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Overall assessment of the two balance-of-payments assistance programmes for Romania, 2009-2013

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EXECUTIVE SUMMARY

1. Over the last four years, the European Union has supported Romania in dealing with the financial and economic crisis and in laying the foundations for future growth. The European Union accorded two financial assistance programmes to Romania in application of Article 143 TFEU and Council Regulation No 332/2002. The first programme (2009-2011) provided financing of EUR 5 bn and was fully disbursed. The second programme (2011-2013) provided precautionary assistance of up to EUR 1.4 bn and was not drawn upon. This assistance came in conjunction with support from the IMF (through Stand-By Arrangements) and the World Bank (see Annex 1). The second programme, which was due to expire by end-March 2013, was extended by 3 months to give Romania time to take corrective actions necessary to complete the last review by the EU and the IMF and therewith the programme. The great majority of the conditions set out in the Memorandum of Understanding concluded with the EU have been fulfilled, albeit sometimes with (considerable) delays (see the annotated SMoU in the separate programme documentation).

2. The programmes aimed at restoring macroeconomic stability and at promoting structural reform with the ultimate objective of laying the foundations for sustained growth. Against the background of the important imbalances that had developed in Romania before the crisis, the focus of the first programme was on restoring macroeconomic stability in terms of the balance of payments, public finances, inflation and financial stability. With macroeconomic imbalances subsiding, the focus of the second programme shifted to structural reform. Structural reforms targeted first and foremost the energy and transport sectors as both are critical to increase growth potential in Romania. On the one hand, there was an important need for regulatory reform to bring Romania's regulation in line with EU requirements. On the other hand, the predominance of large, generally inefficient, state-owned enterprises in these sectors implies that real improvements cannot take place until such enterprises are reformed to improve their performance. Other structural reforms related to healthcare, fiscal governance, public administration, labour markets and the business environment.

3. The programmes have generally been successful in restoring macroeconomic stability, in re-establishing market access for the sovereign, and in safeguarding financial stability. Going forward, it will be key to consolidate and, where necessary reinforce, these achievements.

- *Growth* that had plunged to nearly minus 7% in 2009, recovered and is back in positive territory since 2011, even if it remains weak as a result of an unsupportive external environment and a lack of internal dynamics.

- *Inflation* has come down from nearly 8% in 2008 to just above 3% in 2012 but recently went up again. The reduction in inflation has been more difficult than anticipated as the central bank's end-year inflation targets were missed several times. Going forward, inflation will continue to be affected by upward price pressures stemming from energy price liberalisation.

- The *balance-of-payments* imbalances that peaked prior to the crisis with a current-account deficit of over 13% of GDP in 2007 have been largely corrected; the current-account deficit fell to 4% in 2012 and is projected to come out below 4% of GDP in 2013 and 2014. The external capital inflows that peaked prior to the crisis have largely dried up. FDI remains low both as recession hit the origin countries but presumably also as a result of a perceived lack of interesting investment opportunities.

- The leu's *exchange rate* depreciated considerably (17% in nominal terms against the euro) when the crisis unfolded during the second half of 2008, but broadly stabilised in mid-2009 after the first programme was agreed in March 2009. Since then, the currency has tended to fluctuate in a range of 4.2 to 4.5 RON to the euro while occasionally departing from it.

- *Public finances* were consolidated, moving from a *deficit* of 9% of GDP in 2009 to a deficit of less than 3% in 2012 while further improvements are expected in 2013 and 2014 in the direction of its medium-term objective (-1% of GDP). This important improvement allowed the Council to abrogate the Excessive Deficit Procedure on 21 June 2013. Despite efforts to reduce them, government arrears (0-360 days) remain persistent and their recurrence is indicative of still insufficient budget discipline. Government *debt* has risen from just over 13% of GDP in 2008 to nearly 38% of GDP in 2012 and is expected to stabilise below 39% in 2013-2014.

- *Sovereign financing* from the markets has been fully restored since mid-2011. The Romanian debt management office has succeeded in lengthening the maturities and in smoothing out the redemption profile of its debt instruments. International markets were successfully tapped. Romania's international visibility has been boosted by its inclusion into JP Morgan and Barclays emerging market indices starting from March 2013. The treasury built up a buffer of 4 months of gross financing needs to avert roll-over risks. It is important that this buffer is maintained. Budgetary consolidation has contributed to structurally lower government financing needs. Yields on government loans have been on a declining trend since 2011, and dropped to historical lows in spring 2013. CDS spreads followed a similar pattern and dropped below 200 basis points in mid-June 2013.

- The *external financing* gap that was evaluated at EUR 20 bn at the start of the first programme in spring 2009 for the two years covered by the programme had closed at the end of the programme in spring 2011, allowing for the follow-up programme (2011-2013) to be treated as precautionary. Given the current-account projections, good prospects for financial inflows and ample NBR reserves, no external financing gap is foreseen for 2013 and 2014.

- *International reserves* were strengthened during the first programme and maintained at adequate levels since spring 2011. Gross internal reserves amounted to EUR 36 bn at end-May 2013 covering more than 95% of short-term debt at remaining maturity or 9 months of imports. While substantial IMF repurchases in 2013-2014 will weigh on central bank reserves, there should be opportunities to offset the drawing to the extent that this is considered necessary.

- *Financial stability* was safeguarded throughout the programme period and structural improvements in financial oversight and banking resolution mechanisms were implemented in line with programme conditionality (even if sometimes with delays). Following double-digit credit growth prior to the crisis, the banking sector was hit by the crisis through declining asset quality showing up in increasing non-performing loans (increasing from roughly 4.5% at end-2008 to over 19% in spring 2013), which however are appropriated covered by loan-loss provisions. Against the backdrop of increasing loan-loss provisions and high funding costs (in particular for banks with Greek and Cypriot capital), the profitability of the banking sector came under pressure. Whereas foreign-owned banks (over 80% of the Romanian banking sector) maintained their exposure to Romania under the European Bank Coordination "Vienna" Initiative during the first programme, since the spring of 2011 there has been a gradual and orderly deleveraging with the exposure of these banks declining by 12.8% as of May 2013 compared with the March 2009 benchmark level. Close oversight by the central bank was instrumental in preserving financial stability and the banking sector, including the banks with parents from vulnerable euro area countries, has remained well-capitalised. The local deposit base of banks with Greek and Cypriote capital remains vulnerable to any adverse developments in their home countries although the expected recapitalisation of the Greek parent banks should reduce the probability of renewed pressure.

4. The programmes' track record in promoting structural reforms has been mixed with reasonable progress on the regulatory side but relatively little progress in terms of concrete changes on the ground. While most policy conditionalities linked to the regulatory framework have been implemented on paper, they will only produce real effects through their application in practice. A correct and consistent implementation of the revised regulatory frameworks in practice will be crucial to produce the expected results going forward. Moreover, other structural reforms, that have so far been eschewed, will have to be taken on in earnest to offer the hope of improved economic prospects. More specifically, the situation in the different areas covered by the programme can be summarised as follows:

- *Fiscal governance was enhanced to address the institutional weaknesses that had led to fiscal slippages in the past.* Programme achievements include the introduction of a Fiscal Responsibility Law, the creation of an independent Fiscal Council, the adoption of a major pension reform aimed at improving the long-run sustainability of public finances, and a reform of the public pay system. Measures have also been taken to improve: i) the budgeting process; ii) monitoring of the finances of state-owned enterprises; iii) commitment control; and iv) control and reduction of government payment arrears. Conditionality in this area was broadly complied with. However, recurrent – albeit relatively small - arrears indicate that budget and commitment control mechanisms are still insufficient. Government arrears (0-360 days) continue to hover around 0.5% of GDP. While arrears at central government level and in the social security sector have been controlled relatively well, attempts to control arrears at local government level met with limited success.

- *Healthcare arrears were reduced, but fundamental problems in healthcare remain.* As cash allocations were squeezed but healthcare commitments continued to outstrip available resources, payment arrears accumulated. Efforts under the programme focused on dealing with those arrears in the short term and on addressing the fundamental imbalances characterising the healthcare system. Additional financing was provided to pay off arrears and prevent new ones from arising. To limit the commitments, a claw-back tax on pharmaceuticals was introduced as well as a modest co-payment for patients. Both measures met with heavy resistance and were introduced and finalised with delays over initial programme deadlines. Other measures to control commitments relate to a review of entitlements (negative list, Health Technology Assessments, the definition of a basic package, etc.). Fundamental reforms will still be needed in order to introduce a sustainable system of financing (until which it remains a contingent liability for public finances) and to improve healthcare systems and delivery. The service delivery structure is cost ineffective. Ambulatory care services are weak and under-funded. There is too much inefficient capacity in too many hospitals. Tackling these issues will be important to make better use of the scarce resources and to improve Romania’s poor score on a range of health indicators.

- *Labour market reform focused on reducing undeclared work, rationalising private sector wage bargaining and on enhancing labour market flexibility.* Romania has a relatively large informal sector with estimates putting it in the range of around 30% of the economy. This has negative implications for fiscal revenue, for competition and potentially also for working conditions. It might, however, lead to higher "de facto" employment and labour market flexibility. To reduce undeclared work, measures taken include the adoption in 2010 of a national strategy for reducing undeclared work which is still under implementation and of a law on occasional work of daily labourers. Just before the start of the second programme, measures aimed at increasing labour market flexibility and at streamlining social dialogue were adopted. These aimed, inter alia, at widening the possibilities for fixed-term labour contracts and at reforms to the wage-setting system so as to allow wages to better reflect productivity developments over the medium term, thereby contributing to fulfil conditionality on these areas in the programme.

- *Product market reform focused on energy, transport and on enhancing the business environment.* Conditionality on *energy* aimed at reinforcing the market-driven regulatory framework and at aligning the Romanian energy market functioning with the EU Single Market rules. In this context, Romania adopted new electricity and gas laws as part of the transposition of the 3rd Energy Package and defined roadmaps for the deregulation of administratively-set electricity and gas prices over the coming years. Some progress has been achieved in the certified unbundling of the gas and electricity transmission networks, while the national energy regulator has been given a more independent statute. While the regulatory framework has therefore improved, full implementation in practice will be key and policy reversals should be prevented. However, progress related to some conditionality - notably that on gas reverse flows between Romania and its neighbouring countries and on the re-negotiation of the gas transit agreements with Russia -, has been limited. Conditionality on *transport* focused on bringing Romanian regulatory standards in the rail sector in line with EU standards, thus allowing for a more market-based operation as well as fostering efficiency gains in the rail system. Despite numerous delays, the objectives under the programmes were broadly met; these related, in particular, to the independence of the railways regulator, the determination of rail access charges and the scope of the public service obligation. Proper performance schemes for railways have yet to be defined and implemented. Some progress was made in improving the *business environment*. The transposition of the services directive including the creation of the Point of Single Contact and the removal of retail trade restrictions were mains aim of the programme. The Point of Single Contact has been set up, but would benefit from further development. The retail trade restrictions targeted under the programme were abolished. Possibilities for companies to electronically file their taxes have been substantially increased.

- *The reform of the sizeable state-owned enterprise sector has, overall, met with limited success and remains incomplete.* The more than 900 state-owned enterprises (SOEs) in Romania account for about 9% of the annual output and 10% of the employed labour force. In key sectors like energy and transport, SOEs are a dominant force. Because of their importance for the economy, the programmes aimed at improving SOE performance. In this context, a new corporate governance code for SOEs was introduced. Also, arrears of SOEs which account for 96% of all public-sector arrears have been halved during the programmes, while still remaining above 2% of GDP at end-May 2013. Efforts to restructure SOEs have met with limited success. While so-called "professional/private" management and boards have been installed in a number of SOEs, in several cases they lasted only very shortly while in others there are indications that political considerations have prevailed over professional ones. The sale of stakes in SOEs has met with very limited success (Annex 3). Since the start of the 2nd programme in 2011, two 15% minority stakes in SOEs that were already listed on the stock exchange were sold with the state keeping majority control in both. The majority privatisation of the national postal company Poşta Română due for mid-June 2013 failed as there were no interested bidders and was, once again, delayed. An important step in the process that should lead to the majority (51%) privatisation of the national rail freight company CFR Marfã was taken on 21 June through the initialling of the share sale-purchase agreement between the Romanian state and the sole remaining and winning bidder (Grup Feroviar Român).([1]) The finalisation of the deal involves a few more steps and would be sealed by the transfer of the ownership rights at a later stage. Given important vested interests, it is very hard to see how the situation of the many remaining SOEs can improve without a dramatic increase in ownership in the SOE restructuring policy on the part of the Romanian authorities.

- *Major shortcomings in public administration were identified and action plans to address them were drawn up and are now slowly being implemented.* The independent functional reviews of the main government departments carried out by the World Bank in 2010-2011 revealed major weaknesses in the Romanian public administrative capacity including: the lack of accountability for results and low enforcement of public policies; governance issues and inadequate separation of roles among institutions; lack of sector-wide strategies; a poor organisational structure and a high degree of politicisation of the public administration. The action plans drawn up in response to the functional reviews are now being implemented, but some are falling behind schedule while others will take a long time to complete due to capacity constraints. The main reasons behind the slow implementation are related to the limited capacity to prioritise resource allocation and to coordinate between various

([1]) This was done under heavy programme pressure as this step was a prior action for the IMF board discussion of 26 June 2013.

institutions (especially for cross-sectional/horizontal themes), as well as the lack of a monitoring and evaluation system for public policies.[2]

- *Absorption of EU funds, while improving, remains the lowest in the EU and fell considerably short of the programme target. Absorption is hampered by a lack of prioritisation, weak administrative capacity and a suboptimal regulatory framework.* Absorption of EU structural, cohesion and agricultural funds improved from around 0.9% at the start of the programme in March 2009 to 25% in May 2013. The main obstacles to a better absorption would appear to stem from a lack of ownership and strong guidance at the highest levels. This situation allows for a lack of prioritisation that leads to the scarce resources being too thinly spread, overly complicated regulations, and inefficient and unclear procurement legislation coupled with lengthy tendering procedures. While the Commission (REGIO, EMPL) is doing its best to help Romania address these shortcomings through the implementation of the April 2011 Priority Action Plan, progress remains very slow. To stave off the risk of massive de-commitments in 2013 because of the low absorption, in May 2013 the Commission proposed the Council and Parliament to extend the relevant deadlines for Romania (i.e. the modification of the n+3 rule for Romania and Slovakia).

5. With macroeconomic stability having been regained, it is important that structural reforms be stepped up to unlock Romania's growth potential. This will require ownership and resolve on the side of the Romanian authorities. The improving macroeconomic conditions and the solid majority of the ruling coalition provide a favourable background for the implementation of structural reforms. These will be crucial to restart the convergence process with the perspective of improving productivity and income levels over time. Failure to do so entails the risk of locking Romania on a suboptimal subdued growth path, even if macroeconomic stability could be preserved under these circumstances.

[2] The General Secretariat of the Government is now working, with the support of the World Bank, to develop a system for monitoring and evaluation based on good international practice.

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1. MACROECONOMIC ADJUSTMENT DURING THE PROGRAMMES

1.1. BRIEF OVERVIEW OF THE TWO PROGRAMMES

1. On 6 March 2009, against a background of strongly increased risk aversion during the global economic crisis (leading to reduced capital inflows), of increased pressures on the exchange rate and an of 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 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 first 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.*([3])

2. 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.([4]) 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.

3. Between October 2009 and February 2011, Commission services carried out quarterly 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 programme was successfully completed in spring 2011.

4. 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.

5. On 12 May 2011, the Council of the EU adopted a decision to make available precautionary EU medium-term financial assistance of up to EUR 1.4 bn for Romania (2011/288/EU). A first supplemental MoU, updating some of the conditionalities included in the original MoU, was negotiated with, and signed by the Romanian authorities on 14 December 2011. A second Supplemental MoU was negotiated with and signed by the Romanian authorities on 22 June 2012.

([3]) 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.

([4]) 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).

Box 1.1: The first BoP programme for Romania

Main challenges

- Contain the economic recession and give "breathing" space for reforms.
- Correct of the external (double-digit current-account deficit) and internal (high government deficit) imbalances that had been aggravated by the recession.
- Maintain the stability of the financial sector by enhancing the bank resolution framework and the safety nets availably in cases of distress.
- Improve the efficiency of public administration and the business environment.
- Enhance the quality of public spending.
- Improve usage and absorption of EU structural and cohesion funds.
- Tackle undeclared work.

Main achievements and measures taken

- Fiscal policy:
  - Fiscal consolidation: gradual reduction of the fiscal deficit in line with the Excessive Deficit Procedure requirements.* The adjustment was mainly expenditure-driven given the pre-crisis fiscal slippages with respect to current spending and the financing constraints. After the adoption of the austerity measures, Romania maintained a good track record in terms of achieving the programme's deficit targets.
  - Fiscal governance reforms: the Fiscal Responsibility Law (FRL, 2010), the independent Fiscal Council (2010), the reform of the public pay system by the creation of a Unified Wage Law (UWL, 2010), the adoption of a Pension Reform (2010) aimed at improving the long-term sustainability of the public finances.
- Financial sector regulation and supervision:
  - The bank resolution framework and the deposit guarantee fund were strengthened in line with the EU legislation;
  - Legislation on the winding-up of credit institutions was enhanced;
  - Legislation on the independence of non-banking financial regulators was introduced (May 2010).
- Structural reforms:
  - To reduce undeclared work, in 2010 a national strategy for reducing undeclared work was adopted and a law on occasional work of daily labourers was passed.
  - Labour markets: although not part of programme conditionality, in spring 2011, the government adopted important reforms in labour market by amending the Labour Code and the Social Dialogue Law.
  - Public administration: functional reviews (FRs) of 12 ministries and institutions of the central public administration were conducted by the World Bank in 2010-2011; the action plans based on the FRs findings were adopted by the Government and implementation started.

Main outstanding issues and weaknesses

- Continue the fiscal consolidation by gradually reducing the budget deficit to below 3% of GDP by end-2012; step-up efforts to reduce government payment arrears and enhance the financial reporting system of the SOEs.
- Fiscal governance: continue improving the prioritisation of public investment and its planning, monitoring and evaluation process.
- Structural issues: inefficient state-owned enterprises, weak business environment, cumbersome business registration procedures, relatively rigid labour market legislation and social dialogue code.
- Upgrade the bank resolution framework and continue maintaining financial stability against the backdrop of potential adverse spill-overs from the peripheral euro area countries.
- The EU structural and cohesion funds absorption rate was only 2.9% at end-March 2011.

Note: * The EDP had initially fixed 2011 as the deadline for reaching a deficit below 3% of GDP but in 2010 this was extended to end-2012 due to the significant worsening of economic conditions.

Box 1.2: The second BoP programme for Romania

Main challenges

- In addition to the outstanding issues and weaknesses identified in Box I-1, the SOEs restructuring and the structural reforms were the main focus of the second programme.

Main achievements and measures taken

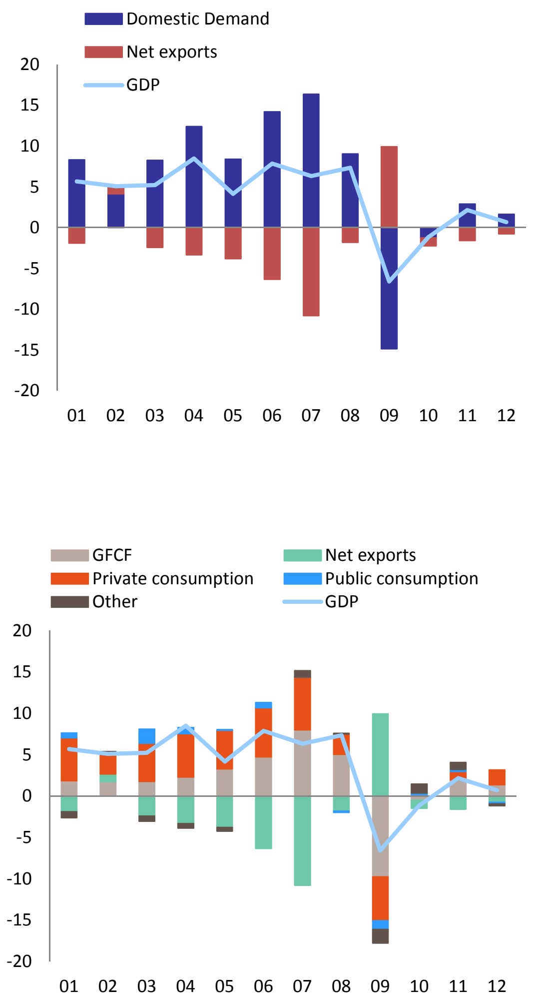
- Fiscal policy:
    - Further fiscal consolidation to achieve the correction of the excessive deficit (the EDP was abrogated on 21 June 2013);
    - Achieve a gradual shift from entirely domestically-funded capital projects towards EU co-funded projects;
    - Reinforce the statistical expertise of the National Institute of Statistics (NIS) in the field of government finance;
    - Reduction in arrears, especially in healthcare and at central government level.
- Financial sector:
    - The bank resolution framework was further enhanced through the introduction of bridge-bank powers and the possibility for purchase and assumption transactions;
    - The data exchange between the central bank (NBR) and the deposit guarantee fund was improved;
    - The International Financial Reporting Standards (IFRS, January 2012) were introduced for the entire banking sector together with prudential filters (permanent from January 2013) for more prudent provisioning;
    - Measures to further discourage un-hedged consumer and SME borrowing in FX were adopted;
    - The Fiscal Code (June 2012) was amended to facilitate the sale of distressed bank loans.
- Energy: the road map to phase out regulated gas and electricity prices was adopted and so far implemented.
- Transport: the independence of the regulator was increased and the setting of the track access charges has been left to the rail infrastructure company, while public service obligation contracts were reviewed and limited.
- SOEs: several loss making companies have been put into insolvency (S.C. Oltchim S.A., C.N. Huilei, S.C. Termoelectrica S.A.) while an important step in the process leading to the majority privatisation of the rail freight company CFR Marfă was taken in June 2013.
- Business environment: the Point of Single Contact was introduced and was made largely operational.
- Public administration: the action plans derived from the FR continued to be implemented (many with the World Bank's support) but some are falling behind the initial schedule mainly due to capacity constraints, lack of coordination and a good monitoring system for public policies.

Main issues and weaknesses remaining

- A very slow and hesitant SOEs restructuring and privatisation process.
- Limited fiscal sustainability of healthcare system and low efficiency of healthcare services.
- Remaining risks of re-accumulation of arrears, especially at local government level.
- Limited active labour market policies and high youth unemployment rate.
- Business environment: challenges remain in the areas of business reporting requirements; the land registry is underdeveloped; facilitation of access to finance and access to international markets for Romanian SMEs could be strengthened.
- Further upgrade the bank resolution framework in line with the developments at EU level. The on-going deterioration of the banks' assets quality remains a matter of concern.
- Romania still displayed the lowest EU structural and cohesion funds absorption in the EU at end-May 2013 hampered by a weak administration.

1.2. MACROECONOMIC ADJUSTMENT DURING THE PROGRAMMES AND OUTLOOK

Graph 1.1: **Romania - GDP Contributions (2001-2012)**

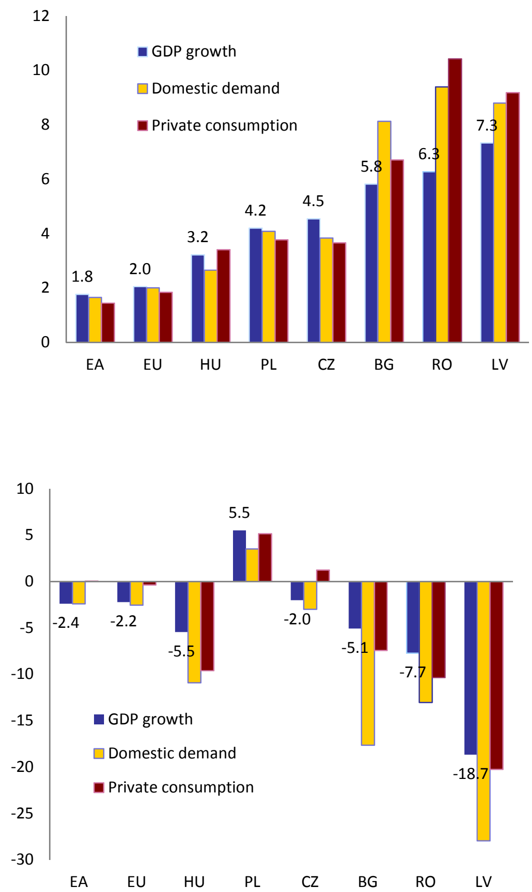


Source: Eurostat and own calculations

6. Prior to the crisis, Romania was posting very high, but unsustainable, growth rates (Graph 1.1). The composition of GDP growth, based mainly on private consumption financed by external capital inflows, led to the accumulation of large imbalances. During 2001-2008, the real growth in domestic demand (Graph 1.2) fuelled initially by financial deepening and a credit boom (Graph 1.3 and Graph 1.4, and later by an expansionary and pro-cyclical fiscal policy, averaged 9.4% per year, substantially above the GDP growth average of 6.3% (Graph 1.1 and Graph 1.2). The difference was financed through imports, generating significant external imbalances. When compared with its peers, similar evolutions were observed in Bulgaria (BG) and Latvia (LV) but not in the Czech Republic (CZ), Hungary (HU) or Poland (PL) (Graph 1.2).

7. With the onset of the financial crisis, foreign private capital inflows to Romania declined sharply, likely reflecting increased global financial market risk aversion as well as the Romanian vulnerabilities. This led to a significant external funding gap (of about EUR 20 bn) that was eventually covered through a joint EU/IMF/WB financial assistance programme (2009-2011). The massive reduction of foreign

Graph 1.2: **Annual GDP growth rate (2001-2008 and 2009-2010)**

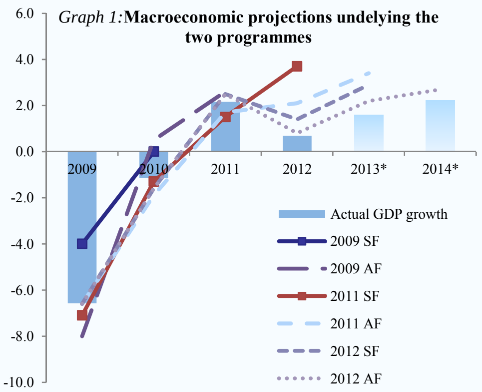


(1) Only RO and LV registered negative GDP growth consecutively in both 2009 and 2010 while PL economy continued expanding
Source: Eurostat and won calculations

Box 1.3: Macroeconomic projections underlying the two programmes

The economic downturn proved to be sharper than anticipated in the first programme. The macroeconomic forecast underlying the first programme (EC 2009 spring forecast) projected an economic contraction of 4% in 2009. However, this proved to be too optimistic as the outturn was a decline of 6.6% in 2009. Already in the EC's 2009 autumn forecast (2009 AF), real GDP projections were significantly revised downwards to predict a contraction of 8% in 2009. As in many other countries in the region, the recession was led by a large drop of export volumes and a collapse of domestic demand. Based on the EC' 2009 AF and the unexpected adverse economic events with major unfavourable budgetary implications, in February 2010, the Council extended the initial deadline for correcting the excessive deficit by bringing it below deficit below 3% of GDP from 2011 to 2012.

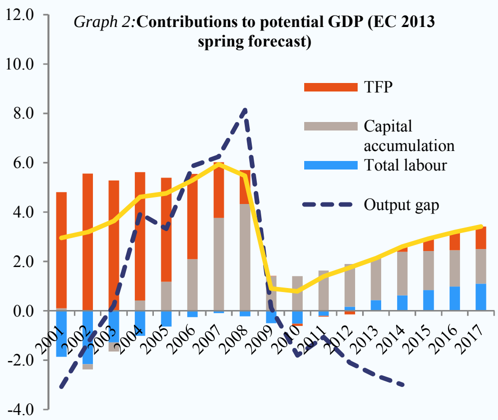
Graph 1: **Macroeconomic projections undelying the two programmes**



The macroeconomic projections underlying the second programme (EC 2011 spring forecast) were closer to the actuals, but still underestimated the length and extent of the global financial crisis. The GDP growth rate of +1.5% projected for 2011 at the time of programme request turned out to be slightly below the actual +2.2% economic growth registered in 2011. The 2011 GDP growth was driven by a robust increase in industrial output and an exceptional agricultural harvest. However, the initial growth projection for 2012 of +3.7% turned out to be too optimistic as the outturn was a mere growth of +0.7%; as in 2012 Romania was affected by a severe summer drought and sluggish growth in its main EU partners (approx. 70% of the country's exports). As illustrated in Graph 1 above, the macroeconomic projections were gradually revised downward as the economic conditions changed and thus GDP growth for 2012 was already downgraded to +1.4% a year later, in the Commission's 2012 spring forecast.

The Commission's 2013 spring forecasts (using the production function approach) show that the recent crisis had a large and lasting impact on the Romanian economy and its potential growth.* After a large drop in 2009, potential growth has started a timid recovery towards reaching +3% in 2017, only about 60% of the peak level reached in 2007 (Graph 2). Since the start of the crisis, potential growth has been driven solely by capital accumulation in 2009-2011 reflecting the high level of investment in the economy. For the coming years, the role of labour and Total Factor Productivity (TFP) is projected to gradually increase, outpacing the contribution of capital, as a result of the product market reforms of the recent years. Only by implementing the remaining structural reforms, Romania will manage to boost its potential growth re-igniting the catching-up process for its convergence to the EU's productivity and income levels.

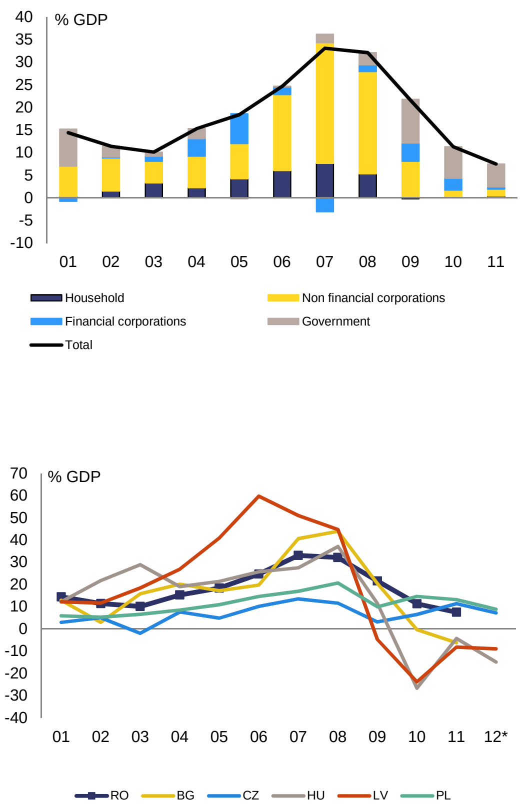
Graph 2: **Contributions to potential GDP (EC 2013 spring forecast)**



Note: *There are many uncertainties and difficulties in estimating the potential GDP in general and, particularly for Romania, these are even higher due to the short sample of usable and reliable data and to the structural changes that happened during the period analysed.

capital inflows led to an immediate adjustment in domestic demand and a cumulated contraction in economic activity of about 8% over 2009-2010 (Graph 1.2).

Graph 1.3: **Decomposition of credit flows in Romania and selected countries (2001-2011)**

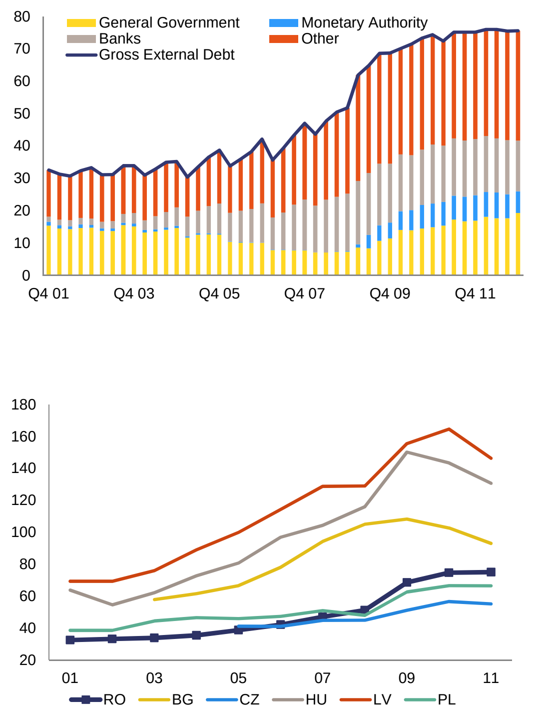


(1) Decomposition of financial transactions (change in liabilities) in % of GDP
Source: Eurostat and NBR

8. A recovery ensued in 2011 accompanied by a shift in the composition of growth towards a healthier foundation based on investment and continued growth in export (Graph 1.1 and Graph 1.5). This was supported by a strong recovery in industrial output in response to increased external demand, as Romania still enjoys competitive prices in the EU, and an exceptional agricultural harvest.

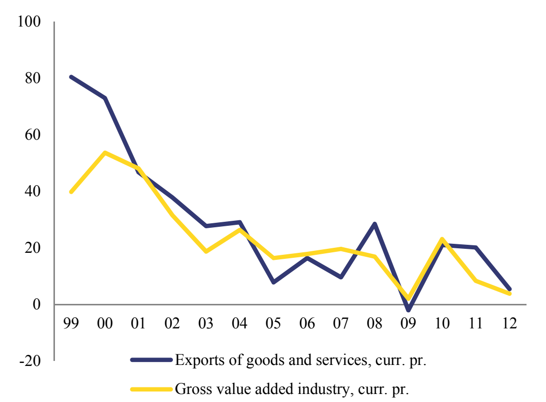
9. In 2012, Romania was affected by a severe summer drought and sluggish growth in its main EU partners, causing real GDP to grow by a mere 0.7%. Economic activity is expected to recover modestly in 2013 (+1.6% in the Commission's spring forecast) and to accelerate in 2014 (+2.2% in SF13), as structural reforms implemented in energy, transport and in labour markets are assumed to start paying off. Domestic demand is forecast to continue to drive growth with investment as a key contributor; the country's public investments should be supported by improved absorption of EU funds (see section on

Graph 1.4: **Gross foreign debt in Romania and selected countries (2001-2012, % of GDP)**



Source: Eurostat and NBR

Graph 1.5: **Exports and GVA industry (y-o-y growth)**

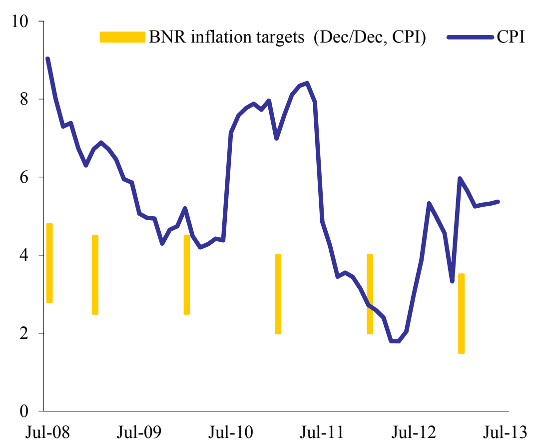


Source: Eurostat

EU funds for more details).

10. Following a succession of upward price shocks, inflation in Romania has remained stubbornly high for a prolonged period (Graph 1.6). Inflation (HICP) peaked in mid-2011 at nearly 8% on the back of significant hikes in indirect taxation (decided under the programme) in the course of the year. It decelerated temporarily to around 2% in April-May 2012, but picked up again in the second half of 2012 due to rising food prices, the impact of which was augmented by the large share of food items in the consumer basket, and the pass-through effects associated with the leu's exchange-rate depreciation. Energy price increases following the roadmap to phase-out administratively-set prices also put some pressure

Graph 1.6: **Romania CPI inflation (in %)**

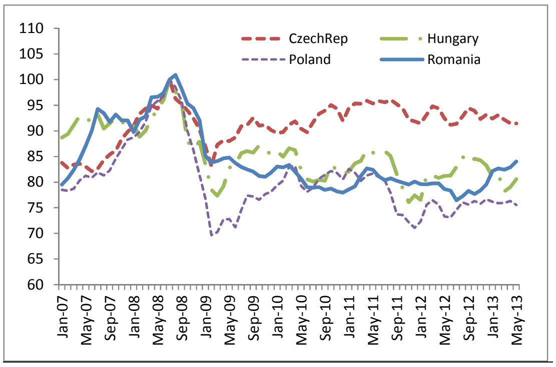


Source: NBR and Eurostat

on inflation, especially by end-2012 and the beginning of 2013. The implementation of monetary policy remained challenging during the programme due to volatile price developments.

11. Romania has seen an improvement in price and cost competitiveness since the onset of the financial crisis. The ULC-deflated real effective exchange rate weakened by some 20% since mid-2008 both due to nominal effective depreciation of the leu and muted growth of unit labour costs (Graph 1.7). The real effective exchange rate has broadly stabilised since then, with only a slight strengthening observed in the first half of 2013. Romania has recorded important market share gains since EU accession, including during the global financial crisis.

