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Balance of Payments Assistance Programme

Romania, 2013-2015

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Directorate-General for Economic and Financial Affairs

Balance of Payments Assistance Programme

Romania, 2013-2015

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The report was prepared in the Directorate General Economic and Financial Affairs under the direction of István P. Székely, Director and European Commission mission chief to Romania and Michael H. Stierle, Deputy Head of Unit and deputy mission chief.

The following Commission staff contributed to this report:

Francisco Barros Castro, Zoltan Gyenes, Nora Hesse, Julda Kielyte, Mona Papadakou, Christoph Schwierz, Sara Simões, Corina Weidinger Soşdean and Samuel Whittaker. Jan Kattevilder provided data support.

Comments on the report would be gratefully received and should be sent, by mail or e-mail to:

Michael Stierle

European Commission

Unit ECFIN.E3; CHAR 14/138

B- 1000 Brussels

e-mail: michael.stierle@ec.europa.eu

CONTENTS

Summary and main findings	1
1. Programme overview and modalities	5
1.1. Overview	5
1.2. Programme modalities	5
1.3. Policy objectives	6
1.4. Post-programme surveillance	7
2. Macroeconomic developments	9
3. Fiscal issues	13
3.1. Fiscal policy	13
3.2. Fiscal structural issues	15
4. Labour market and welfare system	18
5. Debt management	20
6. Monetary policy	22
7. Financial sector	24
8. Structural reforms	28
8.1. State-owned enterprises	28
8.2. Energy	31
8.3. Transport	32
8.4. Public administration	33
8.5. Business environment	34
8.6. Healthcare	35
A1. Financial assistance programmes 2009-2015	38
A2. Repayment schedule to the EU and the IMF	39
A3. Key economic indicators	40
A4. Programme documentation	45
A4.1. Memorandum of Understanding (MoU)	45

A4.2. Memorandum of Economic and Financial Policies	60
A4.3. Technical Memorandum of Understanding	75
A5. Minimum reporting requirements under post-programme surveillance	86

LIST OF TABLES

A1.1. Financial assistance programmes with Romania	38
A2.1. Repayment schedule to the EU and the IMF	39
A3.1. Overview table	40
A3.2. General government accounts	41
A3.3. Key monetary indicators	42
A3.4. EU funds absorption (billion euro), 2007-2013 programme period	44

LIST OF GRAPHS

2.1. GDP and components	9
2.2. Current account balance by components	10
2.3. Cyclical and non-cyclical current account balance	11
2.4. Current account financing	11
2.5. NIIP in Romania and peer countries	11
2.6. NIIP financing	12
4.1. Monthly average wages	18
5.1. Long term government yields (Maastricht definition)	20
6.1. HICP inflation (% change)	22
6.2. Adequacy of international reserves (2010-2015 average, % of GDP)	23
6.3. Romania and peer countries - exchange rate to EUR (Index Jan-2010=100)	23
A2.1. Quarterly repayment schedule to the EU and the IMF (mln €)	39
A3.1. Key monetary and financial market indicators	43

SUMMARY AND MAIN FINDINGS

The 2013-15 programme was the third consecutive Balance of Payments (BoP) programme agreed between the European Union and Romania. The programme provided precautionary support to Romania of EUR 2 bn until end-September 2015. It was part of a joint EU/IMF precautionary programme of EUR 4 bn, equally split between the two institutions. The EU-IMF programme was complemented by a World Bank's development policy loan with a deferred drawdown option (DPL-DDO) and a programmatic DPL series. The authorities did not submit any request to the EU or the IMF for disbursement throughout the programme period. The DPL-DDO was fully disbursed.

This third programme sought to address remaining macroeconomic and financial vulnerabilities and to promote structural reforms. The programme aimed to strengthen the growth potential and adjustment capacity of the Romanian economy, also by preserving the achievements of the previous two programmes and fostering the completion of reforms that had been started during the second programme. The key measures focused on consolidating macroeconomic, fiscal and financial stability, enhancing administrative capacity and the business environment, reforming of state-owned enterprises (SOEs) and the tax administration, improving public financial management and enhancing the functioning of the energy and transport sectors. The programme was integrated with other EU surveillance tools and the agreed conditionality partly overlapped with the Country-Specific Recommendations (CSR) for Romania.

