and we will consult closely with IMF and EC staff. The transaction consultants will have the task of drafting evaluation reports, and recommending and justifying the offer price of the shares in view of a successful closing transaction. Our planned privatization actions are as follows:

- The first group of companies to be offered by end-April 2012 includes: i) Oltchim (sale of remaining public shares to strategic investor), ii) Tarom (IPO of 20 percent), iii) Transelectrica (SPO of a 15 percent stake plus a later capital increase of about 12 percent), iv) Transgaz (SPO of a 15 percent stake); and v) Posta Romana (minority stake). In addition,

[27] If EU infringement procedures require faster action, we will comply with their requirements.

the copper mining company, Cuprumin, will be privatized by mid-February and the IPO of a 15 percent stake in Romgaz will be undertaken by end-June.

- The second group of companies includes i) Hidroelectrica (IPO of 10 percent to increase capital) and ii) Petrom (SPO of 9.84 percent stake will be re-launched), iii) CFR Marfă (majority privatization, possibly with the support of the EBRD and IFC). Appointment of transaction advisors for this group will be completed by mid-February 2012 (structural benchmark).

- The third group comprises i) Electrica Serv (majority privatization of all regional companies currently under creation); ii) Nuclearelectrica (at least 10 percent via capital increase); iii) S.C. Electrica Furnizare S.A. (including the supply activity transferred from SC Electrica SA, majority privatization); iv) the three remaining Electrica distribution subsidiaries (minority privatization). Appointment of legal advisors for this group will be concluded by mid-February (structural benchmark).

- Appointment of legal advisors will be concluded by end-June for (i) the new energy producer Hunedoara to be created by merging the power plants in Paroşeni and Mintia and purchasing the four viable mines of CNH (majority privatization); and (ii) the new energy producer to be created by merging SNLO and the three energy complexes in Craiova, Rovinari and Turceni; and (iii) ElCen Bucuresti (majority privatization).

23. In addition to the privatizations, we continue preparations to resolve the financial situation of Termoelectrica. By end-2011, valuable assets will either be extracted via forced execution by ANAF or be sold. The remaining part of the company will be placed into voluntary liquidation proceeding also by end-2011.

24. A general corporate governance reform has been prepared, which requires regular independent external audits, quarterly publication of financial data, reinforcement of OECD principles on corporate governance and strengthening the rights of minority shareholders. We have approved the legislation in November 2011, somewhat later than originally envisaged in the structural benchmark in order to allow for full public comment. For SOEs, a clearer distinction between the role of line ministries and management is included in this law, along with requirements on the appropriate qualification of management and board members. A government ordinance has been approved to move the financial control of SOEs from line ministries to the MOPF, including enhanced reporting mechanisms. Private management experience will be brought into the largest SOEs that remain under majority government ownership, in line with the criteria described in the letter of intent of September 2011. This management search will begin in November and private management teams will be selected by end-January 2012 to take office as soon as legally possible thereafter. In cases where significant minority stakes are to be sold, this timetable may be adjusted to allow for participation of the new minority shareholders. Based on the experience of this exercise, we are firmly committed to increasing the number of SOEs with private management in the course of 2012.

Other Structural Reforms

25. We are continuing with labor market reforms and the newly implemented legislation has shown positive impact. After the new Labor Code entered into force on April 30, along with economy recovery, more than one million new contracts have been signed, with 33 percent being fixed-term contracts. We will continue to monitor closely implementation of the new Labor Code and its effects on labor market outcomes. The implementation of the Social Dialogue Code stalled due to prolongation of the consultation process with social partners on sector definition in a collective bargaining. We will facilitate the tripartite consultation to reach an agreement and also ensure the

new legislation observes EU directives and core ILO conventions. The Social Assistance Law, which aims to streamline social benefits and improve the efficiency of social protection, was approved by the Parliament. This will be followed by significant changes in secondary legislation. The overall measures on social assistance reforms will result in fiscal savings of around 0.8 percent of GDP in 2010–13.

26. We are committed to improving entry into retail markets to maintain a competitive environment, encourage innovation, and increase efficiency. In this regard we will eliminate by end-January 2012 undue barriers for opening large surface retail stores. We will undertake a Report on Observance of Standards and Codes (ROSC) on corporate insolvency systems and creditor rights in early 2012.

27. Measures to reform the judiciary are underway, with a view to make it more effective, unifying the jurisprudence, and fighting against corruption, which will provide for a transparent business environment and boost the economic performance. One of the top ranking objectives of the Government related to the reform of the judiciary is the successful implementation of the new fundamental legal codes for Romania: the civil code, the criminal code, the civil procedure code and the criminal procedure code. The civil code went into effect on October 1, 2011, and the government put in place measures to support its smooth implementation. In addition, the Ministry of Justice is supporting the transition to the new legal framework. Measures to implement the other three new codes, and any additional measures needed for the new civil code, will be identified by the impact studies currently underway. We will also undertake reforms in the agricultural sector—including by speeding up the surveying and registration of agricultural land—to improve food security and increase export prospects.

Table 1. Romania: Quantitative Program Targets

	2010	2011					2012			
	Dec	March	June	Sept		Dec	March	June	Sept	Dec
	Actual	Actual	Actual	Prog.	Prelim.	Prog.	Prog.	Indicative	Indicative	Indicative
I. Quantitative Performance Criteria										
1. Floor on the change in net foreign assets (mln euros) 1/ 2/	20,026	119	1896	-150	292.8	500	0	250	250	250
2. Floor on general government overall balance (mln lei) 3/	-33,621	-5,254	-11260	-17,500	-13,685	-23,953	-3,100	-6800	-8500	-12210
3. Ceiling on stock of central government and social security arrears (bn lei)	0.19	0.13	0.11	0.15	0.10	0.10	0.08	0.07	0.06	0.05
4. Ceiling on general government guarantees issued since end-2008 (face value, bn lei)	7.6	8.1	6.0	14.0	5.8	14.0	14.0	14.0	14.0	14.0
II. Continuous Performance Criterion										
5. Nonaccumulation of external debt arrears	0	0	0	0	0	0	0	0	0	0
III. Inflation Consultation										
6. 12-month rate of inflation in consumer prices										
Outer band (upper limit)	…	…	…	6.2	…	5.7	4.1	4.4	5.9	5.2
Inner band (upper limit)	…	…	…	5.2	…	4.7	3.1	3.4	4.9	4.2
Actual/*Center point*	7.9	8.0	8.0	*4.2*	3.5	*3.7*	*2.1*	*2.4*	*3.9*	*3.2*
Inner band (lower limit)	…	…	…	3.2	…	2.7	1.1	1.4	2.9	2.2
Outer band (lower limit)	…	…	…	2.2	…	1.7	0.1	0.4	1.9	1.2
IV. Indicative Target										
7. Ceiling on general government current primary spending (excl. EU funds and social assistance, mln lei)	131,938	30,670	62,578	96,350	94,133	130,700	31,600	63,400	93,900	128,300
8. Floor on operating balance (earnings before interest and tax, net of subsidies) of key SOEs. 4/ (as defined in TMU (bn. lei))	-6.8	-0.7	-1.8	-3.6	-2.4	-4.0	-1.5	-2.2	-2.7	-3.2
9. Ceiling on stock of arrears of key SOEs (as defined in TMU (bn. lei)) 4/	17.9	19.2	19.7	19.2	18.5	15.9	17.0	15.0	10.0	5.0
10. Ceiling on stock of local government arrears (bn lei)	0.91	0.82	0.81	0.85	0.82	0.80	0.70	0.60	0.50	0.40
11. Ceiling on the execution of the PNDI program (mln, lei) 5/	…	…	…	…	…	…	200	400	700	1000

1/ The end-December 2010 figure is a stock.

2/ Cumulative flows relative to previous year end stock. 2011 September target is adjusted down from 250 million to -150 million due to the delayed disbursement of 400 million from World Bank.

3/ Cumulative figure during calendar year (e.g. March 2011 figure is cumulative from January 1, 2011).

4/ Adjusted indicative targets for end-September and end-December.

5/ Cumulative figure during calendar year (e.g. March 2012 figure is cumulative from January 1, 2012).