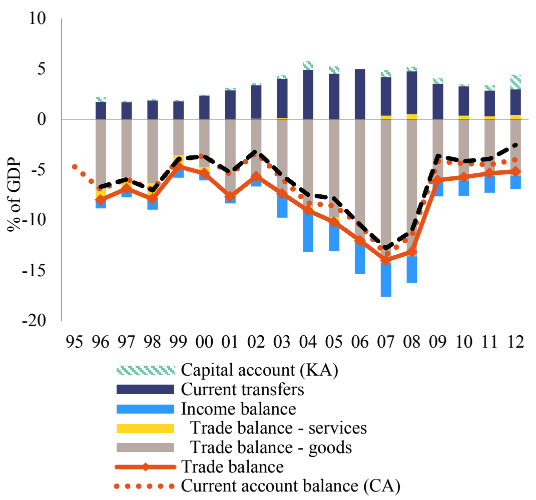
Graph 1.7: **Real effective exchange rate (ULC deflated)**



(1) Index July 2008=100
Source: Commission services

12. The current-account deficit has decreased significantly in the last 4 years. From an average of -10.5% of GDP during the boom period (2004-2008), the current-account deficit shrank to an average of -4.3% of GDP in the last 4 years (2009-2012). In 2012, the current-account deficit was 4%

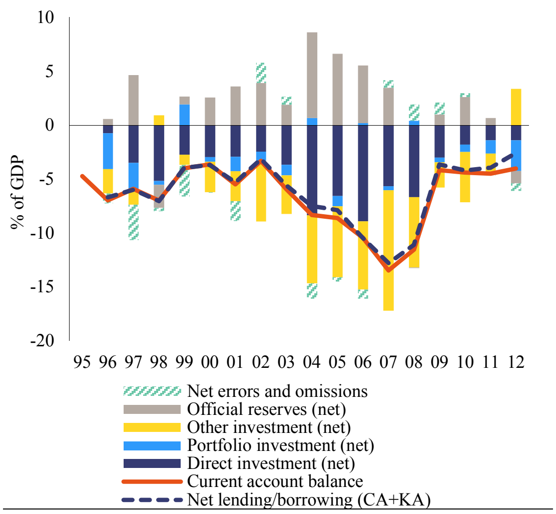
Graph 1.8: **CA decomposition**



Source: Eurostat

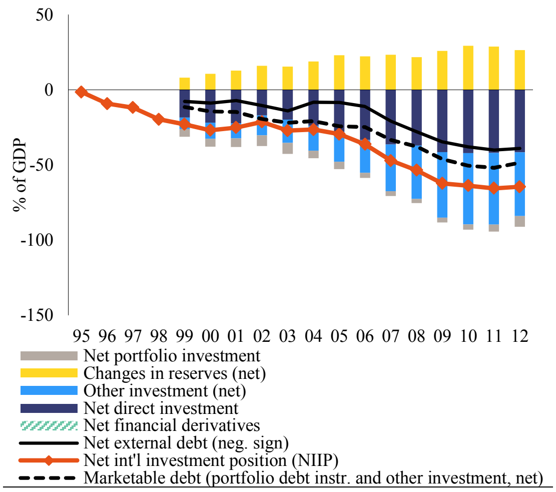
and in the Commission Spring Forecast it is estimated to remain below 4% in 2013 and 2014. The current account is largely driven by the trade deficit and is financed through a balanced mix of foreign direct investment and other investment (Graph 1.8 and Graph 1.9).

Graph 1.9: **CA financing**



Source: Eurostat

Graph 1.10: **Decomposition of NIIP**



Source: Eurostat

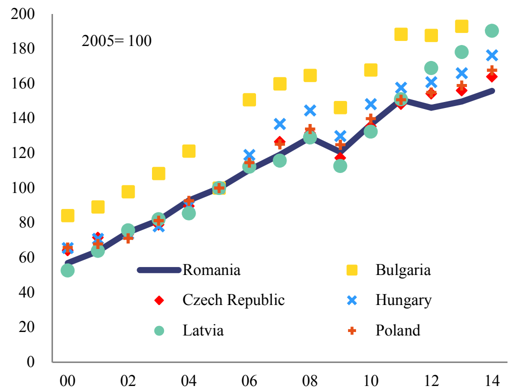
13. Romania's negative net international investment position (NIIP) reflects the accumulation of current-account deficits in the pre-crisis period (1.10). The negative NIIP widened during the boom, largely due to capital inflows and stabilized in the last two years around -65% of GDP, as a result of the adjustment in the current-account deficit, but also due to a nominal growth effect, as the economy started to recover. The net external debt level is much smaller (39% of GDP in 2012), suggesting the vulnerability implied by large external liabilities is reduced if one makes the distinction between debt and non-debt-creating flows.

14. A significant part of external indebtedness is represented by FDI, which was attracted by exporting sectors to a large extent. Export growth, however, could be further boosted. The current NIIP stock reflects large FDI inflows mainly during the boom period, as over the last 3 years the inflows have been much smaller (1.4% of GDP in 2012 from 6.7% of GDP in 2008). The percentage of FDI in manufacturing, Romania's main exporting sector increased from 30% in 2010 to 32% in 2011. About half of the FDI in the manufacturing sector was directed at sectors such as transport, metalurgy and chemicals. The rest of FDI was attracted by the financial intermediation and insurance (18% in 2011), the retail (11% in 2011), the construction (11% in 2011), and the energy (8% in 2011) sectors. FDI had a positive effect on the trade balance: according to an NBR survey,([5]) FDI enterprises - defined as enterprises in which FDI represented at least 10% of capital - accounted for 71.4% of total exports and 62.6% of total imports. While Romanian export shares increased overall, when compared to peers, data on export growth show that there is still room for improvement (Graph 1.11 and Graph 1.12). A further shift of FDI to tradable sectors would likely support export in the future.

15. The current-account adjustment was driven by the private sector and was supported by the fiscal consolidation of the government. Up to 2007, credit-fuelled investment in the private sector, mostly foreign-currency denominated, was driving the fastly widening current-account deficit on the back of low level of savings. However, in 2008, one year before the recession in Romania, the negative saving-investment gap in the private sector started to decrease (Graph 1.14). The current account did not adjust proportionally, as the smaller private sector savings-investment gap was offset by a widening fiscal deficit, generated by unsustainable expenditure policy decisions. Most of the adjustment of the current-account deficit in nominal terms (by more than 7% of GDP) actually took place in 2009, driven by the private sector. Since then, the current-account

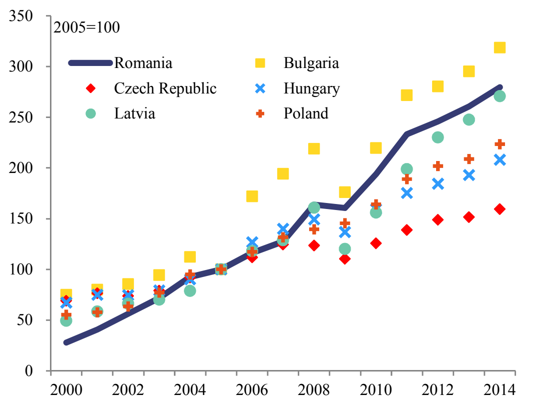
([5]) National Bank of Romania, Foreign Direct Investment in Romanian in 2011, published in 2012.

Graph 1.11: **Export growth compared to peers, fixed prices**



Source: Eurostat

Graph 1.12: **Export growth compared to peers, current prices**



Source: Eurostat

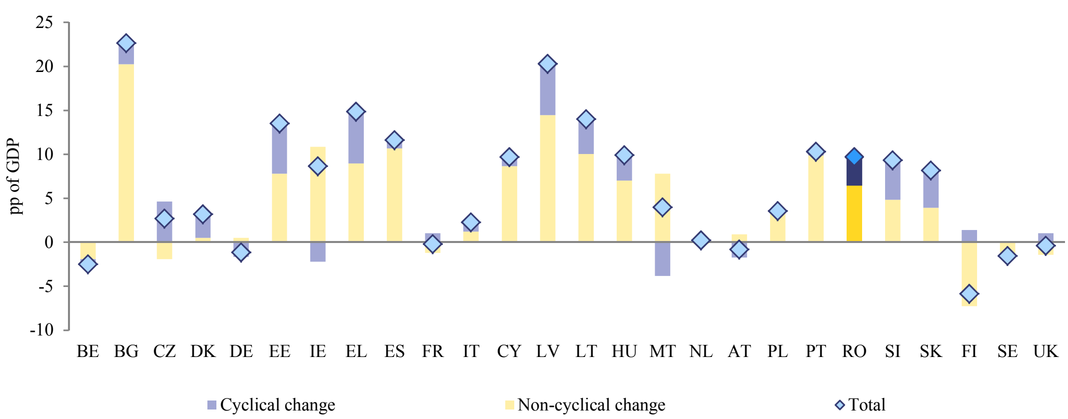
deficit remained broadly stable, in the context of fiscal consolidation by the government and a modest recovery of the private sector.

16. The adjustment of the current-account deficit has been partially structural. The extent to which the adjustment was of a structural (non-cyclical) nature can be assessed based on current-account regressions that control for domestic and trade partners' output gaps.([6]) Graph 1.15 shows that the structural part of Romania's current-account deficit has halved between 2007 and 2013. Moreover, the current-account deficit has stabilised recently around 4% of GDP, a value that is to be expected given the country's characteristics, as measured by the current-account norm.([7]) If the output gap closed, Romania would still have a deficit of around 4% of GDP given the structural characteristics of the economy. In particular, the main contributing factor to the current-account norm in Romania is the old-age dependency ratio (-3.3 percentage points). In a cross-country perspective (Graph 1.13), the magnitude of the current-account adjustment and

([6]) Based on S. Zeugner, "Updated estimates of current-account norms and equilibrium real exchange rates", from May 2013. Estimates are based on the methodology developed in M. Salto and A. Turrini, "Comparing alternative methodologies for real exchange rate assessment", European Commission Economic Papers 427, September 2010.

([7]) The "CA norm" or benchmark of a country can be considered as the usual current-account balance that prevails in countries with similar characteristics. It should not be interpreted as an "equilibrium" current account and in particular it does not guarantee external debt sustainability.

Graph 1.13: **Cyclical and non-cyclical change in CA balance 2007-2013**

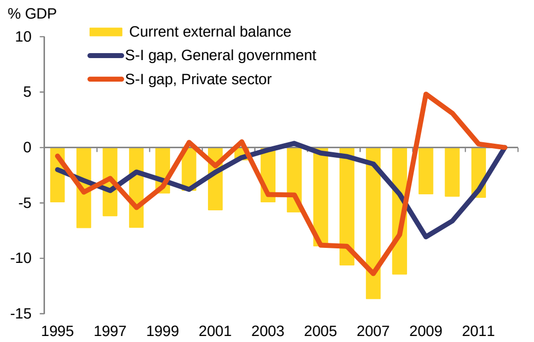


Source: Commission calculations

its structural component seem broadly in line with peers: given the volatility in current-account developments in the New Member States (NMS) during the 2007-2013 period, the adjustment in Romania seems to be close to the NMS average, both in terms of its overall magnitude and its structural component.

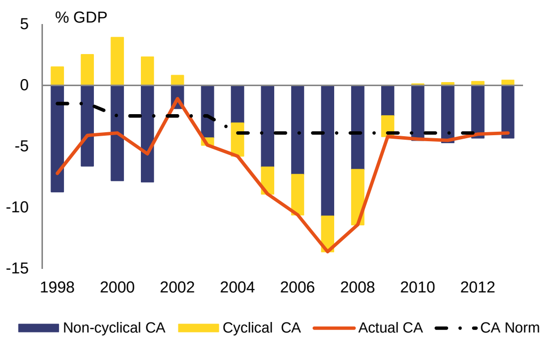
17. While imbalances have been reduced from large pre-crisis levels, Romania still has a current-account deficit and a net investment position which exceed the thresholds of the Commission's Macroeconomic Imbalances Procedure (MIP). The MIP scoreboard, which signals possible imbalances, shows that Romania exceeds the three-year current-account average of -4% of GDP, although it is close to the threshold

Graph 1.14: **Saving-investment gaps and current external balance**



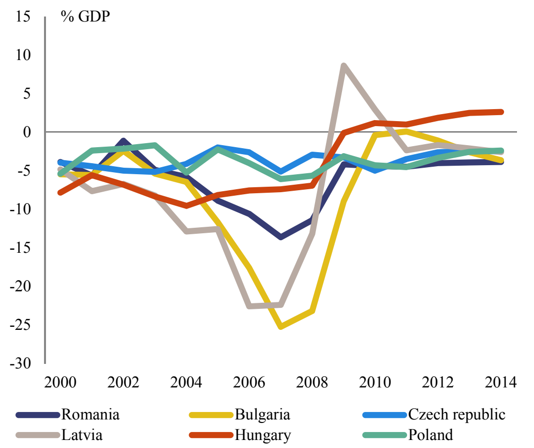
Source: Eurostat

Graph 1.15: **Cyclical and non-cyclical current account**



Source: Commission calculations

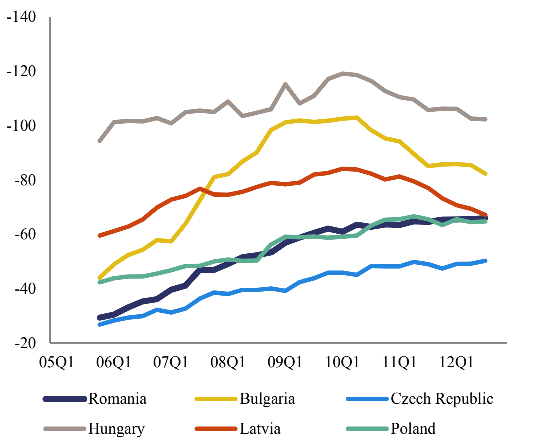
Graph 1.16: **CA in Romania and peer countries**



Source: Eurostat

and the Spring Commission Forecast foresees CA deficits of below 4% for 2013 and 2014. In comparison to its peers, the CA deficit in Romania seems quite large. While Romania also significantly exceeds the NIIP threshold of -35%, this development seems more in line with peer countries (Graph 1.16 and Graph 1.17), as a negative NIIP is typical for catching-up countries where growth was supported by large capital inflows in the past.

Graph 1.17: **NIIP in Romania and peer countries**



Source: Eurostat

18. A reduction in the NIIP is needed to diminish the risk of future imbalances. Such a reduction would require a further correction of the current-account deficit. A negative NIIP is common in catching-up countries where growth was supported by capital inflows. As long as such inflows are put to productive uses, a moderate NIIP deficit can be beneficial for growth. However, a negative NIIP can also be a concern, as it is likely to increase a country's vulnerability to external shocks. The NIIP has been regarded as an indicator of default risk. According to the debt-tolerance literature,([8]) there are countries which fall into debt defaults at relatively low levels of debt to GDP, because they are more vulnerable to external shocks due to weak institutions, problematic political systems, fiscal rigidities and economic inefficiency. As such, default risk can be high, despite a relatively moderate level of indebtedness. Although Romania has a relatively low external debt-to-GDP ratio (in 2012 net external debt was 39% of GDP), such factors suggest that Romania cannot sustain a very high level of indebtedness in the medium-term. According to ECFIN long-run forecasts of growth, inflation and interest rates,([9]) and if the 2012 current-account deficit is preserved until 2020, the NIIP would worsen slightly from -65% in 2012 to - 68% of GDP. Reducing the NIIP by 10% of GDP up to 2020 (to reach -55% in 2020), would require a current-account deficit of -2% of GDP, half of the level in 2012.([10]) The required improvement going further is not as large as the recent current-account adjustment. If the current-account deficit remains on a downward path, the external position could be improved. The opposite scenario, in which recovery will be based on strong domestic demand, that would encourage imports and deteriorate the trade balance further, would signal a build-up of external imbalances.

19. Challenges remain with regard to external imbalances, although a return to pre-crisis imbalances does not seem likely. The government sector does not pose a significant risk of reverting to past imbalances, based on the programme track record in fiscal consolidation and on commitments that the country has taken (like the Fiscal Pact). The economic recovery seems subdued and the economy is not likely to return to pre-crisis growth rates in the near term, as the external environment is less favourable to a return to pre-crisis FDI inflows, in the context of increased risk aversion and lower investor confidence. Moreover, a possible recovery in lending will be slow, as the conditions for returning to pre-crisis double-digit credit growth are absent in the context of tightened lending standards. As such, it is not very likely that Romania will revert to pre-crisis levels of imbalances. However, as external adjustment was partly structural in nature and given an uncertain external environment and volatile capital flows, reducing the possible vulnerability related to external imbalances remains an important challenge.

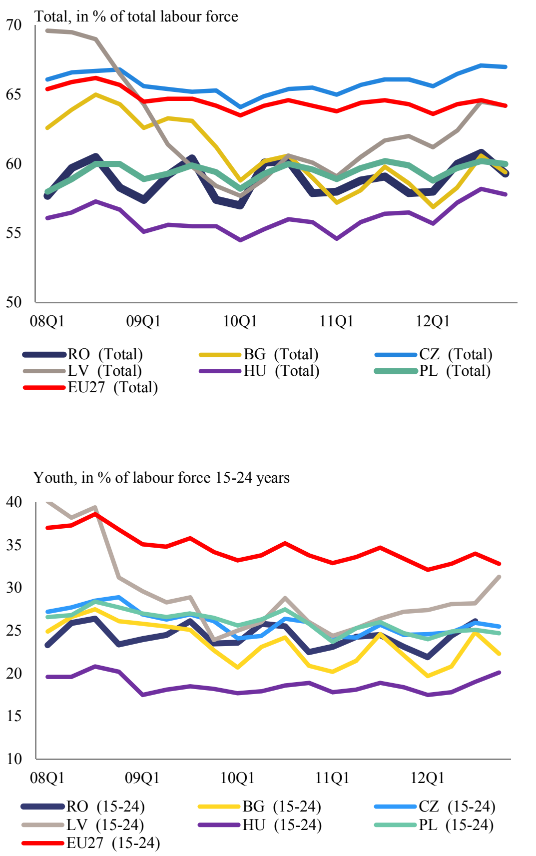
20. Despite a strong macroeconomic adjustment, the labour market situation has not deteriorated significantly during the crisis years. Likewise, despite the recent recovery, no significant improvements can be reported with youth unemployment remaining worryingly high. Prior to the crisis, the Romanian labour market was characterised by increasing unemployment and stagnating employment. On the back of the economic crisis, the unemployment rate increased from 5.8% in 2008 to 6.9% in 2009. Youth unemployment also increased in this period, from 18.6% to 20.8%. The employment rate remained unchanged for the same time period, at around 59% for the total working age population and around 25% for young people (Graph 1.18), thus far below the EU average. Under the programme (2009-2012), the employment rate did not improve. It remained on average at 59% of the total working age population and at 24% for youth. However, despite macroeconomic adjustment and fiscal constraints, the increase in total unemployment could be contained. Peaking at 7.5% in Q1 2010 and Q3 2011, total unemployment has remained at around 7% during the programme period (Graph 1.19). In comparison to its east-European peers, Romania's total unemployment performance has been very good. However, youth unemployment has deteriorated, increasing from around 21% in 2009 to 23% in 2012. The same trend can also be observed among its peers.

([8]) Reinhart, Carmen M., Kenneth S. Rogoff and Miguel A. Savastano. "Debt Intolerance," Brookings Papers on Economic Activity, 34, 2003-1 (2003): 1-74; Luis-Diego Barrot & Geoffrey J. Bannister, 2011. "A Debt Intolerance Framework Applied to Central America, Panama and the Dominican Republic," IMF Working Papers 11/220, International Monetary Fund.

([9]) The long-term macro scenario is based on projections from the Fiscal Sustainability Report 2012.

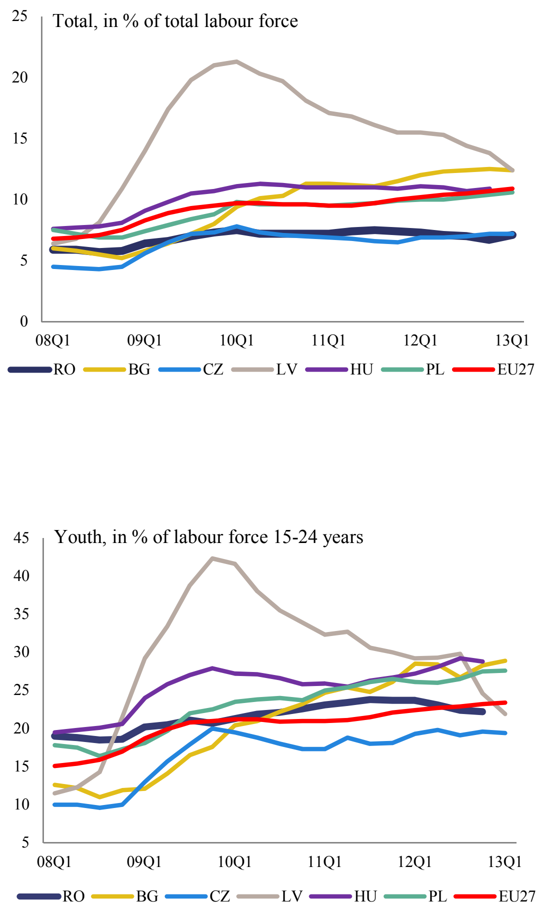
([10]) These simulations abstract from asset and REER valuation changes.

Graph 1.18: **Employment rate in Romania and peer countries (Total and Youth)**



(1) Total, in % of Total labour force
Youth, in % of labour force 15-24 years
Source: Eurostat

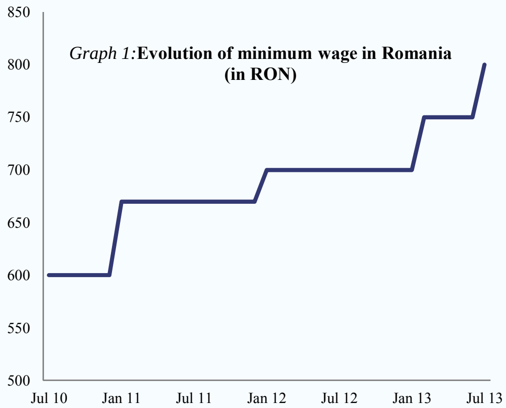
Graph 1.19: **Unemployment rate in Romania and peer countries (Total and Youth)**



(1) Total, in % of total labour force
Youth, in % of labour force 15-24 years
Source: Eurostat

Box 1.4: Social dimension of the programme

Macroeconomic adjustment under the two programmes has been significant and concerns regarding its social implications have been taken into account when designing policies under the programme. Thus, containing the burden on vulnerable parts of the population has been one of the priorities of the programme.



First, under the programme, the minimum wage* was increased several times: in 2011 (by 11.7%), in 2012 (by 4.5%), in early 2013 (by 7.1%), and it is set to further increase in mid-2013 (by 6.7%). Furthermore, the 2010 public wage cut of 25% was restored in several steps in 2011 and 2012, once conditions allowed.

Second, the labour market reforms of 2011 (on which the programme partners were consulted) aimed at increasing labour market flexibility and at streamlining social dialogue were adopted with the aim to promote competitiveness and job creation. Furthermore, the programme addressed the issue of high youth unemployment by urging the government to take a more active stance and introduce additional active labour market policy measures.

The government has now prepared several amendments to the current legislation to improve the transition of young Romanians into the labour market and the a National Job Plan was adopted in April 2013 with further measures focussing on improving the entrepreneurial culture among youth and adapting education and vocational training to the labour market needs.

Third, phasing out of regulated gas and electricity prices is set up in such a way that it limits the additional financial burden of the adjustment on households. Thus, phasing out of administrative prices is slower for households than for the corporate sector. Also, in line with EU legislation, the programme partners requested the authorities to appropriately protect vulnerable consumers. Thus, programme conditionality required the definition of vulnerable consumers and the implementation of appropriate policy measures to protect them. The authorities have now specified the definition of vulnerable consumers to a large extent and adopted legislation that provides additional social benefits from July 2013 to limit the impact of electricity and gas price deregulation. Further reforms, supported by the World Bank's technical assistance, are under way that should make social protection more targeted in the future, thus allowing for a more efficient use of scarce financial resources while still protecting the poorest. Finally, programme partners have urged the authorities to ensure that labour market legislation is in line with the ILO (International Labour Organisation) core labour standards.

Note: *The minimum wage was increased to RON 670 in 2011, to RON 700 in 2012, to RON 750 as of 1 February 2013 and it is set to be increased by another RON 50 to RON 800 (about EUR 183) on 1 July 2013.

Box 1.5: **Monetary policy, exchange rate developments and reserve management**

Monetary policy is geared towards price stability. However, the National Bank of Romania (NBR) faces continued challenges in implementing its monetary policy. In particular, the repeated overshooting of the inflation targets may ultimately pose a risk for the NBR's credibility – although a large part of recent price increases was beyond the direct control of the central bank. During the 2009-11 and the 2011-2013 balance-of-payments programmes the NBR has lowered gradually and cautiously the key policy rate from 8.50% in August 2009 to 5.25% in March 2012 and to 5.00% in July 2013. Since then, the rate was kept unchanged.

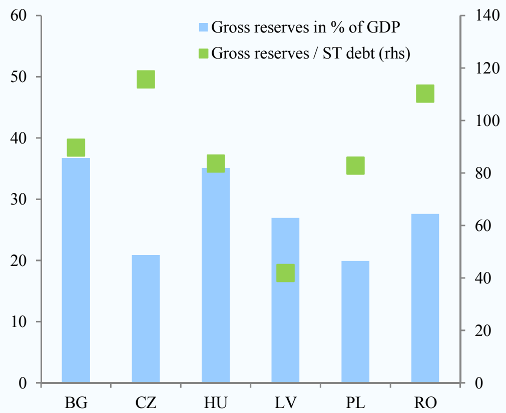
It will be important for the NBR to remain vigilant and maintain prudence in monetary policy going forward. Continuing with an active communication policy by the NBR is warranted in order to ensure the anchoring of inflation expectations. Over the medium term, the implementation of structural reforms aiming at increasing competition and labour market flexibility, together with the already implemented measures aimed at curbing lending in foreign currency, along with the potential narrowing of the interest-rate differential (between RON and foreign currency) will help to strengthen the interest channel of monetary policy, including by reducing the external vulnerability of the Romanian economy.

After a significant weakening in the first half of 2009, foreign-exchange reserves were supported by international financial assistance during the first programme. The first programme (2009-2011) overachieved the original plans to bolster the foreign reserves. From the starting point of EUR 28.2 bn (foreign exchange and gold) as of end 2008 the foreign-reserve stock increased to EUR 35.2 bn as of end of 2010. By the end of the first programme in June 2011, gross international reserves reached around EUR 37.3 bn (i.e. around 104% of short-term external debt at remaining maturity at that time) up from around EUR 27 bn at the start of the programme in April 2009 (88% of short-term external debt at that time).

After peaking at the end of 2011, foreign-exchange reserves decreased somewhat during 2012 as repayments of international financial assistance started to kick in. The reserves largely stabilised at the beginning of 2013, despite substantial repayments of international financial assistance. The reserve-adequacy picture is rather strong in comparison to most regional peers, as Romania's gross international reserves (foreign exchange and gold) amounted to around EUR 36.3 bn as of end-May 2013 covering more than 95% of short-term external debt and around 9 months of imports of goods. This is broadly in line with the Guidotti–Greenspan rule and by large within safety margins vis-a-vis other reserve adequacy indicators.

The repayment of international financial assistance implies a sizeable amortisation effort and a substantial drawdown on Romania's international reserves. International assistance repayments peak in 2013-2015, just after the end of the current programme, and reach about EUR 4.5 bn both in 2013 and 2014 (about 2½% of GDP) and some EUR 3 bn in 2015 (1¾% GDP). The current level of foreign-exchange reserves appears to be sufficient and comfortable to service the repayments without major difficulties, though the peaks could imply a quite substantial drawdown of reserves. Considering these substantial repayments of international financial assistance that started in the second half of 2012, the NBR used opportunities to rebuild foreign-exchange reserves in the first half of 2013. Furthermore, the reserve

Graph 1: **Romania - Adequacy of international reserves (2009-2012 average, in %)**



Source: Eurostat

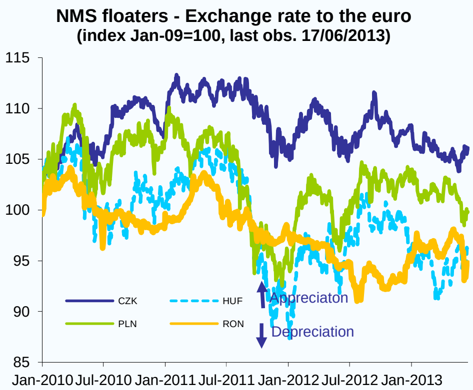
(Continued on the next page)

Box (continued)

drain should be to a large extent offset by continued borrowing on international markets and foreign-currency denominated domestic issuances and also by using financing from international institutions such as the EBRD and the EIB. Maintaining adequate reserve buffers provides an important cushion against shocks. In any event, reserve management should cater for an appropriate reserve stock in advance of the repayment peaks. In line with the programme conditions, the authorities promptly informed the Commission staff when substantial losses in reserves occurred during the second programme.

The Leu's exchange rate broadly stabilised in mid-2009 after the programme was agreed in March 2009 after depreciating considerably (about 17% in nominal terms against the euro) when the crisis unfolded during the second half of 2008. The leu remained broadly stable against the euro during the rest of 2009. It depreciated slightly against the euro during 2010 and at the beginning of 2011, but stayed in a narrow range. The exchange rate vis-à-vis the euro depreciated in the second half of 2011 – to a 16-month low in November of that year – in the midst of a difficult external environment amid a sharp increase in global risk aversion. Nonetheless, the leu's weakening against the euro was more moderate compared to most of the regional peers. The exchange rate broadly stabilized again in early 2012 amid signs of easing global market conditions, but the RON depreciated towards historical lows in July 2012 and subsequently showed several episodes of increased volatility. The weakening of the leu reflected a combination of different factors, including a decline in capital inflows, heightened political uncertainty, and increased risk aversion in international financial markets due to concerns regarding some peripheral euro-area economies. The exchange rate vis-à-vis the euro weakened substantially by some 7.3% between early 2012 and mid-July but regained around 4% in August. During autumn the leu gradually depreciated again (down by around 3% by the end of October 2012). It firmed somewhat during October and November as the NBR limited liquidity provisions. Positive market sentiment following the December 2012 elections and inclusion of Romania in emerging market bond indices boosted the exchange rate, limiting the depreciation against the euro to about 2½% in 2012, and supporting an appreciation of 2½% in the first four months of 2013, but the leu's exchange rate then depreciated back to its levels of the beginning of 2013 amid newly-increased global risk aversion.

Graph 2: **NMS floaters - exchange rate to EUR**



Source: Bloomberg

2. COMPLIANCE WITH PROGRAMME CONDITIONALITY

2.1. FISCAL POLICY

During both programmes, fiscal policy conditionality focused on two main objectives:

(i) the implementation of a fiscal consolidation strategy aimed at bringing the deficit back to below 3% of GDP within the timeframe set out by the Council in the context of the Excessive Deficit Procedure (EDP);

(ii) the implementation of a number of fiscal governance reforms aimed at remedying the most pressing problems in fiscal policymaking. These related mainly to the need for a fiscal responsibility law and an independent Fiscal Council, a reform of the public pay system and a reform of the pension system.

The second programme also included a condition related to the annual review and update of the Government's public debt management strategy by end-2011 and by end-2012 respectively.

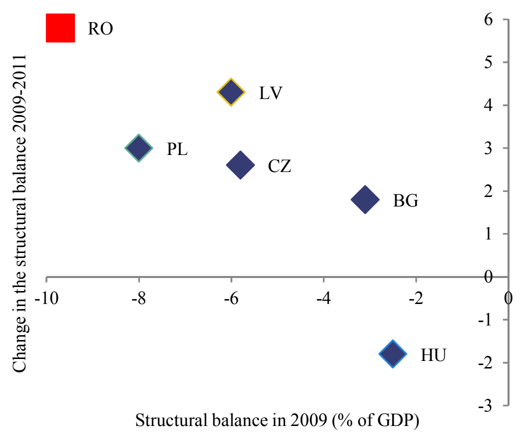
21. Fiscal policy conditionality was one of the main pillars of the two programmes, as it was one of the main factors responsible for the Romanian crisis. Fiscal policy had been highly pro-cyclical during the boom years of 2004-2008, with headline deficits rising from 1.2% of GDP in 2004 to 5.7% of GDP in 2008. The implementation of inadequate fiscal policies prior to the crisis was in part due to weaknesses in the institutional fiscal framework: lack of independent monitoring of budgetary developments; absence of enforcement mechanisms to ensure respect of fiscal targets; poor multi-annual planning; and weak numerical and procedural fiscal rules. The weak institutional framework contributed to recurrent budgetary slippages, notably with respect to current spending. Moreover, public-sector wage growth (the public-sector wage bill doubled in nominal terms over the 2005-2008 period) became the main driver of private-sector wage increases and also led to substantial increases in pensions because of their indexation to wage growth.

22. Given these developments, fiscal policy conditionality pursued both fiscal consolidation and fiscal governance issues. The fiscal consolidation strategy aimed at bringing the budget deficit back to below 3% of GDP, in line with the Excessive Deficit Procedure, while the changes in the fiscal governance framework aimed at putting public finances in Romania on a more sustainable footing and remedying the shortcomings that had led to earlier slippages.

2.1.1. Fiscal consolidation strategy

23. Romania has had the largest fiscal adjustment during the programmes compared to regional peers. The structural deficit improved by 5.5 percentage points of GDP over the 2009-2011 period (Graph 2.1). However, Romania also had the worst starting position with an unsustainable structural deficit of -9.5% of GDP in 2009 brought about by a highly pro-cyclical fiscal policy during the boom years of 2004-2008. Generally, Graph 2.1 shows that the magnitude of the fiscal adjustment made by the country's regional peers was negatively related to the magnitude of the structural deficit in 2009.

Graph 2.1: **Fiscal adjustment in selected European countries**



Source: Commission services

24. The adjustment programme required that consolidation in Romania be mainly expenditure driven given pre-crisis fiscal slippages with respect to current spending and financing constraints. The strategy also required that the deficit be brought back to below 3% of GDP within the timeframe set by the Council in the context of the Excessive Deficit Procedure (EDP). The latter had initially fixed 2011 as the deadline for reaching a deficit below 3% of GDP, but extended it in 2010 to 2012 due to a significant worsening of economic conditions.([11]) The implications for fiscal consolidation were that the deficit targets for 2009 and 2010 had to be changed twice within the context of the balance-of-payments programme. The final consolidation path foresaw a reduction in the general government deficit([12]) from 7.8% of GDP in 2009, to 7.3% of GDP in 2010, to below 5% of GDP in 2011 and to below 3% of GDP in 2012 (as outlined in Table 2.1). With a deficit of 9% of GDP in 2009, Romania missed its programme target by a wide margin. In order to bring public finances back under control, the authorities had to take a series of tough austerity measures in May 2010. The government opted for: (i) a 25% reduction in wages in the public sector; (ii) a 15% reduction in all social benefits except pensions; (iii) a freeze in pensions to their 2009 level; (iv) a freeze in early retirement until a new pension law entered into effect; (v) an acceleration in layoffs in the public sector; (vi) an increase in VAT from 19% to 24%; and (vii) the broadening of the personal income tax base.

Table 2.1: **Evolution in the general government deficit compared to programme targets**

	2009	2010	2011	2012*
Bop programme deficit targets (% of GDP)	7.8	7.3	< 5	< 3
Actual deficit (% of GDP)	9	6.8	5.6 (4.5)	2.9

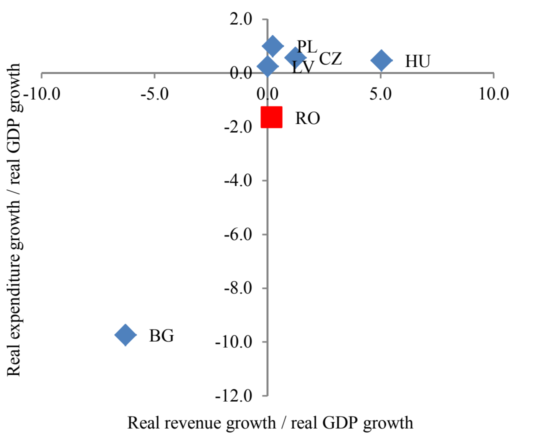
Source: Commission services

([11]) For an overview of the Excessive Deficit Procedure steps, please consult: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/index_en.htm. For more details on Romania, please refer to the related country section at the bottom of the page.

([12]) As measured by net lending/borrowing (N5) of general government according to the European System of integrated economic Accounts (ESA).

25. Since the adoption of the austerity measures, Romania maintained a good track record in terms of achieving its programme deficit targets. Its deficit decreased to 6.8% of GDP in 2010, significantly below the programme target of 7.3%. Romania would also have met the programme target for 2011, but missed it because of a one-off measure worth 1.1% of GDP related to Court decisions.([13]) Without this one-off measure, the ESA deficit for that year would have been 4.5% of GDP, again significantly below the programme target of below 5% of GDP. Moreover, Romania met the deficit target in 2012 (below 3% of GDP in ESA terms), as the outturn was 2.9% of GDP. This led the Council of the European Union to conclude on 21 June 2013 that the excessive deficit situation in Romania had been corrected and to abrogate its earlier decision (Decision

Graph 2.2: **Expenditure and revenue growth 2009-2012 (ratios to economic growth)**



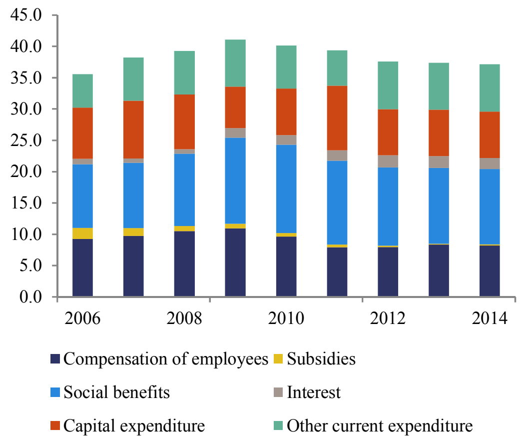
Source: Commission services

([13]) ESTAT's decision on the registration of court decisions was taken at the beginning of 2012. The Court decisions referred to three types of cases: (i) employees from specific sectors of the economy asking for bonuses that were given in other sectors, (ii) teachers that had contested the fact that they did not receive the 50% increase in wages that was decided in 2008 and that the government did not apply, and (iii) individuals contesting the 25% wage cut applied in 2010. The government had passed a law in Parliament at the end of last year which divided the payment of the sum into five yearly tranches from 2012 to 2016. However, ESTAT ruled that according to ESA rules, the authorities need to record the entire sum in 2011 as that is the year when the decisions became definitive and when the exact amount related to these decisions was determined with certainty.

2009/590/EC). The country's prudent fiscal policy stance (Graph 2.2) is also reflected in the fact that its real revenue grew faster than its real expenditure during the crisis period. In particular, the increase in real expenditure was the lowest among regional peers, except for Bulgaria.

26. The measures also started to decrease the rigidity of the expenditure structure. While cyclically-adjusted expenditure decreased as a percentage of GDP from 41.1% in 2009 to 38.9% in 2011 and has fallen further to 35.5% in 2012, the weight of mandatory expenditure items also decreased (Graph 2.3). The weight of personnel expenditure in GDP decreased from 10.9% in 2009 to 7.9% in 2011 and is expected to be slightly above 8% of GDP by 2014 following the last steps in the restoration of the 25% public sector wage cut.([14]) The public sector wage cut was coupled with a reduction in public-sector employment through layoffs and the introduction of a 1-in-7 rule according to which for every 7 people leaving a public institution, only 1 could be hired. The rule was initially applied in a similar manner to all ministries, but has been made more flexible to cover staff shortages in some sectors such as healthcare in 2012. As a result, employment in the public sector was reduced by 189,573 occupied jobs (14%) between December 2009 and December 2012, with most of the reductions being in local government administrations, education and healthcare. The weight of social benefits in GDP was also reduced during the programme period from around 13.8% in 2009 to 12.7% in 2012. This was achieved by consolidating benefits, tightening eligibility criteria and better targeting existing programmes towards the most vulnerable parts of the population. The cuts in social transfers were done in such a way so as to limit the impact on the poorest: the minimum wages and minimum pensions' thresholds were kept unchanged([15]) and a minimum-guaranteed-income scheme was introduced. Subsidies were also reduced from 0.8% of GDP in 2008 to 0.4% in 2012. Heating subsidies from the State budget were eliminated, while local governments were given the freedom to decide whether or not they would continue to grant this type of subsidy from their own resources. In addition, some agricultural subsidies are no longer provided through the Romanian budget, but are instead being granted directly from the EU budget.