Although no review could be completed during the programme, some progress was achieved in several policy areas. The reasons preventing the completion of the reviews included fiscal policy measures that could put at risk fiscal sustainability or resulted in poor compliance with the fiscal framework, insufficient progress with SOEs restructuring and SOEs governance reforms, and the undermining of former or current programme achievements. Nevertheless, in some policy areas it was possible to informally agree on – and implement – new actions and adjust targets in order to maximise progress with implementing original programme objectives.

Economic growth has been robust since the start of the programme and is forecast to stay above potential. Romania's economy grew by 3.5% in 2013 and 2.8% in 2014. Growth is forecast to remain robust at 3.5% in 2015, 4.1% in 2016 and 3.6% in 2017. The drivers of growth switched gradually from net exports in 2013 to domestic demand in 2014-15. Due to the planned fiscal stimuli in 2016 and 2017 domestic demand is expected to remain the growth engine. The current-account deficit contracted from an average of 4.3% of GDP in 2009-12 to 0.6% GDP in 2013-14, driven by a fast improving trade balance still supported by subdued imports and strong exports. It is projected to remain broadly stable in 2015 and to gradually widen in 2016-17 on the back of accelerating imports growth. Annual average HICP inflation has been declining since 2013 due to the abundant harvest in 2013 and 2014, falling global oil prices, reductions of the VAT rate for flour and bakery products (as of September 2013) and for all food items (as of June 2015), and the persistence of low inflation in the EU. It is forecast to reach -0.4% in 2015 and -0.3% in 2016, before re-entering the NBR's target band (2.5%±1 pp) in 2017. The labour market situation has been improving. The tax burden on labour was reduced, even if not in a targeted manner, by decreasing social security contributions paid by employers by 5 pps.

Sovereign financing conditions have been generally favourable through the programme, despite recent global market jitters, and foreign-exchange funding needs are lower than in previous years. The future debt redemption profile looks favourable, though there are risks to the fiscal outlook. The fiscal FX cash buffer met or exceeded the target of four months of gross financing needs set out in the MoU for most of the programme period, but it has recently been lower. At end-September 2015, the level of FX reserves covered about 100% of short-term external debt at remaining maturities. Significant progress has been made with measures to further improve debt management, although full implementation of an electronic trading platform and liability management framework was delayed.

Romania reached its medium-term objective (MTO) in 2014, one year earlier than planned, and is expected to remain at the MTO in 2015, but risks for 2016 and 2017 are mounting. The MTO of a deficit of 1% of GDP in structural terms was achieved in 2014, one year earlier than planned, thanks to

agreed consolidation measures in 2013 and the significant under-execution of the investment budget. Fiscal stability was put at risk in June 2014 when the government unilaterally decided a 5 p.p. cut of social security contributions as from October 2014. The deviation was eventually addressed in the 2015 budget. In the course of 2015, several additional ad-hoc deficit increasing measures were again adopted outside the budget process, with an impact in 2015 and beyond. Good revenue performance in light of strong growth and enhanced tax compliance, the continued under-execution of capital investment, and consolidation measures adopted in the July budget rectification may allow Romania to remain at the MTO in 2015. Beyond 2015, i.e. after the end of the programme, risks are however substantial. Significant tax cuts that will apply as from January 2016, adopted under the new fiscal code, are not yet matched with compensatory measures. Based on measures already adopted, in the absence of compensating measures, the structural deficit could exceed the MTO by more than 1% of GDP in 2016 and more than 2% of GDP in 2017. This would push the headline deficit above 3% of GDP in 2017. Additional expenditure increasing measures are being discussed by the government that would further increase the projected deficits. The reform of the welfare system is slowly progressing, with the new Minimum Social Insertion Income scheme expected to be adopted in 2015.

The fiscal framework is sound but not effectively implemented, while backtracking from previous programmes' achievements create risks to fiscal sustainability. Romania has signed the Fiscal Compact (TSCG) and the Fiscal Responsibility Law (FRL, Law 69/2010) incorporates provisions of the Stability and Growth Pact including the obligation to reach and remain at the MTO and strengthening of the multi-annual budgetary planning. Fiscal initiatives such as adopting a new Fiscal Code outside the budget process and the delayed adoption of the medium-term fiscal strategy indicate that the fiscal framework is not effectively applied. Moreover, several special pension regimes were adopted, undoing the uniform pension system introduced during the first BoP programme in 2010 and creating a potential risk to fiscal sustainability.