Table 2. Romania: Performance for Third Review

Measure	Target Date	Comment
Prior Action		
1. Appoint legal advisor for Hidroelectrica, transaction advisor for Oltchim, Transelectrica, and publish tender for transaction advisor for Romgaz, Tarom and Transgaz.		
2. Enact the copayment law and the revised clawback tax law.		
3. Increase gas price for non-resident consumers, in order to further align with CUG formula, by 5 percent.		
Quantitative performance criteria		
1. Floor on net foreign assets	Sept. 30, 2011	Met
2. Floor on general government overall balance	Sept. 30, 2011	Met
3. Ceiling on central government and social security domestic arrears	Sept. 30, 2011	Met
4. Ceiling on general government guarantees	Sept. 30, 2011	Met
5. Non-accumulation of external debt arrears	Sept. 30, 2011	Met
Quantitative Indicative Target		
1. Ceiling on general government current primary spending	Sept. 30, 2011	Met
2. Floor on operating balance of key SOEs	Sept. 30, 2011	Met
3. Ceiling on stock of arrears of key SOEs	Sept. 30, 2011	Met
4. Ceiling on stock of local government arrears	Sept. 30, 2011	Met
Inflation consultation band		
Inner band	Sept. 30, 2011	Met
Outer band	Sept. 30, 2011	Met
Structural benchmarks		
1. Undertake SOE reforms, including (i) Appointment of legal advisors for privatization of CFR Marfa, TAROM, Transelectrica, Transgaz, and Romgaz; (ii) Preparation of action plans for the remaining SOEs of the central government; (iii) Design mechanisms to facilitate restructuring and securitizing SOE arrears.	July 15, 2011	Partially met / partially reset as prior action
2. Completion of a comprehensive review of the existing investment portfolio, which will prioritize and evaluate existing projects to focus on those where funding can be fully secured, examine the viability of old projects, with low priority and unviable ones discontinued, and production of a final report and an action plan.	Sept. 30, 2011	Partially Met
3. Amend legislation to allow the use of the deposit guarantee fund resources to facilitate bank restructuring, including purchase and assumption transactions.	Sept. 30, 2011	Met
4. Selection of advisors for SOE reform: (i) select transaction advisors for group 1 and (ii) legal advisors for group 2	Oct. 31, 2011	Partially met/ partially reset as prior action
5. Approve legislation to improve governance of SOEs.	Oct. 31, 2011	Met
6. Impose a revised clawback tax on the pharmaceuticals based on the growth in their costs or above a pre-determined threshold.	Nov. 30, 2011	Reset as prior action
7. Introduction of a simplified taxation system for smaller taxpayers under the threshold with help from the IMF and EC, while requesting a shift in the VAT mandatory threshold from the EU Council of Ministers to €50,000.	Dec. 31, 2011	Modified
8. Prepare comprehensive amendments to the health care legislation to address the persistent budgetary shortfalls and to ensure high quality health care services.	Dec. 31, 2011	
New Structural Benchmarks		
1. Design measures to reduce registration of small VAT payers by 20 percent by end-September 2012(compared to end-September 2011).	Dec. 31, 2011	
2. Appoint transaction advisor for group 2 and legal advisor for group 3 as specified in MEFP.	Feb. 15, 2012	

Romania: Technical Memorandum of Understanding (TMU)

December 2, 2011

1. This Technical Memorandum of Understanding (TMU) defines the variables included in the quantitative performance criteria and indicative targets set out in the Memorandum of Economic and Financial Policies (MEFP), the key assumptions, the methods to be applied in assessing program performance, and the reporting requirements to ensure adequate monitoring of economic and financial developments. The quantitative performance criteria and indicative targets, and structural benchmarks for 2011 and 2012 are listed in Tables 1 and 2 of the MEFP, respectively.

2. For the purposes of the program, *the exchange rates* of the Romanian Leu (RON) to the euro is set at RON 4.2848 = €1, to the U.S. dollar at RON 3.2045 = $1, to the Japanese yen at RON 3.9400 = ¥100, and to the pound sterling at RON 4.9673 = ₤1, the rates as shown on the National Bank of Romania's (NBR's) website as of December 31, 2010. The exchange rates to other currencies, where applicable, will also be the ones shown on the NBR's website as of December 31, 2010.

3. For the purposes of the program, the *general government* includes the entities *as defined in the 2011 and 2012 budgets*. These are: the central government (state budget, treasury, self-financed state entities included in the budget, etc.), local governments, social security funds (pension, health, and unemployment), road fund company, and administration of the property fund. This definition of general government also includes any new funds, or other special budgetary and extra budgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's *Manual on Government Finance Statistics 2001*. The authorities will inform IMF staff of the creation of any such new funds or programs immediately. As mentioned in the MEFP (¶3) and ¶11 below, this definition will be expanded to cover state-owned enterprises incorporated into the general government accounts under ESA95, upon completion of the review being undertaken by Eurostat.

QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE TARGETS, INFLATION CONSULTATION BAND, AND CONTINUOUS PERFORMANCE CRITERIA

A. Floor on the Change in Net Foreign Assets

4. For program purposes, Net Foreign Assets (NFA) are defined as the NFA of the NBR minus Treasury liabilities to the International Monetary Fund.

5. NFA of the NBR are defined as the euro value of gross foreign assets of the NBR (including reserve requirements of the commercial banking system held at the NBR) minus gross foreign liabilities of the NBR; and will be measured on the basis of the NBR's operational rather than accounting definitions. Non-euro denominated foreign assets and liabilities will be converted into euro at the program exchange rates.

6. Gross foreign assets of the NBR are defined to include the NBR's holdings of SDRs, the country's reserve position at the IMF, holdings of cash, securities and deposits abroad in convertible foreign currencies. Excluded from reserve assets are: (i) gold and other precious metals; (ii) assets in nonconvertible currencies; (iii) illiquid assets; (iv) any assets that are pledged, collateralized, or otherwise encumbered, unless there is also a gross foreign liability associated with it; (v) claims on residents; and (vi) claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).

7. Gross foreign liabilities of the NBR are defined as all foreign exchange liabilities to residents and nonresidents, including commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options), and all credit outstanding from the IMF, but excluding (i) banks' foreign currency deposits against reserve requirements; and (ii) government foreign currency deposits at the NBR. This definition is meant to bring the concept of foreign liabilities closer to the balance of payment definition, on which the targets are based.

Floor on cumulative change in NFA from the beginning of 2011 and 2012 (in mln. euros)[1]

	2010	2011				2012			
	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
	Stock	Actual	actual	actual	PC	PC	indicat.	indicat.	indicat.
Cumulative change in NFA	20,026	119[2]	1,896	293	500	0	250	250	250
Memorandum Item: Gross Foreign Assets	32,432	996	2,793	1206	1000	0	250	-350	-1250

[1]PC = performance criterion; data for end-month. Flows are cumulative from the beginning of the same calendar year (e.g., March 2012 figure is cumulative from January 1, 2012). Current year stocks are obtained by adding the flows to the previous end-year stock.

[2] PC met with an adjustment for the WB disbursement of €300 million.

8. The NFA target for December 31, 2011 and March 31, 2012, will be adjusted upward (downward) by the full amount of the surplus (shortfall) relative to the baseline of external bond placement by the Ministry of Public Finance (MOPF). NFA targets will also be adjusted (i) upward (downward) by the surplus (shortfall) in program disbursements relative to the baseline projection (Program disbursements are defined as external disbursements from official creditors (WB and the EC) that are usable for the financing of the overall central government budget) and (ii) upward by the increase in commercial bank reserve requirements held with the NBR relative to end-December 2010 (€6,797 million), measured at program exchange rates.

External program and MOPF disbursements–Baseline projections (in mln. euros)

	2011				2012			
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Cumulative flows from end of 2010 under external program	1,200	1,650	2,050	2,050	2,050	2,050	2,050	2,050
Flows of external MOPF bond placement				1,000	0	-	-	-

B. Consultation Mechanism on the 12-month Rate of Inflation

9. The quarterly consultation bands for the 12-month rate of inflation in consumer prices (as measured by the headline consumer price index (CPI) published by the Romanian Statistical Institute), are specified below. Should the observed year-on-year rate of CPI inflation fall outside the outer bands specified below, the authorities will complete a consultation with the IMF on their proposed policy response before requesting further purchases under the program. In addition, the NBR will conduct discussions with IMF staff should the observed year-on-year rate of CPI inflation fall outside the inner bands specified for the end of each quarter in the table below.