Graph 2.3: **Composition of public expenditure (% of GDP)**



Source: Commission services

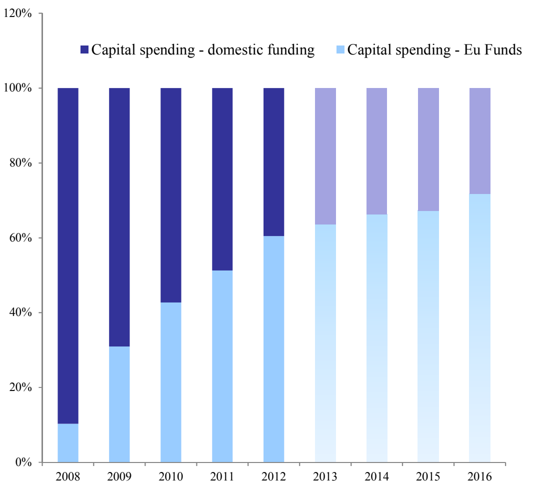
27. Under the programme the authorities tried to re-orient capital spending away from domestic financing sources towards EU Funds and to improve its efficiency. Capital expenditure in Romania appears to be highly inefficient. Notwithstanding one of the highest capital-to-GDP ratios among EU Member States, the quality of infrastructure is very poor: the 2012-2013 World Competitiveness Report ranks Romania as 132 out of 144 countries in terms of quality of overall infrastructure, well below its regional peers. One of the main factors that led to such high capital expenditure was the absence of an investment prioritisation strategy at general government level. Consequently, limited resources tended to be scattered across a very large number of investment projects such that individual projects were chronically under-funded and could not be completed. The authorities have been working as part of the programmes to prioritise investment projects, cancel the projects for which funding could not be ensured and re-orient as many projects as possible away from purely national funding towards EU co-financed projects: the

([14]) Public sector wages were cut by 25% in 2010, for all employees. The measure was temporary and, as fiscal space became available, was restored in several steps: i) in January 2011; increase of 15% compared to October 2010; ii) in June 2012, increase of 8% compared to May 2012; iii) in December 2012, an increase of 7.4% compared to November 2012.

([15]) Since then the minimum wage was increased to RON 700 in 2011, to RON 750 as of 1 February 2013 and is set to be increased by another RON 50 to RON 800 (about EUR 183) on 1 July 2013.

structure of funding for capital investments has changed from 90% domestic and 10% EU-cofinanced investments in 2008 to 40% domestic and 60% EU co-financed spending in 2012 (Graph 2.4). Capital spending was reduced from 7.7% of GDP in 2008 to 5.6% of GDP in 2012 and is forecast to remain around 6% of GDP in 2013 and 2014. Work in the direction of a better prioritisation has also taken place. A capital budgeting unit inside the finance ministry has been set up. It produces quarterly reports on central government investment projects that are submitted for discussion in government meetings. Work is under way for updating the database with the status of projects co-financed by the central and local governments. However, a true prioritisation strategy for capital investments (at both local and central government) and a proper medium-term budgeting of priority investments is not yet in place.

Graph 2.4: **Structure of funding for capital investments (2008-2016)**



Source: Romanian Ministry of Public Finance

28. Finally, expenditure on goods and services ([16]) as a percentage of GDP remained relatively stable between 2009 and 2012. However, a large part of it currently is related to healthcare spending and cannot easily be decreased given the acute underfunding in the sector (Romania is the country with the lowest spending on healthcare as a percentage of GDP among all EU Member States), the need to reduce payment delays for pharmaceuticals and the need to keep arrears under control.

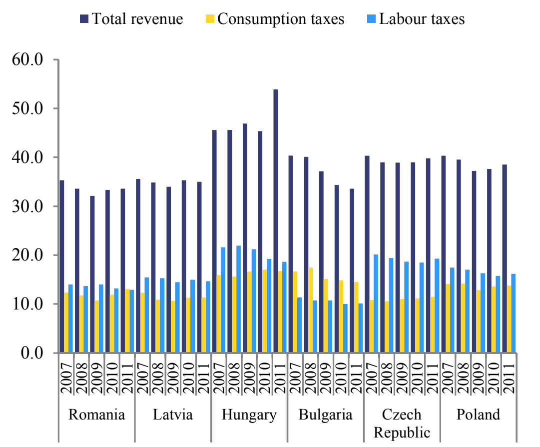
29. Revenue-side measures were limited in the fiscal adjustment process. Apart from the increase in the VAT rate and the increase in excise rates in accordance with the calendar agreed with the EU, the other measures mainly consisted of enlarging the personal income tax base. However, a number of tax administration measures were also taken in order to improve tax collection. These measures were not part of the Memorandum of Understanding with the EU, but were included in the Memorandum of Economic and Financial Policies (MEFP). They are necessary to increase Romania's budget revenue as a share of GDP which is among the lowest in the EU-27 Member States. The most important tax administration measures related to: i) a 20% reduction in the number of small VAT taxpayers registered for VAT purposes in order to allow the tax authority to better use its resources and focus on the compliance of the large VAT taxpayers which bring in most of the revenue; ii) the set-up of a high-net-wealth-individuals tax compliance programme (and the related department within the tax administration) which started its activity by compiling a list of high net-wealth individual taxpayers with high non-compliance risks and by launching verification procedures. However, even though budget revenue has increased as a percentage of GDP during the 2009-2011 period, which was not always the case among regional peers (Graph 2.5), tax productivity indicators([17]) dropped over the same period for the main tax items. The CIT (Corporate Income Tax) productivity ratio dropped from 16.6% in 2009 to 13% in 2011, while the PIT (Personal Income Tax) productivity ratio decreased from 23% in 2009 to 21% in 2011. Despite the increase in the VAT rate, the VAT gross compliance ratio decreased in a first step, but recovered to levels similar to 2009 by 2012, namely 36%. Nevertheless, VAT productivity remains low. The tax efficiency indicators suggest that improving tax collection remains a challenge for Romania and further tax

([16]) Figures on goods and services expenditure are based on cash data as this category is not part of the standard ESA classification. All other figures are based on the ESA95 definition. The cyclical adjustment of revenue and expenditure was based on potential GDP.

([17]) Tax productivity is calculated as a ratio between revenue-to-GDP and the tax rate.

administration measures would be necessary in the future.

Graph 2.5: **Ratio of total revenue & main tax categories to GDP in selected EU countries**



Source: Commission services

2.1.2. Payment discipline and arrears

30. Government arrears have been difficult to control throughout the two programmes and continue to pose a problem. The stock of arrears (0-360 days) has increased from RON 2.8 bn at end-December 2009 to RON 3.8 bn at end-December 2012, while remaining constant as a ratio to GDP (0.6% of GDP). While more recently, the stock has come down to RON 3.2 bn (end-April 2013), it is still higher that at the start of the first program in nominal terms (see Graph 2.6). The stock of arrears over 90 days, formally monitored under the program, registered a similar pattern: they fell only slightly from RON 1.6 bn at end-December 2009 to RON 1.5 bn at end-October 2012, to be reduced more recently, at end-April 2013 to RON 0.8 bn (see Graph 2.7). Arrears at central government level and in the social security sector were controlled better, while those at local government level still pose challenges.

- Arrears (both from 0-360 days and above 90 days) at the **central government** level have decreased significantly between December 2009 and December 2012. Arrears above 90 days were reduced from RON 0.6 bn in December 2009 to RON 27.7 mn at December 2012, only slightly above the end-December 2012 program target of RON 20 million. There was, however, an increase in the stock of arrears in recent months (RON 73 million at end-April 2013), which led Romania to miss the end-programme target of RON 20 million.

- Arrears (0-360 days) in the **social security sector** increased during the same period (December 2009 - October 2012), while those over 90 days have been kept close to zero since September 2011. Additional budget allocations to pay bills were necessary to reduce health-sector arrears, after which the introduction of a new formula for the claw-back tax at the beginning of 2012 has, so far, been successful in controlling arrears.([18]) The authorities were also able to clear unregistered bills in the health sector uncovered during a stocktaking exercise in 2011. However, legal payment delays for bills in the health sector, at 210 days, were substantial, but should be reduced starting March 2013, in keeping with the Late Payments Directive.([19]) The government has foreseen RON 3.5 bn in the 2013 budget to reduce payment delays in the sector to 60 days in order to comply with the EU Late Payments Directive in this area. Despite some measures taken or planned such as the publication of hospital arrears data and the possibility to fire managers of arrears-incurring hospitals, over the medium term, the healthcare sector remains a major contingent liability for public finances. In-depth reforms (see section 2.4.1 on structural reforms in the healthcare sector) are urgently needed in order to introduce a sustainable system of financing that would make it possible to prevent arrears going forward.

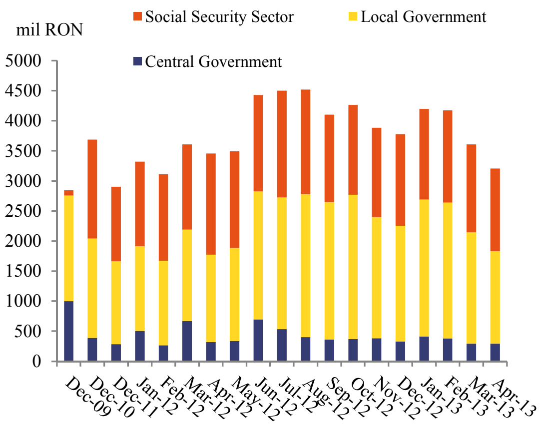
- **Attempts to control arrears at the local government level have failed and arrears have continued to increase**. The authorities changed the local government public finance law as part of programme (LoI/MEFP) conditionality to better control arrears. Key features of the law include the prohibition for local governments to undertake new spending commitments until arrears were paid off, as well as balanced-budget rules applied on

([18]) The revenue from the claw-back tax is used to pay overdue bills in the pharmaceutical sector.
([19]) Directive 2011/7/EU of 16 February 2011 on combating late payment in commercial transactions

spending including arrears. However, the law was poorly enforced and failed to prevent arrears from re-accumulating. The government then took additional measures in September 2012 to bring local government arrears under control. These included: (i) direct payment by the central government of local-government arrears from shared taxes; and (ii) the possibility for local governments to use revenue from shared taxes to pay arrears, as opposed to the previous situation where this revenue could only be used for co-financing investment projects. The authorities also conducted an audit of the use made of additional transfers from central to local governments to pay back arrears and has committed to enforce, together with the Court of Auditors, strict sanctions on local governments which breach the local public finance law. Moreover, an additional RON 500 mn (0.1% of GDP) were given to local governments in the last budget amendment of 2012 to clear arrears. However, data shows that these measures have not been successful. It seems that local governments had unregistered bills which they uncovered once the central government began paying arrears. The end-2012 target of RON 300 mn was missed by a wide margin, and as part of the corrective measures agreed in January 2013, the authorities were requested to meet the same target by end-June, based on arrears data as of end-May 2013.

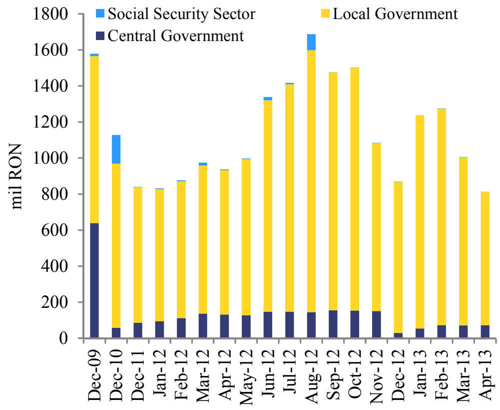
- Since January 2013, a new set of measures aims at reducing local government arrears: (i) local governments with arrears raised property tax rates in line with inflation; (ii) commitments on local government investments on projects co-financed by the central government within budgetary allocations were contained; and (iii) an insolvency law for local governments was approved. Additionally, the Finance Ministry offered an RON 800 mn treasury loan to local authorities for the payment of arrears. Despite these measures, local government arrears amounted to 510 mn RON at end-May 2013 according to preliminary data and were therefore higher than the RON 300 mn arrears target. Of these, the government disputes the validity of bills worth RON 360 mn on various grounds.[20] The IMF considers that these "disputable" arrears are technically not arrears to be counted against the programme target. The IMF therefore considered that the prior action for their last review was met.

Graph 2.6: **Arrears 0-360 days (RON mn)**



Source: European Commission and Ministry of Public Finance, Romania

Graph 2.7: **Arrears 90-360 days (RON mn)**

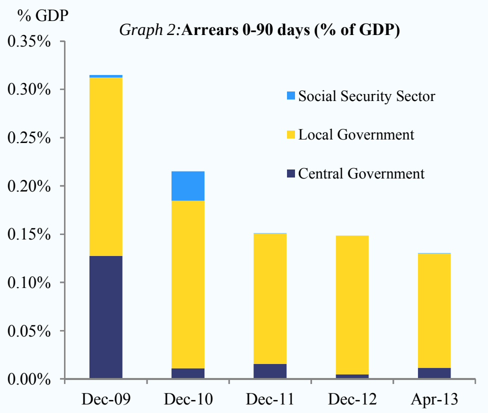


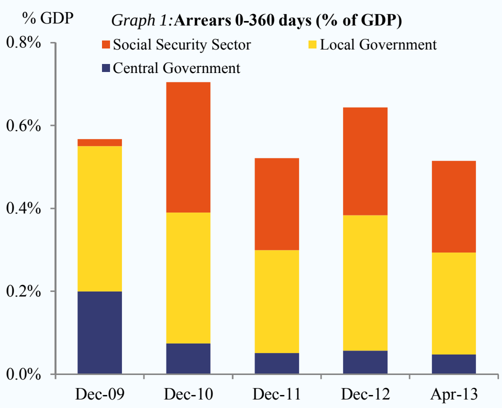
Source: European Commission and Ministry of Public Finance, Romania

(20) According to the latest MEFP, these claims are disputed for one of the following reasons: (i) failure to comply with relevant laws and regulations; (ii) improper invoicing or procurement process; and (iii) a lack of evidence regarding completion of work invoiced. An investigation by the Court of Accounts is planned and the exact nature and causes of these arrears will be clarified once the investigation is finalised.

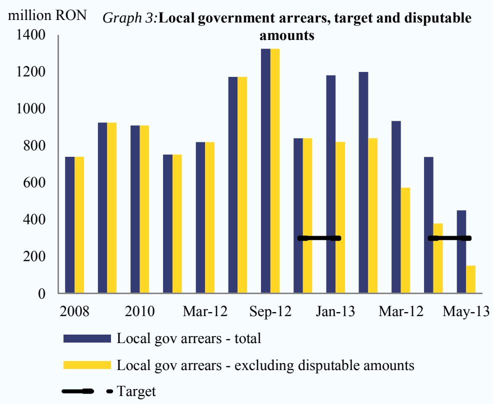
Box 2.1: Arrears situation in Romania

Arrears have been a long-standing problem for the budget in Romania. While they have been reduced during the programme and their proportion in GDP is now 0.5% of GDP for 0-360 days payment delay and 0.1% of GDP for 0-90 days payment delay, the latter being the ones formally monitored during the programme (Graph 1 and Graph 2), their recurrence is a constant threat to budget discipline. If some of the institutional weaknesses that lead to the accumulation of arrears in the past have been tackled during the programme, there is still a significant risk that they could re-emerge. A proper enforcement of the laws, as well as the envisaged development of a comprehensive commitment control system are necessary in order to ensure a better control of arrears. Arrears in social security and at the central government level have been easier to control and therefore remaining amounts are small (Graph 2).



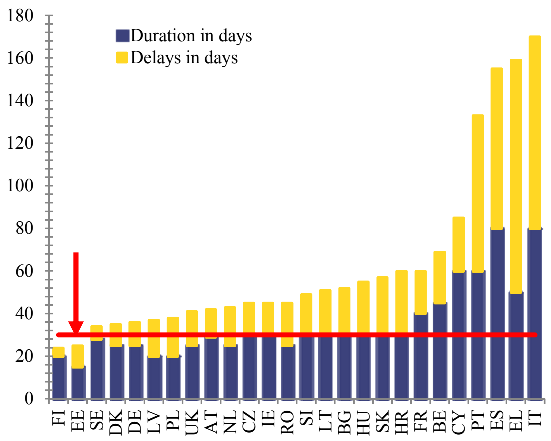


However, an important challenge still remains regarding the control of local government arrears. The local government arrears target as of end-December 2012 was missed and subsequently the government had to bring arrears within the same target by end-June 2013 (Graph 3). Despite efforts undertaken, the target was considered met only with an important caveat, regarding a significant amount of arrears which is currently "disputable": the central government has doubts that the related expenditure has been made with fulfilment of all legal provisions and therefore considers that they should not be considered against the target. An investigation of the Court of Accounts looking into the details of the "disputable" arrears has yet to start.



31. Despite the payment delays of the public administration in Romania being in line with EU practice recently, improved mechanisms for ensuring control of arrears are necessary in order to prevent their re-accumulation. Payment delays by the public administration to businesses in Romania are in line with the EU average (See Graph 2.8), although still over the 30 days threshold foreseen by the Late Payment Directive, which entered into force in March 2013. Control of arrears is important both for the improvement of the efficiency of the public administration in dealing with the business environment, and also for a more predictable picture of government finances. Over the medium-term, a more in-depth reform of local governments, including a strict implementation of the local government insolvency law as well as a better commitment-control system at the level of central government, will be necessary to prevent a re-accumulation of arrears.

Graph 2.8: **Average payment duration of bills by public administration to business, 2013**



Source: European Payment Index 2013

2.1.3. Fiscal governance reforms

32. Fiscal policy conditionality also included a number of governance reforms aimed at addressing the institutional weaknesses that had led to fiscal slippages in the past. These reforms included the introduction of a Fiscal Responsibility Law and the creation of an independent Fiscal Council, the introduction of a Unified Wage Law and the adoption of a Pension Reform aimed at improving the long-term sustainability of public finances. Measures were also taken to improve the budgeting process through: (i) the introduction of an enhanced reporting system for State-Owned Enterprises (SOEs) included in the general government sector; (ii) control by the Ministry of Public Finance of hospital budgets such that they are consistent with programmed expenditure in the overall budget; (iii) a prioritisation of public investment projects; (iv) a reorientation of capital spending away from national spending towards EU co-financed spending; and (v) the reinforcement of the National Institute of Statistics' capacity in compiling government finance statistics and improvements in the methodology used. The latter conditions were linked to the data shortcomings that led ESTAT to put a reservation on the quality of Romanian data during the 2011 EDP Spring notification. The authorities implemented the measures and ESTAT subsequently lifted the reservation in the EDP autumn notification of the same year.

33. The Fiscal Responsibility Law (FRL) was adopted in 2010. It aimed at: (i) introducing a framework of principles to ensure fiscal discipline, including a number of numerical fiscal rules; (ii) strengthening the already existing medium-term budgetary strategy; and (iii) creating an independent Fiscal Council.([21]) The medium-term budgetary strategy sets binding ceilings for the following two years for the budget balance and personnel expenditure, as well as binding ceilings for the following year for a series of other budget indicators such as the primary balance and the level under which the government and local authorities can issue guarantees. The government is also required to use the targets set in the medium-term budgetary strategy as inputs when elaborating the budget for the following year. The Fiscal Council has been set up and is operational since the second part of 2010. It had, however, limited resources which reflected upon its capacity. Capacity should improve in the future, as the council was granted a derogation from the public hiring restrictions that prevented it so far from hiring the planned staff. The Fiscal Council issues opinions and recommendations on official macroeconomic and budgetary forecasts, the annual budget laws, assesses the compliance of the medium-term budgetary strategy with the principles and rules specified in the FRL and the budgetary performance of the government against fiscal targets and policies.

34. Long-term sustainability of public finances was enhanced through the pension reform. The pension reform adopted in late 2010 as part of programme conditionality provides for a gradual indexation of pensions to inflation,([22]) tightens the eligibility criteria for disability pensions and renders compulsory contributions to the social

([21]) www.fiscalcouncil.ro

([22]) The indexation mechanism for pensions initially foresees an increase in pensions according to 50% real wage growth + 100% inflation. The share of the real wage growth in the indexation mechanism will be reduced gradually to 0% by 2030. The indexation mechanism will be applied for the first time in the 2013 budget. Until now, pensions have been frozen at their 2009 level in order to meet the deficit targets.

security system for several categories of individuals that did not have to contribute before. The law also increases the retirement age for men to 65 years and for women to 63 years, which is at odds with the EU recommendation to the EU member states to equalise the pensionable age for men and women. The gradual increase of the retirement age for women to 63 years instead of 65 as originally planned will only have a fiscal impact starting in 2025 when the public pension system will have a higher deficit compared to the scenario where the retirement age for both men and women would be 65. The peak difference between the deficits of the public pension system according to the two versions of the law would be around 0.5% of GDP in 2032.

35. Public sector wages were streamlined and made transparent through the unified wage law adopted in 2010, which will be phased in gradually. The law introduced a new wage grid in the public sector. The different job categories are classified into 15 hierarchical levels each with 9 executive grades. Wages will be calculated as the product of the wage grade and the hierarchical coefficient assigned to each grade. The value of the wage coefficient is set every year in a separate implementing law. The total sum of bonuses, compensations and allowances are capped in the new law and cannot exceed 30% of the individual base salary and of the aggregate total budget for every main budget manager. The new wage grid foreseen by the unified wage law cannot yet be fully applied for several years because it would otherwise imply a wage bill that is not sustainable from a budgetary point of view. The government expressed its intention to apply it starting with the 2014 budget, but it is not yet clear whether enough resources are available to do so.

36. Other fiscal governance reforms are being implemented. These include the introduction of an enhanced monitoring system for SOEs, the prioritisation of public investment projects and the integration of the accounting reporting system with the treasury payment system in the finance ministry. The latter will allow, upon its finalisation, a move towards ESA accounting in real time. The enhanced monitoring system for SOEs that are part of general government is in place; therefore, those SOEs report cash data on a monthly basis. The finance ministry is still fine-tuning the reporting system to eliminate monthly volatility of data before including the SOE data in the monthly cash-deficit figures. The IT project aiming to integrate the accounting reporting system with the treasury payment system has incurred delays due to procurement issues. The contract with the IT developer was signed in March 2013 and the finalisation of the structural architecture is expected to be finalised with delay in June (structural benchmark for the last IMF review). The system should be finalised in spring 2014. It would then be tested on execution data until end-2014 and should be fully operational (both commitment and execution data) as of January 2015. Steps were taken regarding the prioritisation of public expenditure (as explained in paragraph 26). A proper strategy for all capital spending at both central- and local-government sectors, as well as medium-term budgeting for the priority projects is, however, still outstanding.

37. Overall, fiscal policy conditionality has broadly been complied with. The budget deficit has been brought down to sustainable levels and the country has corrected its excessive deficit as required under the Excessive Deficit Procedure. The authorities have also implemented a number of reforms aimed at correcting the institutional weaknesses of the past. The key challenges for public finances going forward are the control of general government arrears, especially in the health sector and at the local government level, and both in the short and medium term. This would require the implementation of a number of in-depth structural reforms in the health sector as well as in the organisation of local governments. Public finances in Romania will continue to remain vulnerable as long as such reforms together with a thorough restructuring of state-owned enterprises are not put in place and properly implemented. Regarding fiscal governance reforms, an improvement in the analysis undertaken in the medium-term budgetary strategy, together with enhanced monitoring of budget entities at central level and the development and implementation of an overall public investment prioritisation strategy, remain key issues going forward.

2.1.4. Debt management and sovereign financing situation

38. Further progress has been made in streamlining public debt management. In line with the updated debt management strategy (March 2013),([23]) the Debt Management Office (DMO) has continued lengthening the maturities and smoothing out the redemption profile of its debt instruments. In line with this target, the treasury has raised RON 1.1 bn issuing a 10Y bond in January 2013 (which has been already reopened in March, April and May 2013 raising an additional RON 1.5 bn) and has re-tapped a 15Y bond issuing the planned RON 200 mn in late May. The share of debt maturing in the next 12 months would remain below 45% for the local-currency debt and 25% for the total debt. The financing strategy aims at financing the budget deficit in a balanced way from domestic and external markets and to refinance the debt respective of the origin of the instrument.

39. The treasury has built up a comfortable financing buffer that should be maintained. Since 2010, the treasury has made efforts to maintain a foreign-currency buffer to avert roll-over risks. The target of 4 months of gross financing needs (RON 22.7 bn, i.e. EUR 5.1 bn) has been reached since January 2013 with a wide margin, partly thanks to the inclusion of the World Bank DDO-DPL loan (Development Policy Loan with a Deferred Drawdown Option effective since 11 January 2013). Maintaining this buffer is warranted given the on-going repayments to the IMF which amount to some EUR 570 mn on the side of the treasury from July to December 2013 (IMF assistance was provided to both the treasury and the central bank - see table in Annex 2). Looking forward to end-2013, the treasury should have a handful of opportunities both within the EMTN (European Medium Term Note) programme and on the domestic market to maintain the level of the buffer.

40. The yearly review of the debt management strategy has been conducted on time in March 2013 as agreed under the programme. In particular, the operational benchmarks within guidelines for managing the foreign-currency debt and refinancing and interest rate risks have been set. As for the foreign-currency management, the treasury will pursue a balanced funding mix keeping a minimum share of 40% of domestic-currency-denominated debt in total debt. When it comes to refinancing risks, the treasury targets maintaining the average remaining maturity above 2 years for domestic-currency-denominated debt and above 4 years for total debt. With respect to interest rate risk, the debt with interest re-fixing in the next 12 months should not exceed 45% for the domestic-currency debt and 35% for the total debt.

41. The deficit financing and roll-over of domestic sovereign issuances have been very favourable recently. The treasury has taken advantage of the positive market sentiment securing financing early this year (around 57% of funding needs raised by end-June 2013). Despite the strong jitters in June based on the US FED policy steering, recent auctions of government securities on the domestic market show a significant improvement of financing conditions (see Graph 2.9).

42. The abundant liquidity on external markets keeps interest rates at historically-low levels. In June 2013, the EMTN programme was increased to EUR 8 bn. Romania already raised USD 1.5 bn in February 2013 at a yield of 4.5%. This issuance covers nearly half of the targeted issuances for 2013 (EUR 2.7 bn, i.e. USD 3.6 bn). Furthermore, Romania's international visibility has been boosted by its inclusion into JP Morgan's and Barclays' emerging market indices starting March 2013. Indeed, already prior to the inclusion, but following its announcement the securities held by non-residents as a proportion of the total securities issued in the domestic market increased from 11% to 27.8% between 1 December 2012 and end-May 2013. The investors were mainly interested in medium-term maturities. However, this money can leave the market just as fast as it entered the country with repercussions both on the exchange rate and on the government bond market.

43. The finance ministry is considering issuing government bonds dedicated to the households. This would happen for the first time in almost ten years with the intention to expand the investor base and to encourage long-term savings. Over the past few years the Romanian state has preferred relying

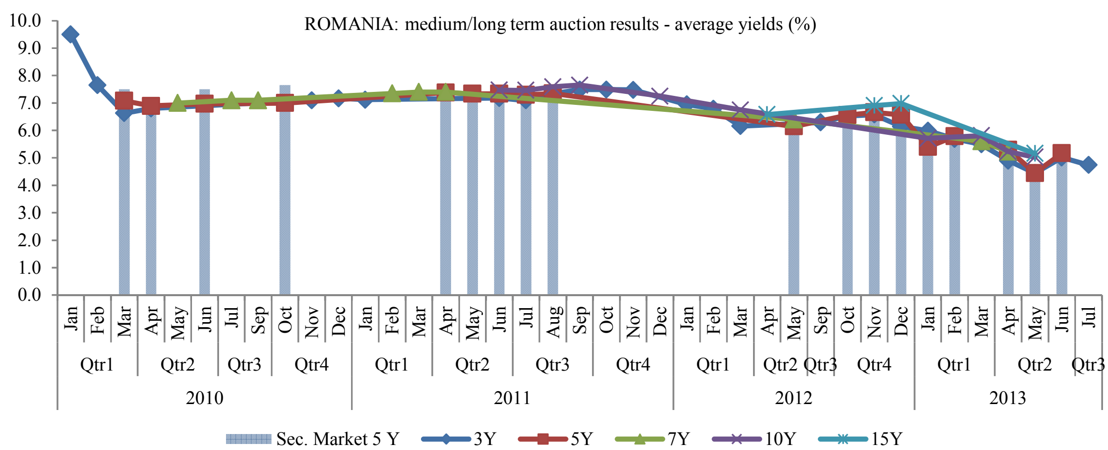
([23]) http://discutii.mfinante.ro/static/10/Mfp/buletin/executii/Gov_publicdebtmanag_strategy2013_2015.pdf on bank financing to avoid competing against banks for resources by launching its own investment instruments dedicated to households. Even though this approach may be more expensive, it is also more reliable. As such, bonds to households can be one of the stabilising elements in the debt management strategy.

44. From July 2013 till end-2013, total government refinancing needs are estimated at EUR 7.6 bn (RON 34.4 bn). Given the authorities' commitment to target a cash deficit for 2013 of 2.1% of GDP, i.e. EUR 2.9 bn (RON 13.1 bn) and the latest data for January to May 2013 bringing it to 1.05% of GDP (EUR 1.4 bn, i.e. RON 6.5 bn), the needs to cover the deficit in the second half of the year are estimated at some EUR 1.4 bn (RON 6.3 bn, see 2.2). Government securities maturing in the second half of 2013 amount to EUR 5.6 bn (RON 25.4 bn) and are made up of T-bills (EUR 1.8 bn), RON-denominated bonds issued on the domestic market (EUR 2.1 bn) and domestically-issued bonds in EUR (EUR 1.7 bn). No external issuance matures in 2013. Repayments by the treasury([24]) of IMF assistance (see table in Annex 2) in the second half of 2013 amount to some EUR 570 mn, thus bringing total government financing needs for July till end-2013 to around EUR 7.2 bn. Given the abundant liquidity buffer, accommodating the sovereign's financing needs, including IMF repurchases, should not be a problem at least until end-2013.

45. For 2014, total sovereign financing needs are estimated at EUR 10.5 bn while for 2015, the estimates are around EUR 8.8 bn. For 2014, EUR 10.5 bn comprises the cash deficit being projected at about EUR 2.7 bn, sovereign redemption of securities estimated at EUR 6.8 bn and IMF repayments at EUR 1 bn (on the treasury side). In 2015, estimates of these needs sum up to some EUR 8.8 bn, assuming a cash deficit around 1.6% GDP (i.e. about EUR 2.5 bn), with EUR 4.5 bn for government securities redemption and EUR 1.8 bn for repayments of the official assistance by the treasury (i.e. around EUR 155 mn to the IMF and EUR 1.6 bn to the EU).

([24]) IMF assistance has been provided to both the treasury and the central bank, with around 18% of overall resources being made available to the treasury.

Graph 2.9: **Romania - medium/long term auction results for RON denominated issuances (average yields, %)**



Source: Bloomberg

Table 2.2: **Sovereign's financing needs**

Sovereign´s gross financing needs in 2013		EUR bn	RON bn
Total financing needs		**14.4**	**65.0**
Total financing needs without Treasury bills´ redemptions		**8.2**	**37.3**
of which			
Cash deficit (2.1% of GDP)		**2.9**	**13.1**
Sovereign bonds maturing in 2013		**4.4**	**19.9**
RON bonds, domestic market		2.6	11.9
FX bonds, domestic market		1.8	8.0
FX bonds, international market		0.0	0.0
Treasury bills maturing in 2013		**6.1**	**27.7**
Official assistance, repayment of principal (Treasury)		**1.0**	**4.3**
Sovereign´s gross financing needs in Q3-Q4 2013		**EUR bn**	**RON bn**
Total financing needs		**7.6**	**34.4**
Total financing needs without Treasury bills´ redemptions		**5.4**	**24.5**
of which			
Cash deficit (2.1% of GDP)		**1.4**	**6.3**
Sovereign bonds maturing in 2013		**3.9**	**17.5**
RON bonds, domestic market		2.1	9.5
FX bonds, domestic market, EUR		1.8	8.0
FX bonds, international market		0.0	0.0
Treasury bills maturing in 2013		**1.8**	**8.0**
Official assistance, repayment of principal (Treasury)		**0.6**	**2.6**
Debt issuances in 2013 (as of 20 June 2013)	**avg. weighted residual maturity (months)**	**FX bn**	**RON bn**
Total issuances	**60.6**		**36.8**
of which			
Medium-to long term instruments	**70.3**		**30.7**
RON bonds, domestic market	64.2		20.7
FX bonds, domestic market, EUR	35.4	1.1	4.9
FX bonds, international market, USD	128	1.5	5.2
Treasury bills (<1y)	**11.3**		**6.1**
Gross financing needs covered as of 20 June:			**56.60%**
Memo items			
Nominal GDP 2013, EC Spring forecast, RON bn			623.4
Exchange rates (as of 20 June 2013)			
RON/USD			3.44
RON/EUR			4.53
SDR/EUR			1.14

Source: Bloomberg, IMF, Ministry of finance, exchange rates: NBR, IMF

2.2. FINANCIAL SECTOR REGULATION AND SUPERVISION

Objectives and conditionality

Under the first balance-of-payments programme, financial-sector policy conditionality was geared towards maintaining financial stability, enhancing the bank-resolution framework and the safety nets available in cases of financial distress. Furthermore, to help preserving financial stability, the commitments of the nine euro-area parent banks with affiliates operating in Romania to maintain their exposure to the country throughout the programme period and provide capital support to their Romanian affiliates constituted a flanking measure to the BoP conditionality in the financial sector.*

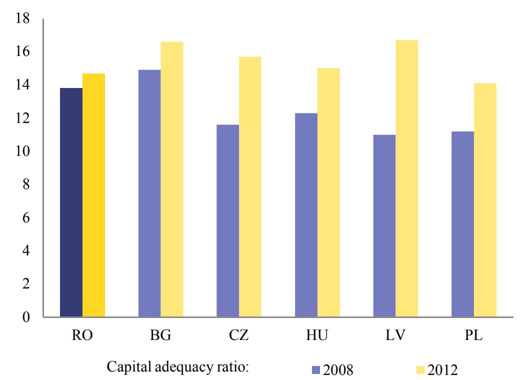
Under the second programme, financial-sector policy conditionality aimed at further strengthening the bank-resolution framework and the preparedness of the National Bank of Romania (NBR) to deal with episodes of financial distress. Furthermore, banking-sector conditionality also aimed at cleaning up of bank balance sheets to ensure the flow of credit to the real economy.

Note: *In the framework of the European Bank Coordination "Vienna" Initiative (Vienna 1.0), the euro area parent banks of the nine largest subsidiaries operating in Romania (accounting for roughly 70% of bank assets) have committed to: (i) maintain their exposure to the country at end-March 2009 levels through the programme period, thereby consolidating the private sector involvement in the programme; (ii) provide at predefined deadlines any additional capital that may be needed to maintain at least a 10 % capital adequacy ratio in their local affiliates, on the basis of stress test conducted by the NBR. To signal the return to normal market conditions, the exposure commitments of these parent banks were not formally prolonged under the second BoP programme. However, in the absence of such commitments, the euro area parent banks committed to maintain their subsidiaries well-capitalised (i.e. solvency well above 10%).

46. Against the backdrop of capital outflows and mounting pressures on the interbank market at the onset of the financial crisis, the banking sector also came under pressure. Following a period of double-digit credit growth, asset quality in the banking sector deteriorated significantly, with non-performing loans increasing from roughly 4.5% at end-2008 to 6.5% at end-March 2009. The deterioration in asset quality started to weigh on the performance of the banking sector, as profitability entered negative territory in the first quarter of 2009. The liquidity pressures in the banking system, which emerged in mid-October 2008, declined somewhat in the first quarter of 2009, as the NBR provided liquidity through repo operations and its existing facilities. However, the Romanian banking sector had similar levels of capitalisation and non-performing loans at the onset of the financial crisis as compared to its peers (Graph 2.10 and Graph 2.11).

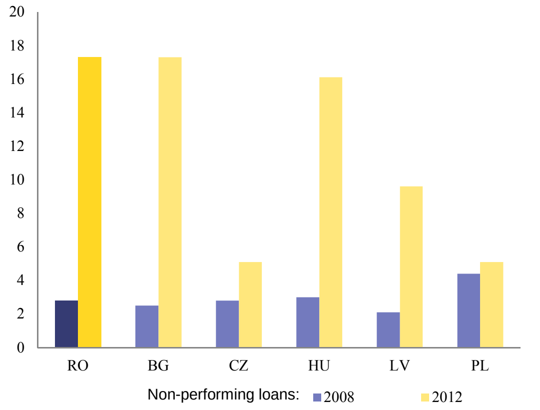
47. Under the first programme, the bank-resolution framework and the deposit-guarantee fund were strengthened in line the EU legislation. Authorities enhanced the powers of the administrators of banks placed under special administration by taking into account the requirements of the EU company law. To observe the rights of creditors of banks placed under special administration, a compensation fund, administered by the deposit-guarantee fund (DGF),

Graph 2.10: **Banking sector capitalisation in Romania & selected countries (% points)**



Source: IMF, NBR

Graph 2.11: **Asset quality in Romania & selected countries (% of total loans)**



Source: IMF, NBR

was set up. The resources accumulated in this fund are earmarked for granting compensations to creditors that are negatively affected by measures taken in a special administration procedure. Furthermore, authorities passed legislation to enhance the remedial powers of the NBR in cases of financial distress. To strengthen depositor compensation, the deposit-guarantee legislation was amended to simplify the procedures for the activation of the deposit-insurance scheme and to shorten the period for compensation pay-outs. Authorities also enhanced the corporate governance of the deposit-guarantee fund as well as its *ex-ante* funding. Moreover, the legislation on the winding-up of credit institutions was amended as requested under the programme. In the area of non-banking financial supervision, the legislation on the independence of non-banking financial regulators was finalised in May 2010 in line with the programme requirements, but with delays compared to initial deadlines.