Tax administration reform efforts advanced and seem to start bearing fruits while progress is ongoing with other fiscal-structural reforms. The restructuring of the national tax agency (ANAF) was broadly completed in 2014 and its Anti-Fraud Department is operational. The restructuring of ANAF, as well as the implementation of a number of measures to improve tax administration and collection seem to contribute to improved tax revenues. Additional efforts, however, are needed to increase efficiency and effectiveness of tax audits, while envisaged reforms in ANAF's organisational structure, including of the large taxpayers unit (LTU), imply some tax collection risks if not carefully designed and implemented. A commitment control system to better control expenditure and prevent the accumulation of payment arrears is being rolled-out to the entire public sector and the Public Investment Evaluation Unit was established to prepare on an annual basis the priority list of significant investment projects.

Financial sector reforms have progressed, but several amendments to the legislative framework need still to be completed. The authorities made significant progress in the cleaning-up of bank balance sheets and a bank asset-quality review and stress test has been launched. The bank resolution framework was further upgraded although several important provisions are still outstanding as the authorities have not implemented the EU bank recovery and resolution directive and the deposit guarantee schemes directive. The covered bonds law was sent to Parliament but it has not yet been passed. The authorities performed the first balance sheet review and stress test of the insurance sector in an EU Member State, comprehensively assessing the vulnerabilities in the insurance sector, and important steps have been taken to strengthen insurance legislation. The financial sector has improved its resilience despite remaining pockets of external and internal vulnerabilities requiring close monitoring. Potential vulnerabilities stemming from legislative initiatives with unwarranted negative impact on the banking sector, such as those aimed to convert foreign exchange denominated loans into local currency loans by using historical exchange rates or requesting banks to provide discounts to borrowers, will also need to be closely monitored.

SOEs corporate governance reform has progressed but important steps are still to be completed and implementation of the current rules has been insufficient. The corporate governance framework of SOEs developed under the previous programmes is being further improved, but legal changes prepared with the support of the programme partners have not yet been finalised. The appointment of professional management in SOEs in accordance with the corporate governance rules (GEO 109/2011) has progressed slower and less decisively than expected. Major delays continue to affect the approval of SOEs budgets and the publication of audited financial statements.

SOEs restructuring efforts were not sufficient to sustainably improve financial performance and viability and only some of the planned privatisation transactions were implemented. Three Initial Public Offerings (two of a minority stake and one of a majority stake) were successfully completed in the first months of the programme, but the process lost momentum and the remaining planned privatisations have been *de facto* suspended. Additionally, two major electricity producing companies, CE Oltenia and CE Hunedoara, are under severe financial strain. The implementation of restructuring measures at CE Oltenia led to some improvement in its operational performance, but authorities recognise that further effort is needed. CE Hunedoara had to receive state aid and needs to present a restructuring plan ensuring the return to viability, as required by European Union state-aid rules. Decisive measures have been adopted to stop production of heavy water and downsize the supplier company (RAAN), significantly reducing losses. A plan to improve the financial situation of Oltchim, an insolvent state-owned chemical producer, has been developed but its implementation is still ongoing. In the transport sector, developments were not in line with programme commitments as the majority privatisation of the rail cargo company (CFR Marfa) could not be implemented, and the improvement of the economic performance of the three rail road companies was only limited, as evidenced by persisting payment arrears. State-aid concerns remain and are being followed up by the Commission's Directorate General for Competition.

Reforms to improve the functioning of energy markets, including deregulation of energy prices, advanced during the programme, but several of the measures agreed are still to be completed. Electricity price liberalisation for corporate consumers was concluded at end-2013 and prices for households are on track to be fully liberalised by end-2017, as planned. The gas market for non-residential consumers has been liberalised since January 2015. The liberalisation of the gas market for residential consumers suffered substantial delay, but a new roadmap was adopted in July 2015, in agreement with programme partners, allowing gas price liberalisation for residential consumers by 2021. Cross-border integration of electricity networks was achieved, while gas interconnections are still limited. Some progress was also registered in unbundling transmission system operators.