Inflation consultation band

	2010	2011				2012			
	Dec. actual	Mar. actual	Jun. Actual	Sep. actual	Dec. target	Mar. target	Jun. indicat.	Sep. indicat.	Dec. indicat.
Outer band (upper limit)					5.7	4.1	4.4	5.9	5.2
Inner band (upper limit)					4.7	3.1	3.4	4.9	4.2
Actual / *Center point*	7.9	8.0	8.0	3.5	*3.7*	*2.1*	*2.4*	*3.9*	*3.2*
Inner band (lower limit)					2.7	1.1	1.4	2.9	2.2
Outer band (lower limit)					1.7	0.1	0.4	1.9	1.2

C. Performance Criterion on General Government Balance

10. The budget deficit will be monitored quarterly through the cash balance of the general government in GFS 1986 classification. The authorities will consult with IMF staff on corrective measures in the event of shortfalls in government revenue and financing.

Cumulative floor on general government balance[1]

	(In millions of lei)
End-December 2010 (actual)	-33,621
End-March 2011 (actual)	-5,254
End-June 2011 (actual)	-11,260
End-September 2011 (actual)	-13,685
End-December 2011 (performance criterion)	-23,953
End-March 2012 (performance criterion)	-3,100
End-June 2012 (indicative)	-6,800
End-September 2012 (indicative)	-8,500
End-December 2012 (indicative)	-12,210

[1] Cumulative figure during calendar year (e.g., March 2012 figure is cumulative from January 1, 2012).

11. Starting from end-March 2012 performance criterion, the budget deficit will be measured from above the line using the budget execution data. Expenditure will include the value of the works executed under the contracts from the National Program for Infrastructure Development (PNDI).

12. Once the reporting system for state-owned enterprises (SOEs) is fully functional, the budget deficit target will be modified to be in line with the expanded definition of the general government, which will include the following SOEs: C.N. de Autostrãzi si Drumuri Nationale din România SA, Fondul Proprietatea SA, Metrorex SA, Administratia Fluviala Dunarea de Jos, CFR Calatori, CN Huila Petrosani SA, SN a Carbunelui SA, CN Radiocomunicatii Constanta, SC Interventii Feroviare, CFR Infrastructura, Termoelectrica, Societatea Nationala "Aeroportul International Mihail Kogalniceanu", SC Electrificarea SA, CN Administratia Canalelor Navigabile Constanța SA , SC CN Romarm SA Buc Filiala SC Uzina Mecanica Cugir SA, SC Santierul Naval Mangalia SA, Societatea Feroviara de Turism SFT CFR, SC Uzina Mecanica Orastie, Societatea de Transport Maritim si de Coasta CFR Ferryboat SA, SC Avioane Craiova SA, SC Petromin SA, SC Constructii Aeronautice SA, SC Sanevit 2003 SA, SC Uzina AutoMecanica SA Moreni, SC Terom SA, SN Plafar SA, and SC Nicolina SA.

13. The Ministry of Public Finance (MOPF) will also provide monthly data to measure the deficit from below the line. The balance of the general government measured from below the line will include:

+ (i) net external financing, excluding valuation gains and losses;

+ (ii) change in net domestic credit from the financial system, excluding valuation gains and losses from deposits denominated in foreign currency and including adjustments for:

  + (a) received EU funds not yet spent (advance payments);

  + (b) claims of the government on EU funds;

  + (c) property fund obligations not yet paid;

+ (iii) change in the stock of issued government securities, net of valuation changes;

+ (iv) net changes in other financing.

14. If the difference between the general government deficit measured from above the line and from below the line is larger than lei 200 million each quarter during 2011 and 2012, the MOPF will consult with IMF staff.

15. The performance criterion for the general government balance for end-March 2012 (measured on a cumulative basis from the beginning of the year) will be adjusted downward by the amount that capital spending (including spending related to EU funds and arrears reduction plans, but excluding the works executed under the contracts from the PNDI) exceeds lei 6,970 million up to a limit of lei 1,400 million.

D. Performance Criterion Limiting the Issuance of Government Guarantees to the Non-Financial Private Sector and Public Enterprises

16. The issuance of general government guarantees to the non-financial private sector and public enterprises will be limited during the program period. This ceiling is set at RON 14 billion but may be adjusted upward by up to RON 9.6 billion for guarantees for financing the Nabucco project. Revision to targets will be renegotiated during future missions to allow for reasonable public guarantees in the context of privatization of majority stakes in state-owned enterprises and securitization of domestic payment arrears.

Ceiling on new general government guarantees issued from end-2008 until:	(In billions of lei)
End-December 2010 (actual)	7.6
End-March 2011 (actual)	8.1
End-June 2011 (actual)	6.0
End-September 2011 (actual)	5.8
End-December 2011 (performance criterion)	14.0
End-March 2012 (performance criterion)	14.0
End-June 2012 (indicative)	14.0
End-September 2012 (indicative)	14.0
End-December 2012 (indicative)	14.0

E. Performance Criterion on the Stock of Domestic Arrears by the Central Government and Social Security System

17. The performance criterion established on the stock in domestic payments arrears of the central government and social security sector (as defined in ¶3 above) contemplates their elimination during the program period. The stock will be measured net of intergovernmental arrears, but both gross and net arrears will be reported by the government. In case of need, the government will take corrective measures to prevent the accumulation of new spending arrears. For the purpose of the program, arrears mean accounts payable past due date by 90 days (in line with ESA95 definitions for expenditures).

Stock of central government and social security arrears	(In billions of lei)
End-December 2010 (actual)	0.19
End-March 2011 (actual)	0.15
End-June 2011 (actual)	0.11
End-September 2011 (actual)	0.10
End-December 2011 (performance criterion)	0.10
End-March 2012 (performance criterion)	0.08
End-June 2012 (indicative)	0.07
End-September 2012 (indicative)	0.06
End-December 2012 (indicative)	0.05

F. Continuous Performance Criteria on Non-Accumulation of External Payments Arrears by the General Government

18. The general government will not accumulate external payment arrears during the program period. For the purposes of this performance criterion, an external payment arrear will be defined as a payment by the general government that has not been made within seven days of falling due. The performance criterion will apply on a continuous basis.

G. Indicative Target on General Government Current Primary Spending

19. The indicative target on current primary expenditure of the general government is defined as spending on personnel, goods and services excluding EU funds (specified under external grant category), subsidies, transfers to public entities, pensions (social security budget in social assistance category), state aid and other spending in other transfers category, Reserve Fund, and other expenditure as classified in the monthly reporting tables. Actual data (to which the target will be compared) should include payments related to arrears reduction plans.

Cumulative change in general government current primary expenditures[1]	(In millions of lei)
End-December 2010 (actual)	131,938
End-March 2011 (actual)	30,670
End-June 2011 (actual)	62,578
End-September 2011 (actual)	94,133
End-December 2011 (indicative)	130,700
End-March 2012 (indicative)	31,600
End-June 2012 (indicative)	63,400
End-September 2012 (indicative)	93,900
End-December 2012 (indicative)	128,300

[1] Cumulative figure during calendar year (e.g., March 2012 figure is cumulative from January 1, 2012).

H. Indicative Target on the Execution of the PNDI Program

20. An indicative target on the ceiling is set for the execution of the PNDI program.

Ceiling for the execution of the PNDI Program	(In million of lei)
End-March 2012 (indicative)	200
End-June 2012 (indicative)	400
End-September 2012 (indicative)	700
End-December 2012 (indicative)	1,000

[1] Cumulative figure during calendar year (e.g., March 2012 figure is cumulative from January 1, 2012).

I. Indicative Target on Local Government Arrears

21. The indicative target on the stock of domestic payments arrears of local governments contemplates no accumulation of new arrears and their reduction during the program period. In case of need, the government will take corrective measures to prevent the accumulation of new spending arrears. For the purpose of the program, arrears mean accounts payable past the due date by 90 days (in line with ESA95 definitions for expenditures).