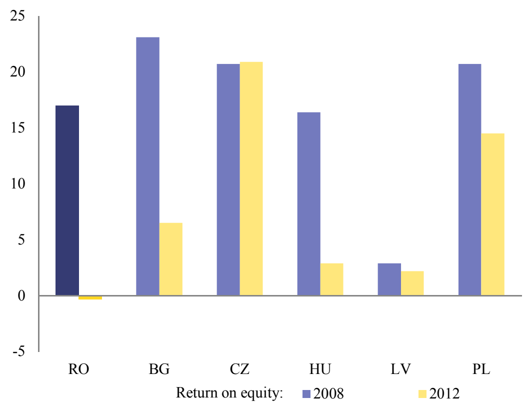
48. The bank-resolution framework was further enhanced through the conditionality foreseen in the second programme. Authorities introduced in January 2011, with slight delays compared to the initial deadlines, bridge-bank powers and other stabilisation measures including purchase and assumption transactions. Furthermore, the NBR enhanced its contingency planning and preparedness to deal with situations of financial distress. Notwithstanding some delays, the exchange of information between the NBR and the deposit-guarantee fund was further improved on the basis of a Memorandum of Understanding signed between the two institutions in April 2012. The International Financial Reporting Standards (IFRS) were introduced as the accounting basis for the entire banking sector in January 2012. To preserve under IFRS the prudent provisioning regime as under the Romanian Accounting Standards, the authorities introduced as of January 2012 prudential filters on solvency, loan-loss provisions and reserves, which became permanent at the beginning of 2013. However, these prudential filters will have to be phased out within five years after the entering into force of the CRR/CRD IV (Capital Requirements Regulation/Capital Requirements Directive IV).

49. To address the vulnerabilities associated with foreign-currency denominated lending, the NBR adopted in 2011 measures aimed at further discouraging un-hedged consumer borrowing in foreign exchange. Following a recent NBR assessment, some of these measures were also extended to un-hedged Small and Medium-sized Enterprises (SMEs) in line with the ESRB (European Systemic Risk Board) recommendations. To encourage the cleaning up of bank balance sheets as committed to in the programme, the June 2012 amendments to the Fiscal Code changed the unfavourable fiscal treatment applicable to bank receivables sold to asset-recovery companies incorporated in Romania. Due to several delays in Parliament, the SMoU deadline (end-October 2012) on the enactment of the law on the winding up of insurance companies was not met. In the latest MEFP negotiated in January 2013, authorities committed to enact this law by end-March 2013. Following the approval by Parliament, the Law 139/2013 amending the law on the winding-up of insurance companies was published in the Official Journal on 9 May 2013 and entered into force on 12 May.

50. With the exception of several provisions in the legislation on the setting-up on the non-bank financial regulator, authorities complied with the financial sector policy conditionality under the two programmes and managed to preserve financial stability notwithstanding the subsistence of several pockets of vulnerability both internal and external. Banking sector capitalisation has remained at reassuring levels throughout the two programmes and in line with peers. The nine euro-area parent banks participating in the first phase of the European Bank Coordination "Vienna" Initiative have complied with their commitment to maintain their Romanian subsidiaries well-capitalised (Graph 2.10). However, going forward, the banking sector remains vulnerable to the still on-going deterioration in asset quality, which is also putting pressure on post-provisioning profits (Graph 2.11). Against the backdrop of increasing loan-loss provisions and high funding costs, in particular for banks with Greek and Cypriote capital, the profitability of the Romanian banking sector was in negative territory in the third quarter of 2012. In contrast, its peers recorded positive results, with the Czech Republic and Poland among the best performers (Graph 2.12). Foreign-bank deleveraging has been orderly so far. The exposure of the nine euro-area parent banks, which were part of the first phase of the "Vienna" Imitative, stood at 87.2% of the March 2009 benchmark level at the end of May 2013 compared with roughly 92% at end of December 2012. The country has been confronted with unwarranted spill-overs from the Cypriote package, as the branch of Bank of Cyprus operating on the Romanian market was initially supposed to be subject to the bail-in of depositors. The bail-in of Romanian depositors would have had a negative impact on the operations of banks with Greek capital and, consequently, also on financial stability in Romania. Following a carve-out agreement between the Cypriote and Romanian authorities, the local deposit base (backed by assets and cash) of the Romanian branch of Bank of Cyprus was transferred to Marfin, the subsidiary of Popular Bank of Cyprus, and exempted from bail-in. In order to stabilize Marfin on a permanent basis, the change in ownership through a sales process appears as a feasible option going forward.

51. In the latest MEFP, authorities committed to ensure that the legislation on the integrated non-bank financial regulator (FSA) will be in line with international best practices. In this respect, authorities committed to amend the legislation on the FSA to adhere to international best practices, notably as regards minimum-required professional qualifications of FSA board members and avoidance of conflicts of interest. In June 2013, authorities adopted a Government Emergency Ordinance (GEO), which reduced the number of board members of the FSA from 17 to 11. However, this GEO has not fully addressed the outstanding issues on the minimum-required professional experience of FSA board members and conflicts of interest, in particular as regards the connection of these members with members of Parliament. Furthermore, this GEO introduced new provisions with sizeable impact on the budgetary independence of the FSA. Although fully financed by the supervised entities, the FSA will have to transfer 80% of the excess of revenues over expenditures to the state budget.

Graph 2.12: **Banking sector profitability in Romania & selected countries (ROE, % points)**



Source: IMF, NBR

Table 2.3: **Banking sector - Financial soundness indicators**

(%)	07	08	09	10	11	12	12Q3	12Q4	13Q1
Capital Adequacy									
Capital Adequacy Ratio	13.8	13.8	14.7	15.0	14.9	14.9	14.7	14.9	15.0
Leverage Ratio	7.3	8.1	7.6	8.1	8.1	8.6	8.3	8.6	8.2
Ratio of level 1 own funds to credit risk exposure	10.7	11.8	13.4	14.2	14.3	16.6	16.5	16.6	16.7
Asset quality									
NPL's (90 days overdue)	-	2.8	7.9	11.9	14.3	18.2	15.9	18.2	19.1
NPL's (60 days overdue)	4.0	6.5	15.3	20.8	23.3	29.9	26.6	29.9	30.0
Profitability									
Return on assets (after tax)	1.0	1.6	0.3	-0.2	-0.2	-0.6	0.1	-0.6	0.6
Return on equity (after tax)	9.4	17.0	2.9	-1.7	-2.6	-5.9	1.3	-5.9	5.1
Liquidity									
Immediate liquidity	38.7	34.4	35.3	37.8	37.2	35.9	37.5	35.9	37.6

Source: NBR

2.3. STRUCTURAL REFORMS

2.3.1. Healthcare sector

> The overall objective of healthcare conditionality has been to improve fiscal sustainability and the efficiency and effectiveness of healthcare service delivery.
>
> In the first programme, initially no conditionality on the healthcare sector was foreseen. The need for measures in this area was acknowledged towards the end of the first programme, but given the limited time frame until the finalisation of the first agreement, the measures foreseen at the time (co-payment and the need to address arrears in this sector) were taken over in the second programme. Therefore, in the second programme, key conditionality in the SMoU related to: i) the provision of financing to reduce the payment delays in the health sector in line with the Late Payment Directive; ii) the monitoring of public hospital budgets at central government level and further efforts to reduce risks of arrear accumulation in public hospitals; and iii) the introduction of co-payments for medical services.
>
> Conditionality in the MEFP was related to: i) progress towards a comprehensive healthcare reform; ii) the publication of financial statements of public hospitals and introduction of penalties for hospital managers generating arrears; iii) progress towards implementing components of the IT system (health card, electronic prescription, etc.). Various other additional measures have been agreed in the MEFP to increase the efficiency and effectiveness of the healthcare system.

52. The healthcare system is facing major challenges. This includes low health outcomes, underfunding, weak financial controls, and an inefficient and cost-ineffective service delivery structure. Life expectancy at birth is one of the lowest in the EU, and is roughly 6 and 7 years lower than in the EU, for females and males respectively. Similarly, public and private expenditure on healthcare are low. Public expenditure accounted for only 4.5 % of GDP (EU: 6.5%) and 9.0 % (EU: 13.5%) of public government expenditure in 2010, far below EU average (see Table 2.4. This is against a backdrop of cumulative annual increases of 15.5% in public expenditure between 2003 and 2009. Similarly, private funding of healthcare is relatively low, accounting for 21% of total healthcare expenditure (EU: 27%).([25]) In addition to low funding levels, weak financial controls have contributed to the accumulation of considerable arrears in hospital and pharmaceutical spending in the past. The service delivery structure is cost-ineffective. Ambulatory care services are weak and under-funded. There is too much inefficient capacity in too many hospitals. These challenges continuously call for broad and deep reforms of the healthcare system.

53. Healthcare reforms have been initiated, but progress so far has been slow and the extent/impact of reforms is difficult to measure in most cases. Some key measures, related with program conditionality, have been implemented, such as: providing additional financing to reduce payment delays in the health sector; improving monitoring of hospital budgets and introducing penalties for hospital managers that generate arrears; introducing a functioning budget ceiling for pharmaceutical spending (claw-back) and co-payments for medical services; and reducing hospital bed capacity. Still, the system remains severely underfunded and there is yet no government strategy for increasing public or private funding sources for healthcare services.

54. While formal SMoU conditionality has been achieved, several other commitments (in the MEFP), in particular related with a comprehensive reform strategy have been delayed. Rather than introducing a comprehensive framework law, as envisaged in 2012, the government now intends to implement the healthcare reforms via an action plan. This action plan aims to strengthen ambulatory and preventive care, re-evaluate hospital financing to lower the risk of building up arrears, revise the National Health Programmes, define the basic-benefits package, redefine the scope for private funding and improve the regulatory framework for healthcare services. To further increase the efficiency of

([25]) Private funding is nearly fully done via out-of-pocket payments by patients for pharmaceuticals and medical services provided by private clinics and not covered by the social insurance scheme. Private insurance schemes are negligible.

Table 2.4: **Healthcare sector main indicators, 2010**

Country	Life expectancy at birth for females	Life expectancy at birth for males	Total health care expenditure as % GDP	Public healthcare expenditure as % of GDP	Public healthcare as % of total government expenditure	Private as % of total healthcare expenditure	Public hospital expenditure	Public ambulatory care expenditure	Public pharmaceutical expenditure
							as % of public healthcare expenditure		
Bulgaria	77.4	70.3	7.3	4.2	10.4	42.2	61.0	19.5	11.9
Latvia	78.4	68.6	6.5	4.1	11.8	36.9	57.0	20.5	13.3
Lithuania	78.9	68.0	7.5	5.6	12.8	26.2	47.0	23.0	14.1
Hungary	78.6	70.7	7.8	5.0	10.3	35.2	44.0	17.3	26.0
Poland	80.7	72.1	7.0	5.0	11.0	28.3	47.0	26.6	13.5
Romania	**77.4**	**69.8**	**5.7**	**4.5**	**9.0**	**21.1**	**51.0**	**13.5**	**18.7**
EU	77.4	69.8	8.8	6.5	13.5	26.5	47.3	22.5	15.0

Source: Eurostat, Commission services

healthcare spending, the government plans to prepare a medium-term financing strategy by September 2013.

55. Major reform efforts are still outstanding, implying continued inefficiencies and cost-ineffectiveness in healthcare service delivery. This relates to measures such as: introducing systematic assessments of cost-effectiveness of medicines; shifting sufficient resources from inpatient to ambulatory care; implementing centralized procurement procedures; improving IT-structures (central patient database, e-health cards); streamlining the basic-benefits package; improving the regulatory framework for provision and monitoring of healthcare services; and establishing the framework for a private supplementary insurance market. It is too early to judge the impact of the many on-going, frequently-delayed reforms.

56. The slow reform progress implies that the effectiveness of the health system to improve the low health outcomes of the population remains far under its potential. This is disappointing, also in view of a substantial long-term technical assistance by the World Bank. The poor performance regarding a comprehensive reform is due to divergent views within the government on the key features of a credible long-term strategy to improve the fiscal sustainability of healthcare provision. Moreover, there seems to be insufficient commitment from the Ministry of Health to put into effect the recommendations from the EU/IMF/WB for a more efficient and effective use of resources in the sector.

57. Although programme measures have been partially fulfilled, the fiscal sustainability and efficiency of the system has not improved significantly. Further efforts should focus on a targeted combination of policies, specifying quantitative targets. Policies include a more rational use of existing resources, better and tighter controls of interventions that are not cost-effective, and additional funding for the sector (from public and/or private sources). The current action plan presented by the Ministry of Health is promising in this sense. However, it should be strengthened by specifying clear targets, thus allowing for impact assessments and clear measurability of the reform progress.

2.3.2. Labour markets

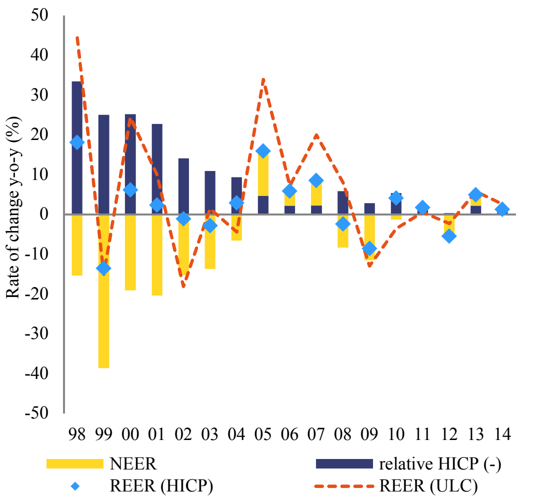
Conditionality related to labour market reforms remained relatively limited in the first programme. The programme promoted measures that would bring down undeclared work and supported the introduction of the Unified Wage Law for the public sector servants with the aim to limit and control the public wage bill over the medium-term and to provide for transparent and comparable conditions of employment.

The second programme aimed at rationalisation of wage bargaining and streamlining wage setting institutions in the private sector. The reform objective has been to allow wages to better reflect productivity developments in the medium term. The aim of the second programme was to avoid backtracking on the ambitious reform implemented in the spring of 2011. The second programme also aimed at improving employability of young employees.

58. At the start of the first programme, the Romanian labour market was characterised by a high share of undeclared work while, due to wages growing faster than productivity, Romania was also losing competitiveness.

Undeclared work has been a long-standing issue in Romania's labour market. Furthermore, prior to the crisis, the Romanian labour market was characterised by fast increases in wages and modest increases in productivity which contributed among other factors to real effective exchange-rate appreciation and growth of unit labour costs (see Graph 2.13) and thus weakened Romania's price competitiveness. Since the crisis, cost competitiveness has been largely preserved due to moderate increases in wages.

Graph 2.13: **Decomposition of real effective exchange rate**



Source: Ameco, EC calcuations

59. There has been a significant rise in the detection by labour inspectors of undeclared work in 2012.([26]) As requested in the MoU, in 2010 the Government prepared and adopted a national strategy on reducing the incidence of undeclared work for 2010-2012.([27]) The national strategy for reducing undeclared work is still under implementation and a law on occasional work of daily labourers was adopted in order to combat undeclared work. The recent progress observed in this area can be partly attributed to enhanced provisions for labour inspection in the labour reforms: inspectors have new powers and can access information more easily, while tough sanctions have been introduced to discourage employers from taking on undeclared workers. It can also be attributed to the new requirement that the employment contract must exist.

60. In the run-up to the second programme, the government pushed through important reforms in the area of labour market legislation. The labour-code amendments aimed to address the limited flexibility of the Romanian labour market. The main changes are related to the extension of the probation period for newly-hired employees, simplifying conditions governing fixed-term individual employment contracts, introducing new terms related to collective dismissals and individual redundancies, strengthening working-time flexibility and temporary agency contracts. The reform has shown already some effects as, for example, nearly one-third of newly-concluded contracts are fixed term.

61. The reform of the social dialogue law has been the second major pillar of the labour market reform that took place at the beginning of the second programme. The Social Dialogue Law has been amended to reform the wage-setting system to allow wages to better reflect productivity developments over the medium term. The new law does not regulate national level collective agreements anymore. Legislative changes also introduced new minimum-membership thresholds for forming trade unions. Collective bargaining is regulated only for collective agreements at company level, for a group of companies, or for a sector of activity, as determined by the government decision of 2011. According to the new legislation, collective agreements concluded at sectorial level only apply to the employees of the companies within the activity sector that the agreement was expressly passed to cover. Whereas the extension of collective agreements in a sector was previously automatically applicable 'erga omnes', under the new law, an extension of agreements is only possible through a special ministerial order. The Social Dialogue Law limits the duration of collective agreements to a maximum of two years. The reforms also changed the representativeness requirements of the social partner organisations. It

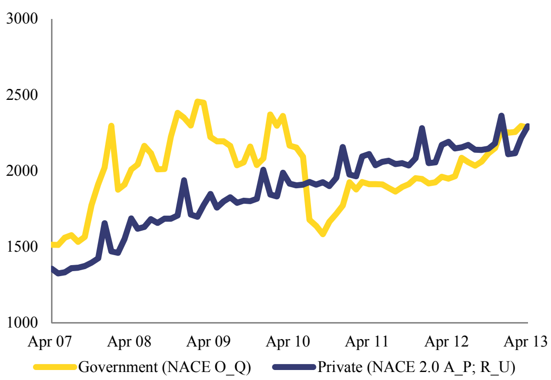
([26]) A report on the informal economy published by the Romanian national trade union confederation (BNS) in 2011 shows that informal employment represents 31.4% of total employment in Romania; http://www.eurofound.europa.eu/ewco/2012/02/RO1202019I.htm.

([27]) The 'National Strategy for the Prevention and Combat of Undeclared Work for 2010-2012' was formalised via a Government Decision (no. 1024/2010). Deriving from the Strategy, a specific national Action Plan was elaborated to implement the strategy for reducing the incidence of undeclared work for 2010-2012.

is no longer possible for more than one trade union to be accredited as 'representative' in a particular company.

62. While it is too early to assess the impact of these institutional reforms on wage bargaining, nominal-wage increases in the private sector are expected to develop more in line with productivity in the coming years. In 2013-14, while productivity is expected to turn positive, nominal compensation per employee is expected to remain moderate and increase by around 5-6%.

Graph 2.14: **Monthly gross earnings (in RON)**



Source: National statistical institute of Romania, EC calculations

63. In view of youth unemployment remaining worryingly high, the authorities stepped up efforts to strengthen the employability of young employees. The programmes dedicated to improve youth entrepreneurial skills and supporting the set-up of micro-enterprises continued. In addition, the government amended the current legislation to improve the transition of young Romanians into the labour market. The law on apprenticeship in the workplace has been submitted to the Parliament, while the draft law on traineeships for higher-education graduates is under preparation. Under the umbrella of the new National Job Plan adopted in April 2013, further measures focus on improving the entrepreneurial culture among youth and support the SMEs, as well as on adapting education and vocational training to the labour market needs. The plan is currently subject to inter-ministerial consultation. To fight the high youth unemployment, reforms supporting the integration of youth into the labour market need to be completed.

64. Further challenges remaining for the Romanian labour market include the weak role of active labour market policies and the promotion of longer working lives. Most of the spending on active labour-market policies goes on various forms of employment subsidies, while training, guidance and counselling are underdeveloped. In addition, the quality of employment activation, job-search and retraining services is still relatively low. Romania is currently modifying the legislation on the unemployment insurance system and on employment stimulation. In this context, it would be useful to reassess the current package of active employment measures. Beyond efforts to strengthen the administrative capacity of the National Employment Agency, it may be helpful to focus policy efforts on better integrating active and passive labour-market policies, with improved targeting to the skill profiles and the needs of the unemployed. Increased attention should also be given to anticipating labour-market needs. Furthermore, measures to promote longer working lives are warranted, as older workers have a high potential for growth. An entrenched culture of early retirement, notably for women, as also indicated by the employment rates for older workers and the duration of working lives, which are among the lowest in the EU, is a key reason for low benefits. Going beyond the 2011 pension reform, Romania is currently rolling out a number of fiscal incentives for the employment of older workers, but labour market measures to promote longer working lives are too few and too isolated to deliver the necessary change in working and retirement practices. A comprehensive active ageing strategy to facilitate longer working lives could enhance synergies between the different current initiatives and would complement efforts on lifelong learning, career guidance policies and good age management in work places.

2.3.3. Energy sector

There were no conditions related to energy sector reform in the first programme. The overall objective of energy sector reforms in the second programme has been to allow the energy sector to better contribute to economic growth in Romania over the medium term by reinforcing a market-driven regulatory framework that creates a level playing field for all economic actors and aligning Romania's market functioning with the EU Single Market rules.

The major pillars of reforms in this sector under the second programme have been i) the transposition of the EU's Third Energy package; ii) the deregulation of the administratively-set electricity and gas prices and the improvement of the mechanisms to protect vulnerable consumers; iii) the removal of legal and regulatory barriers to the export of gas; iv) advancing cross-border gas trading; v) the review of gas transit agreements with Russia to bring them in line with EU Single Market rules; and vi) the unbundling of electricity and gas transmission networks and their operation in a transparent and non-discriminatory manner.

65. At the start of the second programmes, Romania's regulatory framework for energy was not in line with the EU legislation. Certified unbundling of the electricity and gas networks had not taken place, while the independence of the energy regulator was limited. Furthermore, with the legal provision on the (implicit) gas export ban and gas transit agreements with Russia, Romania did not comply with the provisions of the EU Single Market. Furthermore, there have been large inefficiencies in the system linked to artificially-low electricity and gas prices that allowed for cross-subsidisation of different customer groups. Finally, Romania did not make the best use of its growth potential linked to the energy sector as gas and electricity trading platforms were underdeveloped, as was trading in gas with the neighbouring countries.

66. The reform commitments in the energy sector have been broadly honoured. The legislation transposing the Third Energy Package was largely put in place in July 2012. The remaining legislation related to the energy regulator entered into force in October 2012. This law re-established the energy regulator's (ANRE) independence. The first phases of the electricity-price deregulation have been implemented in accordance with the electricity roadmap that envisages complete deregulation of electricity prices for corporate consumers by end-2013 and for households by end-2017 (see Table 2.5). However, the implementation of the gas roadmap (with gas prices converging to market prices by end-2014/2015 for corporates and by end-2018 for households) started badly with the authorities failing to take the required steps in early December 2012. It was only on 1 February 2013 that it has been brought back on track with the government's firm commitment to henceforth stick to the original deregulation timeline.

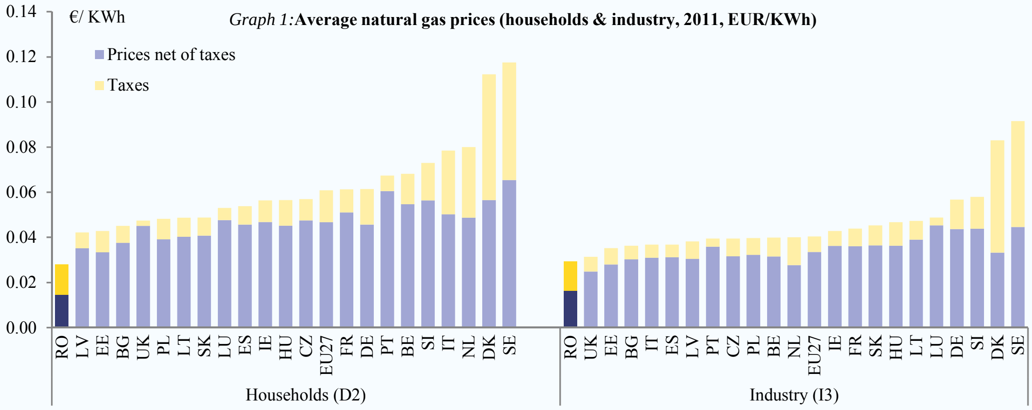
67. Regarding the protection of vulnerable consumers in the context of energy price increases, the government commitment has been broadly honoured. The existing scheme of social tariffs already provides a compensation for a number of consumers. With the government ordinance of 23 May 2013, amending the 2001 social allowance law, the authorities further specified the definition of vulnerable consumers and adopted legislation that provides additional measures (additional social benefits) as of 1 July 2013 to limit the impact of electricity and gas price deregulation.

68. While having been required in the second programme from 2011, the Romanian authorities acted only in March 2013 when the energy regulator, ANRE, adopted an order.([28]) The (implicit) gas export ban in Romania is a direct consequence of the obligation to supply gas at regulated prices for the domestic gas basket and is, therefore, closely connected to the regulator's ability to impose (lower-than-market-price) regulated retail prices. The energy regulator proposes to phase out the (implicit) gas export ban in conjunction with the regulated prices liberalisation. Whilst price liberalisation is a highly sensitive issue as Romania's own domestic gas is much cheaper than the gas it imports from Russia, such restrictions to natural gas exports are

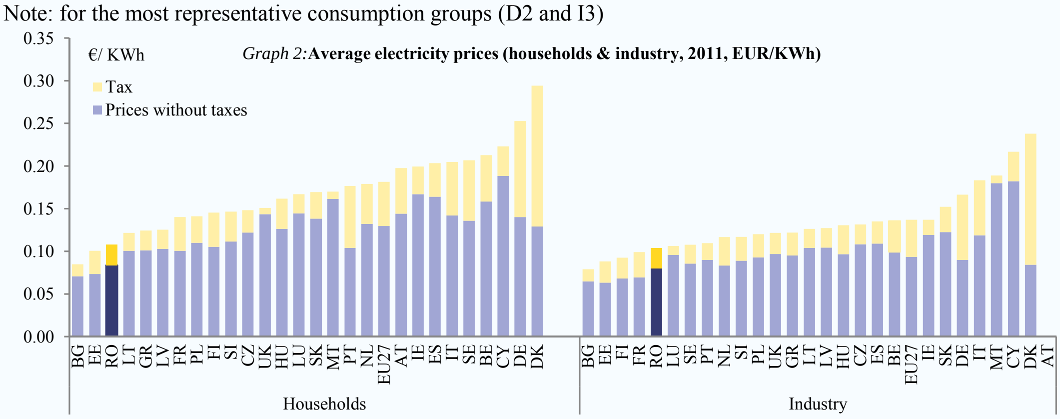
([28]) Order no 12/2013 of the President of the National Energy Regulatory Authority, ANRE, approving the rules on providing backhaul natural gas transmission services that entered into force on 1 April 2013.

Box 2.8: **Energy prices in Romania**

Romania's electricity and gas markets have been characterised by a high share of administratively-set prices. This has contributed to very low energy prices in Romania. The charts below show that Romania's gas prices were the lowest in the EU in 2011 for both customer groups – households and corporates. Romania's electricity prices were third-lowest for households and fifth-lowest for industrial consumers in the EU. They have been low even when considered in relation to the purchasing power of the population. Administratively-set prices allowed limiting the burden of economic transition for the households and industrial consumers. However, from an economic point of view, this practice has been a source of large inefficiencies and cross-subsidisation. Furthermore, the costly energy subsidies have contributed to making the Romanian economy one of the least energy efficient in the EU, thus undermining its competitiveness. Furthermore, energy producers in both electricity and gas had only few incentives to invest and expand domestic production. As a result, Romania’s power grid has not been well maintained, resulting in frequent outages, mainly in distribution networks. Power losses are high and electricity theft is frequently encountered while utility companies did not improve service and delivery systems.



Note: for the most representative consumption groups (D2 and I3)



Note: for the most representative consumption groups (Ic and Dc)

Source: Eurostat energy statistics

After a long period of resistance by the authorities, an agreement was reached with the authorities during the second programme to gradually phase out the regulated price component, thus allowing the prices to reflect market supply and demand. The electricity roadmap adopted in March 2012 envisages the complete deregulation of electricity prices for corporate consumers by end-2013 and for households by end-2017. The gas roadmap adopted in June 2012 envisages the convergence of gas prices to market prices by end-2014/2015 for corporates and by end-2018 for households. Important benefits of price liberalization include reducing cross-subsidisation, freeing resources for investment and encouraging energy efficiency.

Table 2.5: **First steps in Romania's roadmaps for electricity and gas**

	Share of electricity sourced from the competitive market			Gas price increases		
	Corporates	Households	Status	Corporates	Households	Status
01/09/2012	15	-	implemented	-	-	implemented
01/12/2012	-	-		5	-	implemented on 01/02/2013
01/01/2013	30	-	implemented	-	-	
01/04/2013	45	-	implemented	5	-	implemented
01/07/2013	65	10		5	8	
01/09/2013	85	-		-	-	
01/10/2013	-	-		3	2	
01/01/2014	100	20		4	2	

Source: Romanian authorities, European Commission

incompatible with the basic principles of free trade within the EU.

69. Progress on the gas trade exchange platform has been limited. Both OPCOM (Romanian power market operator) and the Romanian Commodities Exchange (RCE) are now preparing their platforms and traded contracts and are likely to receive an operating license in the near future. From 3 June 2013, OPCOM is operating an experimental gas-trading platform during which it would offer only base-load monthly products. However, there are a number of legal issues that still need to be solved. These are mainly related to the regulatory framework for licensing gas-trading platforms and the elaboration and adoption of trading and balancing rules, allowing trading of products of shorter and longer duration than the one-month product currently in place. Consequently, to create a competitive, liquid gas market, considerable work still needs to be done including the development of trading and balancing rules.

70. Some progress on the revision of the Inter-Governmental Agreements with Russia on gas transit through Romania has been achieved but re-negotiations have not yet started due to the refusal of the Russian side. Progress in this area depends on the will of both negotiating parties and is therefore not fully in the hands of the Romanian government. It can be considered that, for the moment, the Romanian side has largely fulfilled its part of work: it renounced from concluding any new inter-governmental agreements with Russia, prepared the mandate for negotiations with Russia and agreed it with the Commission. However, so far negotiations have not started due to the refusal of the Russian side to re-negotiate.

71. The authorities have started the process of certified unbundling of transmission networks in electricity and gas but the progress has been slow. The preliminary certification of the transport operators (Transgaz and Transelectrica) by the national energy regulator ANRE has not yet been achieved. The ordinance providing for the transfer of the shares owned by the state in the transmission system operators (Transelectrica and Transgaz) from the Ministry of Economy to the Ministry of Public Finances was adopted in March 2013. However, subsidiaries of Transgaz and Transelectrica responsible for the dispatch of the Romanian gas and electricity system were not part of the transferred assets. As dispatch must be considered as part of the core tasks of a transmission system operators this omission appears to prevent the certification of Transgaz and Transelectrica and, thereby, prevent Romania's compliance with the provisions of Directive 2009/73/CE. Preliminary certification by ANRE might only be issued later in 2013.

72. While authorities broadly complied with the commitments taken under the second programme in the energy sector, many challenges remain. The implementation of the gas and electricity roadmaps needs to continue. The reverse flows on the gas interconnectors on the Hungarian and Bulgarian borders are still to be made operational. Further efforts need to be pursued in negotiations with Russia on reviewing gas-transit agreements.

2.3.4. Transport sector

> The overall objective of reforms in the transport sector has been to bring Romanian regulatory standards in the rail sector in line with EU standards and allow for a more market-based and unbiased regulation in the field. The conditions of the first programme focused on adoption of a multi-annual performance agreement between the transport ministry and the agencies that – being in line with government's medium-term fiscal strategy - would help defining accountability framework and reduce political interference and frequent changes in priorities.
>
> In the second programme, policy conditions included the following pillars: i) leasing of lowest-cost recovery segments of railway lines; ii) amending regulation related to provisions on setting infrastructure charges, introduction of incentives to reduce unit costs; iii) CFR Infrastructura reviewing its business plan by elaborating on the marketing strategy and providing details on financing sources; iv) introducing performance schemes related to disruption of services.

73. Prior to the programme, Romania's transport sector had a number of regulatory provisions that were not in line with the EU legislation and therefore did not allow the regulatory framework to sufficiently reflect market incentives. There was political interference in the tariff setting for the rail-access charges; the independence of the rail regulator was limited; Romania did not yet use competitive tendering for passenger services, as set out in the Regulation 2007/1340/EC on public passenger-transport services. Furthermore, the efficiency of rail network has been low due to an over-extended rail system and the lack of market-based incentives.

74. Conditionality under the first programme related to the preparation and adoption of a multi-annual performance agreement by the transport ministry was broadly met. The Romanian authorities designed an agreement in line with the programme's request; this was finalised at the beginning of 2011. The next step was the approval of the multi-annual performance agreements (MAPA) and their signature by the transport ministry. However, as these agreements are also relevant and should be implemented for other sectors as well, the MAPA request has been taken over by the functional-review process. Although some progress has been made in some areas, the implementation process has been very slow (see Functional Review section).

75. Despite numerous delays, the objectives under the second programme in the transport area were largely met. Government reform commitments in the areas of the independence of rail regulator, more independent tariff setting for rail-access charges, reducing the scope of the public-service obligation and reducing the rail network have also been largely honoured. Steps to improve the regulatory framework under which the railway companies operate have been taken. The rail regulator’s independence was enhanced through the removal of transport ministry representatives from the regulator's board in October 2012. The regulatory framework was revised so as to end political interference in tariff setting and to allow the rail infrastructure company (CFR Infrastructura) to independently determine rail track access charges. In line with programme conditionality, the government also completed a study in December 2012 on competitive tendering of the public service obligation contract for the passenger rail. Going beyond programme conditionality, the government has undertaken preparatory steps to introduce competitive tendering from the next regulatory period starting in 2016.

76. Several efficiency measures for the rail sector have also been introduced, in line with programme commitments. From January 2013, the passenger company (CFR Călători) took the intercity and international trains out of the public service obligation (PSO) allowing for free price setting on these lines and reformed the PSO subsidy by introducing a 20% share of passenger-km factor into a previously pure line-km subsidy. On the authorities' commitment to reduce the rail network to 15,500 line km by closing or leasing out lowest cost recovery segments of the railway lines, progress has also been good. Overall, around 1,200 line km were closed or leased out. Due to the lack of interest for leasing the remaining 230 km, the authorities are preparing to close them down.

77. While overall progress in transport sector commitments has been good, a number of policy conditions in the transport sector have not been implemented. Performance schemes related to delays to be negotiated between the infrastructure company, on the one hand, and the passenger/freight companies, on the other has not been implemented. Performance-based incentives for managers have not been included in the contracts of the professional managers in CFR Infrastructure. A new/updated business plan in CFR Infrastructure that would reflect the new marketing strategy of the company has not been submitted.

2.3.5. State-Owned Enterprises

The overall objective of the SOE reform has been to improve their performance and transparency of operation. This would contribute to reducing (contingent) claims on budgetary resources, an improved business climate and a greater contribution of the SOEs to Romania's overall economic performance. Conditionality related to the reduction of arrears as specified in the successive LoI/MEFPs and TMUs, the strengthening of corporate governance, to introduce competent professional management, as well as opening up the share capital to outside investors through the sale of (minority and majority) stakes or participation in capital increases.

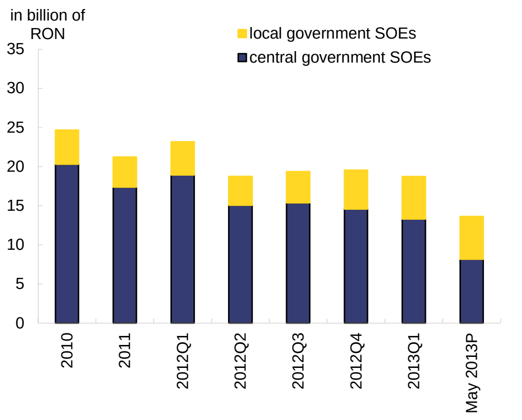
78. State-owned enterprises play a large, but suboptimal, role in the Romanian economy. There are over 900 State-Owned Enterprises (SOEs) at central and local government level in Romania that together account for about 9% of annual output and 10% of the employed labour force. Many SOEs produce suboptimal profits or outright losses and don't pay their bills on time.([29]) Transparency on their operations is limited as many are not quoted on the stock exchange and therefore do not have to do the related reporting. SOEs are especially dominant in energy and transport, where big investment needs exist. This situation is problematic in several regards. Losses or lack of profits weigh on public finances as the revenues accruing to the budget are lower than they could be and (contingent) liabilities are building up that may at some point have to be assumed by the state. The scope for (implicit) subsidisation of those companies and possible cross-subsidisation between them possibly distorts competition and as such does not help the business environment. Because of their suboptimal performance they do not contribute to the country's economic growth as they could. Necessary investments are not or insufficiently undertaken as resources for those are lacking. In addition, they may deter private investment in sectors where they are dominant. Against this background, the programmes included conditionality on SOE reform, notably on the reduction of arrears, strengthening of corporate governance, and opening up their capital. The attention focused on 20 key SOEs.

79. The operating performance and arrears situation of twenty key SOEs monitored under the programme continues to be cause for concern. The aggregate losses of those SOEs in 2012 increased slightly over 2011 in absolute terms, while remaining at 0.4% of GDP. The combined arrears of all SOEs declined from 4.7% of GDP in 2010 to 3.0% of GDP at the end of 2013Q1. An important drop in arrears occurred in May 2013 as two state-owned enterprises (C.N. Huilei and S.C. Termoelectrica S.A.) were put in voluntary liquidation; the projected arrears at end-May 2013 have fallen to 2.2% of GDP (Graph 2.15). The arrears are concentrated in the SOEs that belong to the central government.

80. Restructuring of the SOEs, and particularly the privatisation agenda, has met with very limited success. Faced with sub-optimally functioning SOEs, there are several options for the government. One option is to improve their performance by taking the necessary measures. If this is not possible, the government can open up the capital to other investors by selling minority or majority stakes in those SOEs, thereby bringing in fresh capital and know-how. If neither of the previous two works and the company continues to post losses, closing it down would be a logical way to go. During the two programmes, attempts were

([29]) There is ample anecdotal evidence of contracts concluded that were disadvantageous to the companies involved by charging too high prices for inputs and too little for the sale of outputs. Furthermore, management and civil servants sitting on the boards of SOEs often get remunerations that seem out of line with the performance of the companies (2.1).