Progress in the healthcare sector was visible but still slower than planned. Arrears of hospitals have declined significantly since the start of the programme albeit payment arrears still pose risks to the budget. Existing fiscal control mechanisms have been effectively used and new mechanisms, such as the e-health card, are in place. Funding was increased mainly by improving the potential to take up private supplementary health insurance. Conditionality aimed to improve the sustainability of pharmaceutical spending was partially met and structural overspending moderately decreased. Nevertheless, it remains high. Structural reforms promoted through the programme have set a partial basis for improved effectiveness and efficiency of care. This relates e.g. to the approved National Health Strategy 2014-2020, the improved package of publicly reimbursed benefits, higher funding of primary and ambulatory care services, or enhanced centralized tendering procedures. Finally, a new healthcare reform programme was initiated with the help of the World Bank to increase the efficiency of hospitals. Despite these achievements, the system remains underfunded and hospital-centred, and provides limited access to effective care.

Several initiatives to improve Romania's public administration and business environment have been advanced but not yet fully implemented. The actions following the functional reviews conducted during the previous programmes were, for the most part, implemented and a new strategy for the public

administration was approved. This went beyond the measures agreed at the beginning of the programme, but implementation has been slow. The business environment remains a drag on growth, despite significant improvements with on-line payment of taxes, land registration, and legislation to encourage inventions and start-ups. Announced measures to improve SME's access to finance have for their most part been implemented, but information services and support mechanisms to support investment and exports by SMEs remain disperse. Measures to improve the quality and coherence of legislation affecting business still need to be implemented.

Overall, the programme's final assessment is mixed as significant progress has been achieved in various areas but implementation was clearly insufficient in some policy areas while fundamental former achievements have been put at risk. On the positive side, Romania corrected its external imbalances. The financial sector has been stable and measures were taken to improve the regulatory framework. In addition, Romania performed the first balance sheet review and stress test of the insurance sector in the EU and the NBR launched the internal procedures to prepare for a comprehensive asset quality review and stress test of the banking sector with third party involvement. Energy price deregulation is progressing. Restricted administrative capacity and a poor business environment started to be addressed, albeit with few results so far due to insufficient implementation of adopted legislation and strategies. Progress related to SOEs is rather limited, with various state-aid concerns to be fully addressed. The SOE governance reform remains to be fully implemented and the approval of a corresponding law according to international good practice is still pending. Most importantly, fiscal sustainability has again been put at risk. After consolidating public finances between 2009 and 2014, the government decided to significantly cut various taxes outside the budget process, posing risks for breaching both the national fiscal framework and SGP requirements. In times when the output gap is closing, there is a risk of returning to pro-cyclical policy pursuits. In addition, the government has unilaterally decided to undo former programme achievements such as the uniform public pension system.

Post-programme surveillance (PPS) is envisaged until spring 2018. PPS applies to Romania because of the disbursements made under the 2009-11 programme. The second and third programmes remained precautionary. PPS is envisaged until 70% of the loan has been repaid, i.e. until spring 2018, its purpose being to monitor the repayment capacity of a country exiting the programme. During PPS, Romania is required to discuss any new major economic policy intention with the European Commission staff and, if deemed necessary, with the EFC. The modalities of PPS have been agreed with the Romanian authorities and officially communicated on 30 September 2015. Missions will initially be launched every six months, the first being tentatively scheduled for spring 2016.

1. PROGRAMME OVERVIEW AND MODALITIES

1.1. OVERVIEW

The 2013-15 balance of payments financial assistance programme provided precautionary support to Romania of EUR 2 bn until end-September 2015. The programme was part of a joint EU/IMF precautionary programme of EUR 4 bn, equally split between the two institutions. The IMF support (1.75 billion SDR, around EUR 2 bn) was provided under a stand-by arrangement (SBA). Neither the EU nor the IMF loans have been drawn upon. The programme was complemented by a EUR 1 bn development policy loan with a deferred drawdown option (DPL-DDO), which was fully drawn upon, and a programmatic series of two development policy loans (DPLs) by the World Bank.

The 2013-15 programme was the third consecutive balance of payments financial assistance programme agreed between the European Union and Romania. The first two programmes sought to support Romania in dealing with the financial and economic crisis as well as in laying the foundations for future growth ⁽¹⁾. The first programme (2009-2011) provided financing of EUR 5 bn and was fully disbursed. The second programme (2011-13) provided assistance of up to EUR 1.4 bn. It was treated as precautionary and was not drawn upon. Both programmes were part of joint efforts with the IMF, and were supported by the World Bank and, in the case of the 2009-11 programme, the EBRD and the EIB ⁽²⁾.