Stock in local government arrears	(In billions of lei)
End-December 2010 (actual)	0.91
End-March 2011 (actual)	0.82
End-June 2011 (actual)	0.81
End-September 2011 (actual)	0.82
End-December 2011 (indicative)	0.80
End-March 2012 (indicative)	0.70
End-June 2012 (indicative)	0.60
End-September 2012 (indicative)	0.50
End-December 2012 (indicative)	0.40

J. Monitoring of Public Enterprises

22. Public enterprises are defined as all companies, research institutes and *regii autonome* with a cumulative public capital share of 50 percent or more, held directly or indirectly by local governments and the central government.

23. A quarterly indicative target for 2011 is set on the aggregate operating balance (earnings before interest and tax) net of subsidies, accumulated per calendar year, of the following public enterprises: C.N. Căi Ferate CFR S.A., C.N. de Autostrãzi si Drumuri Nationale din România S.A., C.N. a Huilei S.A., C.N. Poşta Românã S.A., S.C. Complexul Energetic Turceni S.A., S.C. Filiala de Intretinere si Servicii Energetice “Electrica Serv” - S.A., S.C. Metrorex S.A., S.N. de Transport Feroviar de Marfã ”CFR Marfã” S.A., S.N. Transport Feroviar de Călători ”CFR Călători” S.A., C.N. Tarom S.A., S.C. Electrocentrale Bucuresti S.A., S.C. Electrica Furnizare Transilvania Nord S.A., S.C. Oltchim S.A., S.C. Termoelectrica S.A., SNa Lignitului Oltenia S.A., S.C. Electrificare

CFR S.A., S. C. Interventii Feroviare S.A., S. C. Telecomunicatii C.F.R. S.A. The data shall be reported with operating results by firm. The targets will be as follows:

Floor on cumulative operating balance[1 2]	(In billions of lei)
End-December 2010 (actual)	-6.8
End-March 2011 (actual)	-0.7
End-June 2011 (actual)	-1.8
End-September 2011 (preliminary)	-2.4
End-December 2011 (adjusted, indicative)	-4.0

[1] Cumulative figure during calendar year (e.g., March 2011 figure is cumulative from January 1, 2011).
[2] End September actual data and end-December target exclude operating balance of S.C. Electrica Furnizare Transilvania Nord S.A.

24. A quarterly indicative target for 2012 is set on the aggregate operating balance (earnings before interest and tax) net of subsidies, accumulated per calendar year, of the following public enterprises: C.N. de Autostrãzi si Drumuri Nationale din România S.A., S.C. Metrorex S.A., C.N. Căi Ferate CFR S.A. (including S. C. Interventii Feroviare S.A.), S.C. Electrificare CFR S.A., S. C. Telecomunicatii C.F.R. S.A., S.N. Transport Feroviar de Călători ”CFR Călători” S.A., S.N. de Transport Feroviar de Marfã ”CFR Marfă” S.A.,C.N. Tarom S.A., S.C. Oltchim S.A., C.N. a Huilei S.A., S.C. Termoelectrica S.A., S.C. Electrocentrale Deva S.A., S.C. Electrocentrale Paroseni S.A., S.C. Electrocentrale Galati S.A., S.C. Electrocentrale Bucuresti S.A., SNa Lignitului Oltenia S.A., S.C. Complexul Energetic Craiova S.A., S.C. Complexul Energetic Rovinari S.A., S.C. Complexul Energetic Turceni S.A., S.C. Hidroelectrica, S.C. Electrica S.A., C.N. Poşta Românã S.A. The data shall be reported with operating results by firm. The targets will be as follows:

Floor on cumulative operating balance[1]	(In billions of lei)
End-March 2012 (indicative)	-1.5
End-June 2012 (indicative)	-2.2
End-September 2012 (indicative)	-2.7
End-December 2012 (indicative)	-3.2

[1] Cumulative figure during calendar year (e.g., March 2012 figure is cumulative from January 1, 2012).

25. In case one of these firms is liquidated, or its majority share is privatized or merged with a company not listed above, the aggregate target listed above will be adjusted by the original operating balance target for this firm. If any of the companies listed above is split into a new company, both companies will remain under monitoring. If some of the above companies are merged, the newly created companies will remain under monitoring.

26. A quarterly indicative target for 2011 is set on the stock of arrears of the public enterprises listed in ¶23. The data shall be reported at the firm level. The targets will be as follows:

Ceiling on stock of arrears [1]	(In billions of lei)
End-December 2010 (actual)	17.9
End-March 2011 (actual)	19.2
End-June 2011 (actual)	19.7
End-September 2011 (adjusted, preliminary)	18.5
End-December 2011 (adjusted, indicative)	15.9

[1] End September actual data and end-December target exclude arrears of S.C. Electrica Furnizare Transilvania Nord S.A.

27. A quarterly indicative target for 2012 is set on the stock of arrears of the public enterprises listed in ¶24. The data shall be reported at the firm level. The targets will be as follows:

Ceiling on stock of arrears	(In billions of lei)
End-March 2012 (indicative)	17.0
End-June 2012 (indicative)	15.0
End-September 2012 (indicative)	10.0
End-December 2012 (indicative)	5.0

In case one of these firms is liquidated, its majority share is privatized or is merged with a company not listed above, the aggregate target listed above will be adjusted by the original arrears target for this firm. If any of the companies listed above is split into a new company, both companies will remain under monitoring. If some of the above companies are merged, the newly created companies will remain under monitoring.

K. Private Management for Key SOEs

28. Private management will be selected, in line with MEFP ¶24, at least for the following state-owned enterprises: i) C.N. Poşta Românã S.A., ii) C.N. Tarom S.A., iii) S.C. Electrificare CFR S.A., iv) SNa Lignitului Oltenia S.A., v) S.C. Electrica Furnizare S.A., vi) S.C. Hidroelectrica, vii) C.N. Romarm aparat central, and viii) S.C. Oltchim S.A..

29. In addition, private management is envisaged in the course of 2012 for the following additional companies: i) C.N. Căi Ferate CFR S.A., ii) S.N. Transport Feroviar de Călători "CFR Călători" S.A., iii) SN Nuclearelectrica, iv) S.N. Transgaz, v) CN Transelectrica, vi) S.N. Romgaz and vi) C.N. Adm. Port. Maritim Constanta S.A.

L. Reporting Requirements

30. Performance under the program will be monitored from data supplied to the IMF and EC by the NBR and the MOPF as outlined in the table below. The authorities will transmit promptly to IMF and EC staff any data revisions as well as other information necessary to monitor the arrangement with the IMF and EC.

Romania: Data Provision to the IMF and EC

Item	Periodicity
To be provided by the Ministry of Finance	
Preliminary monthly data on general government accounts, including public enterprises as defined by ESA95	Monthly, on the 25th day of the following month
Quarterly final data on project execution under the Program for National Infrastructure Development	Quarterly, on the 25th day past the test date
Quarterly final data on general government accounts, including public enterprises as defined by ESA95	Quarterly cash data, on the 35th day past the test date; Quarterly accrual data, on the 55th day past test date
The budget deficit of the general government using ESA95 definition	Quarterly, with a lag of three months
Preliminary data on below-the-line financing for the general government	Monthly, with a lag of no more than 35 days past the test date
Final quarterly data on below-the-line financing for the general government	Quarterly, no later than 45 days past the test date
Total accounts payable and arrears of the general government, including local governments	Preliminary monthly, within the next month. Quarterly, within 55 days
Stock of the central government external arrears	Daily, with a lag of not more than seven days
Public debt and new guarantees issued by the general government	Monthly, within one month
Preliminary monthly data on general government primary spending, net of EU disbursements	Preliminary monthly data within 25 days
Final quarterly data on general government primary spending, net of EU disbursements	Quarterly, within 35 days from the test date
Preliminary data on the operating balance, profits, stock of arrears, and personnel expenditures for each key public enterprise as defined in ¶22	Quarterly, within 30 days
Final data on the operating balance, profits, stock of arrears, and personnel expenditures for each key public enterprise as defined in ¶22	Quarterly, end May for the previous year and end-August for first half of the current year
Data on EU project grants (reimbursements and advances), capital expenditures and subsidies covered by EU advances or eligible for EU reimbursement on EU supported projects specifically agreed with the EU	Monthly, within three weeks of the end of each month