Graph 2.15: **SOE arrears**



Source: Romanian authorities, IMF staff estimates

made along these lines. To improve performance, there was a programme to privatise or professionalise management and boards in the key SOEs. With considerable delays, some professional managers were appointed, but often they did not last long and in other cases the final appointments would not seem to have been based on entirely professional criteria. The sale of stakes in SOEs has met with very little success (Annex 3). Despite commitments to do much more, so far only two 15% minority stakes of companies that were already quoted on the stock exchange and in which the government continues to hold a majority stake have been sold via a Secondary Public Offering (SPO). An important step in the process that is expected to lead to the first majority privatisation of an SOE (the rail freight company CFR Marfă) was taken on 21 June when the sale-purchase agreement with the winning bidder Grup Feroviar Român([30]) was initialled.([31]) The transaction is scheduled to be closed/finalised with the transfer of the ownership rights at a later stage. The privatisation of the national post company, Poşta Română, that had been on the table since the start of the programme in 2011, was repeatedly delayed. Moreover, when it came to the actual tender in June 2013 it failed because there was no interest from investors to even buy the tender documentation. Confronted with this echec, the government then decided to delay it further. Other big loss-making companies like Hidroelectrica and Oltchim were put in insolvency procedures. Hidroelectrica is set to exit the insolvency procedure on 1 July 2013.

81. Because of the very limited success in restructuring the SOE sector, big challenges remain to turn them in a contributing factor for the economy. As the programme focused on only 20 key companies and met with relatively little success, big challenges remain. This is especially true as, apart from the 20 companies that were closely monitored, there are more than 900 others that were not monitored and on which little seems to have been done to improve matters. Given the important vested interests, it is very hard to see how the situation can improve without a dramatic increase in ownership in the SOE restructuring policy on the part of the Romanian authorities.

2.3.6. Business environment

> In the second programme, strengthening the business environment has been an overall policy objective. Policy conditionality addressed the administrative restrictions for setting up retail shops. Further policy conditionality related to establishing a Point of Single Contact to reduce the administrative burden on companies in the field of service, ensuring legal clarity as well as reducing the burden on public administrations. The required reform of administrative procedures covered by the Services Directive allows improving business environment and is thus conducive to medium-term economic growth objective.

82. While Romania has had long-standing challenges in creating a business-friendly environment conducive to growth, progress in this respect has been made **in recent years**. The fragmented institutional set-up and the rapidly changing governance arrangements for the business environment have been major bottlenecks that are responsible for a lack of continuity and efficiency in the implementation of business-friendly policies. In addition, the heavy regulatory environment and the significant red tape in all sectors of public administration impacted negatively on the business climate. According to the World Bank Doing Business report, Romania's

([30]) http://www.gfr.ro/
([31]) Completion of this step was a prior action for the conclusion of the seventh and eighth review by the IMF board on 26 June 2013.

rank improved from 108 in 2008 to 72 in 2013 in the global ranking on ease of doing business.

83. Government commitments in the area of business environment have been largely honoured. Restrictions to setting up retail shops were removed in 2012 thus improving business environment in this sector. Measures linked to the setup of the Point of Single Contact (PSC) have been put in place albeit with important delays. The final deadline of December 2012 for making the PSC fully operational has been largely adhered to. Outstanding issues are certain procedures relevant for the Services Directive that are not available on-line (in the construction sector and regulated professions). Furthermore, the user-friendliness of the portal remains poor. Finally, the completion of procedures by users from other EU member states is not possible due to missing e-signature and e-identification systems. Thus, to make the PSC fully operational, all relevant administrative procedures need to be available online and the involvement of certain authorities (especially at local level) needs to be ensured. The usability of the portal needs to be considerably improved and proper solutions for the e-identification of users from other Member States needs to be introduced. However, despite these shortcomings Romania's progress in implementing the PSC has been substantial.

84. The government has made progress in implementing e-filing of taxes and e-governance projects. While not being part of formal program conditionality, the government has implemented, in cooperation with the World Bank, several projects aimed at streamlining and simplifying tax returns, at facilitating electronic filing of taxes and at reducing the tax compliance burden for companies. As of end-November 2012, electronic filing of taxes was expanded to cover nearly 90% for companies for all important and most frequent forms. Further progress might be more difficult to achieve as remaining tax payers are small or active only in specific periods.

85. Despite certain progress under the programmes, a number of challenges remain in the areas of business reporting requirements and the land registry. Furthermore, facilitation of access to finance and access to international markets for Romanian SMEs could be strengthened. There continue to be too cumbersome fiscal reporting requirements and property registration procedures. Further areas that need to be improved include obtaining an electricity connection, paying taxes, dealing with construction permits and resolving insolvency. Priority should be given to the application of the EU Small Business Act 'only once' principle in order to avoid requesting enterprises and citizens to provide the same information that has already been made available in the context of other procedures. Incomplete and not digitalised land registry system is another challenge for Romania's business environment. Currently, less than one third of the country is covered by the traditional land registry thus making investment in land or infrastructure difficult and hampering the development of the real estate market. Access to finance is one of the most pressing problems facing Romanian SMEs as Romania ranks among the lowest performers in the EU in terms of total loan volumes granted to SMEs. Current measures such as the risk facility under the JEREMIE([32]) programme, guarantee instruments such as Mihail Kogalniceanu Programme, as well as the Programme for Young Entrepreneurs need to be made more accessible, in particular by providing assistance on the application procedures and cutting red tape. Finally, more efforts are needed to help Romanian companies to access international markets, in order to offset the decline in domestic demand. The National Export Strategy for the period 2012-2016 has not been adopted.

([32]) JEREMIE (Joint European Resources for Micro to Medium Enterprises) is an initiative of the European Commission developed together with the European Investment Fund promoting the use of financial engineering instruments to improve access to finance for SMEs via Structural Funds interventions.

2.3.7. Public administration

> Both balance-of-payments (BoP) programmes included conditionalities related to the improvement of the Romanian public administration through independent functional reviews (FR). The first BoP programme conditionalities focused on the finalisation of the first phase of the FR including six ministries and public institutions. Moreover, some tranches disbursements were conditioned on the adoption of the action plans based on the FR's outcome and progress in their implementation.
>
> The second BoP programme focused on the completion of the second phase of the FR and the adoption of the action plans based on their recommendations. In the first SMoU (December 2011), one more condition was added requiring quarterly reporting on the progress made with the implementation of the Action Plans.

86. The independent functional reviews conducted by the World Bank were aimed at increasing the efficiency and the effectiveness of the Romanian public administration. The sectors and institutions included in these reviews differed in their characteristics, strengths and challenges but there were a number of common themes across all, as identified by the Worlds Bank (WB):([33]) (i) lack of oversight and accountability for results and low enforcement of public policies; (ii) governance issues of both government institutions and SOEs, and inadequate separation of roles and division of responsibilities among institutions;([34]) (iii) lack of sector wide strategies, high politicisation of the administration, low quality of and insufficient usage of information for decision-making; and (iv) the organisational structure not aligned with the evolving needs of the sectors and lack of strategic human resource management.

87. Albeit with some delays, the Romanian authorities conducted functional reviews of the public administration in order to improve its efficiency and effectiveness. They focused on twelve key sectors (ministries and institutions) of the central public administration. The twelve reports([35]) provided operational recommendations on strategic management, governance, budgeting, internal organisational structure and Human Resource management to help steer the structural reforms. The reviews were done in two phases with the World Bank support:

- **Phase 1** FR were conducted during the first programme and presented to the Government in October 2010; they included reports on the following ministries and institutions: the Centre of Government, the Ministry of Public Finance, the Ministry of Transport and Infrastructure, the Ministry of Education (Pre-university), the Competition Council and the Ministry of Agriculture and Rural Development.

- **Phase 2** FR were presented to the Government in March 2011 and included reports focused on the Ministry of Education (Higher Education), Ministry of Regional Development and Tourism, Ministry of Labour and Social Protection, Ministry of Environment and Forestry, Ministry of Health, Ministry of Economy (Energy) and Business Environment, and the National Authority for Scientific Research.

88. The action plans defined in response to the findings of the functional reviews were finalised and adopted by the Government. The authorities, under the coordination of the General Secretariat of the Government, are currently producing quarterly progress reports on the action plans' implementation process, as agreed within the second programme. However, the implementation of the action plans remains slow and lags behind initial deadlines, especially as regards the medium- and long-term actions. Nevertheless, most of the contracts with the World Bank for implementing the later actions have been signed. And, through the General Secretariat of the Government and in coordination with the Ministry of Public Finance, a monitoring and evaluation system for public policies (also for tracking the implementation of the action plans) is being developed with the support of the World Bank.

([33]) http://www.sgg.ro/docs/File/UPP/doc/rapoarte-finale-bm/etapa-I/09_FR1%20Dalberg.pdf

([34]) For instance, the transport ministry had multiple conflicting roles: it set the policy for the sector, it owned the SOEs, it bought their services and it also regulated them.

([35]) The 12 FR reports are available here: http://www.sgg.ro/index.php?politici_publice_documente.

89. Many challenges remain for enhancing the administrative capacity in Romania and therefore the implementation of the Action Plans would continue to be supported and financed from the EU funds and monitored as part of the 2014-2020 programming period. Structural and endogenous reinforcement of the Romanian administrative capacity has already been formally addressed in the Commission's position paper on the development of the partnership agreement and the programmes for the next programming period (2014-2020).([36]) Moreover, during the informal dialogue conducted in spring 2013 for discussing the next programming period, one of the Commission's recommendations conveyed to the Romanian authorities was to implement the measures included in the existing Action Plans (derived from the functional reviews exercise). The main issues mentioned and that remain to be tackled include: (i) shift to a streamlined, stable and more consistent legal framework together with clearer and simpler procedures; (ii) strengthen the coordination and public policy making capacities and the empowerment at government level; and (iii) enhance the professionalism, independence and attractiveness of the public administration.

([36]) The "*Modernisation and reinforcement of the national administration and the judiciary*" is one of the main five future challenges identified and proposed by the Commission both as a suggested funding priority and critical ex-ante conditionality; http://ec.europa.eu/regional_policy/what/future/pdf/partnership/ro_position_paper.pdf

2.3.8. EU funds absorption

The sound use and improved absorption of EU funds was a key objective of the first BoP programme already. However, only the second programme included clear numerical targets related to the EU Structural and Cohesion Funds (SCF) absorption in 2011 and 2012 (measured as the total eligible expenditure certified to the Commission).

The programme's end-2011 absorption target definition was updated in the first (S)MoU (December 2011) of the second programme: the agricultural funds (i.e. the European Agricultural Funds for Rural Development - EAFRD) were also added to the calculation of the programme's overall EU funds absorption target, the June 2012 absorption target was removed and the end-2012 target was raised from EUR 5.7 bn to EUR 8 bn.

90. Improving the absorption of EU funds represented and still represents a top priority for the Romanian government as especially during crisis periods, the EU funds are a key resource for the short- and long-term development of the economy. At the beginning of the first programme, Romania had a very poor absorption status (as of end-March 2009, excluding the pre-financing, the Commission repayments for SCF and EAFRD represented 0.5% of the total available EU funds; see Table 2.6) mainly due to faulty public procurement and lengthy tendering procedures, poor and limited administrative capacity, lack of prioritisation, inadequate management of the project cycle by the institutions responsible for implementing the operational programmes (OPs), and low ownership by the beneficiaries. At the beginning of the second programme, in April 2011, the Romanian government, with the Commission's support, clearly identified the issues impacting the country's EU funds absorption capacity in a Priority Action Plan.([37]) Moreover, in June 2011, President Barroso wrote([38]) to the erstwhile prime-minister Emil Boc, to convey his grave concerns with

([37]) http://www.fonduri-ue.ro/documente-programare/planul-de-masuri-prioritare

([38]) http://www.hotnews.ro/stiri-9391178-scrisoarea-presedintelui-comisiei-europene-jose-manuel-barroso-catre-premierul-boc-comisia-ramane-foarte-preocupata-nivelul-foarte-scazut-absorbtiei-financiare-atins-doar-3.htm

Table 2.6: **Romania - Cumulative absorption of EU funds (mn Euro)**

Date	**EAFRD**	% of total EAFRD	**SCF**	% of total SCF	**Grand total**	% of total	**End-year target***	**Distance from target****
Mar-09	*171*	*2.1%*	*87*	*0.5%*	*258*	*0.9%*		
Dec-10	1436	17.7%	368	1.9%	1804	6.6%		
Mar-11	*1552*	*19.1%*	*548*	*2.9%*	*2100*	*7.7%*		
Dec-11	2209	27.2%	1066	5.5%	3275	12.0%	2100	1175
Dec-12	3323	40.9%	2204	11.5%	5527	20.2%	8000	-2473
May-13	3946	48.6%	2927	15.2%	6874	25.1%		

Legend
EAFRD: European Agricultural Fund for Rural Development
SCF: Structural and Cohesion Funds
Total EAFRD 8124
Total SCF 19213
Total Funds 27337
* Absorption targets for end-2011 and end-2012 respectively.
** A positive sign means the target was overachieved and a negative sign that there is still a shortfall.
Source: Commission services

regard to the very low absorption of structural and cohesion funds in Romania that – at the time - had barely reached 3%.

91. The EU fund absorption conditionality from the first programme mainly related to the preparation and adoption of a multi-annual performance agreement - MAPAs (see section on Transport sector for more details) and the introduction of general measures for improving the EU funds absorption in Romania.

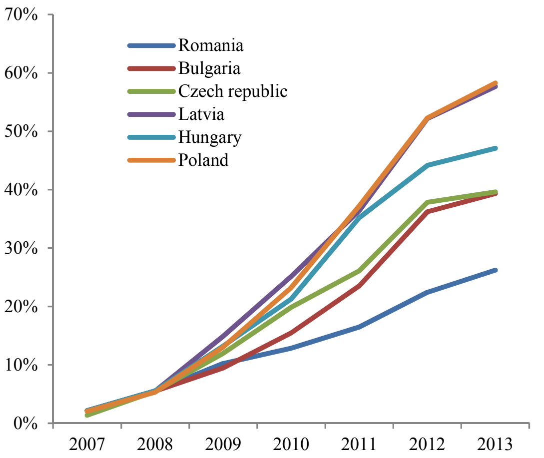
92. The second programme included numerical absorption targets for the 2011-2012 period. The end-2012 cumulative absorption target of EUR 8 bn was missed by a wide margin. The end-December 2011 absorption target of EUR 2.1 bn was met only because the definition of the programme's absorption target was updated in the first SMoU (December 2011). The target was changed to include also the country's absorption of European Agricultural Funds for Rural Development (EAFRD) together with the Structural and Cohesion Funds. Nevertheless, the end-December 2012 cumulative absorption was EUR 5.53 bn or 20.2% of total available structural, cohesion and agricultural funds of EUR 27.3 bn. This is still EUR 2.47 bn short of the programme's end-2012 target of EUR 8 bn (Table 2.6).

93. Romania stands to lose several billions of euros worth of SCF funds (Graph 2.18). With an absorption rate of 25% in May 2013 for the structural and cohesion funds (the lowest absorption rate in the EU), Romania has failed to benefit from the SCF allocation granted for the 2007-13 programming period. Moreover, there is a significant risk of de-commitment of funds in 2013. When compared with other new EU member states (Graph 2.16), we can observe that Romania is lagging behind its regional peers.([39])

94. The situation is much better for the agricultural funds for rural development. The current EAFRD absorption rate is 43.6% (of the total EUR 8.1 bn EAFRD allocation – Graph 2.17) and there is a small risk of de-commitment of funds in 2013. The main reasons behind the better EAFRD absorption situation when compared to the SCF status are related to: (i) the pre-accession programmes (i.e. SAPARD) already gave the Romanian authorities direct experience with shared management systems; (ii) the EAFRD's measures with the highest absorption were those relatively similar to those offered under the pre-accession programmes (i.e. SAPARD) and therefore the beneficiaries were also already familiar with them; (iii) most EAFRD projects are small projects with private beneficiaries and thus were less affected by faulty public procurement processes; (iv) the specific nature of some of the

([39]) The SCF absorption ratio is calculated based on the total SCF allocation for 2007-13 for all the countries and the amount of SCF absorbed until 6 June 2013, including the pre-financed amounts, which stand at EUR 2.1 bn for Romania.

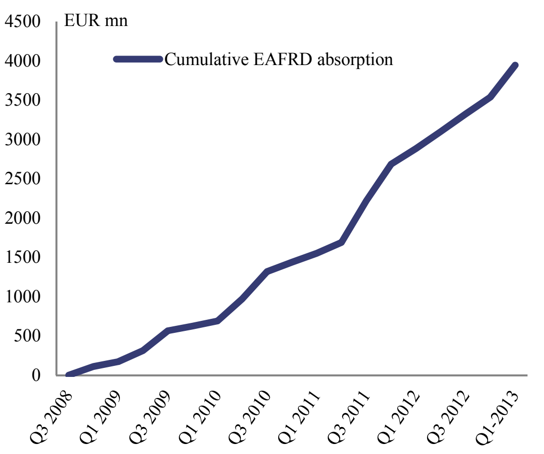
Graph 2.16: **Cumulative absorption of SCF in RO and selected countries (% of total allocation 2007-2013)**



Source: Commission services

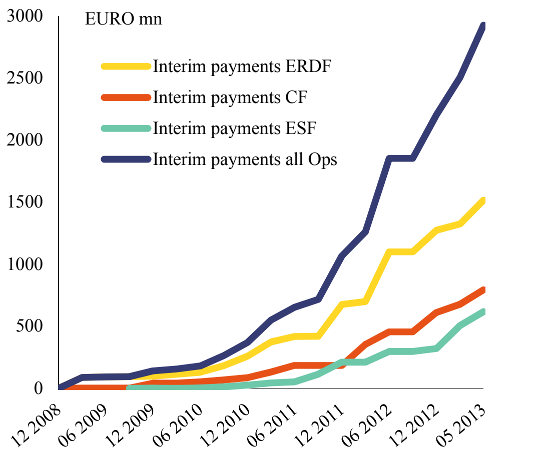
EAFRD measures, i.e. axis 2 measures, which are effectively annual payments to farmers hence leading to a more steady absorption capacity once the ball starts rolling; (v) the EAFRD text and requirements are usually more detailed, including direct guidance from the Commission and allowing for less room for discretion; and finally (vi) the relative stability of the Romania staff working on the EAFRD, at least in the first years of this programming period, helped creating some absorption momentum too.

Graph 2.17: **Cumulative EAFRD absorption**



Source: Commission services

Graph 2.18: **Cumulative SCF absorption**



Source: Commission services

95. The implementation of the 2011 Priority Action Plan on EU funds has largely failed and many challenges remain in this area. Although not a specific conditionality in the (S)MoU, the full implementation of the April 2011 Priority Action Plan and other specific measures to boost EU funds absorption were continuous commitments included in the joint LoI/MEFPs negotiated with and signed by the Romanian authorities after each review mission in 2011-2012. Despite an active contribution and on-going support from the Commission services, the authorities did not manage to implement all the measures included in the Action Plan (e.g. the simplification of the management procedures and the standardisation of the tender documentation). Moreover, another pillar of the Barroso initiative, the utilisation of the International Financial Institutions (IFIs) expertise through technical assistance, has also not been fully implemented, initially due to delays in signing the Memorandums with the relevant institutions and subsequently due to the authorities' poor ownership and capacity to correctly identify and address the country's own needs. In its Position Paper published in October 2012, the Commission has already identified a number of ex-ante conditionalities([40]) that are critical for the successful implementation of the 2014-2020 EU funding priorities. The main ones require/refer to:

([40]) All the ex-ante conditionalities need to be fulfilled by the deadline agreed with the national authorities and, at the latest, within two years of the adoption of the Partnership Agreement or by end-2016.

(i) the improvement of the public procurement system through the implementation of the recommendations received as part of the evaluation carried out by the Commission services; and (ii) the reinforcement of the country's administrative efficiency, including public administration reform.

ANNEX 1

Financial Assistance Programmes in 2009-2013

Table A1.1: **Financial assistance programmes with Romania**

Institution and type of programme/ support	Financial support
<u>2009-2011 programme</u>	
European Commission (EC): Balance of Payments programme – EU medium term financial assistance [1]	€5 billion
International Monetary Fund (IMF): Stand-by Agreement (SBA)	SDR 11.4 billion (~ €12.9 billion; 1,110.77% of Romania's IMF quota)
World Bank (WB): Loans	€1 billion
European Investment Bank (EIB) & European Bank for Reconstruction and Development (EBRD) - Loans	€1 billion
TOTAL financial support received from IFIs during 2009-2011	**€19.9 billion [2]**
<u>2011-2013 programme</u>	
European Commission (EC): Balance of Payments programme – precautionary EU medium term financial assistance	Up to €1.4 billion
International Monetary Fund (IMF): Stand-by Agreement (SBA) treated as precautionary	Up to SDR 3.09 billion (~ €3.5 billion; 300% of Romania's IMF quota)
World Bank (WB): development loan programme (DPL3 of EUR 400 million) and results based financing for social assistance and health (of EUR 750 million)	€1.15 billion
TOTAL financial support available in 2011-2013	**€6 billion**

[1] Based on the Council Regulation (EC) No 332/2002 of 18 February 2002 establishing a facility providing medium-term financial assistance for Member States' balances of payments and in particular Article 3(2)

[2] Only seven out of the eight IMF tranches, totalling SDR 10,569 mn (out of the SDR 11.4 bn), had been used.

Source:

ANNEX 2

Repayment schedule to the EU and the IMF

Table A2.1: **Yearly repayment schedule to the EU and the IMF**

Yearly data	EU (€ mn)*			IMF (SDRs mn)**			Grand total (€ mn)
	Charges	Principal	Total	Charges	Principal	Total***	
2013	151.6	-	151.6	236.0	4,051.8	4,287.8	5,100.5
2014	151.6	-	151.6	43.0	3,881.1	3,924.1	4,680.7
2015	151.6	1,500.0	1,651.6	13.0	1,232.8	1,245.8	3,089.5
2016	104.8	-	104.8	0.4	96.1	96.5	216.1
2017	104.8	1,150.0	1,254.8			-	1,254.8
2018	77.4	1,350.0	1,427.4			-	1,427.4
2019	33.8	1,000.0	1,033.8			-	1,033.8

* EU BoP assistance has been in full chanelled to the MoPF

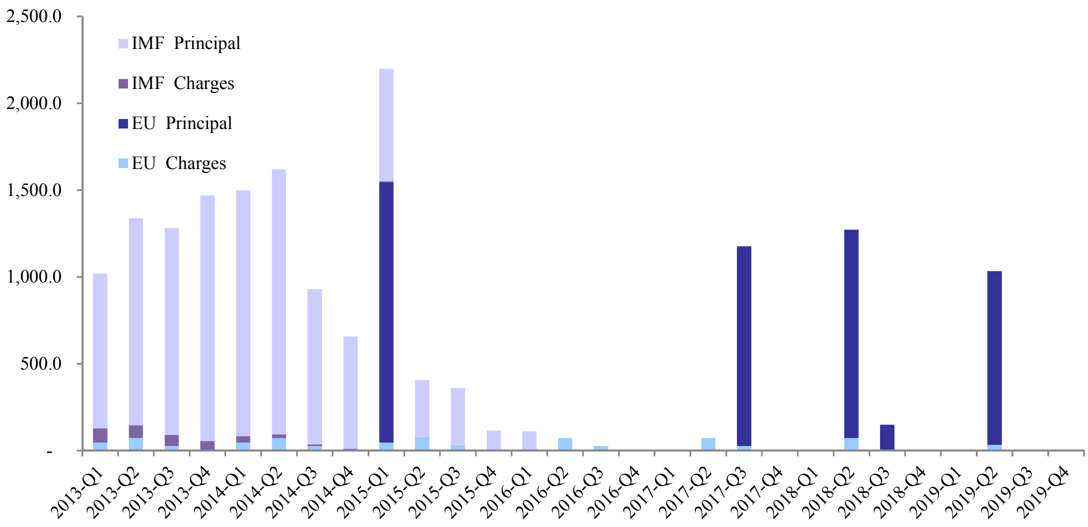
**The 2nd & 3rd IMF disbursements (out of 6) were made 50:50 to the MoPF and the NBR, all other disbursements were made fully to the NBR.

***Out of the total, The ministry of public finance shall repay SDR 47 mn on charges and SDR 837 mn in principal in 2013, respectively SDR 12 mn and SDR 866 mn in 2014 and SDR 1 mn and SDR 136 mn in 2015.

Note: *The SDR's exchange rate is assumed to remain unchanged as of 28 May 2013;
http://www.imf.org/external/np/fin/data/param_rms_mth.aspx

Source: Commission services and the IMF

Graph A2.1: **Quarterly repayment schedule to the EU and the IMF**



Source: Commission services and the IMF

ANNEX 3

Privatisation of State-Owned Enterprises

Table A3.1: **Privatisation of state-owned enterprises**

Company	Privatisation	Loi 10 March 2011	LoI 9 June 2011	LoI 14 Sept 2011	LoI 2 Dec 2011	LoI 28 Feb 2012	LoI 8 June 2012	LoI 12 Sept 2012	LoI 10 June 2013	Current status; Privatisation & liquidation Yes/No?	Current (June 2013) status on privatisation
Electricity - Electrica distribution					Legal advisors for privatisation to be appointed by mid-February 2012 (structural benchmark for IMF)		Privatisation of 5 regional service companies by end-October 2012			Pending	
Electricity - Electrica Furnizare (Transilvania Nord)					Legal advisors for privatisation to be appointed by mid-February 2012 (structural benchmark for IMF)	Legal advisors for privatisation to be concluded by end-April 2012; privatisation by end-October 2012	Majority privatisation by early 2013			Pending	
Electricity - Electrica Serv (S.C. Electrica S.A.)					Legal advisors for privatisation to be appointed by mid-February 2012 (structural benchmark for IMF)	Transaction advisors for privatisation to be completed by April 2012		Conclude privatisation by early 2013.	Launch the majority sale with a view to conclude privatisation by end-November 2013.	Pending	
Electricity - Electrocentrale Bucuresti (ELCEN)						Majority privatisation of ELCEN Bucuresti by end-Dec 2012/early 2013	Majority privatisation in early 2013	privatisation by early-2013		No	
Electricity - Hidroelectrica	IPO of 10% to increase capital		minority stake by end-March 2012		transaction advisors to be selected by mid-February 2012	Legal advisors for privatisation to be appointed by end-April 2012; IPO to be concluded by end-October 2012	IPO by mid-October 2012	Publish prospectus for privatisaiton within 3 months after exit of insolvency	Launch IPO promptly after Hidroelectrica exits from the insolvency procedures.	Pending	Awaiting exit from insolvency (expected for 1 July 2013).
Electricity - S.N. Nuclearelectrica	At least 10% via capital increase		minority stake by end-June 2012		Legal advisors for privatisation to be appointed by mid-February 2012 (structural benchmark for IMF)	Legal advisors for privatisation to be concluded by end-April 2012	Sale of shares by end-2012	IPO to be concluded by end-March 2013	IPO to be concluded by end-October 2013	Pending	End-May 2013 deadline agreed in January 2013 was shifted to end-October.
Electricity - Termoelectrica			viable parts to be privatised by March 2012			Complete privatisation by the end of 2012 of the new energy company Hunedoara	Privatisation by end-2012/early 2013	File for liquidation in mid-October 2012	File for liquidation by end-January 2013	Yes	Placed in voluntary liquidation
Electricity - Transelectrica	SPO 15% stake	15% stake be end-2011		by 01/10/2011	SPO 15% by end-April 2012	SPO 15% by end-April 2012				Yes	15% stake was sold in March 2012
Mineral resources - CN Huilei			privatisation of viable parts by end-March 2012	Complete majority privatisation of new energy producer by end-June 2012		Liquidation by end-September 2012	Liquidation to be started by end-September 2012	File for liquidation by end-September 2012	File for liquidation by end-January 2013	Yes	Placed in voluntary liquidation
Mineral resources - Complexul Energetic Turceni				Conclude privatisation by end-June 2012						No	The company became part of Oltenia
Mineral resources - Cuprumin					To be privatised by mid-February 2012	Full privatisation by end-April 2012	Privatisation failed as the signing of the purchase agreement within the required timeframe did not happen			No	

Table A3.2: **Privatisation of state-owned enterprises (continued)**

Company	Privatisation	Loi 10 March 2011	LoI 9 June 2011	LoI 14 Sept 2011	LoI 2 Dec 2011	LoI 28 Feb 2012	LoI 8 June 2012	LoI 12 Sept 2012	LoI 10 June 2013	Current status; Privatisation & liquidation Yes/No?	Current (June 2013) status on privatisation
Mineral resources - S.C. Hunedoara S.A.	majority privatisation					Majority privatisation by end-Dec 2012/early 2013	majority privatisation in early 2013	Majority privatisation by end-April 2013	Merge company with viable mines by end-May 2013; proceed with the majority sale of shares once the merger is completed. If there is no investor interest, place company into insolvency procedures.	Pending	Awaiting merger with viable mines
Mineral resources - Lignitului Oltenia (S.C. Complexul Energetic Oltenia S.A.)	minority- majority-minority privatisation			Appoint PM and board for new company by end-December 2011		Majority privatisation of the New Oltenia by end-December 2012/early 2013.	Majority privatisation in early 2013; transaction advisor to be appointed by fall 2012	IPO to be launched in early 2013 (50% + 15% = 65%)	Launch IPO of 15% by end-October 2013 (note: no longer 50+15% but only 15%); contract with transaction advisor to be signed by mid-April 2013.	Pending	Deadline now end-October 2013
Mineral resources - Petrom	sale 10%	sale of 10% is already underway		Recent offer of an additional 9.8% stake in Petrom was unsuccesful; Petrom to be re-offered in a market friendly process in early 2012	transaction advisors to be selected by mid-February 2012					No	Sale of 10% has not been done
Mineral resources - S.N. Romgaz	IPO of 15%	IPO of 15% stake by Spring 2012			IPO of 15% by end-June 2012	IPO of 15%; Nomination of Transaction advisors for privatisation to be completed by April 2012	IPO by mid-September 2012	IPO launch by end-March 2013	IPO of 15% to be launched before end-October 2013	Pending	New deadline is end-October 2013
Mineral resources - Transgaz	SPO 15%	SPO of 15% stake be end-2011	legal advisor fr privatisation to be appointed by mid-July 2011, investement bank by Sept, conclude tender end-2011.	Dec-11	SPO 15% by end-April 2012	SPO 15% by end-April 2012	SPO 15% by end-June 2012	Tender for 15% to be launched by mid-September 2012	Tender for 15% to be launched by mid-April 2013	Yes	15% stake was sold in mid-April 2013
S.C. Oltchim S.A.			privatise remaining public stake (completion of the tender) by end-2011	Appoint PM and board by end-Dec 2011; conclude privatisation by end-2011	Privatisation by end-April 2012	Privatisation by end-April 2012	Privatisation postponed until September 2012 due to technical problems	Winning bidder by mid-September 2012; otherwise liquidation.	Put in insolvency procedure by end-January 2013	Pending	Awaiting exit from insolvency
C.N. Posta Romana S.A.	Majority		Elimination of losses by 2012	Appoint PM and board by end-Dec 2011	minority stake by end-April 2012	Hiring of transaction advisors for privatisation to be completed by April 2012; Capital increase postponed to end-June 2012	Capital increase to be finalised by end-September 2012	Capital increase to be finalised by end-December 2012	Sign a privatisation contract by mid-June 2013	No	Privatisation failed as there was no investor interest.
Transport - TAROM	IPO max 20% stake		max 20% stake by end-2011, private management by end-Jan 2012	Conclude privatisation by end-2011; appoint PM and board members by end-January 2012	IPO of 20% by end-April 2012	IPO 20%; Transaction advisors for privatisation ot be completed by April 2012; privatisation by end-june 2012	IPO of 20% remains a priority for the transport ministry in 2012; IPO 20% to be concluded by mid-july 2012	IPO of 20% to be concluded by mid-November 2012		No	IPO of 20% did not take place. IPO postponed to allow new professional management time to improve operating performance.
Transport (Railways) - CFR Marfa	20% stake		20% stake to strategic investor by end-2011, private management by end-Jan 2012	PM and board members by end-Dec 2011 or by Jan 2012 if a significant minority share will have been sold by end-2011	transaction advisors to be selected by mid-February 2012; now majority privatisation by end-October 2012	Legal advisors for privatisation to be concluded by end-April 2012; Conclude privatisation by end-october 2012	Majority privatisation remains a priority for transport ministry in 2012; privatisation to be concluded by end-October 2012	Sign privatisation agreement by mid-December 2012	Finalise/initial a sale-purchase agreement with the winning bidder by 20 June 2013	Pending	51% majority stake to be sold; intialing of sale-purchase agreement by 20 June 2013; signing of agreement by 12 July.

Source:

ANNEX 4

Key Economic Indicators

Table A4.1: Key economic indicators for Romania (Overview, 2007-2014)

	2007	2008	2009	2010	2011	2012	2013*	2014*
Gross Domestic Product	*(annual percentage change, unless otherwise indicated)*							
Nominal GDP (in bn RON)	416	515	501	524	557	587	623	660
Real GDP	6.3	7.3	-6.6	-1.1	2.2	0.7	1.6	2.2
Private Consumption	11.9	9.0	-10.1	-0.3	1.1	1.1	1.9	2.0
Public Consumption	-0.1	7.2	3.1	-4.7	0.2	1.7	1.8	1.9
Gross fixed capital formation	30.3	15.6	-28.1	-1.8	7.3	4.9	3.4	5.0
Exports	7.8	8.3	-6.4	13.2	10.3	-3.0	2.5	4.0
Imports	27.3	7.9	-20.5	11.1	10.0	-0.9	4.0	5.0
Contribution to GDP growth								
Domestic demand	15.9	11.9	-15.0	-1.5	2.6	2.2	2.3	2.9
Inventories	0.0	-3.5	1.4	0.4	0.1	-0.7	0.1	0.0
Net exports	-9.6	-1.0	7.0	0.0	-0.5	-0.8	-0.8	-0.7
Prices								
HICP inflation (average)	4.9	7.9	5.6	6.1	5.8	3.4	4.3	3.1
HICP inflation (year-end, quarterly)	6.8	6.9	4.5	7.8	3.4	4.6	3.8	3.1
NBR target [1]	4	3.8	3.5	3.5	3.0	3.0	2.5	2.5
Labour market								
Total employment	9364.8	9365.9	9181.0	9156.1	9058.1	9197.9	9243.7	9305.3
Unemployment rate (registered, year-end)	4.1	4.4	7.8	7.0	5.1	5.6	*5.3*	n.a.
Unemployment rate (LFS,annual average)	6.4	5.8	6.9	7.3	7.4	7.0	6.9	6.8
General Government Accounts	*(in percent of GDP, cash)*							
Total revenues	30.6	32.2	31.4	32.3	32.7	33.1	33.6	n.a.
Total expenditures	32.8	37.0	38.7	38.7	37.2	35.6	35.7	n.a.
Current	29.4	32.1	34.8	35.1	33.0	32.3	32.9	n.a.
Capital	3.5	5.0	4.4	3.7	4.1	3.3	2.8	n.a.
Govn deficit, cash definition	-2.3	-4.8	-7.3	-6.4	-4.5	-2.5	-2.1	n.a.
Government deficit, ESA95 definition, target [2]	-2.9	-5.7	-9.0	-6.8	-5.6	-2.9	-2.4	n.a.
Government deficit, ESA95 definition, EC forecast [2]	-2.9	-5.7	-9.0	-6.8	-5.6	-2.9	-2.6	-2.4
Gross debt, general govn, ESA95 definition	12.8	13.4	23.6	30.5	34.7	37.8	38.6	38.5
Balance of payments	*(in percent of GDP)*							
Current account balance **	-13.6	-11.4	-4.2	-4.4	-4.5	-4.0	-3.9	-3.8
Trade balance	-13.9	-13.0	-6.0	-5.7	-5.3	-5.2	-5.2	-5.2
Capital and financial account balance	14.0	12.8	5.0	4.6	4.2	3.2	n.a.	n.a.
FDI balance	5.7	6.7	3.0	1.8	1.4	1.3	n.a.	n.a.
Net international investment position	-43.5	-49.4	-62.4	-62.6	-64.3	-64.9	n.a.	n.a.
Foreign exchange reserves (in bn Euro)	25.3	26.2	28.3	32.4	33.2	31.2	32.7	n.a.
Gross external debt	47.0	51.8	68.7	74.4	75.2	75.1	n.a.	n.a.
Monetary and exchange rate developments								
Broad money M3 (annual % change, end of the period)	33.70	17.49	8.97	6.93	6.63	2.69	*4.18*	n.a.
NBR policy rate (in %, end of period)	7.50	10.25	8.00	6.25	6.00	5.25	*5.25*	n.a.
Exchange rate (lei/euro, end of period)	3.61	3.99	4.23	4.28	4.32	4.43	*4.32*	n.a.
REER (Unit Labour Costs deflator, % change)	19.9	8.0	-13.0	-3.6	11.8	-3.2	n.a.	n.a.
Financial market & banking sector developments								
Private credit growth (y-o-y)	60.4	33.7	0.9	4.7	6.6	1.3	*-2.1*	n.a.
Capital Adequacy								
CAR	13.8	13.8	14.7	15.0	14.9	14.9	*15.0*	n.a.
Leverage ratio	7.3	8.1	7.6	8.1	8.1	8.6	*8.2*	n.a.
Ratio of level 1 own funds	10.7	11.8	13.4	14.2	14.3	16.6	*16.7*	n.a.
Asset quality								
NPLs (90 dpd)	-	2.8	7.9	11.9	14.3	18.2	*19.1*	n.a.
NPLs (60 dpd)	4.0	6.5	15.3	20.8	23.3	29.9	*30.0*	n.a.
Profitability								
ROA (after tax)	1.0	1.6	0.3	-0.2	-0.2	-0.6	*0.6*	n.a.
ROE (after tax)	9.4	17.0	2.9	-1.7	-2.6	-5.9	*5.1*	n.a.
Liquidity								
Immediate liquidity	38.7	38.7	38.7	38.7	38.7	38.7	*37.6*	n.a.

Note: * Forecasts or *latest values*

Note: ** Current account and trade balances are reported based on the latest Commission forecast using National Accounts Data.

[1] Based on National CPI (Dec-Dec) Variation band +/- 1%

[2] The ESA95 deficit for 2011 includes the one-off item regarding the payment of obligations related to court decisions which became definitive in 2011.