This third programme sought to address the remaining macroeconomic vulnerabilities and structural reforms implementation. The reforms pursued in the programme aimed to strengthen the growth potential and adjustment capacity of the

Romanian economy, also by preserving the achievements of the previous two programmes and fostering the completion of reforms that had been started during the second programme. The key measures focused on consolidating macroeconomic, fiscal and financial stability, SOEs reform and corporate governance, energy price deregulation, administrative capacity, reforming the tax administration and improving public financial management.

1.2. PROGRAMME MODALITIES

As in the two previous programmes, support was requested simultaneously from both the EU and the IMF. The EU received a request from the Romanian authorities on 4 July 2013. Following a positive opinion of the Economic and Financial Committee (EFC) on the opening of negotiations, a joint EU/IMF staff mission took place in July 2013 to review the macroeconomic framework and to negotiate the conditions for the new precautionary programme. The letter of intent was sent to the Commission and the Council on 12 September 2013. The ECOFIN approved the programme on 22 October 2013, and the memorandum of understanding (MoU) was signed on 5 and 6 November. In parallel, a Memorandum of Economic and Financial Policies (MEFP) was agreed between the authorities and the IMF on 12 September 2013 and approved on 27 September. The MoU and the MEFP can be found in Annex 4.

Progress in programme implementation was monitored by Commission and IMF staff and reported to the EFC and the ECOFIN. Monitoring took place through semi-annual programme reviews. During these reviews adjustments to the Memorandum of Understanding were also expected. European Commission review missions took place in June 2014, January/February 2015 and June 2015. In addition, staff visits to Romania took place in October 2013, January/February 2014 and May 2015. Technical fiscal missions were launched in July and December 2014. Between missions, contacts were maintained at various technical and political levels, including through a Romanian ministerial visit to Brussels in September 2014. The EFC was informed of developments following these interactions and when requested by its president.

⁽¹⁾ European Commission (2013), *Overall assessment of the two balance-of-payments assistance programmes for Romania, 2009-2013*, Occasional paper 156, July 2013. http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/ocpl156_en.pdf

⁽²⁾ In the first programme, the IMF provided a SBA of EUR 12.9 bn, of which EUR 12 bn were disbursed. In the second, a IMF (precautionary) SBA of EUR 3.5 bn was made available, but not drawn upon. The WB supported the first programme with development policy loans (DPL) of EUR 1 bn and the second with a DPL with a deferred drawdown option (DDL) of the same amount. All have been disbursed. In the first programme, the EIB and EBRD jointly contributed with a further EUR 1 bn in loans.

Informal updates to ECOFIN Ministers were made when requested by the Council presidency.

No review could be finalised during the EU programme, despite progress in several policy areas. The reasons preventing the completion of the reviews included fiscal policy measures threatening sustainability, sluggish progress with the SOEs restructuring and governance reforms, and the undoing of former programme achievements. In some policy areas, however, it was possible, to refine actions to continue implementing the programme conditionality and to adjust targets in order to maximise compliance with the original objectives of the programme. The insurance sector, energy policy, fiscal governance as well as initially fiscal policy are key areas where this approach permitted relevant progress. Similarly, the IMF completed its first two reviews of the SBA, in October 2013 and January/February 2014, but not the following ones ⁽³⁾.

1.3. POLICY OBJECTIVES

The point of departure for the new programme was to preserve the achievements of the previous two programmes and to complete the reforms that had been started in the second programme. This was reflected in the MoU where explicit references were made when appropriate. New conditionality was selected on the basis of its significance for overall macroeconomic performance and financial stability. Programme conditionality partly overlapped with the country-specific recommendations addressed to Romania by the Council on 9 July 2013.

Fiscal policy: with government revenue underperforming and the government's plans to reduce VAT on bread, the programme pursued fiscal consolidation in line with the Stability and Growth Pact (SGP) requirement for Romania to achieve its medium term objective (MTO) by 2015. As to fiscal governance, the programme targeted an update of the fiscal framework in line with Fiscal Compact requirements. Other measures aimed to improve the content of the Romanian

Fiscal Strategy, the transparency of the budgeting process, annual and medium-term capital budgeting, to finalise the commitment control system (to prevent new arrears), and to improve tax administration.