Item	Periodicity
The balance of the TSA in RON	Monthly, within two weeks of the end of each month
The balance of the two foreign currency accounts used for budget financing and public debt redemption purposes (average, and end-of-period)	Monthly, within two weeks of the end of each month
The balance of the privatization receipts registered in the account of the State Treasury, details on any claims on these receipts and projected net outflows.	Monthly, within two weeks of the end of each month
Reporting of progress in the implementation of the Romanian public administration's functional review	Quarterly, to be sent two weeks before each mission for each of the 12 ministries
To be provided by the National Bank of Romania	
NFA data, by components, in both program and actual exchange rates	Weekly, each Monday succeeding the reporting week and with a 3 working day lag in the case of end-quarter data
Monetary survey data in the format agreed with IMF and EC staff	Monthly, within 30 days of the end of the month
The schedule of contractual external payments of the *banking sector* falling due in the next four quarters, interest and amortization (for medium and long-term loans)	Monthly, 45 days after the end of each month
The schedule of contractual external payments of the *corporate sector* falling due in the next four quarters interest and amortization (for medium and long-term loans)	Monthly, 45 days after the end of each month
The stock of short-term external debt of banks and corporate	Monthly, 45 days after the end of each month
Balance of payments in the IMF format currently used to report	Monthly, 45 days after the end of each month
Exposure (deposits, loans, subordinated loans) of (i) foreign parent banks to their subsidiaries in Romania; (ii) IFI and (iii) other creditors to banks in Romania (by national and foreign currency).	Monthly, 20 days after the end of each month

Item	Periodicity
Financial soundness indicators[28]	Monthly, 15 days after the end of each month
Foreign currency reserves including information on FX market interventions and swaps by the NBR	Bi-weekly
The IMF and the EC shall be immediately informed in case of sudden loss of reserves exceeding EUR 600 million, or if the stock of foreign exchange reserves falls below the floor of EUR 23 billion	Immediately, upon occurrence

[28] Data on solvency should be provided on quarterly basis.

ANNEX

Measures to Improve Performance of SOEs under Monitoring

C.N. de Autostrãzi si Drumuri Nationale din România S.A.

- Ensure sufficient public support (via EU structural funds and national budget) for investments in road infrastructure needed in budget for 2012, by end-2011.
- Increase revenues by extending information system for the toll system; contract for installation of 63 new fixed control points will be signed by end-2011.
- Finalize customization of internal management control standards by end-March 2012.
- Reduce costs by applying standard costs both for existing contracts, through a renegotiation process, and for new contracts.

S.N. de Transport Feroviar de Marfă "CFR Marfă" S.A.

- Amend the company's budget by end-November 2011, as the originally included capital increase is not included in the government's budget revision.
- Negotiate with the Ministry of Public Finance, Ministry of Internal Affairs and Ministry of Economy possibilities of arrears cancellation schemes by end-2011.
- Appoint the investment bank / SSIF (Financial Investments Services Company) which will also provide the legal advice for privatization for majority privatization to strategic investor by end-January 2012.
- Merger of the maintenance companies of Marfa and Calatori (Societatea Comercială Întreţinere şi Reparaţii Locomotive şi Utilaje "C.F.R. IRLU"-S.A and Societatea comerciala de reparaţii locomotive C.F.R. SCRL Braşov S.A.), to be directly owned by Ministry of Transport and Infrastructure, by end-June 2012.
- Publish prospectus by mid-June 2012.
- Conclude privatization by end-October 2012.
- Continuous reinforcement of efforts to collect outstanding invoices, including by giving notice on contracts and taking legal measures against companies with substantial arrears.
- Reduce costs by applying standard costs both for existing contracts, through a renegotiation process, and for new contracts.

S.N. Transport Feroviar de Călători "CFR Călători" S.A.

- Approve remaining standard costs for maintaining rolling stock by end-November 2011, to be required on all new contracts.
- Allocate in investment budget for 2012 amount needed to start replacing the old rolling stock with diesel railcars and electric multiple units, by end-2011.
- Develop assessment of viability of lines and develop plan for suspension of services by end-January 2012.
- Scrap 240 depreciated cars by end-June 2012.
- Merger of the maintenance companies of Marfa and Calatori (Societatea Comercială Întreţinere şi Reparaţii Locomotive şi Utilaje "C.F.R. IRLU"-S.A and Societatea comerciala de reparaţii locomotive C.F.R. SCRL Braşov S.A.), to be directly owned by Ministry of Transport and Infrastructure, by end-June 2012.
- Appoint private management and board members in the course of 2012, if experience with private management in SOEs is positive.

C.N. Căi Ferate CFR S.A.

- Sign consultancy contract by end-November 2011 for analysis of rail system and develop strategy for sustainability by end-January 2012.
- Revise PSO contract in February 2012 in line with findings of study, aiming at a substantial reduction of lines under management of CFR towards 10,000 over the coming years, while preserving and enhancing the actual and future TEN-T network, and including a corresponding personnel reduction while preserving the necessary personnel in charge with the implementation of structural funds.
- Assuming a corresponding agreement concerning the payment of electricity related receivables from CFR Infrastructure, issue a corresponding legal act to wave penalties for receivables of S.C. Electrica S.A. by end-2011.
- Ensure sufficient public support (via EU structural funds and national budget) for investments in rail infrastructure needed in budget for 2012, by end-2011.
- Develop plan how to increase revenues from renting out and better administrating commercial space, including potential public-public partnerships, by mid-January 2012.
- Use expected government capital increase to repay arrears to the central budget and social security contributions, including those to be taken over from CFR Electrificare, by end-2011.
- Use excess budgetary means in 2011 and / or a credit guaranteed by the state to reduce arrears to electricity suppliers by end-March 2012, strictly conditioned on reform measures.
- Develop by end-March 2012 ways to improve management of the real estate of the various transport sector SOEs, possibly through the establishment of a special real estate company.
- Continue tendering process for public service obligations and infrastructure maintenance for 1600 line kilometers of extended railway, bringing the total number of line kilometers under private management to 4000 kilometers. Close all lines for which tenders failed by end-April 2012, bringing network under management of CFR down to 15.500 line kilometers.
- In light of the reduction of lines to be maintained and technology modernization, reduce personnel by 2000 (compared with end-September 2011) while not reducing personnel managing structural funds, by end-April 2012.
- Continue insolvency procedure for the Tipografia subsidiary; if liquidation can be avoided, the process to full privatization of the company will be started immediately.
- Appoint private management and board members in the course of 2012, if experience with private management in SOEs is positive.
- Present a short report on which measures have been implemented during last month, key findings of the various studies and which new measures are envisaged, during first week of every month.

S.C. Interventii Feroviare S.A.

- Complete integration into mother company by end-2011.
- Reduce personnel by 28 positions until end-2011.
- Enforce 4 days leave without pay for remaining personnel by end-2012.

S.C. Electrificare CFR S.A.

- Arrears to the state budget will be taken over by the mother company C.N. Căi Ferate CFR S.A. together with ANAF by end-2011.
- Appoint private management and board members by early-2012.

- Continue the restructuring and modernization program, including a further reduction of 85 positions by end-2012 (compared with September 1, 2011).
- Ensure the acquisition of electricity via OPCOM when taking over supply and distribution activity for traction energy for the whole railway system.

S.C. Telecomunicatii C.F.R. S.A.

- Complete administrative formalities for subordinating SC Telecomunicatii S.A. under the authority of the Ministry of Transports and Infrastructure.
- Continue to elaborate legislation establishing the new framework for supplying telecommunication services within an integrated system.

S.C. Metrorex S.A.

- Develop plan how to increase revenues from commercial activities like renting advertising and commercial spaces by mid-January 2012.
- Increase revenues by introducing 16 new metro trains into circulation in 2012.
- Include S.C. Metrorex S.A. in the list of potential beneficiaries of SOP – Transport 2014 – 2020 in order to use European Structural Funds.