Source: Commission services, Eurostat, National authorities

Table A4.2: **General Government Accounts, 2007-2013**

	2007 Final	2008 Final	2009 Final	2010 Final	2011 Final	2012 Final	2013 Proj
	(in percent of GDP, cash projection)						
TOTAL REVENUES	30.6	32.2	31.4	32.3	32.7	33.1	33.6
Profit tax	2.5	2.5	2.4	1.9	1.9	1.9	2.1
Income and wage tax	3.5	3.6	3.7	3.4	3.4	3.6	3.7
VAT	7.5	7.9	6.8	7.5	8.6	8.6	8.5
Excises	3.0	2.7	3.1	3.3	3.4	3.5	3.6
Social insurance contributions	9.3	9.5	9.6	8.7	9.1	8.8	8.7
Non fiscal revenue	1.9	3.1	3.1	3.8	3.3	3.2	3.2
Other fiscal taxes	1.9	2.0	2.0	2.6	1.7	2.0	1.7
Revenue from capital	0.9	0.8	0.8	0.9	1.2	1.5	2.0
TOTAL EXPENDITURES	32.8	37.0	38.7	38.7	37.2	35.6	35.7
Current expenditures	29.4	32.1	34.8	35.1	33.0	32.3	32.9
Personnel expenditures	6.2	8.9	9.3	8.2	6.9	7.0	7.4
Goods and services	6.2	6.3	5.7	5.7	5.7	5.8	6.0
Interest	0.7	0.7	1.2	1.4	1.6	1.8	1.8
Subsidies	1.7	1.5	1.4	1.3	1.2	1.0	0.8
Transfers	14.7	14.7	16.7	18.2	17.3	16.3	16.7
Social Assistance	9.2	10.5	12.8	13.1	12.2	11.5	11.2
Other transfers	5.5	4.1	3.9	5.1	5.0	4.8	5.5
Other	0.0	0.0	0.4	0.3	0.4	0.3	0.2
Capital expenditures	3.5	5.0	4.4	3.7	4.1	3.3	2.8
Other expenditure (net lending)	0.0	-0.1	-0.5	-0.1	0.1	0.1	0.0
Government deficit, cash definition	-2.3	-4.8	-7.3	-6.4	-4.5	-2.5	-2.1
Government deficit, ESA95 definition, *target* [1)]	-2.9	-5.7	-9.0	-6.8	-5.6	-2.9	*-2.4*
Government deficit, ESA95 definition, *EC forecast* [1)]	-2.9	-5.7	-9.0	-6.8	-5.6	-2.9	*-2.6*
Gross debt, general government, ESA95 definition	12.8	13.4	23.6	30.5	34.7	37.8	38.6

(1) The ESA95 deficit for 2011 includes the one-off item regarding the payment of obligations related to court decisions which became definitive in 2011

Source: Romanian authorities, European Commission

Table A4.3: **Key monetary indicators**

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

	2007	2008	2009	2010	2011	2012	Apr 13	May 13
Broad money (M3)	**148116**	**174028**	**189630**	**202763**	**216208**	**222018**	**225751**	…
Intermediate money (M2)	148044	173629	188013	199572	212059	221830	225547	…
Money market instruments	72	399	1617	3201	4149	171	176	…
Narrow money (M1)	79914	92549	79361	81592	85834	89020	89226	…
Currency in circulation	21442	25287	23968	26794	30610	31477	32379	…
Overnight deposits	58473	67262	55394	54799	55224	57543	56847	…
Time deposits**	68129	81080	108652	117980	126225	132809	136322	…
Money and credit (Annual percentage change, eop)								
Broad money (M3)	33.7	17.5	9.0	6.9	6.6	2.7	3.3	…
- NFA contribution	…	-10.7	5.0	0.7	0.1	6.7	8.3	…
- NDA contribution	…	28.2	4.0	6.2	8.0	-4.0	0.0	…
Intermediate money (M2)	…	17.3	8.3	6.2	6.2	4.6	4.3	…
Narrow money (M1)	…	15.8	-14.2	2.8	5.2	3.7	3.1	…
Currency in circulation	…	17.9	-5.2	11.8	14.2	2.8	3.5	…
Overnight deposits	…	15.0	-17.6	-1.1	0.8	4.2	2.9	…
Time deposits*	…	19.0	34.0	8.6	7.0	5.2	5.0	…
p.m. Credit to private sector	60.4	33.7	0.9	4.7	6.6	1.3	0.3	…
Interest rates (In percent, eop)								
Robor, 3 m	8.38	15.46	10.65	6.17	6.05	6.05	4.21	4.15
Robor, o/n	8.06	14.53	8.90	2.99	4.53	6.30	4.66	3.96
NBR policy rate	7.50	10.25	8.00	6.25	6.00	5.25	5.25	5.25
NBR credit facility rate	12.00	14.25	12.00	10.25	10.00	9.25	9.25	8.25
NBR deposit facility rate	2.00	6.25	4.00	2.25	2.00	1.25	1.25	2.25
Exchange rates								
Lei per euro (end of period)	3.61	3.99	4.23	4.28	4.32	4.43	4.32	4.38
Lei per euro (average)	3.34	3.68	4.24	4.21	4.24	4.46	4.38	4.34
Real effective exchange rate (percentage change)**								
HICP based	8.4	-5.0	-7.6	2.5	3.1	-5.5	…	…
ULC deflator based	19.9	8.0	-13.0	-3.6	11.8	-3.2	…	…

*Maturity of up to two years
**REER data for September
Source: NBR, Commission services

Table A4.4: **Gross external financing requirements & sources, 2010-2014**

(In billions of euros, unless otherwise indicated)

	2010	2011	2012					2013					2014
			Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	
	Act	Act	Act	Act	Act	Act	Prel.	Act	Proj	Proj	Proj	Proj.	Proj.
I. Total financing requirements	**38.2**	**38.5**	**10.8**	**12.1**	**9.8**	**10.8**	**43.4**	**8.0**	**8.2**	**7.6**	**9.5**	**33.3**	**31.1**
I.A. Current account deficit	5.5	5.9	0.5	2.0	1.6	1.0	5.2	-0.1	1.8	1.8	1.8	5.4	5.6
I.B. Short-term debt	21.0	21.8	7.9	6.5	5.7	5.6	25.8	5.3	3.8	4.0	4.6	17.8	16.7
Public sector	4.6	5.9	3.1	1.7	1.5	1.2	7.5	2.0	1.0	0.8	1.5	5.3	5.2
Banks	11.2	11.9	3.9	4.0	3.2	3.1	14.2	2.5	1.8	1.8	1.8	7.9	6.6
Corporates	5.2	4.0	1.0	0.8	1.0	1.4	4.2	0.9	1.0	1.3	1.3	4.6	4.9
I.C. Maturing medium- and long-term debt	11.3	11.4	2.5	3.3	2.6	3.6	12.0	2.8	2.7	2.0	3.3	10.7	9.6
Public sector	1.7	1.8	0.4	1.1	0.4	0.8	2.8	0.4	0.3	0.6	0.9	2.2	1.8
Banks	3.2	3.7	1.3	1.0	1.2	1.5	4.9	1.6	1.3	0.7	0.5	4.0	4.0
Corporates	6.4	5.9	0.9	1.2	1.0	1.3	4.3	0.8	1.2	0.7	1.8	4.5	3.8
I.D. Other net capital outflows 1/	0.4	-0.5	-0.2	0.3	-0.2	0.5	0.5	0.0	-0.2	-0.2	-0.2	-0.6	-0.8
II. Total financing sources	**33.9**	**34.6**	**12.4**	**9.3**	**10.0**	**10.0**	**41.6**	**10.3**	**7.1**	**7.5**	**8.8**	**33.7**	**31.5**
II.A. Foreign direct investment, net	2.2	1.8	0.1	0.4	0.9	0.3	1.7	0.1	0.5	0.5	0.5	1.8	2.2
II.B. Capital account inflows	0.2	0.7	0.4	0.5	0.3	0.7	1.9	0.3	0.3	0.3	0.3	1.1	1.0
II.C. Short-term debt	23.2	23.8	8.5	5.0	5.5	4.3	23.3	4.9	3.9	4.0	4.4	17.2	16.8
Public sector	5.4	6.3	3.3	1.2	1.0	1.2	6.7	1.9	1.0	0.8	1.5	5.2	5.2
Banks	12.5	12.3	4.2	2.7	3.2	1.8	11.9	1.8	1.8	1.7	1.6	7.0	6.4
Corporates	5.3	5.1	1.0	1.0	1.3	1.3	4.6	1.1	1.1	1.4	1.3	4.9	5.2
II.D. Medium- and long-term debt	8.2	8.3	3.4	3.3	3.3	4.7	14.7	5.0	2.4	2.7	3.6	13.7	11.5
Public sector	2.3	2.7	2.2	0.6	1.1	2.7	6.6	3.7	0.2	1.4	1.3	6.5	3.2
Banks	2.3	3.0	0.8	1.8	1.2	1.3	5.1	0.9	1.2	0.7	0.5	3.3	4.2
Corporates	3.7	2.6	0.5	0.9	0.9	0.7	3.0	0.4	1.0	0.7	1.8	3.9	4.2
Errors and Omissions	-0.2	0.4	0.1	0.5	0.1	0.3	1.0	-0.4	0.0	0.0	0.0	-0.4	0.0
III. Increase in gross reserves	**3.5**	**0.9**	1.8	-2.1	-0.3	-0.9	-1.5	1.0	-2.3	-1.2	-2.0	-4.5	-3.1
IV. Financing Gap	**8.0**	**4.4**	**0.1**	**0.3**	**-0.5**	**-0.4**	**-0.6**	**-0.9**	**-1.2**	**-1.2**	**-1.4**	**-4.6**	**-3.5**
V. Program financing	**8.0**	**4.4**	**0.1**	**0.3**	**-0.5**	**-0.4**	**-0.6**	**-0.9**	**-1.2**	**-1.2**	**-1.4**	**-4.6**	**-3.5**
IMF 2/	4.3	0.9	0.0	0.0	-0.7	-0.9	-1.6	-0.9	-1.2	-1.2	-1.4	-4.6	-3.5
Purchases	4.3	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases	0.0	0.0	0.0	0.0	-0.7	-0.9	-1.6	-0.9	-1.2	-1.2	-1.4	-4.6	-3.5
Others	3.7	3.5	0.1	0.3	0.1	0.5	1.0	…	…	…	…	…	…
European Commission	2.2	1.4	0.0	0.0	0.0	0.0	0.0	…	…	…	…	…	…
World Bank	0.0	0.7	0.0	0.0	0.0	0.0	0.0	…	…	…	…	…	…
EIB/EBRD/IFC	1.5	1.4	0.1	0.3	0.1	0.5	1.0	…	…	…	…	…	…
Memorandum items:													
Rollover rates for amortizing debt ST (in percent)													
Public sector	118	108	107	71	64	104	90	97	100	100	100	99	100
Banks	112	104	109	67	100	59	84	75	100	95	90	89	97
Corporates	101	128	98	134	129	94	111	127	105	105	100	108	105
Rollover rates for amortizing debt MLT (in percent)													
Public sector	135	149	557	53	249	343	238	960	67	241	135	299	179
Banks	71	82	63	188	104	86	104	59	95	100	100	82	103
Corporates	58	43	53	79	95	52	69	45	90	95	100	87	109
Rollover rates for total amortizing debt (in percent)													
Public sector	122	117	158	63	106	200	130	236	93	158	113	157	120
Banks	102	99	97	90	101	68	89	69	98	96	92	87	100
Corporates	77	78	77	101	113	74	90	88	97	101	100	97	107
Gross international reserves 3/	36.0	37.3	38.8	37.1	37.0	35.4	35.4	…	…	…	…	30.9	27.8
Coverage of gross international reserves													
- Months of imports of GFNS (next year)	7.2	7.5	7.9	7.6	7.6	7.3	7.3	…	…	…	…	6.1	5.7
- Short-term external debt (in percent)	118.6	98.4	103.2	97.2	96.1	99.1	99.1	…	…	…	…	92.5	84.9

1/ Includes includes portfolio equity, financial derivatives and other investments, assets position.
2/ Last disbursement of the previous program is treated as precautionary
3/ Operational Definition.

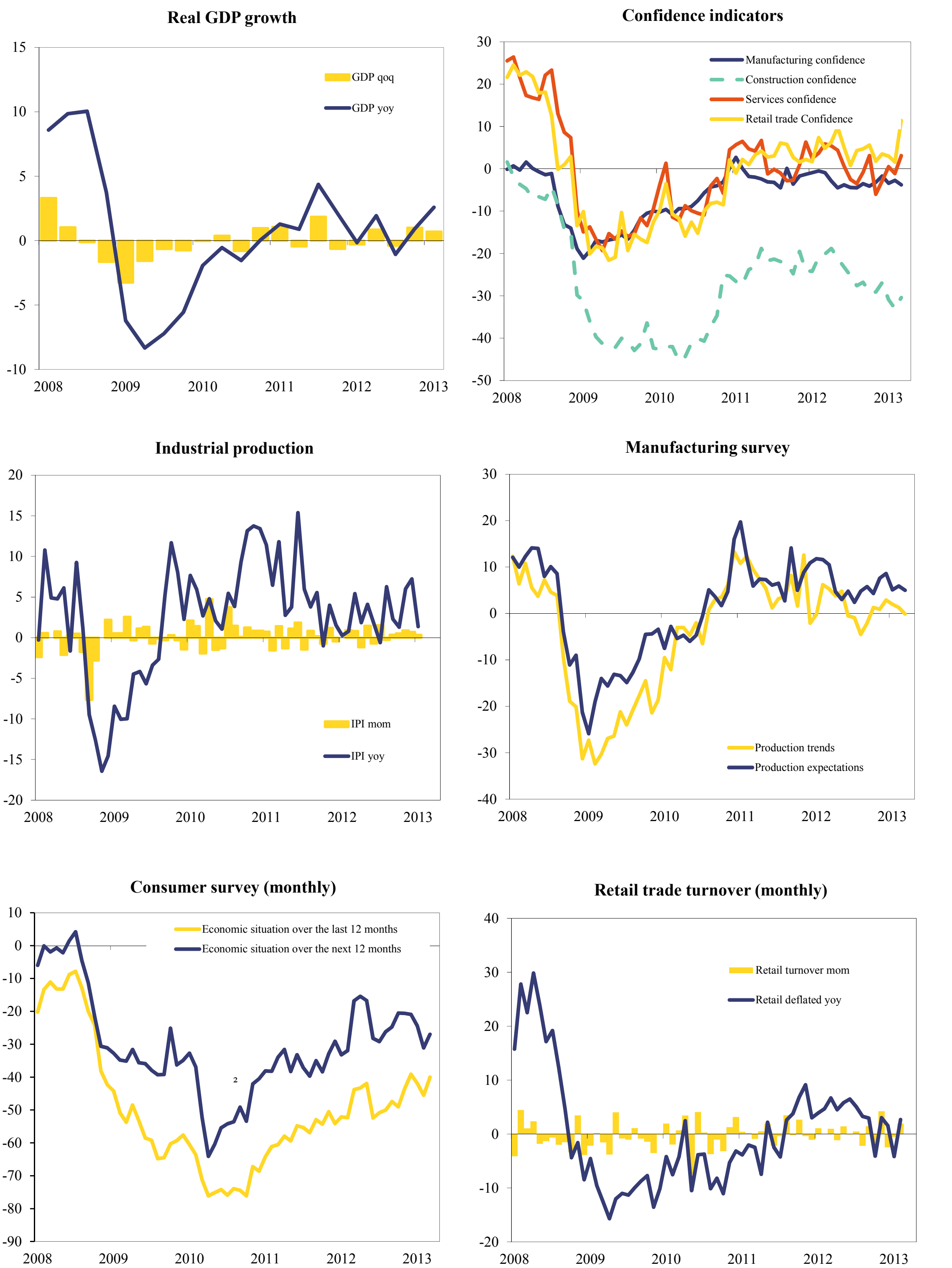
Source: Romanian authorities and IMF staff estimates

Table A4.5: **Key labour market indicators, 2007-2013**

	2007	2008	2009	2010	2011	2012	2013 Q1	2012-2011	
1 - Population (total, 1000 pers.)	21551.3	21516.5	21484.3	21446.7	21384.1	21336.1	:	-0.2	%
2 - Population (working age:15-64, 1000 pers.)	15046.3	15042.3	15028.2	14999.4	14967.5	14928.3	:	-0.3	%
3 - Labour force (15-64, 1000 pers.)	9479.169	9461.607	9482.794	9539.618	9474.427	9583.968	:	1.2	%
4 - Activity rate (% of population 15-64)	63	62.9	63.1	63.6	63.3	64.2	:	0.9	pps
Young (15-24)	30.5	30.4	30.9	31.2	31.1	30.9	:	-0.2	pps
Prime age (25-54)	79	78.3	78.5	79.5	79.1	79.8	:	0.7	pps
Older (55-64)	42.4	44.2	43.9	42.5	41.5	42.9	:	1.4	pps
Nationals (15-64)	63	62.9	63.1	63.6	63.3	64.2	:	0.9	pps
Non-nationals (15-64)	67	62.7	65	:	:	:	:		
Male	70.1	70.6	70.9	71.5	70.7	72.1	:	1.4	pps
Female	56	55.2	55.4	55.8	56	56.4	:	0.4	pps
5 - Employment rate (% of population 15-64)	58.8	59	58.6	58.8	58.5	59.5	:	1.0	pps
Young (15-24)	24.4	24.8	24.5	24.3	23.8	23.9	:	0.1	pps
Prime age (25-54)	74.6	74.4	73.7	74.4	74.1	74.9	:	0.8	pps
Older (55-64)	41.4	43.1	42.6	41.1	40	41.4	:	1.4	pps
Low-skilled (15-64)	40.3	41	42	43	40.5	41.9	:	1.4	pps
Medium-skilled (15-64)	63.9	63.5	62.2	62.2	62.3	63.1	:	0.8	pps
High-skilled (15-64)	85.8	85.7	84.1	82.4	82.1	81.4	:	-0.7	pps
Nationals (15-64)	58.68297	58.91099	58.53478	58.77001	58.47392	59.45782	:	1.0	pps
Non-nationals (15-64)	0.117032	0.089012	0.065223	0.029993	0.026077	0.042185	:		
Male	64.8	65.7	65.2	65.7	65	66.5	:	1.5	pps
Female	52.8	52.5	52	52	52	52.6	:	0.6	pps
6 - Employed persons (15-64, 1000 pers.)	8842.5	8882.2	8804.7	8822	8750	8885.6	:	1.5	%
7 - Self employed (% of total employment)	22.44558	21.9466	21.84789	22.69351	20.85272	21.01742	:	0.2	pps
8 - Temporary employment (% of total employment)	1.6	1.3	1	1.1	1.5	1.7	:	0.2	pps
9 - Part-time (% of total employment)	9.7	9.9	9.8	11	10.5	10.2	:	-0.3	pps
10 - Unemployment rate (harmonised:15-74)	6.4	5.8	6.9	7.3	7.4	7	:	-0.4	pps
Young (15-24)	20.1	18.6	20.8	22.1	23.7	22.7	:	-1.0	pps
Prime age (25-54)	5.6	5	6.1	6.4	6.4	6.2	:	-0.2	pps
Older (55-64)	2.3	2.5	3	3.3	3.7	3.4	:	-0.3	pps
Low-skilled (15-64)	8.6	8.6	8.9	7.2	8.6	8.1	:	-0.5	pps
Medium-skilled (15-64)	6.9	6	7.3	8.3	8.1	7.6	:	-0.5	pps
High-skilled (15-64)	3	2.7	4.4	5.4	5.2	5.6	:	0.4	pps
Nationals (15-64)	5.7	5	6.2	6.9	7.1	6.7	:	-0.4	pps
Non-nationals (15-64)	:	:	:	:	:	:			
Male (harmonised:15-74)	7.2	6.7	7.7	7.9	7.9	7.6	:	-0.3	pps
Female (harmonised:15-74)	5.4	4.7	5.8	6.5	6.8	6.4	:	-0.4	pps
11 - Long-term unemployment (% total unemployment)	50	41.3	31.6	34.9	41.9	45.3	:	3.4	pps
12 - Worked hours (average actual weekly hours)	39.7	39.6	39.4	39.2	39.2	39.1	:	-0.3	%
13 - Indicator board on wage developments (% change)									
Compensation per employee	22.0256	31.91209	-1.88576	-3.28649	4.162494	5.163929	:	1.0	pps
Real compensation per employee (GDP deflator)	7.511543	14.40771	-5.84046	-8.50189	0.060033	0.34726	:	0.3	pps
Hourly labour costs (Eurostat labour cost index)	19.78708	22.58658	10.825	0.812092	4.520016	4.520016	:	0.0	pps
Wage and salaries	22.8231	36.30338	-6.56122	-7.50232	7.663199	7.316782	2.93	-0.3	pps
Labour productivity (real GDP/person employed)	5.930048	7.3362	-4.69449	-0.88017	2.934704	-1.17493	:	-4.1	pps
Nominal unit labour costs	:	:	2.9	-2.4	0.9	6.4	:	5.5	pps
14 - Sectoral breakdown of unit labour costs									
Business economy	23.45	21.425	11.3	6	7.125	6.2	:	-0.9	pps
15 - Sectoral breakdown of compensation per employee									
Manufacturing	27.62356	36.30875	-29.087	8.483415	:	:	:		
Construction	6.991908	37.90615	15.33494	-28.751	12.52191	3.659221	:	-8.9	pps
Trade, transport and information services	12.73029	29.58039	3.403207	-7.91178	9.520307	6.09644	:	-3.4	pps
Finance and business services	41.91938	13.34324	-0.11896	10.05196	8.837704	9.8324	:	1.0	pps
Non-market related services	27.59995	34.26348	1.020656	-7.2396	-11.8374	5.706105	:	17.5	pps

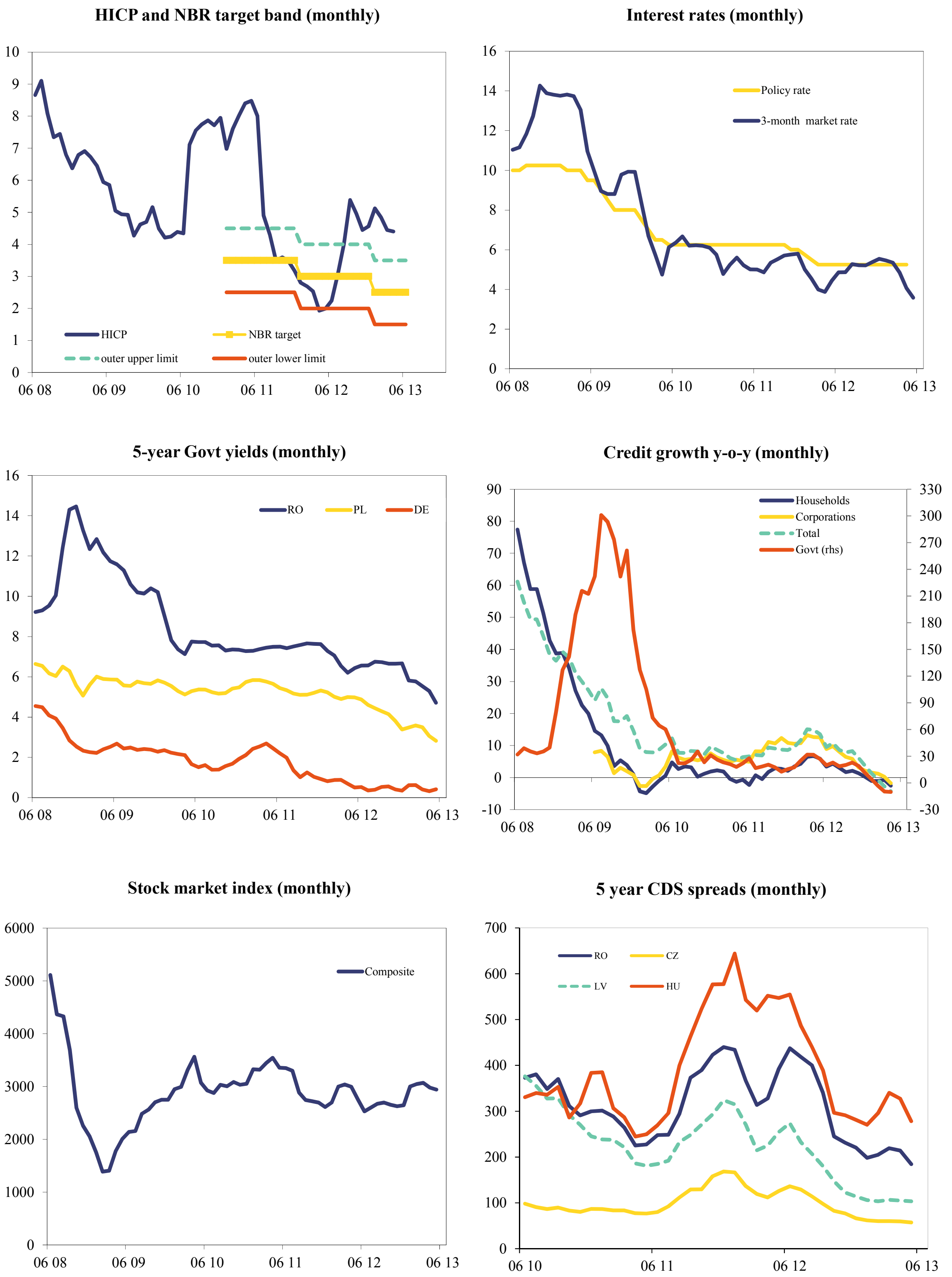
Source: Eurostat

Graph A4.1: **Key economic indicators, 2007-2013**



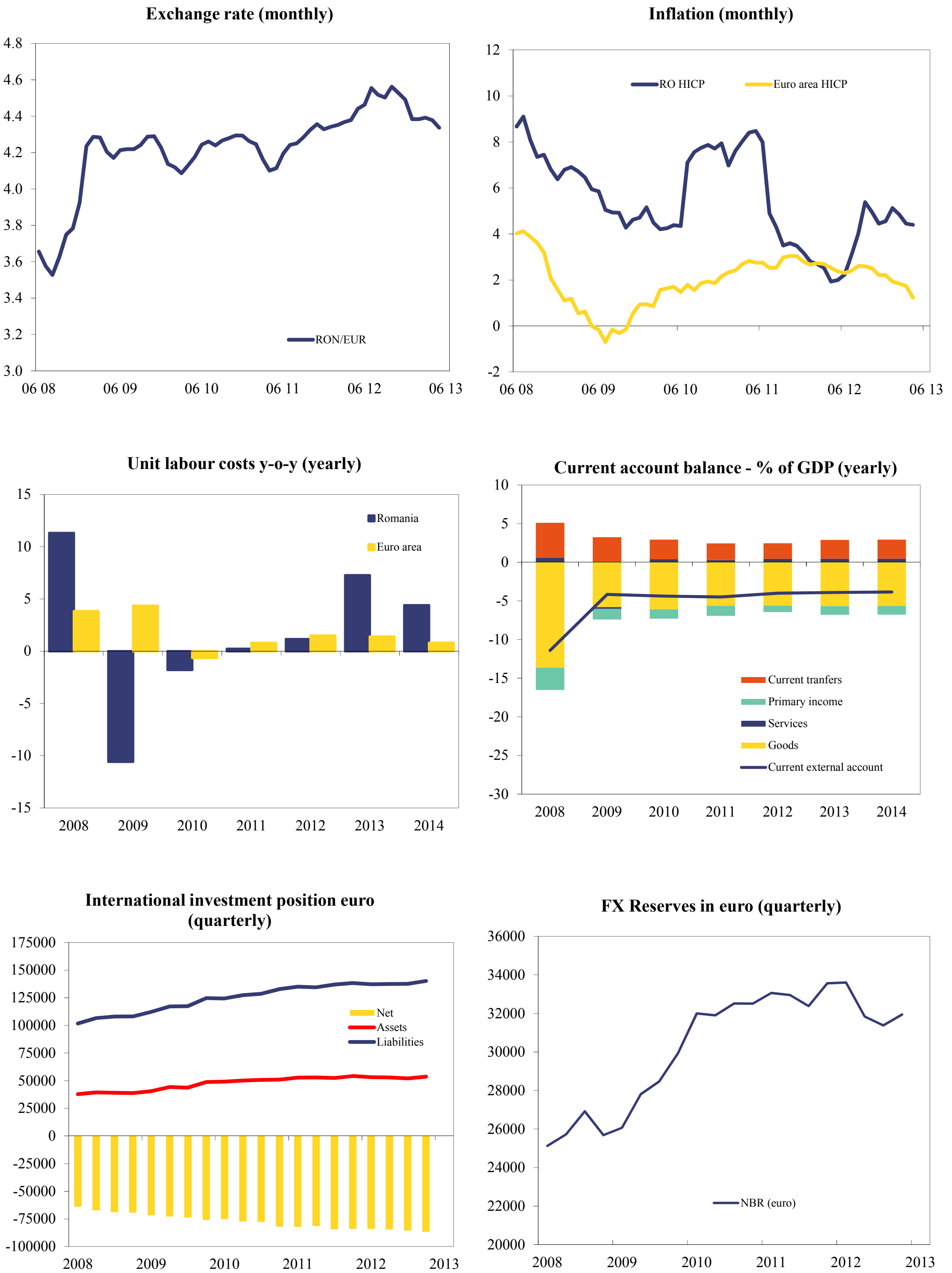
Source: European Commission, Romanian authorities

Graph A4.2: **Monetary and financial market indicators, 2007-2013**



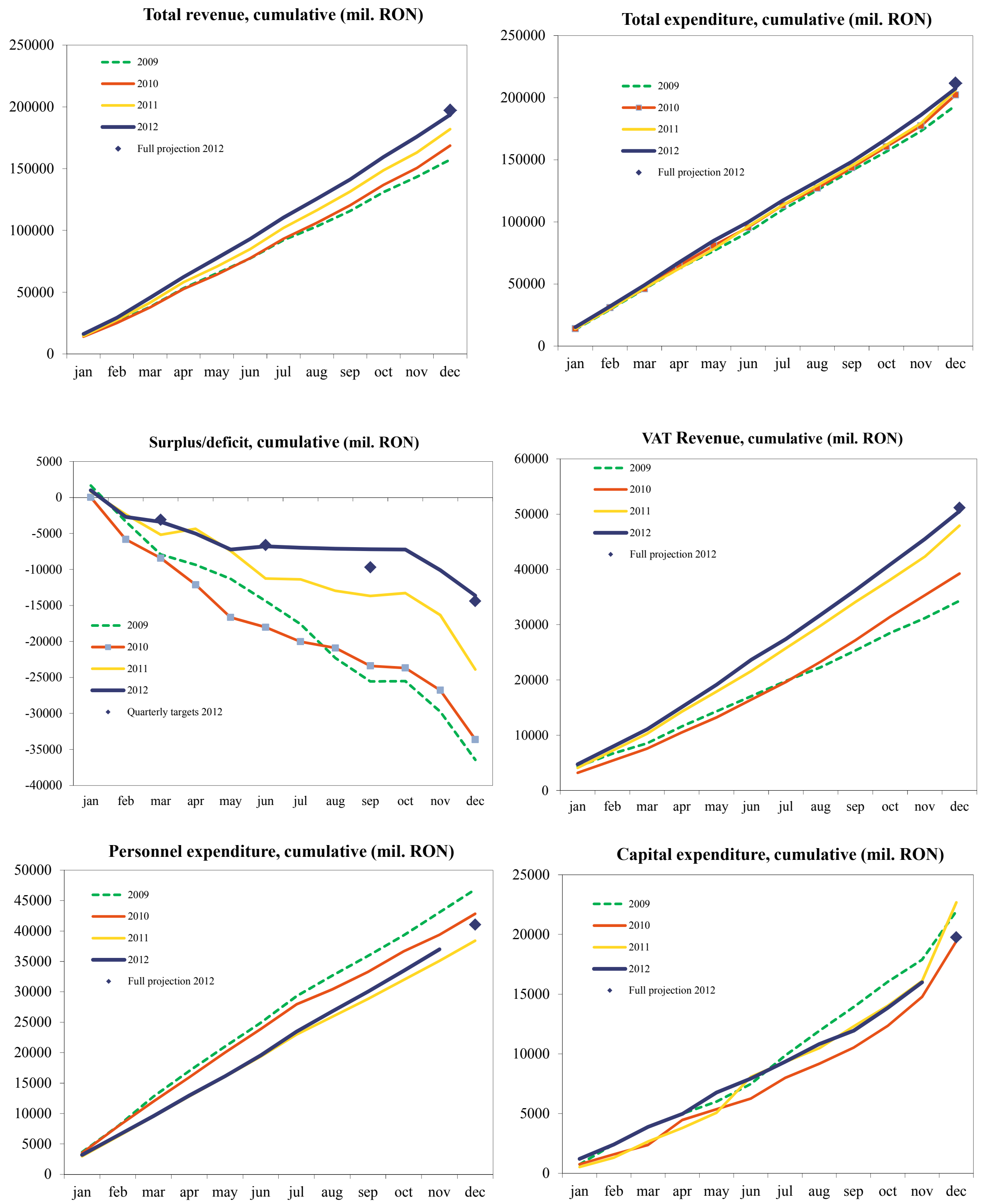
Source: European Commission, Romanian authorities

Graph A4.3: **Price and competitiveness indicators, 2007-2013**



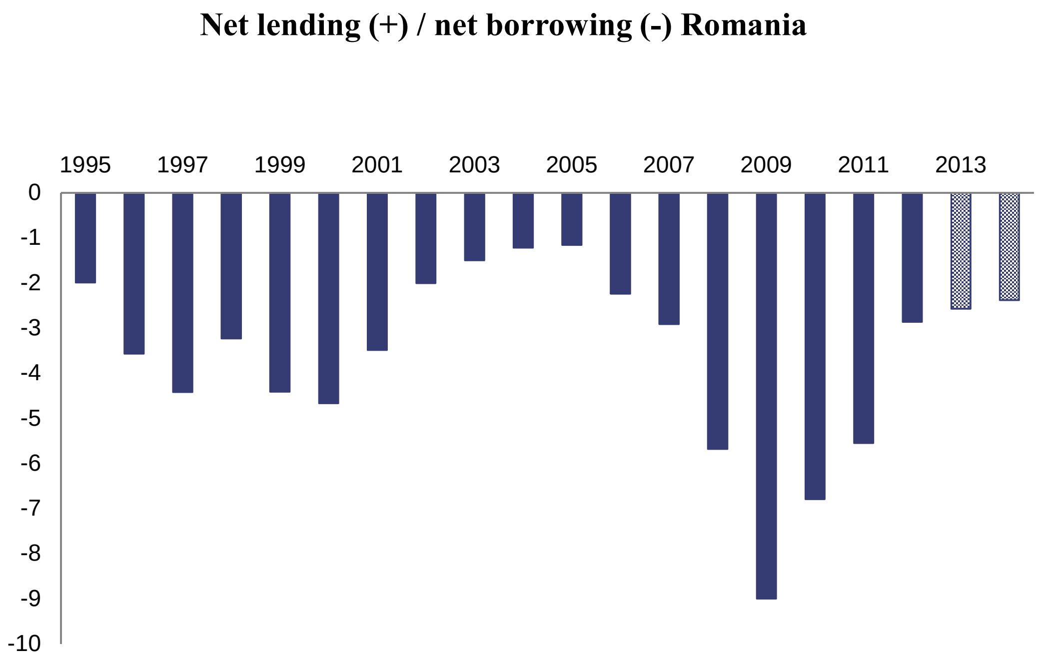
Source: European Commission, Romanian authorities

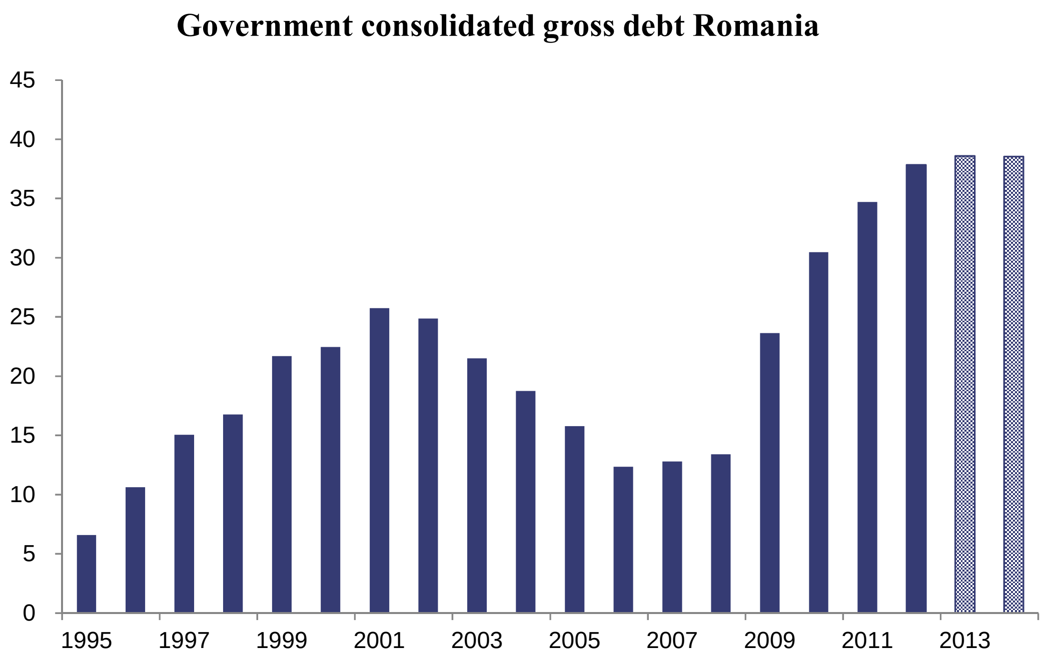
Graph A4.4: **Budgetary execution, 2009-2013**



Source: European Commission, Romanian authorities

Graph A4.5: **Evolution in government deficit and debt (ESA definition)**





Source: European Commission

ANNEX 5
List of Abbreviations

ANRE	National Energy Regulatory Authority
BG	Bulgaria
BoP	Balance of Payments
CA	Current Account
CF	Cohesion Fund
CZ	Czech Republic
DGF	Deposit Guarantee Fund
DMO	Debt Management Office
DPL/DDO	Development Policy Loan with a Deferred Drawdown Option
EA	Euro Area
EAFRD	European Agricultural Fund for Rural Development
EBCI	European Bank Coordination Initiative
EC	European Commission
EDP	Excessive Deficit Procedure
EMTN	European Medium Term Notes
ERDF	European Regional Development Fund
ESA	European System of Integrated Economic Accounts
ESF	European Social Fund
EU	European Union
FDI	Foreign Direct Investment
FR	Functional Reviews
FRL	Fiscal Responsibility Law
FX	Foreign Exchange
GDP	Gross Domestic Product
GSG	General Secretariat of the Government
GVA	Gross Value Added

HICP	Harmonised Index of Consumer Prices
HU	Hungary
IFRS	International Financial Reporting Standards (www.ifrs.org)
ILO	International Labour Organisation
IMF	International Monetary Fund (www.imf.org/external/country/rou/index.htm, www.fmi.ro)
JEREMIE	Joint European Resources for Micro to Medium Enterprises
LoI	Letter of Intent
MEFP	Memorandum of Economic and Financial Policies
MIP	Macroeconomic Imbalances Procedure
(S)MoU	(Supplemental) Memorandum of Understanding
NBR/BNR	National Bank of Romania/ Banca Naţională a României (www.bnr.ro)
NIIP	Net International Investment Position
NIS	National Institute of Statistics
NMS	New Member States
NPL	Non-Performing Loans
OP	Operational Programme
PL	Poland
PNDI	National Programme for Infrastructure Development / Programul Naţional de Dezvoltare a Infrastructurii
PPP	Public-Private Partnership
PSC	Point of Single Contact
RAS	Romanian Accounting Standards
REER	Real Effective Exchange Rate
ROA	Return on Assets
ROE	Return on Equity
RON	ROmanian New lei (leu/lei)

SA	Seasonally Adjusted
SAPARD	Special Accession Programme for Agriculture and Rural Development
SBA	Stand-by Arrangement
SCF	Structural and Cohesion Funds
SDR	Special Drawing Rights
SOE	State-Owned Enterprise
TFP	Total Factor Productivity
TMU	Technical Memorandum of Understanding
WB	The World Bank (www.worldbank.org)
YOY (y-o-y)	Year-on-year

ANNEX 6
Programme Documentation

Annotated Supplemental Memorandum of Understanding (SMoU)

Conditionality of the June 2012 SMoU due by the end of the programme

A. Fiscal consolidation

No.	Measures	Comments on implementation
1	Progress in terms of fiscal consolidation with a view to reaching a deficit below 3% of GDP for 2012 in ESA terms.	Fulfilled. Romania reduced its government deficit to 2.9% of GDP in 2012 (validated by Eurostat).
2	In the 2012-2015 update of the Medium Term Fiscal Strategy, provide the financing necessary to gradually reduce the payment delays in the health sector from 210 days to 60 days as required by Article 4 (4) of the EU late payments directive (Directive 2011/7/EU).	Fulfilled. The Law for the transposition of Directive 2011/7/EU was adopted in March 2013 and the required amounts (estimated at RON 3.5 bn) have been provisioned for in the 2013 budget.
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 joint program.	Partially fulfilled. Central government arrears at end-May 2013 (preliminary data) are within the target. Local government arrears stand at RON 510 mn at end-May 2013 (preliminary data), higher than the RON 300 mn target. The IMF considers the local arrears target met, as they take into account the fact that RON 360 mn in local government arrears are disputable by the central government on various grounds([41]). When taking these into account, the local government arrears would be RON 150 mn, therefore within the target. However, the Court of Accounts has yet to start its investigation into this matter.
4	Introduction of an enhanced reporting system for the State Owned Enterprises which are part of the ESA definition of the general government. 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	Broadly fulfilled. The enhanced monitoring system for SOEs that are part of the general government is in place; therefore those SOEs report cash data on a monthly basis. However, the data is not yet included in the monthly cash deficit figures, as the MOPF is still fine-tuning the

([41]) According to the MEFP, these claims are disputed for one of the following reasons: failure to comply with relevant laws and regulations; improper invoicing or procurement process; a lack of evidence regarding completion of work invoiced. However, an investigation by the Court of Accounts is planned and the exact nature and causes of these arrears will be clarified once the investigation is finalized.

