MEMORANDUM OF UNDERSTANDING

BETWEEN

THE EUROPEAN UNION

AND

ROMANIA

The present supplemental memorandum of understanding updates the specific Economic Policy Criteria contained in the original memorandum of understanding signed in June 2011.

The memorandum of understanding may be amended upon mutual agreement of the parties in the form of an Update. The Update will become effective after the completion of the internal procedures required under the Laws of Romania.

Done in Bucharest on ..DECEMBER..14, 2011 and in Brussels on 27 DECEMBER 2011 in five originals in the English language.

ROMANIA
Represented by

Emil Boc
The Prime Minister

Gheorghe Ialomițianu
Minister of Public Finance

Mugur Isărescu
Governor of the National Bank of Romania

EUROPEAN UNION
Represented by
EUROPEAN COMMISSION

Olli Rehn
Member of the European Commission

E.B. G.I. M.I.

ANNEX

ROMANIA

MEMORANDUM OF UNDERSTANDING
ON
SPECIFIC ECONOMIC POLICY CONDITIONALITY
(FIRST SUPPLEMENTAL MEMORANDUM)

14 December 2011

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

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

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

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

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

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

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

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Annex 1: Specific Economic Policy Criteria

A: Fiscal consolidation

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

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B: Fiscal governance and structural fiscal reform

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

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No.	Measures
	first quarter of 2012 and end-December 2012.

C: Financial sector regulation and supervision

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

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No.	Measures
	treatment and which are treated as retained earnings from specific provisions to support regulatory capital will not be taxed as long as they remain in the corresponding retained earnings account. On an ongoing basis, the authorities will ensure that the IFRS provisions, and any additional prudential filters applied by the NBR, are tax deductible when they are made and taxable when they are released. To maintain its current capacity to effectively supervise the banking sector, the NBR will strengthen its expertise in IFRS, including *via* consultation with international experts.
19	As preserving credit discipline and avoiding moral hazard among debtors contributes significantly towards enhancing financial stability, we will continue refraining from adopting legislative initiatives (such as the personal insolvency law or proposals for the debt collecting law), which would undermine credit discipline.

D: Structural reforms

No.	Measures
20	Implementation of the Action Plans adopted in response to the findings of the functional reviews. Report on progress on a quarterly basis starting in January 2012.
21	Modernise and streamline the relations between different levels of government and between the government and citizens and businesses by greater reliance on electronic data exchange and online interfaces.
	Product markets
22	Notification of the laws relevant for the transposition of EU Directives 2009/72/EC and 2009/73/EC (part of the 3rd Energy Package) on electricity and gas markets as soon as possible. The laws should ensure a full and correct transposition of Directive 2009/72/EC and 2009/73/EC and should reflect, among other things, the commitments of Romania under the MoU. The laws should include the final timeline of price deregulation in electricity and gas, which should be achieved as soon as possible, but not later than by end-2013 (non-domestic consumers) and end-2015 (domestic consumers) for electricity and gas.
23	Phase out regulated prices in electricity and gas: adopt a detailed roadmap for the phasing out of regulated prices in electricity and gas for non-domestic and domestic customers through a government memorandum by end-January 2012, to be submitted at the same time to parliament for adoption through national legislation as soon as possible. The draft roadmap has to be submitted to the programme partners by the beginning of January 2012 and to be agreed by end-January 2012 between ANRE, the Romanian government, the European Commission and the IMF. The roadmap has to specify: *i)* the final timeline of deregulation which should be achieved as soon as possible, but not later than by end-2013 (non-domestic consumers) and end-2015 (domestic consumers) for electricity and gas; *ii)* the main intermediary steps of deregulation, which