C.N. Tarom S.A.

- Publish tender for investment bank / SSIF (Financial Investments Services Company) which will also provide the legal advice for privatization of at least a 20 percent stake via IPO, prior action.
- Elaborate the TAROM 2012-16 Development Plan, signing the consulting services contract until end-November 2011.
- Publish prospectus by end-January 2012.
- Conclude privatization offer by end-April 2012.
- Appoint private management and board members shortly after conclusion of privatization.
- Reduce costs (e.g. by renegotiation of contracts, voluntary personnel reductions, discontinuation of selected lines and flights, by renegotiation of lease-in contract for flying staff, extending the saving oil consumption program).
- Increase revenues (e.g. by alternative sales strategies and optimizing pricing policies, developing strategy for additional lines to Eastern Europe in cooperation with Skyteam partners, resuming on-board sales and sale of TAROM branded products).

C.N. Poşta Românã S.A.

- Reduce postal subunits from 7100 at end-2010 to around 5800 by end-December 2011.
- Ensure respecting 2011 budget allocation for wage bill by end-2011.
- Repayment of all arrears (depending on court decision, where applicable) by end-2011.
- Hire legal and transaction advisor for capital increase by at least 20 percent by end-January 2012.
- Start process of collective layoffs in line with restructuring plan by end-2011.
- Publish prospectus for capital increase of strategic investor by end-February 2012.
- Finalize capital increase by end-April 2012.
- Appoint private management and board members shortly after capital increase has been implemented in close cooperation with new shareholder.

S.C. Oltchim S.A.

- Appoint investment bank for full privatization (prior action), publish prospectus for SPO by mid-February 2012, conclude privatization offer by end-April 2012.
- Appoint team of private management and board members to prepare the company for privatization by end-December 2011.
- Neither Oltchim nor the government will acquire the refinery in Arpechim prior to privatization.

S.C. Termoelectrica S.A., including subsidiaries S.C. Electrocentrale Paroseni S.A. and S.C. Electrocentrale Deva S.A.

- Dismantle production capacity in groups 1, 2 and 3 of Electrocentrale Paroseni of at least 150 MW (compared with end-2010) by end-December 2011.
- Put group 1 of Electrocentrale Deva of 210 MW into conservation by end-April 2012.
- Use forced execution by ANAF for the subsidiaries Paroseni and Deva by end-December and start forming the new energy company Hunedoara by merging these two companies.
- Use forced execution by ANAF for Electrocentrale Bucuresti by end-December 2011 and put it under direct ownership of the Ministry of Economy.
- Approve voluntary liquidation of Termoelectrica and appoint special single administrator by end-2011 in order to appoint liquidator by end-February 2012.
- Appoint legal advisor for majority privatization of new energy company Hunedoara by end-June 2012.
- Appoint transaction advisor for majority privatization of new energy company Hunedoara by end-August 2012.
- Complete majority privatization offer of new energy company Hunedoara by end-2012.

S.C. Electrocentrale Bucuresti S.A.

- Accelerate discussions between ElCen Bucuresti, Radet Bucuresti, and Radet Constanta, the Ministry of Economy, and the municipality of Bucharest to find a solution for outstanding payments.
- Use payments from government under district heating related arrears reduction schemes (about 0.1 bn. lei) for arrears reduction by end-November 2011.
- Elimination of all arrears to Romgaz by end-December 2011.
- Use forced execution by ANAF against Termoelectrica by end-December 2011 and put it under direct ownership of the Ministry of Economy.
- Appoint legal advisor for the majority privatization by end-June 2012.
- Appoint transaction advisor by end-August 2012.
- Publish prospectus by end-October 2012.
- Finalize privatization offer by end-2012.
- Continue process of creating joint ventures with strategic investors to built new power units in Bucharest, Constanta and Fantanele with private majority share.

S.C. Filiala de Intretinere si Servicii Energetice "Electrica Serv" S.A.

- Appoint legal advisor for majority privatization of regional companies via IPO or to strategic investor by mid-February.
- Appoint transaction advisor for privatization by end-March 2012.

- Conclude privatization for the new company active in the area of Transilvania Sud, Transilvania Nord and Muntenia Nord by end-June 2012, finalize the process for the other 5 companies by autumn 2012 and file for liquidation for all subsidiaries for which privatization failed immediately thereafter.

S.C. Complexul Energetic Turceni S.A., including energy complexes in S.C. Complexul Energetic Craiova S.A. and S.C. Complexul Energetic Rovinari S.A.

- Turceni: Reduce personnel by 200 (compared with end-2010) by end-December 2011.
- Create new energy producer by merging SNLO and the three energy complexes in Craiova, Rovinari and Turceni by end-March 2012.
- Appoint legal advisor for majority privatization of newly created company via IPO or to strategic investor by end-June 2012.
- Appoint transaction advisor by end-August 2012.
- Publish prospectus for privatizations by end-October 2012.
- Conclude privatization offer by end-2012.

C.N. a Huilei S.A

- Start forced execution by ANAF to take over non-viable parts of CNH for tax liabilities as soon as legal acts have been approved. Thereafter, create by end-2011 separate, independent company for non-viable mines for closing them down in line with EU regulations.
- Sell viable mines in open and transparent tendering process in spring 2012.
- Start liquidation process thereafter.

SNa Lignitului Oltenia S.A.

- Use government payments under district heating and heavy water related arrears reduction schemes (about 0.3 bn. lei) for arrears reduction by end-November 2011.
- Decrease personnel by 200 compared with end-September 2011 by end Mach 2012.
- Create new energy producer by merging SNLO and the three energy complexes in Craiova, Rovinari and Turceni by end-March 2012 (see above under S.C. Complexul Energetic Turceni S.A.).
- Appoint private management and board members as from the formation of the new Complexul Energetic Oltenia.
- Continuous reduction of underground operation with aim to terminate it by end-March 2013.

S.C. Hidroelectrica S.A.

- Appoint legal advisor for 10% capital increase via IPO, prior action.
- Giving cancellation notice to all bilateral contracts not having been traded on Opcom by end-December 2011.
- Appoint private management and board members by end-December 2011.
- Appoint investment bank by mid-February 2012.
- Publish prospectus by end-July 2012.
- Conclude IPO by end-October 2012.

S.C. Electrica S.A. and S.C. Electrica Furnizare SA

- Keep remaining 3 distribution subsidiaries in separate companies as merging them could lead to competition restrictions.
- Assuming a corresponding agreement concerning the payment of electricity related receivables from CFR Infrastructure, issue a corresponding legal act to wave penalties for receivables of S.C. Electrica S.A. by end-2011.
- Transfer the own supply activity of SC Electrica SA to SC Electrica Furnizare SA by the end January 2012.
- Appoint legal advisor for majority privatization of Electrica Furnizare SA, including the own supply activity of SC Electrica SA, and minority privatization of all 3 distribution subsidiaries by mid-February 2012.
- Appoint investment bank for privatizations by mid-June 2012.
- Publish prospectus for privatizations by mid-August 2012.
- Conclude privatization offering by end-October 2012.
- Reduce personnel in parallel to privatization of subsidiaries and own supply activity.

Romania: First Supplemental Memorandum of Understanding (SMoU)

MEMORANDUM OF UNDERSTANDING[29]

BETWEEN

THE EUROPEAN UNION

AND

ROMANIA

[29] The present supplemental memorandum of understanding updates the specific Economic Policy Criteria contained in the original memorandum of understanding signed in June 2011 and available on http://ec.europa.eu/economy_finance/eu_borrower/mou/20110629-mou-romania_en.pdf .

ANNEX

ROMANIA

MEMORANDUM OF UNDERSTANDING

ON

SPECIFIC ECONOMIC POLICY CONDITIONALITY

(FIRST SUPPLEMENTAL MEMORANDUM)

14 December 2011

With regard to Council Decision (EU) n° 2011/289/EU of 12 May 2011 granting mutual assistance for Romania, this first update of the Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) details the general economic policy conditions as embedded in the Implementing Council Decision (EU) n° 2011/288/EU of 12 May 2011 providing precautionary EU medium-term financial assistance for Romania.