No.	Measures	Comments on implementation
	include, inter alia, a monthly monitoring of arrears, subsidies and transfers, and losses.	reporting system to eliminate monthly volatility of data.
5	Prevent the further accumulation of arrears and losses for the companies which have been reclassified by Eurostat into the general government sector.	Fulfilled so far, although arrears of state owned companies remain a risk for the budget, in the absence of significant progress in the restructuring of SOEs.
6	Continued monitoring of the public sector wage bill, and necessary action taken in a timely fashion if the wage bill is projected by the Ministry Of Public Finances (MOPF) or by the Commission staff to exceed the relevant limits set in the Medium-Term Fiscal Strategy. The public sector wage bill should remain sustainable over the 2012-2014 period.	Fulfilled. The public sector wage bill remains within the established parameters.
7	Approval of legislation by mid-June 2012 to modify the co-payment system for medical services in cooperation with the World Bank.	Fulfilled with some delay and with more exemptions than agreed. Legislation was approved by the Parliament in 2012 with a view to entering into effect on 1 January 2013 (Law 138/2012). However, the secondary legislation allowing for implementation was approved by the Government only on 20 March 2013 and the co-payment entered into force on April 1st 2013.However, it appears that the legislation foresees more exemptions from the co-payment than initially agreed.
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.	The final decision of the SHAH Deniz Consortium (Azerbaijan) was to export gas to Europe by using the Trans-Adriatic Pipeline (TAP) rather than starting the Nabucco project.

B. Fiscal governance and structural fiscal reform

No.	Measures	Comments on implementation
9	The MOPF should receive the information on hospital budgets at central government level from the Health Ministry in a timely fashion. Once the new Health Law is approved, the MOPF should also receive the information on hospital budgets at local government level from the Health Ministry. The MOPF 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.	Fulfilled. The MOPF receives the information for both central and local government level hospitals. Moreover, such information is now also available for the public, on the website of the Ministry of Health. The MOPF checks regularly the information received and is cooperating with the Ministry of Health to take timely action.
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 MOPF. 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 MOPF 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 MOPF. Continue to improve the expertise in the public investment monitoring unit in the MOPF. Going forward, the public investment monitoring unit of the MOPF 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	Partially fulfilled. The government has made important progress for a better prioritization of capital expenditure, especially in the last year. A capital budgeting unit inside the finance ministry has been set up and its activity was enhanced. It produces quarterly reports on central government investment projects that are submitted for discussion in government meetings. Work is under way for updating the database with the status of projects co-financed by the central and local governments. However, a true prioritization strategy for capital investments (at both local and central government) and a proper medium-term budgeting of priority investments is not yet in place.

No.	Measures	Comments on implementation
	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.	Fulfilled. Public capital spending was already being shifted to EU funds in 2012. Moreover, in the 2013 budget approved in February 2013, re-orienting investment projects away from domestic capital spending and towards EU funded spending seems to be the government approach.
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.	Fulfilled. Since 2011, when ESTAT put a reservation on the quality of Romanian data, significant progress has taken place. The capacity of the INSSE in the field of government finance statistics should be further consolidated.
13	Delivery to the Commission Services of the second report on the implementation of conventional measures to tackle VAT fraud by June 2012 and the third report by December 2012.	Fulfilled.
	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 second quarter of 2012 and by end-December 2012.	Fulfilled with some delay over the original SMOU deadline of end-December, but this delay was already recognised/agreed in the context of the August 2012 review (as reflected in the MEFP of 9 Sept 2012); at the time, it was agreed to have the next update of the 2013-15 debt management strategy published in the first quarter of 2013. The revised Debt Management Strategy for 2013-2015 was indeed approved and published on 27 March 2013([42])

([42]) See http://discutii.mfinante.ro/static/10/Mfp/buletin/executii/Gov_publicdebtmanag_strategy2013_2015.pdf

C. Financial sector regulation and supervision

No.	Measures	Comments on implementation
15	Based on the Memorandum of Understanding between the NBR and the Deposit Guarantee Fund (DGF), the two institutions will agree by end-May 2012 the set of relevant financial information as well as the necessary internal arrangements to provide this information to the DGF.	Fulfilled.
16	To foster the development of the market for impaired assets and mitigate the risks associated with the still on-going deterioration in asset quality, authorities will ensure by end-June 2012 that the tax treatment of bank receivables sold by banks to asset recovery companies incorporated in Romania is neutral.	Fulfilled.
17	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. The authorities will ensure that the law amending the Law 503/2004 will be enacted by end-October 2012.	Fulfilled. The law 139/2013 amending the Law 503/2004 on the bankruptcy of insurance undertakings was published in the Official Journal on 9 May and entered into force on 12 May.
18	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.	Fulfilled. Throughout the programme period the authorities complied with the request.
19	Based on available data, the NBR will prepare an assessment of the experience with the application of the prudential filters on loan-loss provisions, solvency and reserves as well as proposals for the permanent arrangements (including possible adjustments) that will apply in 2013. These will be shared with the EC and IMF staff and subsequently released for consultation with the banking community no later than end-July 2012.To strengthen its capacity to effectively supervise the banking sector, the NBR will continue to upgrade its	Fulfilled.

No.	Measures	Comments on implementation
	expertise in IFRS, including *via* consultation with international experts.	
20	To avoid the ever-greening of loan portfolios while allowing banks some flexibility in loan restructurings, the NBR will continue to closely oversee bank practices to ensure that loan-loss provisioning and the assessment of credit risk of restructured loans continue to remain prudent and in line with good international practices.	Fulfilled. Throughout the programme period the authorities complied with this condition.
21	Authorities will amend, by end-October 2012, Government Ordinance 10/2004 on the winding up of credit institutions to ensure that the treatment of subordinated debt in the table of creditors is determined by contractual terms and not by thresholds related to the participation to the capital of credit institutions.	Fulfilled.
22	Once sufficient data becomes available, the NBR will assess, by end-October 2012 at the latest, the impact of the recently introduced measures on foreign-exchange lending to households, and share its observations with the EC and IMF staff.	Fulfilled.
23	As preserving credit discipline and avoiding moral hazard among debtors contributes significantly towards enhancing financial stability, we will continue refraining from adopting legislative initiatives (for instance the personal insolvency law, proposals for the debt collecting law), which would undermine credit discipline.	Fulfilled. Throughout the programme period the authorities complied with this request.

D. Structural reforms

No.	Measures	Comments on implementation
24	Implementation of the Action Plans adopted in response to the findings of the functional reviews. Report on progress on a quarterly basis.	Fulfilled in the sense that quarterly progress reports were submitted by the Romanian authorities on time. Implementation remains however slow.
25	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.	Partially fulfilled. Romania has introduced e-governance tools for businesses and citizens (e-procurement, point of single contact, trade registry, employee registry etc.). In 2012, progress has been made in implementing e-governance solutions in the health sector (-prescription, e-card of health insurance, patient electronic health record). The authorities have recently submitted an update on the e-governance reform agenda, the National Strategy for Digital Agenda 2013. Technical discussions with the EC on the use of the EU funds for upgrading of the e-governance services under the next financial framework are on-going. However, more needs to be done.
	Product markets	
26	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 for electricity not later than by end-2013 (non-domestic consumers) and end-2017 (domestic consumers), and for gas as soon as the price for domestically produced gas converges with the average European market price for gas, but not later than by 2014, unless a large gap remains between the average European price and the import price (which could endanger market stability), in which case adjustment would continue until end-2015 (non-domestic consumers). For households, regulated gas prices will be increased starting in July 2013 and converge to international gas prices no	Fulfilled.

No.	Measures	Comments on implementation
	later than December 2018.	
27	Phase out regulated prices in electricity: According to the electricity road map, adopted in March 2012 by government memorandum, implement the actions by the agreed deadlines and provide quarterly progress reports starting from 1 October 2012. Publish the adopted electricity roadmap before 30 June 2012. Phase out regulated prices in gas: Adopt a detailed roadmap for phasing out regulated prices in gas for non-domestic and domestic customers through a government memorandum by mid-June 2012. The draft roadmap will be agreed between ANRE, the Romanian government, the European Commission and the IMF, before its adoption by the Romanian government. The roadmap will specify: *i)* the final timeline of deregulation which should start on 1 December 2012 for non-domestic consumers and on 1 July 2013 for domestic consumers and which should be achieved by the deadlines referred to in paragraph 26; *ii)* the main intermediary steps of deregulation, which should be based on a clear and transparent method for gradually increasing the tariffs, in a broadly linear fashion in order to ensure that during the phasing-out period market prices and regulated tariffs will not diverge significantly, 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 gas market, by involving the Competition Council and ensuring the development of a trade exchange platform, in particular for gas contracts which currently does not exist. Publish the adopted gas road map by 30 June 2012.	Partially fulfilled. Fulfilled. Phasing out of regulated prices: compliance as of mid-June 2013. Not fulfilled. The requirement on quarterly progress reports has not been complied with as of mid-June 2013. The report due in April had not been submitted to DG ENER as of June 2013. i) Fulfilled. There was a delay in the implementation of the gas roadmap in December 2012 but the increase of February 2013 caught up with the delay bringing the timeline back on track. ii) Fulfilled. iii) Partially fulfilled. Some progress has been made (the gas platform on OPCOM is operating in the experimental mode), but the regulatory framework is still incomplete. ANRE has made a proposal on the draft of the commercial code and balancing rules. Gas can in theory be traded on OPCOM but in practice this trading platform is not fully operational as neither OPCOM nor the RO commodity exchange has the right licences.
28	Explicitly define the vulnerable consumers in the electricity and gas laws, and develop mechanisms to protect them in conjunction with the MOPF and the Ministry of Labour.	Partially fulfilled. The basic definition of vulnerable consumers is provided by the Electricity and Gas law. With the government ordinance amending the 2001 social allowance law on 23 May 2013, the authorities further specified the definition of vulnerable consumers as well as adopted

No.	Measures	Comments on implementation
		legislation that provides additional measures (additional social benefits) from July 2013 to limit the impact of electricity price deregulation. These amendments have not yet been notified to the Commission. Measures related to protect vulnerable customers from the impact of the gas price deregulation are being discussed but have not yet been adopted.
29	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 as soon as possible; *ii)* presentation of a roadmap towards bi-directional flows of gas at the border with Hungary by end-June 2012; *iii)* improving coordinated auctions at the borders with Hungary and Bulgaria and establishing an intraday market in electricity by end-August 2012; 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.	i) Partially fulfilled. A number of orders have been issued by the authorities in early 2013. The authorities argue that the gas export ban has been lifted. However, there is an order 15/2013 on using quantities of gas for the internal domestic market. EC's final legal assessment is not yet complete. ii) Not fulfilled. The roadmap has not been received by the EC. iii) Partially fulfilled. Intra-day electricity market is in place. Certain steps to establish market coupling have been undertaken: the government memorandum on market coupling with HU, CZ and SK was sent to Romania's counterparts in 2012 and technical discussion have started. Further efforts are needed to have a functioning market coupling. iv) Not fulfilled.
30	Ensure an effective unbundling of electricity and gas transmission networks and their operation in a transparent and non-discriminatory manner; *i)* finalise 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 as soon as possible, but no later than end-2012.	i) Partially fulfilled as Romania renounced the IGAs, prepared the mandate for negotiations with Russia and agreed on it with the EC. The negotiations could not start because the Russian side reportedly refuses to negotiate. ii) Partially fulfilled. Ordinance providing for the transfer of the shares owned by the state in the transmission system operators (Transelectrica and Transgaz) from the Ministry of Economy to the Ministry of Public Finances was adopted in March 2013 (GEO 18/2013). However, subsidiaries of Transgaz and Transelectrica responsible for the dispatch of the Romanian gas and electricity system were not part of the transferred assets. As dispatch must be

No.	Measures	Comments on implementation
		considered as part of the core tasks of a TSO this omission appears to prevent the certification of Transgaz and Transelectrica and, thereby, Romania's compliance with the provisions of Directive 2009/73/CE. Commission expects this to be corrected in the few weeks, then ANRE will need several months to prepare the certification.
31	Put in place the legal framework through the correct transposition of EU Directives 2009/72/EC and 2009/73/EC with a view to ensuring that the energy regulator operates independently and efficiently and is equipped with adequate means to fulfil its tasks and responsibilities as defined in the third energy package.	Partially fulfilled. The legal framework has been updated through the adoption of the Gas and Electricity Law in 2012 but the oustanding issues for Ro to correct in the current legislation will be specified in the referral to the court to be prepared by Commssion by end June 2013.
32	Railway reform - Infrastructure: *i)* identify and close or lease lowest cost recovery segments of the railway lines; *ii)* Ensure that the law, in particular the Government Decision on the multi-annual contract: *(a)* leaves it to the infrastructure manager to determine or approve infrastructure charges and that the regulator has the necessary powers to request data and to take independent decisions on infrastructure charges; *(b)* sets out the sources of finance on an annual basis for the entire duration of the contract and is consistent with CFR's business plan; and *(c)* ensure that the contract provides sufficient incentives to the infrastructure manager to reduce unit costs and charges. If necessary, amend the Decision to this effect. *iii)* CFR Infrastructura to complete the present business plan with marketing oriented information (including market segments and charging policies) and ensure the consistency of the funding sources between the business plan and the multiannual contract.	Partially fulfilled. i) Due to the lack of interest for leasing the lowest cost recovery segments of the railway lines, 10 our of 15 sections were granted on 4 April 2013 conservation closure notices. A government decision to this effect is being prepared. For the remaining segments, another round of tendering took place in late May 2013. ii) a) An amendment of the annual track access contract has been introduced allowing the infrastructure manager to determine infrastructure charges; b) No evidence in the annual contracts of the sources of finance; c) No evidence for incentive-based remuneration of the staff of the infrastructure manager. iii) An update of the business plan has not been submitted.
33	Railway reform – Passenger traffic: *i)* submit by December 2012 a government commissioned study on the promotion of competitive tendering of public service obligation contracts; and *ii)* encourage CFR Calatori to implement performance schemes in cooperation with CFR Infrastructura in	Partially fulfilled. i) A study was finalised in December 2012. ii) Not fulfilled. No evidence of performance schemes related to service disruption having

No.	Measures	Comments on implementation
	accordance with EU legislation, i.e. modify charging schemes according to responsibility for disrupting services.	been submitted.
34	Railway reform – Freight traffic: encourage CFR Marfa (the cargo rail company) to implement performance schemes in accordance with EU legislation.	Not fulfilled No evidence of performance schemes related to service disruption having been submitted.
35	Public Private Partnerships: The authorities involved in overseeing PPPs (ANRMAP and UCPPP) commit to jointly report by December 2012 on the functioning of the arrangements (including on the information flow and acces to relevant documents by both authorities).	Not applicable. No PPP have taken place and thus no reports on the functioning of the PPP arrangements could be produced.
36	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-June 2012, 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. By end-August 2012, 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 stage by the procedures under the PSC. By end-October 2012, the PSC should: i) make	Fulfilled. The majority of procedures relevant for the Services Directive are available on-line. Main outstanding issues: (i) a number of procedures relevant for the Services Directive are not available on-line (in the construction sector, regulated professions); (ii) user-friendliness of the portal remains poor; (iii) completion of procedures by users from other MS is not possible due to missing e-signature and e-identification systems.

No.	Measures	Comments on implementation
	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 end-December 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.	
	Labour markets	
37	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.	Fulfilled. The new Labour Law and Social Dialogue Law are in place.
38	Widen the set of cases for use of fixed-term labour contracts (by end-October 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.	The conditionality is no longer applicable as after further assessment it is considered that the current set of cases for the use of fixed-term labour contracts is satisfactory and does not need further widening.
39	Extend the period over which overtime can be compensated with paid hours off to 3 months (by end-October 2012).	Fulfilled. The conditionality is no longer applicable as there was an agreement to substitute this condition with compensatory measures. The compensatory measures were related to the improving integration if youth into the labour markets in view of the high youth unemployment in Romania. Under the umbrella of the new National Job Plan a number of measures and legislative amendments were introduced in early 2013. The law on apprenticeship in the workplace was amended; the Romanian authorities finance programmes dedicated to improving young people's entrepreneurial skills and helping young entrepreneurs to set up microenterprises; the National Plan for Youth Employment is being prepared, which is a starting point for the introduction of the

No.	Measures	Comments on implementation
		Youth Guarantee([43]).
	Pensions	
40	Safeguard the long-term sustainability of the pension system.	Fulfilled. Throughout the programme period the authorities complied with this condition, even if there have been attempts by the authorities to diminish the agreed contributions to pillar II. However, a recent Parliamentary initiative threatens the achievements of the pension reform done under the previous BoP program. On the 22nd of May the Senate approved a law (which still has to pass the Chamber of Deputies) allowing military pensions which decreased as a result of the reform to increase back to their previous levels. If adopted, this poses a high risk that other pensioner categories (formerly having a "special pension regime" which was abolished via the reform) will request the same treatment thus undermining the budget and the sustainability of the pension system.
	Absorption of EU Funds	
41	The EU funds contribution to the total eligible expenditure that is certified to the Commission by the indicated dates is at least equal to 8000 million euro at 31 December 2012. The advance payments are not considered part of the certified expenditure. The targeted amounts are based on a cumulative basis starting from 2007.	Not fulfilled. The end-2012 absorption target was missed by a wide margin (EUR 5.4 bn was absorbed, thus constituting a shortfall of EUR 2.6 bn to the target)

([43]) Council Recommendation of 22 April 2013 on establishing a Youth Guarantee (2013/C 120/01) to ensure that all young people under the age of 25 years receive a good-quality offer of employment, continued education, an apprenticeship or a traineeship within four months of becoming unemployed or leaving formal education).

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

E. Price stability and reserve management

No.	Measures	Comments on implementation
42	Monetary policy should remain geared towards price stability and the achievement of the NBR's inflation targets (3.0% ± 1 percentage point end-2012).	The NBR faces challenges in implementing its monetary policy. In particular, the repeated overshooting of the inflation targets may ultimately pose a risk for the NBR's credibility – although a large part of recent price increases was beyond the direct control of the central bank (related to tax increases, adverse shocks and currency depreciation).
43	Commission staff will be promptly informed if reserve losses exceed EUR 2 billion in any 30-day period during the program period.	Authorities promptly informed Commission staff if substantial losses in reserves occurred.

ANNEX 6
Programme Documentation

Letter of Intent

Bucharest, 10 June, 2013

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 Michael Noonan

Minister for Finance of Ireland

Upper Merrion Street, 2

Dublin, Ireland

Dear Mr Rehn,

Mr Noonan,

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 that we had started to implement under the previous Balance-of-Payments program (2009-2011) as well as structural reforms to increase the resilience and growth potential of Romania's economy.

The Romanian authorities reaffirm our commitment to our economic program supported by the International Monetary Fund (IMF), the European Union (EU), and the World Bank (WB). Unfortunately, there were slippages in program implementation during the latter part of 2012. While fiscal consolidation continued, the structural reform agenda was delayed. We are committed to taking the corrective actions described in the attached Memorandum of Economic and Financial Policies (MEFP), notably by pushing ahead with the planned structural reforms. We expect growth to pick up in 2013, after it nearly stagnated in 2012. Our economy remains vulnerable to developments abroad, which requires continued firm policy implementation and maintenance of fiscal, external, and financial sector buffers to safeguard against risks.

Our performance has been mixed. In the attached MEFP, we set out our plans to further advance towards meeting the objectives of our macroeconomic program. To allow time to implement the proposed remedial measures, we asked an additional three-month, i.e. until end-June 2013. In view of our performance under the program supported by the IMF, the EU, and the World Bank and the remedial measures taken to bring the program back on track, the Government of Romania and the NBR request the completion of the last review. We stand ready to take additional measures as appropriate to ensure achievement of these objectives.

We will consult with the IMF and European Commission (EC) before modifying measures contained in this Letter and the attached MEFP 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.

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

Sincerely,

Daniel Chiţoiu

Deputy Prime Minister

and Minister of Public Finance

Mugur Isărescu

Governor of the National Bank of Romania

Memorandum of Economic and Financial Policies

Recent Economic Developments and Outlook

1. Real GDP growth slowed to 0.7 percent in 2012, after reaching 2.2 percent in 2011 on a bumper harvest. Domestic demand slowed amid political uncertainty and a recession in the euro area dragged down exports. In addition, severe winter weather depressed activity in the first quarter and a drought led to a sharp contraction in agricultural production in the third quarter. Headline inflation picked up in the second half of the year on account of a supply-driven increase in volatile food prices, the pass-through of the depreciation of the exchange rate during May-September, and an increase in international commodity prices. Annual inflation reached 6 percent in January 2013, but subsequently came down to 5.3 percent in April. Core inflation (HICP basis) also rose from a low near 2 percent earlier in the year to around 3 percent, reflecting the pass through of agri-food commodity prices to processed food prices and some increase in inflation expectations, but has then abated to 2.4 percent in March.

2. For 2013, we expect GDP growth to pick up to 1.6 percent due to a rebound in domestic demand as confidence improved after the elections, EU fund disbursements resume, the budget structure is more supportive, and agricultural output returns to normal levels. Net exports' contribution is expected to remain negative, reflecting both slow growth in export markets and stronger domestic demand. With administered energy price increases in the first part of the year, inflation remained above 5 percent but is expected to fall to the upper end of the central bank's revised target band of 2½ ± 1 percent by year-end. The current account deficit is expected to remain below 4 percent of GDP in 2013. Risks to the outlook continue to be tilted to the downside, particularly from weaker-than-anticipated economic activity in the euro area and lower-than-expected EU funds absorption. Firm implementation of the policy program will thus be crucial to bolstering confidence and securing policy buffers.

Fiscal Policy

3. In 2012, an election year, the fiscal deficit narrowed significantly. Estimates point to a deficit (in ESA terms) below 3 percent of GDP, a first step to exit the EU's Excessive Deficit Procedure. The cash deficit target under the program was missed, however, mainly due to suspensions in the second half of the year of reimbursements for some EU-funded projects because of past irregularities discovered by the Romanian audit authorities. Tax receipts were broadly as planned, partly reflecting one-off revenues from mobile license fees that offset underperformance in VAT and the personal income tax, while nontax revenues recovered due to sizable dividends. We continued to reduce public employment, but current expenditures slightly exceeded the program ceiling owing to increased subsidies. Overall spending was less than foreseen as we curtailed domestically financed capital outlays in favor of higher spending on EU-funded projects and transfers for arrears reduction. Nevertheless, the arrears target for the central government was narrowly missed. At the local government level, although we took measures and arrears started to decline in the last quarter of 2012, they remained above the program target.

4. The 2013 budget targets a cash deficit of 2.1 percent of GDP. This is consistent with a reduction in the ESA structural deficit by 0.5 percent of GDP, in line with the commitments under the EU's Stability and Growth Pact. The budget includes measures to offset: (i) the second step in restoring public sector wages to pre-crisis levels; (ii) restitute health contributions to pensioners; (iii) higher national co-financing needs and a buffer for potential financial corrections for EU-funded projects; and (iv) implementation of the 2010 pension law, which will result in a 4 percent increase in pensions. The budget also contains a significant allocation to implement the EU Late Payments Directive that shortens the deadline for settling unpaid bills. The minimum wage will be increased from RON 700 to RON 800 per month in two steps: it

was increased by RON 50 as of February 1 and will be increased by another RON 50 on July 1. The budget includes measures to improve the quality of domestically financed capital projects through improved prioritization, and to reorient resources towards EU-funded projects while reducing subsidies. We have placed limits on non-eligible spending under EU projects in the budget. A revenue package (of RON 2.9 billion) has been adopted to enhance the tax base through reductions in tax deductibility, improving the taxation of agriculture, and making the turnover tax of 3 percent on small enterprises mandatory. Property tax and excise rates have also been increased in an effort to keep up with inflation. Fiscal performance through the first quarter of 2013 was in line with projections. While grants were lower than planned, we have offset the shortfall by strictly containing spending.

5. We will reduce arrears at the central and local governments to the levels targeted at end-December 2012 as a prior action, before eliminating them over the course of the year. Following the measures undertaken in late 2012, arrears have started to decline in both the central and local governments. However, additional unpaid bills have caused program targets to be missed for local governments. General government arrears decreased by RON 641 million between end-September 2012 and end-December 2012 to 0.14 percent of GDP (almost entirely in local governments). In SOEs monitored under the program, arrears at end-2012 stood at 2 percent of GDP, above the indicative program ceiling of 1.5 percent of GDP.

- Prevention of future arrears cannot be achieved until a commitment control system for all levels of government is operational. We are preparing a detailed definition of the structural architecture of the system that integrates the accounting reporting system with the Treasury payment system, including the commitment control and reporting module for all levels of government. We already signed a contract with a consultant to help design the system and work is currently in progress. We have also approved legislation to ensure better control of budgetary commitments by line ministries.

- Arrears of local governments are a key challenge. We will take stricter measures for monitoring and enforcing the Local Government Public Finance Law (LGPFL). Measures to allow: (i) tax-sharing resources assigned to local governments to be used for paying arrears; and (ii) the central government to directly pay off arrears of local governments from shared taxes, are being strictly implemented. We have settled most of the arrears of the local government through a RON 800 million loan from the central government, which will be recovered from future tax-sharing revenues and other own resources. We performed an investigation of local government arrears, which identified that a significant share of arrears RON 360 million are disputable claims, for one of the following reasons: failure to comply with relevant laws and regulations; improper invoicing or procurement process; or lack of evidence regarding completion of the work invoiced. These disputed claims will not be accounted for in the total amount of outstanding local government arrears. The Court of Accounts will audit the disputed claims and the final decision will be validated by the courts. We also took a series of measures to prevent future arrears, ensuring that: (i) local governments with arrears have raised property tax rates in line with inflation; (ii) commitments on local government investments on projects co-financed by the central government within budgetary allocations are contained; and (iii) the recent Emergency Ordinance 46/2013 on insolvency procedures of local governments will be implemented. The introduction of the copayment law for hospitals will also help reduce spending pressures in local hospitals by encouraging outpatient care.

- In the health sector, the clawback tax yielded RON 1.8 billion in 2012, which was fully used to pay down outstanding pharmaceutical bills. We revised the formula of the clawback tax in consultation with the pharmaceutical industry. All revenues from the clawback tax will be used to reduce payment periods and ensure non-accumulation of arrears on pharmaceutical products. In order to implement the EU Late Payments Directive, which became effective end-March 2013, the budget contains an allocation of RON 3.5 billion to cover the timely payment of unpaid bills. We have made an additional budgetary allocation to clear arrears to hospitals.

- For SOEs, we made progress in reducing arrears in some of the monitored companies through swap operations, payments, and other financial operations. However, we missed the overall indicative arrears target for end-December 2012 because of renewed arrears accumulation notably in the state-owned rail companies. We will continue our efforts to reduce SOE arrears (paragraphs 24, 25, and 29).

6. To address health sector financial imbalances, we are committed to implementing the following key measures:

- In March 2013, we started to introduce copayments, based on a modest fixed amount depending on services provided, in the hospital sector, excluding emergency services.

- To control expenditures and ensure efficiency gains in the short term, we will continue to revise the positive list for reimbursable drugs and, in the framework contracts for the health services providers, we will introduce mechanisms to reduce hospitalization periods and to increase the use of ambulatory services. In 2012 we started to implement the National Hospital Bed Plan and reduced the number of hospital beds that can be contracted. We will not introduce any new drugs or indications in the list of compensated drugs without an interim health technology assessment (HTA) which will become operational in July. For this purpose, we will complete the proposed HTA training. We started to implement the centralized procurement system for pharmaceuticals and medical devices for hospitals, in order to realize cost savings, and we will assess the system at the end of 2013.

- To avoid the future build-up of arrears in the hospital sector, we have shifted some financial resources from hospitals with limited competences to those in the network of regional emergency hospitals. This objective will be achieved through adjustments of the weighted-per-case tariffs, while ensuring that arrears will not accumulate in hospitals with decreased funding. At the same time, we will amend the contracts of hospital managers so that they can be replaced following quarterly appraisals if the hospital has run arrears for three consecutive months.

- We will continue to monitor public hospital budgets to ensure that they are consistent with the expenditure programmed in the general government budget. We started publishing online up-to-date financial statements of all public hospitals in October 2012 (structural benchmark). Moreover, the Ministry of Health has started to conduct mandatory financial audits of public hospitals and financial audits of the use of public funds.

- We will continue implementation of new components of the healthcare IT system. The auditing of insured patient registries was completed at end-2012 and this activity will continue this year. We started the distribution of patient cards at the end of 2012, albeit with delay, and we will continue this process in 2013. This will help control fraud and abuse in the system while enabling better monitoring of spending commitments. A new electronic prescription module for the National Health Information System became operational in June 2012. This will also help to streamline pharmaceutical prescription and dispensing behavior. Efforts are ongoing under an EU-funded project to build a central data base with electronic health records.

7. We continue our efforts to prepare a comprehensive reform of the healthcare system. Rather than adopting a new framework law, we are preparing a new strategy plan, which sets out the main objectives of the reform and deadlines. The strategy plan also lists the proposed measures to achieve the objectives, and existing legislation will be amended accordingly. We will publish supporting evidence and impact assessments of the reform proposals. The reform will aim to raise the efficiency of healthcare spending in Romania, enhance service quality and thereby improve health outcomes, and address the persistent budgetary shortfalls. To this end, we will define the basic package to be financed publicly within the limitations of available funding; shift the delivery of health services away from hospitals to ambulatory

and primary health care providers; reevaluate the hospital financing system; revise the national health programs; improve the regulatory framework for provision and monitoring of healthcare services; and establish the framework for a private supplementary insurance market. On the revenue side we have started to broaden the contribution base to the social health insurance scheme.

8. We continue to improve the efficiency of the tax system. In January 2013, we enacted measures to move VAT collection onto a cash accounting basis for companies with annual turnover below EUR 500,000. We have implemented measures to enlarge the tax base in agriculture through a presumptive tax; limit deductions in the corporate income tax; and increase excises with the goal of maintaining their real value. A mandatory 3 percent turnover tax on small businesses below a turnover threshold of €65,000 has been put in place. We have also introduced a solidarity levy on the windfall gains from the deregulation of gas prices. By July 1, we will: (i) enact measures to simplify the depreciation schedules for fixed assets; (ii) revise the base for property taxes, which will vary depending on use of the property and not the legal status of the property owner; and (iii) start preparing a strategy for a new oil and gas taxation regime for the period 2015-24. We will also seek to ensure that excise rates on alcoholic beverages are better correlated with the alcohol content and the production process. A comprehensive analysis of the social contribution system with the goal of improving collections, expanding the base, and limiting exemptions in order to provide incentives to work and to reduce the tax wedge will be undertaken before finalizing the draft 2014 budget. We will consult with IMF/EC staff before undertaking any further changes of the tax system.

9. We are making progress on a comprehensive reform of the tax administration (ANAF):

We applied the deregistering criteria for small VAT payers and reduced the total number of small taxpayers registered for VAT purposes by more than 20 percent between December 2011 and December 2012. At the end of 2012 the number of small taxpayers stood at 154,300, down from 253,800 the year before. We will continue our efforts in 2013 to reduce the number of small VAT taxpayers.

- We have finalized a list of High Net-Wealth Individual (HNWI) taxpayers for the dedicated compliance program and of individuals with risks and have started prior verification procedures. Soft notification letters have been sent out, and audits have begun in the first half of 2013. In order to strengthen capacity, we are undertaking training programs with the assistance of partner-country tax administration specialists and IMF technical assistance.

- As part of ANAF restructuring and modernization, we are consolidating the current 221 tax offices to eight regional directorates (by mid-2013) and 47 local tax offices (by 2015). We agreed with the World Bank on a project to support the modernization of the tax administration.

- ANAF took over the collection of health contributions by self-employed individuals as scheduled in July 2012. In December 2012 we adopted the necessary regulations to complete the integration of social contributions within the tax collection processes of ANAF and to allow individual taxpayers to submit a single declaration for income tax and social contributions as of January 2013. We will set up a central database that will allow us to manage and assess together with local authorities data regarding taxes and contributions owed to the general consolidated budget as well as information on properties.

10. We continue to make progress in the implementation of the action plans based on the recommendations of the functional reviews of government ministries and agencies conducted together with the World Bank in 2011. We have signed most of the contracts with the World Bank for implementing a number of key medium- and long-term actions. Moreover, through the General Secretariat and in coordination with the Ministry of Public Finance (MOPF), we are working with the World Bank to develop and implement a monitoring and evaluation system for public policies in

accordance with the Convergence Program and National Reform Program, including for tracking the implementation of the action plans. Based on the functional reviews, we will develop personnel norms for each line ministry and will ensure a more flexible application of the 1-for-7 rule while keeping the wage bill close to 7 percent of GDP. This will be done under the coordination of the Ministry of Regional Development and Public Administration and the MOPF. We will also review the Unified Public Wage Law to identify key bottlenecks and challenges in its implementation.

11. Faster absorption of EU funds is a key priority. Although we have made some progress in absorbing EU funds, further efforts are still required. We will take immediate measures to correct past irregularities in the system that led to the financial corrections last year, particularly as regards the public procurement issues. We will ensure that all systems and processes are in line with the EU requirements and best practices so as to minimize the risk of future derailment. Nevertheless, certain programs remain interrupted. Given risks of de-commitment, we have continued to reallocate budgetary resources towards high-priority EU-funded projects where EC reimbursements were interrupted. To contain risks to the budget, we will closely monitor spending on non-eligible expenditures and ensure that they are within the limits set in the budget. Improved performance in certified EU-funds absorption will be reflected in increased flexibility in EU-projects related budget allocations within the agreed fiscal targets. Moreover, we will step up our efforts to boost absorption and are closely working with the EC to simplify the procedure that will help with faster absorption up to the beneficiaries' level. Furthermore, we will continue to implement fully the April 2011 Priority Action Plan for the absorption of Structural and Cohesion Funds.

12. We continue to improve the investment portfolio of all government projects to ensure proper prioritization and monitoring, such that funding can be fully secured within a medium-term horizon (3–5 years). We will ensure that national programs co-financed with local governments are fully funded and no new projects of this type will be initiated. New investment projects from own resources will be strictly contained and projects that can be completed within a year will be prioritized in 2013. The investment database was initially updated in March and, according to Emergency Ordinance No.28/2013, will be finalized in early June to identify local-government priority projects funded through budgetary and EU funds (structural benchmark). Based on this prioritization exercise, we have discontinued low priority projects. We will work with the World Bank, through a project financed with EU funds, to enhance the capacity of the MOPF to develop the criteria to evaluate and monitor public investment projects.

13. We are committed to strengthening fiscal institutions in line with our commitments under the Fiscal Compact. We are preparing amendments to the Public Finance Law and the Fiscal Responsibility Law to adopt a structural fiscal rule and corrective actions in line with EU requirements. We will also undertake efforts to strengthen the capacity of the Fiscal Council.

14. Market conditions for public debt financing have improved considerably owing to reduced domestic political uncertainty and better external market conditions. We continued to consolidate the financing buffer and achieved our objective of four months of gross financing needs to protect against unforeseen external shocks. The net interest paid on this buffer represents a necessary cost for insurance against shocks. We are continuing our efforts to widen the investor base and improve outreach efforts. Inclusion of Romania in major emerging market indices will help diversify the investor base and strengthen capital markets. We are undertaking a project, financed with European funds and implemented with support of the World Bank, to strengthen the debt management department. We published the update of the 2013-15 debt management strategy in March 2013.