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No.	Measures
	should be based on a clear and transparent method for gradually increasing the tariffs in order to ensure that during the phasing-out period market prices and regulated tariffs will not diverge significantly and the methods to avoid cross-subsidisation between consumer segments, as well as clear and transparent criteria for the customers to be gradually phased-out; and *iii)* an appropriate regulatory framework that contains mechanisms to ensure competition in the energy market, in particular in the gas market, by involving the Competition Council and ensuring the development of a trade exchange place, in particular for gas contracts which currently does not exist. The Romanian authorities will provide to the programme partners all preparatory work, such as the studies currently being carried out, as soon as they become available.
24	Explicitly define the vulnerable consumers in the electricity and gas laws, and develop mechanisms to protect them in conjunction with the Ministries of Finance and Labour.
25	Eliminate legal, regulatory and physical barriers to cross-border trade of electricity and gas: *i)* removal of legal and regulatory barriers to the export of gas by December 2011; *ii)* presentation of a roadmap towards bi-directional flows of gas at the border with Hungary by 15 December 2011; *iii)* improving coordinated auctions at the borders with Hungary and Bulgaria and establishing an intraday market in electricity by December 2011; and *iv)* take all the necessary actions on the part of the government to ensure that a bi-directional flow of gas at the border with Hungary is established before the end of 2012.
26	Ensure an effective unbundling of electricity and gas transmission networks and their operation in a transparent and non-discriminatory manner; *i)* open negotiations with the Russian Federation to review historical Intergovernmental agreements concerning the "gas transit" pipelines through Romania as soon as possible; and *ii)* ensure fully certified unbundling of transmission networks in electricity and gas by February 2012.
27	Establish through the electricity and gas laws transposing EU Directives 2009/72/EC and 2009/73/EC the conditions for a strong and independent energy regulator by putting in place the legal framework to ensure independence of the energy regulator and equip it with adequate means to fulfil its tasks and responsibilities as defined in the third energy package.
28	Railway reform - Infrastructure: *i)* identify and close or lease lowest cost recovery segments of the railway lines; *ii)* in order to ensure the economic and financial viability of CFR Infrastructura, negotiate by December 2011 with CFR Infrastructure a new multiannual contract for at least 5 years. The contract should set out the sources of finance on an annual basis for the entire duration of the contract and should be consistent with CFR's business plan. The contract should also provide sufficient incentives to the infrastructure manager to reduce costs and sufficient financial means; and *iii)* CFR Infrastructura to prepare a realistic business plan taking into account EU requirements by April 2012.
29	Railway reform – Passenger traffic: *i)* continue competitive tendering in the

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No.	Measures
	public service obligation contract; and *ii)* encourage CFR Calatori to implement performance schemes in cooperation with CFR Infrastructura in accordance with EU legislation, i.e. modify charging schemes according to responsibility for disrupting services.
30	Railway reform – Freight traffic: encourage CFR Marfa (the cargo rail company) to implement performance schemes in accordance with EU legislation.
31	Public Private Partnership: The authorities involved in overseeing PPPs (ANRMAP and UCPPP) commit to jointly report by mid-April 2012 on the functioning of the arrangements (including on the information flow and acces to relevant documents by both authorities).
32	Establish an operational Point of Single Contact (PSC), provided for in the Services Directive, to help businesses with all administrative procedures involved for the establishment in Romania or for the cross-border service provision. The PSC should provide all information about the conditions and requirements applicable in all services sectors covered by the Services directive, both for establishment and for temporary cross-border service provision as well as the online completion of any relevant administrative procedures (for example obtaining authorisations, making declarations, etc.). By end-November 2011, the following actions should be taken: *i)* appoint an authority in charge of coordinating the setting up of the PSC, monitoring of the functioning of the PSC and reporting the progress made to the Commission; *ii)* grant to this authority the necessary powers, competences and resources and set complementary obligations on all the competent authorities in order to ensure their cooperation in the completion of this project; and *iii)* ensure that this authority cooperates with the Ministry of Communication and the National Center Digital Romania in respect of the technical development of the PSC and with the Ministry of European Affairs in respect of compliance with the EU law obligations. By end of December 2011, the appointed authority should: *i)* provide the European Commission with a working plan and calendar for the implementation of the PSC; and *ii)* provide a list of priority sectors and horizontal procedures to be covered at the first stage by the procedures under the PSC. By March 2012, the PSC should: *i)* make information available online in respect of administrative procedures covered by the Services Directive; and *ii)* make online completion of relevant procedures available for the priority sectors and horizontal issues identified previously. By the end of June 2012, the PSC should be fully operational and the electronic completion of procedures should be possible in all the services sectors covered by the Services Directive.
33	Remove restrictions in setting up retail shops. The government should eliminate the legal provisions requiring an economic needs test and the involvement of the competitors in the procedure for the authorisation of opening large surface retail stores by end-January 2012, making the relevant legislation compliant with the Services Directive (Directive 2006/123/EC of 12 December 2006), in

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No.	Measures
	general, and Article 14 of it, in particular.
34	Introduction by the National Authority for Regulating and Monitoring Public Procurement of a request for a functional review of public procurement which should be completed by end-June 2012. Thereafter a timed action plan should be drawn up and subsequently be executed.
	<u>Labour markets</u>
35	Implement reforms to the wage setting system allowing wages to better reflect productivity developments in the medium term, while respecting the autonomy of social partners, national traditions and practices.
36	Widen the set of cases for use of fixed-term labour contracts (by end-June 2012), while ensuring that this does not increase labour market segmentation. In parallel, improve the adequacy of the employment protection legislation and adapt to the flexicurity principles.
37	Extend the period over which overtime can be compensated with paid hours off to 3 months (by end-June 2012).
	<u>Pensions</u>
38	Safeguard the long-term sustainability of the pension system.
	<u>Absorption of EU Funds</u>
39	The EU funds contribution to the total eligible expenditure that is certified to the Commission by the indicated dates is at least equal to: 31 December 2011: 2100 million euro 31 December 2012: 8000 million euro The advance payments are not considered part of the certified expenditure. The targeted amounts are based on a cumulative basis starting from 2007.

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

<u>Price stability and reserve management</u>

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

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