This first supplemental Memorandum of Understanding updates the specific economic policy criteria contained in annex 1 to the original Memorandum of Understanding.[30]

For the duration of the EU/IMF financial assistance programme the Romanian authorities will take all the necessary measures to ensure a successful implementation of the programme. In particular, they commit to:

- Consult with the European Commission and the IMF on the adoption of policies that are not included in this Memorandum but that could have a material impact on the achievement of programme objectives.

To facilitate programme monitoring, the authorities will provide the European Commission and the IMF with:

- All information required to monitor progress during programme implementation and to track the economic and financial situation.

[30] The signatures on the "Memorandum of Understanding between the European Union and Romania" were completed on 29 June 2011.

Annex 1: Specific Economic Policy Criteria

A: Fiscal consolidation

No.	Measures
1	Progress in terms of fiscal consolidation with a view to reaching a 4.4% of GDP deficit for 2011 on a cash basis (below 5% of GDP in ESA terms) and a below 3% of GDP deficit for 2012 in ESA terms.
2	Ensure that there are sufficient buffers on the expenditure side in the 2011 budget to compensate for any revenue underperformance such that the 4.4% of GDP deficit target (below 5% in ESA terms) is met.
3	Further progress with the reduction in government payment arrears both at central government and local government levels, as specified by the quantitative targets of the program.
4	Introduction of an enhanced reporting system for the State Owned Enterprises which are already part of the ESA definition of the general government, and also for those which will likely be re-classified into the general government sector by Eurostat in 2011 and 2012. The system should require these companies to report all necessary data for the calculation of the likely impact on the general government deficit. The data should be reported monthly and on a cash basis; and should include, inter alia, a monthly monitoring of arrears, subsidies and transfers, and losses. The reporting of this data should start on 1 December 2011.
5	Prevent the further accumulation of arrears and losses for the companies which have been reclassified by Eurostat into the general government sector, and for those which will likely be re-classified in 2011 and 2012.
6	Continued monitoring of the public sector wage bill, and necessary action taken in a timely fashion if wage bill is projected by the MOPF or by the Commission staff to exceed this limit, such that it remains capped at 39 billion RON in 2011 (excluding 1574 million RON in social security contributions for the military as a result of the application of the new pension law). The public sector wage bill should remain sustainable over the 2012-2014 period and respect the relevant limits set in the Medium-Term Fiscal Strategy.
7	Approval of legislation to introduce a means-tested co-payment system for medical services developed in cooperation with the World Bank.
8	In case the Nabucco project starts, which would make it necessary to issue a state guarantee on the part of Romania, the ceiling for the state guarantees defined in the Medium-Term Fiscal Strategy will be temporarily adjusted accordingly. In case these or any other guarantees are called, compensatory measures - to the extent the ESA treatment of the called guarantees requires - will be taken to keep the fiscal deficit within the (ESA) targets defined.

B: Fiscal governance and structural fiscal reform

No.	Measures
9	The Ministry of Finance should receive the information on hospital budgets from the Health Ministry in a timely fashion. The Ministry of Finance should check that the aggregate figures for hospital budgets are consistent with the expenditure programmed in the general government budget, and if the need arises take the necessary action in cooperation with the Ministry of Health, in order to avoid a re-accumulation of payment arrears as a result of expenditure commitments based on over-estimated revenue.
10	Improvement in capital investment budgeting by establishing a list of priority investment projects for which financing will be available over the next 3-5 years. The list of priority projects should be based on detailed feasibility studies, and take account of criteria such as cost benefit analysis, estimated share of completion, how well the project implementation has been managed to date by the ministry, their matching to the strategic priorities of the government, as well as on the analysis produced by the capital monitoring unit of the Ministry of Finance. Improve the monitoring and evaluation of investment projects at the central government level in particular by improving the database relative to capital investment managed by the Ministry of Finance which would also contain information on the status of the projects such as project delays or cost overruns. The development of the database should follow the same timeline as the IMF assisted IT project of integrating the accounting reporting system with the Treasury payment system of the Ministry of Finance. Continue to improve the expertise in the public investment monitoring unit in the Ministry of Finance. Going forward, the public investment monitoring unit of the Ministry of Finance will produce quarterly reports to the government on the status of ongoing and planned investment projects. The government will discuss this report and, if necessary, take timely action to eliminate potential fiscal slippages or any other problems related to budget execution.
11	Reorient public capital spending so as to obtain a gradual shift from entirely domestically financed investment to EU co-financed investment; ensure that the share (% of GDP) of capital spending on EU co-financed investment including from external loans in 2012 will be around 4.0% of GDP and remains thereafter higher than the share of non-co-financed investment in line with the medium-term fiscal strategy; and ensure congruence with EU priorities.
12	Reinforcement of the statistical capacities and expertise at the Romanian National Statistical Institute (INSSE) in the field of Government Finance Statistics (GFS). INSSE will submit semi-annual reports on progress made.
13	Delivery to the Commission Services of the first report by 10 December 2011, on the implementation of conventional measures to tackle VAT fraud.
	Debt management
14	Review (and in this context discuss it with Commission staff), update and publish the debt management strategy on an annual basis, i.e. under this programme by the first quarter of 2012 and end-December 2012.

C: Financial sector regulation and supervision

No.	Measures
15	Adopt by end-November 2011 the amendments to OUG 99/2006 on stabilization measures including bridge bank powers. Furthermore, to ensure the implementation of these measures and strengthen the financial safety net by year end, authorities will adopt the following measures: *(i)* the Deposit Guarantee Fund (DGF) will join the National Committee on Financial Stability as full member; *(ii)* the NBR and the DGF will sign a memorandum of understanding, which includes the appropriate procedures to enhance information sharing, warrant the early identification of problematic credit institutions and prepare contingency plans to deal with such institutions; *(iii)* Under the guidance of the supervision department, the NBR will set up a bilateral working group of the NBR and the DGF aiming at, *inter alia*, preparing contingency plans and finalizing intra- and inter institutional operational procedures. To further strengthen the capacity of the DGF to finance bank resolution measures including bridge-bank powers, authorities will ensure that the DGF has sufficient funding to fulfil these tasks. Consequently, the ceiling limiting the public funding to the DGF to the resources accumulated in the privatization account will be removed. Authorities will make by end-November 2011, the legislative amendments to ensure that the additional funding necessary for the DGF to fulfil its obligations will be available from the treasury operations of the Ministry of Finance. Loans to the DGF will be made available within five working days from the Ministry of Finance on the terms and conditions agreed by the latter.
16	Make the necessary legislative amendments to Law 503/2004 on the bankruptcy of insurance undertakings to ensure, inter alia: *(i)* the correlation with the Law 32/2000 on the insurance business and insurance supervision with subsequent amendments and with the general law on insolvency; *(ii)* the expansion of the scope of application of this law to re-insurance companies; *(iii)* the introduction of provisions on voluntary dissolution and liquidation. Authorities will ensure that the law amending the Law 503/2004 will be sent to Parliament before year end. Subsequently, it will be enacted by end-April 2012.
17	To continue preserving financial stability, the NBR will ensure that any future consolidation process in the banking sector will lead to the emergence of well-capitalized credit institutions backed by a strong private shareholder base.
18	To introduce International Financial Reporting Standards (IFRS) for the banking sector at the beginning of 2012, the NBR will ensure that if prudential provisions exceed IFRS provisions, the calibration of prudential filters for provisions and solvency will substantively preserve the current approach, and not result in a reduction in banks' solvency ratios compared to the present provisioning regime. The NBR will complete consultations with the banking community to reach a common agreement on the calibration issues by end-November 2011. Net amounts arising at the start of 2012 from the release of provisions due to the new accounting treatment and which are treated as retained earnings from specific provisions to support regulatory capital will not be taxed as long as they remain in the corresponding retained earnings account. On an ongoing basis, the authorities will ensure that the IFRS provisions, and any additional prudential filters applied by the NBR, are tax deductible when they are made and taxable when they are released. To maintain its current capacity to effectively supervise the banking sector, the NBR will strengthen its expertise in IFRS, including *via* consultation with international experts.
19	As preserving credit discipline and avoiding moral hazard among debtors contributes significantly towards enhancing financial stability, we will continue refraining from adopting legislative initiatives (such as the personal insolvency law or proposals for the debt collecting law), which would undermine credit discipline.