Monetary Policy

15. Headline inflation increased mainly on the back of higher food prices in the latter part of 2012, following the poor harvest, and exceeded our target band of 3±1 percent in December 2012. Inflation remained above 5 percent during the early months of 2013, due to base effects and increases in administered prices and excise duties, but we expect it to gradually return to the upper end of our new target band of 2.5±1 percent in the second half of the year. Core inflation (HICP basis) came down to 2.4 percent in April, and is expected to remain low throughout the rest of the year, mainly on account of the dissipation of pressures from food prices and the persistent negative output gap.

16. We kept the monetary policy rate at 5.25 percent since May 2012, but interbank rates increased and temporarily exceeded the policy rate towards the end of 2012 after the move to firm liquidity management. Interbank rates came down again from January, as the NBR resumed the adequate management of liquidity in the banking system. As a result of central bank action to counteract excess volatility in the exchange rate market, the exchange rate stabilized in mid-October, before appreciating by some 3 percent since end-November on account of improved investor appetite for Romanian assets, particularly government securities. However, the NBR action to limit exchange rate volatility also resulted in the NFA target being missed at end-December, after taking into account the adjuster on issuance of government securities on external markets. We have since taken advantage of improved market sentiment to ensure an adequate international reserves buffer while making substantial repayments to the IMF. Liquidity conditions have eased since early 2013, owing inter alia to the NBR increasing and subsequently lifting the cap on repurchase operations in March. We have also narrowed the interest rate corridor around the policy rate from ±4 percent to ±3 percent in order to moderate interest rate volatility on the interbank money market and to consolidate the transmission of the policy rate signal.

17. Risks associated with the inflation projections are balanced, with possible deviations on either side of the baseline scenario on account of higher volatility in international capital flows, which continues to require a prudent monetary policy stance supported by the consistent implementation of the macroeconomic policy mix. The current monetary policy stance appears broadly appropriate but will be adjusted as needed to continue anchoring inflation expectations while also ensuring that international reserves are on an appropriate path. We will continue regular repurchase operations as needed to ensure adequate liquidity conditions in the banking system, while underpinning the good functioning of money markets and consolidating the transmission of monetary policy signals. Minimum reserve requirements are expected to remain unchanged. Furthermore, in an effort to enhance the redistribution of liquidity across the banking sector, we continue to encourage the finalization of the master repurchase agreement, of which a draft has been prepared, and of all procedures needed for banks to be able to engage in collateralized repo interbank lending.

Financial Sector

18. The Romanian banking sector maintains reassuring capital buffers and provisions but faces continuing pressures on asset quality, and from deleveraging and spillovers from abroad. The Cyprus crisis so far had a limited impact on the banking system. Annual credit growth to both corporates and households has turned negative. Nonperforming loans (NPLs) rose significantly, driven mainly by the deterioration of the economic environment and tighter supervisory enforcement, and stood at 19.1 percent in March, 2013, compared to 14.3 percent at end-2011. Total prudential provisions at end-March were sufficient to cover 102.6 percent of NPLs while the IFRS provisioning ratio stood at 78 percent. The NBR-mandated collateral audit resulted in a provisioning gap of around €600 million (around 1 percent of the total loan portfolio and partly due to the regular provisioning flow in the examination period), which has been fully closed. Bank profitability remains poor with an overall system loss during 2012, mainly due to higher provisioning, the weak economy, and the high cost base of some banks. But the banking system turned a

profit in the first quarter of 2013. The capitalization of the banking sector remained strong at 15 percent at end-March 2013 albeit with some differences between banks. Overall, system household and corporate deposits have increased by around 9 percent since end-2011. While the liquidity situation has improved for the banking system, funding conditions are still uneven among some banks. Foreign-owned bank deleveraging has been orderly so far with a parent funding decline of 13½ percent during 2012 and 8 percent between January-April, 2013, but risks from continuing parent funding retrenchment remain elevated and could be an impediment to credit growth recovery should credit demand pick up sizably. The system-wide loan-to-deposit ratio stood at around 114 percent at end-March 2013, declining from 117 percent at end-2012.

19. The NBR will continue to intensively supervise the banking system and take any necessary measures to ensure that banks have sufficient capital and liquidity, especially in light of the uncertain economic environment which could pose further profitability and asset quality challenges for some banks. The NBR will continue to regularly conduct top-down and bottom-up solvency and liquidity stress tests of the banking industry. The NBR, Deposit Guarantee Fund (DGF), and the MOPF will continue to coordinate the implementation of operational preparedness plans and the arrangements for the acquired bank resolution powers according to their competencies. Following the successful bridge-bank simulation exercise, the NBR will update the internal procedures for bridge-banks. Based on the finalization of these internal procedures, the details of the updated NBR contingency planning framework will be shared and agreed with the IMF and EC staff. The NBR is preparing detailed contingency plans on an ongoing basis.

20. Based on the Memorandum of Understanding between the NBR and the DGF, the two institutions have finalized the necessary internal arrangements to provide the DGF with access to the agreed set of relevant financial and prudential information. The NBR board has approved the data transfer from the NBR to the DGF in January 2013. The DGF will swiftly build up its expertise in analyzing the financial information provided by the NBR. Furthermore, the DGF has separated its bank resolution and liquidation functions into two separate departments, each with the appropriate policies and internal procedures. The DGF will also improve the governance structure of its senior management in line with good international practices. As part of the prudential arrangements that would continue to apply in 2013, the prudential filter will remain in place in the current form, in line with evolving EU regulatory developments. Besides adopting measures in 2011 to restrict foreign-currency lending to un-hedged households, the NBR also implemented measures with a similar purpose for corporate lending in 2013, in line with ESRB recommendations on foreign-currency lending.

21. The NBR will continue to closely oversee bank practices to avoid evergreening so as to ensure that IFRS loan-loss provisioning and collateral valuations, as well as the assessment of credit risk of restructured loans, remain prudent and in line with good international practices. The NBR will continue to collect periodic and detailed supervisory data on restructured loans, including to SOEs. Given the sizable NPL overhang, we will remove, where possible, impediments to corporate and household out-of-court debt restructuring and NPL resolution. We will also explore options within the IRFS framework to enable banks to remove fully-provisioned NPLs from their balance sheets at an earlier juncture (consistent with the IAS 39 provisions on the de-recognition of financial assets), inter alia, by clarifying, together with the Romania Banking Association and other relevant stakeholders, the accounting rules applicable to the write-off of loans.

22. We will ensure that the legislation and institutional arrangements for the integrated non-bank financial regulator, the Financial Supervision Authority (FSA), will be amended to adhere to international best practices, notably as regards minimum required professional qualifications of FSA board members and avoidance of conflicts of interest. The law amending the Law 503/2004 on the bankruptcy of insurance undertakings was approved by Law No. 139/2013 in May. Because preserving credit discipline among debtors contributes significantly towards enhancing financial stability, we will take all efforts to avoid the adoption of legislative initiatives (for instance, proposals for the personal insolvency law and for the debt collecting law or amending Ordinance 50/2010), which would undermine credit discipline. In this regard,

we have initiated an impact study and public consultation with all relevant stakeholders on the procedural law for the application of the civil code, especially as regards the provisions on abusive clauses in loan contracts, before it will be enacted.

Structural Reforms

Regulatory and Strategic Reforms in Transportation and Energy Sectors

23. Comprehensive reform of the energy and transportation sectors is a critical element of our economic program to boost investment and growth. In the transportation sector, we seek to improve the quality of service and the reach of the network to foster investment and leverage our favorable geographic location. Exploitation of our large energy reserves requires greater private-sector participation in the sector, which can bring significantly more investment.

24. In the railway sector, we repaid principal arrears to electricity providers and secured a waiver of associated penalties with a government-guaranteed loan from the European Bank for Reconstruction and Development. A key condition of the loan was the appointment of a professional board and management in the railway infrastructure company (CFR Infrastructura). However, we dismissed the board after several months because we were not satisfied with the administrative plan it had prepared. We will seek to avoid such situations in the future. Arrears quickly remerged, reflecting systemic problems within the railway sector. In addition to undermining the smooth functioning of the economy, the arrears would present an obstacle for the railway companies to source electricity once the electricity market is deregulated.

25. To halt the accumulation of arrears and prepare for the full deregulation of electricity prices, we are undertaking significant restructuring measures. The majority stake in the state-owned railway freight company (CFR Marfa) is in the process of being sold to a strategic investor. A professional board and management were appointed in the government-owned passenger operator (CFR Calatori). We changed the formula for calculation of the subsidy for the public service obligations (PSO) of the passenger rail company and removed the international and inter-city trains from the PSO, in order to encourage the passenger company to increase ticket receipts and facilitate payments by CFR Calatori to CFR Infrastructura for use of the rail lines. With about 1,000 line-kilometers already leased out, the rail infrastructure company will close the remaining 230 line-kilometers of the lowest cost recovery segments of the railways in order to bring the total railway network under management of CFR Infrastructura to 15,500 line-kilometers. We also closed the most unprofitable routes for passenger traffic. We acknowledge that these measures are just a start. In particular, we will support efforts of the boards and management of the rail infrastructure and passenger companies to reduce costs and increase revenues. Once the accumulation of new arrears has halted, we will consider a new financial operation to eliminate the stock of arrears of these companies.

26. We have made good progress on regulatory reform in the transportation sector. As of February 2013, the revised regulatory framework allows CFR Infrastructure to establish rail access charges independently. The rail regulatory body has become more independent as the representatives of the Ministry of Transport were removed from its supervisory board in late 2012. Also, in line with the requirements of the EU legislation, performance schemes to reduce delays and traffic disruption will be set up between CFR Infrastructura and both CFR Marfa and CFR Calatori by end-2013. Furthermore, incentives to reduce unit costs and charges have been introduced in CFR Infrastructura.

27. For the energy sector, we have begun to implement the regulatory framework that we established to improve the sector's efficiency. The law to ensure the independence of the energy regulator (ANRE) was promulgated in October 2012. We implemented the first three phases of electricity price deregulation in

accordance with the agreed roadmap that envisages complete deregulation of electricity prices for non-residential consumers by January 1, 2014, and for households by December 31, 2017. Regulated electricity prices were increased by around five percent on January 1, 2013. We also raised gas prices by 5 percent for non-residential consumers on February 1, 2013, albeit slightly later than planned. We intend to implement the remainder of the roadmap to deregulate gas prices as planned to achieve the complete price deregulation for non-residential consumers at the latest December 31, 2015, and for households by December 31, 2018. We will provide quarterly progress reports on the implementation of both the gas and electricity roadmaps. We have also approved an Emergency Ordinance increasing the minimum guaranteed income and the family support allowance starting July to better protect the most vulnerable households for electricity and gas price increases.

28. We plan to further improve the pricing and regulatory framework in the energy sector by undertaking the following steps:

- The pass-through mechanism for electricity and gas purchases by the supply companies will continue to be applied in line with the regulatory framework, in order to strengthen investment in this sector. To better align the current regulated end-user prices of gas with the actual cost of supply and distribution, we increased tariff rates for non-residential consumers by 10 percent and for households by five percent in September 2012. In April 2013, we published the new transmission tariff in the gas sector, and in mid-May we published for consultation the framework for the third regulatory period and the new tariffs for distribution of gas. We are reviewing the sustainability of support schemes for renewable energy.

- We are taking steps to strengthen OPCOM as a trading platform. ANRE approved a new electricity trading instrument tailored for the needs of large consumers. To make this trading instrument operational, a set of procedures and pre-qualification criteria for sellers and buyers, including a standardized template for contracts, was introduced. OPCOM also launched a new gas trading platform in December in a testing/participant training mode and will start commercial operation after receiving a license from ANRE.([44]) We also plan to establish the rules and procedures for operation of the gas market, including the day ahead and balancing markets by July 2013.

- In line with our obligations as a member of the EU, we are ready to begin negotiations on the Inter-Governmental Agreement with Russia and will also strive to take steps to diversify our gas supply. We are phasing out the existing implicit gas export restrictions in parallel with the implementation of the gas price deregulation road map. We have made progress in the construction of the physical infrastructure on the Romanian-Hungarian border, and will enable reverse flows on the gas interconnectors by the end of 2013. We have started the process of certified unbundling of transmission networks in electricity and gas in agreement with the European legislation. The preliminary process for certification of the transport operators (Transgaz and Transelectrica) was started by issuing the Governmental Emergency Ordinance No.18/2013, published in the Official Gazette on April 1, 2013.

State-Owned Enterprises

29. The end-2012 indicative target on the operating balance for monitored companies was met, but their arrears target was missed. Since then, arrears have declined significantly following the placement of Oltchim into insolvency and the liquidation of C.N. Huilei and Termolectrica. SOEs under the purview of

([44]) The new regulations for gas licensing and authorization will be approved by ANRE after an extensive public consultation process by the end of May 2013. This regulation will be published only after repeal of Government Decision 784/2000. Only after this event OPCOM and/or other companies have the possibility to ask for commercial license.

the specialized divisions of financial control within the MOPF will submit their 2013 budgets for review in accordance with provisions in the budget law. The budgets will include quantitative targets reflecting medium-term restructuring objectives. We will monitor performance against those targets on a quarterly basis. The MOFP prepared and published a report on 2011 SOE performance. The MOFP and the relevant line ministries prepared and will publish reports on SOEs within their portfolios, including an analysis of ownership, operating, and financial trends, by end-May 2013, in accordance with Article 58 of ordinance 109/2011.

30. We have stepped up our efforts to accelerate SOE reform by concentrating on the sale of shares in Transgaz, Oltchim, Romgaz, Hidroelectrica, and Nuclearelectrica (companies in the Ministry of Economy's portfolio) and CFR Marfa and the state-owned airline Tarom (companies in the Ministry of Transportation's portfolio), and we are determined to avoid any further delays in completing share sales.

- We launched the tender for the privatization of Oltchim in late August 2012 (prior action for the 6th review) but the winning bidder did not have the financial resources to conclude the sale and we placed the company into insolvency procedures in January. This will result in a significant downsizing of the company and we plan to privatize any part of the company that emerges from insolvency. We submitted a report on key steps taken by the judicial administrator to restructure the company.

- In September 2012, we deposited public tender documents with the securities commission (CNVM) for the secondary public offering (SPO) of government shares in Transgaz. After resubmitting the documentation, we held the SPO of Transgaz shares in April (prior action).

- We intend to meet the structural benchmark (mid-March 2013) for the sale of shares in Romgaz and Hidroelectica albeit with a delay.

– We hired in January a consultant to conduct an audit of Romgaz's natural gas holdings, a step that the transaction advisor recommended be completed before an initial public offering (IPO) is launched. We are firmly committed to launch the IPO of Romgaz before end-October 2013.

– Considerable progress has been made by the judicial administrator in restructuring Hidroelectrica under insolvency procedures. The judicial administrator has cancelled all contracts at below-market prices with energy traders, renegotiated 400 commercial contracts, stopped funding for investment projects where energy generation is a secondary component, and commenced negotiations with labor unions on revising collective bargaining agreements with the aim to better incentivize worker performance and reduce labor costs. In addition, we will issue a government decision, in accordance with all required procedures, for an IPO of 10 percent of the shares in Hidroelectrica immediately after its juridical situation has been solved.

- The new energy producer Oltenia Energy Complex plays a key role in Romania's energy security. We signed a contract with a transaction advisor in early-May 2013 (prior action) for an IPO of 15 percent of the share capital by end-October 2013. In light of Oltenia's large investment needs, we will re-evaluate future steps concerning an enlargement of the private sector involvement through joint ventures or majority privatization to a strategic investor.

- For CFR Marfa, preparations are advanced for the sale of a majority stake to a strategic investor. We published the privatization announcement in April, will hold a public auction to select the winning investor in June, and intend to initial the share sale-purchase agreement on June 21 (prior action). We intend to close the transaction as soon as possible, once all the conditions in the sale-purchase agreement are satisfied.

- The minority privatization of Tarom (SPO of 20 percent) will take place once the new professional board and management have improved the operating and financial results of the company, in order to make it more attractive to potential investors.

- We have signed a contract with a transaction advisor to sell at least 10 percent of Nuclearelectrica shares through an IPO by end-October 2013.

31. We are also making progress in preparing other SOEs for privatization.

- We approved a government decision in February and will sign a contract with a transaction advisor for the majority sale of Electrica (a state-owned company for electricity distribution, supply, and service) by end-July 2013. We plan to conclude the transaction by end-November 2013.

- The merger of the new energy producer Hunedoara with the four viable mines of C.N. Huilei started after the Decision of the Board regarding the merger plan was published in the Official Gazette on May 24th; therefore it is expected to take place by end-July 2013. In preparation for the majority privatization of the merged company, we approved a government decision in February for the majority sale to a strategic investor of Hunedoara through a capital increase and signed a contract in March with a legal advisor for the privatization. Once the company is merged, we will proceed with the privatization. If there is no investor interest, we intend to put the company into insolvency.

- Despite of all our efforts, no strategic investor has submitted any offer for Posta Romana. Therefore, we will extend the privatization process to the end of 2013.

- We placed C.N. Huilei and Termoelectrica in liquidation after the respective general shareholder meetings' decisions regarding the voluntary dissolution and liquidation were published at the beginning of April 2013.

32. Building on Emergency Ordinance 109/2011, the law on SOE corporate governance with modifications sought by the government is on course to be adopted by parliament. The modifications establish a limited negative list of three companies exempted from the law on defense, public order, and national security grounds. The modifications also require SOEs to implement the provisions to appoint professional boards and general managers and complete this process within a maximum period of nine months. Moreover, the modifications will specify that the appointment of interim boards and general managers will be only for a limited time period and impose penalties for not following the provisions of the law.

33. The corporate governance law requires that professional boards and management be appointed in SOEs that remain under majority government ownership. We will only select professional board members and management from lists of qualified candidates prepared by independent firms hired to assist in the process. We recognize that doing otherwise would undermine the credibility of our reform program for the public and for prospective investors. In addition, we will not interfere in the implementation of the administration plans, the management plans, or the day-to-day operations of SOEs for which professional boards have been appointed. We have made recent progress in appointing professional boards and managements at monitored SOEs, including the appointment of a professional board and management in Posta Romana. Other measures undertaken include:

- For Hidroelectrica, a professional supervisory board will be appointed, after the insolvency procedures have been closed. We appointed a general manager and we will establish a new supervisory board for Oltenia. To accelerate the process, we have entered into a framework agreement with five consortia that are pre-qualified to bid on packages of companies to draw up candidate lists. Romgaz, Transgaz, and Nuclearelectrica were in the first package of companies and professional boards and management have been appointed for these companies. All appointments were published for full transparency.

- For SOEs under the Ministry of Transportation and Infrastructure, we hired a human resource firm to select qualified candidates for the boards of directors and managements of eleven firms in its portfolio. We have made appointments of professional boards and management at CFR Infrastructura, Tarom, CFR Marfa (on an interim basis) and CFR Calatori. For other firms, we redoubled our efforts and completed the appointment of professional boards and management in accordance with the provisions of the corporate governance law by end-June 2013.

34. Based on law 123/2012, all new bilateral contracts of electricity producers will be made transparently and non-discriminatorily through OPCOM (electricity) and other competitive procedures (gas), and the terms of the contracts will be published. In addition, we put in place regulations requiring that the key terms (counterparties, price, volume, and duration) of contracts on the over-the-counter (OTC) platform entered into by SOEs will be published.

Other Structural Reforms

35. We continue to make progress in implementing the new labor market and social assistance legislation. The new Labor Code has significantly improved the functioning of the labor market. Nearly one third of new contracts are fixed term. We will continue to monitor implementation of the Social Dialogue Law, ensure that any amendments will be undertaken in consultation with all stakeholders through the normal legislative process, and continue our cooperation with the International Labor Organization (ILO) to ensure that the new legislation respects core ILO Conventions.

36. In view of the high youth unemployment in Romania, we will amend current legislation to improve the transition of young Romanians into the labor market under the umbrella of the new National Job Plan. These measures focus in particular on strengthening training and facilitating apprenticeships. We are also taking measures to strengthen the national vocational training system that can be supported by the EU Structural and Cohesion Funds. We will prepare a comprehensive reform package to lower the high labor tax wedge, which will be implemented in a revenue neutral manner.

37. We will coordinate with all relevant stakeholders the speedy implementation of the recommendations from the World Bank Report on Standards and Codes on insolvency and creditor rights, once the report is finalized. Beyond passing the amended insolvency code, an effective implementation of the amendments will be crucial.

Table A6.1: **Romania- Quantitative program targets**

	2010	2011				2012					
	Dec Actual	March Actual	June Actual	Sept Actual	Dec Actual	March Actual	June Actual	Sept Prog.	Sept Actual	Dec Prog.	Dec Prelim.
I. Quantative Performance Criteria											
1. Floor on the change in net foreign assets (mln euros) 1) 2)	20026	119	1896	2928	-457	1696	-457	-267	-243	683	-317
2. Floor on general government overall balance (mln lei) 3)	-33261	-5254	-11260	-13685	-23837	-3421	-7631	-10470	-8257	-14770	-17430
3. Ceiling on stock of central government and social security arrears (bn lei)	0.19	0.15	0.11	0.10	0.09	0.14	0.15	0.04	0.18	0.02	0.027
4. Ceiling in general government guarantees issued since end-2008 (face value bn lei)	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6
II. Continuous Performance Criterion											
5. Nonaccumulation of external debt arrears	0	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)	…	…	…	…	…	…	…	5.9	…	5.6	…
Inner band (upper limit)	…	…	…	…	…	…	…	4.9	…	4.6	…
Actual /Center point	8.0	8.0	7.9	3.5	3.1	2.4	2.0	3.9	5.3	3.6	5.0
Inner band (lower limit)	…	…	…	…	…	…	…	2.9	…	2.6	…
Outer band (lower limit)	…	…	…	…	…	…	…	1.9	…	1.6	…
IV. Indicative Target											
7. Ceiling in general government current primary spending (excl. EU funds and social assistance mln lei)	131938	30670	62578	94133	128317	30921	63968	99000	96995	133700	134330
8. Floor on operating basis (earnings before interest and tax, net of subsidies) of key SOEs	-6.8	-0.7	-1.8	-2.4	-2.0	-0.4	1.4	-2.7	-2.3	-3.2	-2.2
9. Ceilng on stock of arrears of key SOEs (as defined in TMU, bn lei)	17.9	19.2	19.7	18.5	14.9	16.2	12.4	12.4	12.7	8.9	11.5
10. Ceilng of stock of local government arrears (bn lei)	0.91	0.82	0.81	0.82	0.75	0.82	1.17	0.75	1.32	0.3	0.84
11. Ceilng on the execution of the PNDI program (mln lei) 4)	…	…	…	…	…	66	67	700	67	1000	210

1) The end- Decmber 2010 figure is a stock

2) The September 2012 target is adjusted downward with 67 million Euros to reflect less than projected Eurobond placement of the MoPF, and the target is adjusted upward by 50 million Euros to reflect higher than projected commercial bank reserve requirements held with the NBR. The December 2012 target is adjusted upward by 1433 million Euros to reflect more than projected Eurobond placement of the MoPF.

3) Cumulative figure during calendar year (e.g. September 2011 is cumulative from January 1, 2011). The September 2012 dificit target is adjusted 770 mln to RON 10470 million for the loan to CFR Infrastructura. Actual data is adjusted for PNDI (67.5 mln RON), the loan to CFR Infrastructura (770 mln RON) and the EU cash accrual gap (239 mln RON) for end September. For end_December, actual data includes PNDI (210 mln RON) and EU cash accrual gap (2477 mln RON)

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

Source: MEFP

Table A6.2: **Romania – Performance for Seventh and Eighth Reviews**

	Measure	Target date	Comment
Prior actions			
1.	Reduce central government arrearrs to RON 0.02 billion		Expected to be met [1)]
2.	Reduce local government arrearrs to RON 0.3 billion		Expected to be met [1)]
3.	Initial a sale-purchase agreement with the winning strategic investor for the sale of the majority stake in the capital of CFR Marfa.		Underway [1)]
4.	Launch the tender for a secondary public offering of 15 percent of the geovernment shares in Transgaz.		Met
5.	Sign a contract with a transaction advisor for an initial public offering of 15 percent of the share capital of Oltenia.		
Quantative performance criteria			
1.	Floor on net foreign assets	December 31, 2012	Not met
2.	Floor on general government overall balance	December 31, 2012	Not met
3.	Ceiling on central government and social security domestic arrears	December 31, 2012	Not met
4.	Ceiling on central government guarantees	December 31, 2012	Met
5.	Non-accumulation of external debt arrears	December 31, 2012	Met
Quantative indicative target			
1.	Ceiling in general government current primary spending	December 31, 2012	Not met
2.	Floor on operating basis of key SOEs	December 31, 2012	Met
3.	Ceilng on stock of arrears of key SOEs	December 31, 2012	Not met
4.	Ceilng of stock of local government arrears	December 31, 2012	Not met
5.	Ceilng on the execution of the PNDI program	December 31, 2012	Met
Inflation consultation band			
	Inner band	December 31, 2012	Exceeded
	Outer band	December 31, 2012	Met
Structural benchmarks			
1.	Update the investment database to identify priority local government projects funded through budgetary and EU funds, and publish a list of low priority projects which will be discontinued	September 30, 2012	Not met
2.	Publish up-to-date financial statements of all public hospitals on a website of the Ministry of Health	October 31, 2012	Met
3.	Sign a contract with a legal and transaction advisor for the majority privatization of Oltenia.	November 30, 2012	Not met
4.	Finalize a detailed definitio of the structural architecture of the accounting and treasury reporting syst	December 31, 2012	Not met
5.	Hold IPOs of gevernment shares in Romgaz and Hidroelectrica.	March 15, 2013	Not met
1)	Staff will report on the status of these prior actions in a supplement before the Board meeting		

Source: MEFP

Technical Memorandum of Understanding (TMU)

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 2012 budget*. 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), and the road fund company. 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 operation of a fiscal nature as defined in the IMF's *Manual on Government Finance Statistics 2001*. The authorities will inform the IMF staff of the creation of any such new funds or programs immediately. As mentioned in ¶12 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 and successful implementation of the monitoring system being undertaken by the Ministry of Public Finance (MOPF).

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. stock	Mar. actual	Jun. actual	Sep. actual	Dec. actual	Dec. Stock	Mar. actual	Jun. actual	Sep. actual	Dec. actual
Cumulative change in NFA	20026	119[2]	1896	293	-457[3]	19569	1696[4]	-457[5]	-243[6]	-317[7]
Memorandum Item: Gross Foreign Assets	32432	996	2793	1206	464	32897	1662	-496	-854	-1821

[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.

[3] PC met with an adjustment for the Eurobond issue of €1000 million.

[4] PC met with an upward adjustment by €533 million due to the more than projected Eurobond issue of MoPF.

[5] PC met with a downward adjustment by €817 million due to lower than projected Eurobond issue of MoPF and an upward adjustment by €10 million due to higher than projected commercial bank reserve requirements held with the NBR.

[6] PC met with an adjustment of €67 million due to lower than projected Eurobond issues of MoPF and an adjustment of €50 million due to higher than projected commercial bank reserve requirements held with the NBR .

[7] PC missed with an adjustment for higher than projected Eurobond issues of MoPF by €1433 million.

8. The NFA targets will be adjusted upward (downward) by the full amount of the surplus (shortfall) relative to the baseline of external bond placement by the 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 (World Bank, WB, and the European Union, EU) 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 2011 (€6,037 million), measured at program exchange rates.

External Program and MOPF Disbursements—Baseline Projections (in mln. euros)[1]

	2011				2012			
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Cumulative change under external program	1200	1650	2050	2050	0	0	0	0
Cumulative change in external MOPF bond placement				1000	1150	2500	2500	2500

[1] Flows are cumulative from the beginning of the same calendar year (e.g., March 2012 figure is cumulative from January 1, 2012).

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.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
	actual	actual	actual	actual	actual	actual	actual	actual	actual
Outer band (upper limit)									
Inner band (upper limit)									
Actual / *Center point*	7.9	8.0	8.0	3.5	3.1	2.4	2.0	5.3	5.0
Inner band (lower limit)									
Outer band (lower limit)									

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.

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 Autostrazi si Drumuri Nationale din România SA, Metrorex SA, Administratia Fluviala Dunarea de Jos, CFR Calatori, CN Huila Petrosani SA, SN a Carbunelui Ploiesti SA, CN Radiocomunicatii Constanta, SC Interventii Feroviare, CFR Infrastructura, SC Termoelectrica SA, Societatea Nationala Aeroportul International Mihail Kogalniceanu, SC Electrificare SA, CN Administratia Canalelor Navigabile Constanţa SA , SC CN Romarm, Santierul Naval Mangalia SA, Societatea Feroviara de Turism SFT CFR, SC Uzina Mecanica Orastie, 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;

of which: (a) temporary financing for EU projects;

(b) reimbursement payments from EU for the EU projects

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-September 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 25,150 million, respectively, up to a limit of lei 700 million. The performance criterion for the general government balance for end-June 2012 and end-September (measured on a cumulative basis from the beginning of the year) will be adjusted downward by the amount of a bridge bank loan for arrears clearance of CFR Infrastructura, up to a limit of lei 900 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 nonfinancial 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 (actual)	6.5
End-March 2012 (actual)	7.0
End-June 2012 (actual)	7.7
End-September 2012 (actual)	8.3
End-December 2012 (actual)	9.8

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 (actual)	0.09
End-March 2012 (actual)	0.14
End-June 2012 (actual)	0.15
End-September 2012 (actual)	0.18
End-December 2012 (actual)	0.03

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

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 (actual)	128,317
End-March 2012 (actual)	30910
End-June 2012 (actual)	64,046
End-September 2012 (actual)	96,595
End-December 2012 (actual)	134,300

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 (actual)	66.1
End-June 2012 (actual)	67.45

End-September 2012 (actual)	67
End-December 2012 (actual)	210

[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 (actual)	0.75
End-March 2012 (actual)	0.82
End-June 2012 (actual)	1.17
End-September 2012 (actual)	1.32
End-December 2012 (actual)	0.84

J. Absorption of EU Funds

22. The EU funds contribution mentioned in the European Commission's Memorandum of Understanding (MoU) conditionality is to be measured taking into account the eligible expenditure from both the structural and cohesion funds (SCF) and the European Agricultural Fund for Rural Development (EAFRD).

K. Monitoring of Public Enterprises

23. 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.

24. A quarterly indicative target for 2011 was 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 Autostrăzi si Drumuri Nationale din România S.A., C.N. a Huilei S.A., C.N. Poşta Română 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 Marfă ”CFR Marfă” 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. Actual performance was 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 (actual)	-2.4
End-December 2011 (actual)	-2.0

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

[2] End September and end-December preliminary data exclude operating balance of S.C. Electrica Furnizare Transilvania Nord S.A.

25. 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 Autostrăzi 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 Marfă ”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., S.C. Complexul Energetic Oltenia S.A., S.C. Hidroelectrica, S.C. Electrica S.A., C.N. Poşta Română 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 (actual)	-0.4
End-June 2012 (actual)	-1.4

End-September 2012 (actual)	-1.9
End-December 2012 (preliminary)	-2.1

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

26. 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.

27. A quarterly indicative target for 2011 was set on the stock of arrears of the public enterprises listed in ¶24. The data shall be reported at the firm level. Actual performance was 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 (actual)	18.5
End-December 2011 (actual)	14.9

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

28. A quarterly indicative target for 2012 is set on the stock of arrears of the public enterprises listed in ¶25. 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 (actual)	16.0
End-June 2012 (actual)	12.4
End-September 2012 (actual)	12.7
End-December 2012 (preliminary)	11.5

29. 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.

L. Private Management for Key SOEs

30. Private management will be selected, in line with MEFP ¶32 and ¶33, at least for the following state-owned enterprises: i) S.N. Nuclearelectrica ii) C.N. Căi Ferate CFR S.A. (including S. C. Interventii Feroviare S.A.), iii) S.C. Complexul Energetic Oltenia S.A., iv) S.C. Electrica S.A., v) S.C. Hidroelectrica, (vi) S.N. Romgaz, (vii) S.N. Transport Feroviar de Călători "CFR Călători" S.A., and (viii) S.N. Transgaz.

31. In addition, private management is envisaged in the course of 2012 for the following additional companies: i) C.N. Autostrazi si Drumui Nationale din Romania S.A. ii) C.N. Telecomunicatii CFR S.A., (iii) S.C. Electrificare CFR S.A. (iv) C.N. Tarom S.A. (v) S.C. Transport cu Metroul Bucuresti S.A. "Metrorex" and (vi) S.N. de Transport Feroviar de Marfã "CFR Marfã" S.A..

Reporting Requirements

A. Reporting Requirements for the Prior Actions

32. For the prior action related to Transgaz, the launching of the tender will involve the listing of the secondary public offering of 15 percent of the shares on the Bucharest stock exchange. The prior action related to CFR Marfa requires the initialing of a sale-purchase agreement with the winning strategic investor for a majority stake in the share capital of CFR Marfa. The prior action related to Oltenia requires the signing of a contract with a transaction advisor for an IPO of 15 percent of the share capital of Oltenia.

B. Reporting Requirements

33. 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 ¶24-25	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 ¶24-25	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	Monthly, within three weeks of the end of

by EU advances or eligible for EU reimbursement on EU supported projects specifically agreed with the EU	each month
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

Financial soundness indicators([45])	Monthly, 45 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

([45]) Data on solvency should be provided on quarterly basis.

ANNEX

Measures to Improve Performance of SOEs under Monitoring

Ministry of Transportation and Infrastructure

- Appoint professional board members and management for CFR Marfă (interim basis) and CFR Călători by end February 2013;

- Appoint professional board members and management for CFR Telecomunicatii, CFR Electrificare, and Metrorex by end-March 2013; and

- Ensure that all appointments will be made from short lists of qualified candidates selected by an independent human resource firm in accordance with the provisions of the SOE corporate governance law (109/2011).

C.N. Căi Ferate CFR S.A. "CFR Infrastructura" (including subsidiaries)

- Lease out the remaining 230 line-kilometer of the lowest cost recovery segments of the railways to bring the total railway network under management of CFR Infrastructura to 15,500 line-kilometers by mid-March 2013;

- Sign a contract with evaluators to undertake and complete an inventory and valuation of private assets by end-March 2013, with a view to completing the valuation by end-June 2013;

- Establish a business plan by end-March 2013; and

- Conduct a study of the economic rationale for the existence of CFR Electrificare and CFR Telecommunicatii and begin process of merging them with CFR Infrastructura, privatizing, or liquidating the companies based on the study by mid-April 2013.

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

- Approve a privatization strategy to sell a majority of the company to a strategic investor by early-February 2013;

- Publish privatization announcement by mid-March 2013; and

- Hold a public auction to select a winning bidder and finalize/initial a sale-purchase agreement with the winning bidder by June 20, 2013.

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

- Reduce the train volumes under the personal service contract by 10 percent by mid-May 2013.

Ministry of Communication

C.N. Poşta Românã S.A.

- Seek European Commission (EC) approval for majority privatization to a strategic investor through a capital increase;

- Publish privatization announcement by end-February 2013, subject to EC approval noted above;

- Establish a list of eligible investors by early April by applying the pre-eligibility criteria to interested investors;

- Select investor based on final submission of offers by mid-May 2013; and

- Sign a privatization contract by mid-June 2013.

Ministry of Economy, Trade, and Business Environment

Transgaz

- Deposit public tender documents with the securities commission (CNVM) for the secondary public offering (SPO) of 15 percent of government shares in Transgaz by mid-March 2013;

- Appoint professional board members and management from short lists of qualified candidates selected by an independent human resource firm by mid-April 2013; and

- Launch the tender for a secondary public offering of 15 percent of government shares by mid-April 2013.

S.C. Oltchim S.A.

- Put into insolvency procedures by end-January 2013;

- Submit a report on key steps taken by judicial administrator to restructure the company by mid-April 2013; and

- Neither Oltchim nor the government will acquire the refinery in Arpechim.

S.N. Romgaz

- Sign contract with consultant to value natural gas reserves holdings by end-January 2013;

- Appoint professional board members and management from short lists of qualified candidates selected by an independent human resource firm by mid-April 2013;

- Complete valuation of natural gas holdings by end-June 2013; and

- Launch an initial public offering (IPO) of 15 percent of government shares in Romgaz before end-October 2013.

S.C. Hidroelectrica S.A.

- Sell all electricity that is not committed to the remaining bilateral contracts or the regulated market on OPCOM;
- Appoint professional board members from short list of qualified candidates selected by an independent human resource firm by end-March 2013;
- Issue a government decision, in accordance with all required procedures, for an IPO of 10 percent of government shares in Hidroelectrica by mid-March 2013; and
- Launch the IPO promptly after Hidroelectrica exits from the insolvency procedures.

S.C. Complexul Energetic Oltenia S.A.

- Issue a government decision by end-February 2013 for an IPO of 15 percent of capital;
- Appoint professional supervisory board members from short lists of qualified candidates selected by an independent human resource firm by mid-April 2013;
- Sign a contract with a transaction advisor for the IPO by mid-April 2013; and
- Launch the IPO by end-October 2013.

S.N. Nuclearelectrica

- Sign a contract with a transaction advisor by mid-February 2013 for an IPO of at least 10 percent of government shares;
- Appoint professional board members and management from short lists of qualified candidates selected by an independent human resource firm by mid-April 2013; and
- Publish the prospectus for the IPO by mid-October 2013, with a view to conclude the IPO by end-October 2013.

S.C. Electrica S.A.

- Issue a government decision by end-February 2013 for a sale of the majority of government shares in Electrica;
- Sign a contract with a transaction advisor for the majority sale by end-April 2013;
- Appoint professional board members and management from short lists of qualified candidates selected by an independent human resource firm by end-April 2013; and
- Launch the majority sale with a view to conclude privatization by end-November 2013.

S.C. Hunedoara S.A.

- Obtain a government decision by end-February 2013 for the sale of a majority of government shares in Hunedoara through a capital increase to a strategic investor;

- Sign contract with legal advisor for the majority sale by end-March 2013;
- Merge the company created through the merger of the viable mines of C.N. a Huilei S.A into Hunedoara by end-May 2013; and
- Proceed with a majority sale of shares once the merger is completed. If there is no investor interest, place the company into insolvency procedures.

C.N. a Huilei S.A

- File for liquidation by end-January 2013.

S.C. Termoelectrica S.A.

- File for liquidation by end-January 2013.

S.C. Electrocentrale Bucuresti S.A.

- Engage a consultant to evaluate whether a joint concession of the assets of Radet Bucuresti and El Cen will yield better operating performance and investment; and
- Agree with the municipality of Bucharest on a strategy for settling Radet Bucaresti arrears to El Cen.

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