D: Structural reforms

No.	Measures
20	Implementation of the Action Plans adopted in response to the findings of the functional reviews. Report on progress on a quarterly basis starting in January 2012.
21	Modernise and streamline the relations between different levels of government and between the government and citizens and businesses by greater reliance on electronic data exchange and online interfaces.
	Product markets
22	Notification of the laws relevant for the transposition of EU Directives 2009/72/EC and 2009/73/EC (part of the 3rd Energy Package) on electricity and gas markets as soon as possible. The laws should ensure a full and correct transposition of Directive 2009/72/EC and 2009/73/EC and should reflect, among other things, the commitments of Romania under the MoU. The laws should include the final timeline of price deregulation in electricity and gas, which should be achieved as soon as possible, but not later than by end-2013 (non-domestic consumers) and end-2015 (domestic consumers) for electricity and gas.
23	Phase out regulated prices in electricity and gas: adopt a detailed roadmap for the phasing out of regulated prices in electricity and gas for non-domestic and domestic customers through a government memorandum by end-January 2012, to be submitted at the same time to parliament for adoption through national legislation as soon as possible. The draft roadmap has to be submitted to the programme partners by the beginning of January 2012 and to be agreed by end-January 2012 between ANRE, the Romanian government, the European Commission and the IMF. The roadmap has to specify: *i)* the final timeline of deregulation which should be achieved as soon as possible, but not later than by end-2013 (non-domestic consumers) and end-2015 (domestic consumers) for electricity and gas; *ii)* the main intermediary steps of deregulation, which should be based on a clear and transparent method for gradually increasing the tariffs in order to ensure that during the phasing-out period market prices and regulated tariffs will not diverge significantly and the methods to avoid cross-subsidisation between consumer segments, as well as clear and transparent criteria for the customers to be gradually phased-out; and *iii)* an appropriate regulatory framework that contains mechanisms to ensure competition in the energy market, in particular in the gas market, by involving the Competition Council and ensuring the development of a trade exchange place, in particular for gas contracts which currently does not exist. The Romanian authorities will provide to the programme partners all preparatory work, such as the studies currently being carried out, as soon as they become available.
24	Explicitly define the vulnerable consumers in the electricity and gas laws, and develop mechanisms to protect them in conjunction with the Ministries of Finance and Labour.
25	Eliminate legal, regulatory and physical barriers to cross-border trade of electricity and gas: *i)* removal of legal and regulatory barriers to the export of gas by December 2011; *ii)* presentation of a roadmap towards bi-directional flows of gas at the border with Hungary by 15 December 2011; *iii)* improving coordinated auctions at the borders with Hungary and Bulgaria and establishing an intraday market in electricity by December 2011; and *iv)* take all the necessary actions on the part of the government to ensure that a bi-directional flow of gas at the border with Hungary is established before the end of 2012.

No.	Measures
26	Ensure an effective unbundling of electricity and gas transmission networks and their operation in a transparent and non-discriminatory manner; *i)* open negotiations with the Russian Federation to review historical Intergovernmental agreements concerning the "gas transit" pipelines through Romania as soon as possible; and *ii)* ensure fully certified unbundling of transmission networks in electricity and gas by February 2012.
27	Establish through the electricity and gas laws transposing EU Directives 2009/72/EC and 2009/73/EC the conditions for a strong and independent energy regulator by putting in place the legal framework to ensure independence of the energy regulator and equip it with adequate means to fulfil its tasks and responsibilities as defined in the third energy package.
28	Railway reform - Infrastructure: *i)* identify and close or lease lowest cost recovery segments of the railway lines; *ii)* in order to ensure the economic and financial viability of CFR Infrastructura, negotiate by December 2011 with CFR Infrastructure a new multiannual contract for at least 5 years. The contract should set out the sources of finance on an annual basis for the entire duration of the contract and should be consistent with CFR's business plan. The contract should also provide sufficient incentives to the infrastructure manager to reduce costs and sufficient financial means; and *iii)* CFR Infrastructura to prepare a realistic business plan taking into account EU requirements by April 2012.
29	Railway reform – Passenger traffic: *i)* continue competitive tendering in the public service obligation contract; and *ii)* encourage CFR Calatori to implement performance schemes in cooperation with CFR Infrastructura in accordance with EU legislation, i.e. modify charging schemes according to responsibility for disrupting services.
30	Railway reform – Freight traffic: encourage CFR Marfa (the cargo rail company) to implement performance schemes in accordance with EU legislation.
31	Public Private Partnership: The authorities involved in overseeing PPPs (ANRMAP and UCPPP) commit to jointly report by mid-April 2012 on the functioning of the arrangements (including on the information flow and acces to relevant documents by both authorities).
32	Establish an operational Point of Single Contact (PSC), provided for in the Services Directive, to help businesses with all administrative procedures involved for the establishment in Romania or for the cross-border service provision. The PSC should provide all information about the conditions and requirements applicable in all services sectors covered by the Services directive, both for establishment and for temporary cross-border service provision as well as the online completion of any relevant administrative procedures (for example obtaining authorisations, making declarations, etc.). By end-November 2011, the following actions should be taken: *i)* appoint an authority in charge of coordinating the setting up of the PSC, monitoring of the functioning of the PSC and reporting the progress made to the Commission; *ii)* grant to this authority the necessary powers, competences and resources and set complementary obligations on all the competent authorities in order to ensure their cooperation in the completion of this project; and *iii)* ensure that this authority cooperates with the Ministry of Communication and the National Center Digital Romania in respect of the technical development of the PSC and with the Ministry of European Affairs in respect of compliance with the EU law obligations. By end of December 2011, the appointed authority should: *i)* provide the European Commission with a working plan and calendar for the implementation of the PSC; and *ii)* provide a list of priority sectors and horizontal procedures to be covered at the first

No.	Measures
	stage by the procedures under the PSC. By March 2012, the PSC should: *i)* make information available online in respect of administrative procedures covered by the Services Directive; and *ii)* make online completion of relevant procedures available for the priority sectors and horizontal issues identified previously. By the end of June 2012, the PSC should be fully operational and the electronic completion of procedures should be possible in all the services sectors covered by the Services Directive.
33	Remove restrictions in setting up retail shops. The government should eliminate the legal provisions requiring an economic needs test and the involvement of the competitors in the procedure for the authorisation of opening large surface retail stores by end-January 2012, making the relevant legislation compliant with the Services Directive (Directive 2006/123/EC of 12 December 2006), in general, and Article 14 of it, in particular.
34	Introduction by the National Authority for Regulating and Monitoring Public Procurement of a request for a functional review of public procurement which should be completed by end-June 2012. Thereafter a timed action plan should be drawn up and subsequently be executed.
	<u>Labour markets</u>
35	Implement reforms to the wage setting system allowing wages to better reflect productivity developments in the medium term, while respecting the autonomy of social partners, national traditions and practices.
36	Widen the set of cases for use of fixed-term labour contracts (by end-June 2012), while ensuring that this does not increase labour market segmentation. In parallel, improve the adequacy of the employment protection legislation and adapt to the flexicurity principles.
37	Extend the period over which overtime can be compensated with paid hours off to 3 months (by end-June 2012).
	<u>Pensions</u>
38	Safeguard the long-term sustainability of the pension system.
	<u>Absorption of EU Funds</u>
39	The EU funds contribution to the total eligible expenditure that is certified to the Commission by the indicated dates is at least equal to: 31 December 2011: 2100 million euro 31 December 2012: 8000 million euro The advance payments are not considered part of the certified expenditure. The targeted amounts are based on a cumulative basis starting from 2007.

Throughout the implementation of the financial assistance programme, performance in the following area will be monitored:

Price stability and reserve management

No.	Measures
40	Monetary policy should remain geared towards price stability and the achievement of the NBR's inflation targets (3.0% ± 1 percentage point at end-2011 and end-2012).
41	Commission staff will be promptly informed if reserve losses exceed EUR 2 billion in any 30-day period during the program period.