Public debt management: the programme supported the establishment of a deeper and more liquid sovereign debt market, the development of the domestic capital market and the reduction of financing risks. The agreed measures included further improvements in the public debt management strategy; the finalisation of an electronic auction system for domestic primary issuances; the introduction of an electronic trading platform to monitor transactions in the secondary market; better outreach to investors; the establishment of the necessary framework to carry out buybacks, bond exchanges and repo operations; and participation of the treasury in a central counterparty clearing house.

Financial sector: the programme focused on further strengthening the bank resolution framework, the contingency planning by the National Bank of Romania (NBR) and the corporate governance of the Deposit Guarantee Fund. To strengthen financial stability, it was agreed to speed up the process of balance-sheet cleaning in the banking sector and to promote credit discipline, reducing moral hazard on the part of the debtors. To develop the capital market and diversify the sources of funding for banks, authorities agreed to amend the covered-bonds legislation. Finally, to strengthen the supervision of the non-bank financial market, authorities committed to further align the legislation on the Financial Supervisory Authority (FSA) with international good practices.

Administrative capacity: in order to improve the country's public administration and increase Romania's capacity to design and implement high-quality policies, the programme promoted the follow up on the implementation of action plans drawn up in response to the findings of the functional reviews. The authorities were invited to report every six months to the Economic and Financial Committee (EFC) and the Economic Policy Committee (EPC). A central delivery unit, to be created by end-2013, was expected to improve government-wide policy prioritisation and ensure an appropriate follow up to the CSRs issued

⁽³⁾ Given that the IMF planned quarterly reviews, starting in October 2013, the first two IMF reviews coincided with EU staff visits. Joint review missions were held in June 2014 and January/February 2015.

by the Council in the context of the European Semester.

Product markets: while important progress has been made with regulatory reforms in the energy and transport sectors in the previous programme, some measures were not implemented and were thus carried over into this programme. In the energy sector, reforms aimed at creating functioning electricity and gas markets should boost investment. They included electricity and gas price liberalisation and the finalisation of the unbundling of energy transmission and dispatch operators. In rail transport, reforms comprised performance schemes discouraging delays and incentives for the rail infrastructure manager to reduce unit costs and charges.

Business environment: Romania's poor business environment is a drag on growth and investment. The programme aimed at improving the quality of business regulation, reducing administrative burdens for SMEs; improving access to finance for SMEs; supporting SMEs capacity to export; improving the land registry system to allow for a better functioning land and property markets; and improving incentives for inventions by employees.

Labour markets: following the measures already taken under the previous programmes, the only new condition was to duly consider a review of labour taxation with a view to reducing, in a budget-neutral manner, the effective tax burden for low- and middle-income earners.

Pensions: Following the pension reform of 2010, the Romanian authorities committed to pass the necessary legislation to equalise the retirement age of men and women.

State-owned enterprises: the programme included measures to improve state-owned enterprises' (SOE) governance, to reduce SOEs' arrears, and to improve the operational performance of the three railway companies and their subsidiaries, which generate the largest arrears. Timelines were set for the sale of stakes in key SOEs in the transport and energy sector.

Healthcare: the programme promoted a comprehensive medium-term health strategy, to be prepared by the Ministry of Health and the Ministry of Public Finance by end-2013, in order

to close current and future financing gaps. As a key measure, the publicly-reimbursable basic-benefits package was set to be re-defined to fit within available funding. The implementation of an action plan to rationalise and restructure the hospital structure and to increase the scope for primary care was also part of the programme.

1.4. POST-PROGRAMME SURVEILLANCE

Post-programme surveillance (PPS) has started with the end of the programme. The framework for PPS was specified by the EFC in 2011 ⁽⁴⁾. It applies to Romania because of the disbursements made under the 2009-11 programme. The second and third programmes remained precautionary.

PPS will need to be maintained until 70% of the loan has been repaid, i.e. at least until spring 2018. The repayment schedule is provided in Annex 2. The purpose of PPS is to monitor the repayment capacity of the country exiting the programme. During PPS, the Member State is required to discuss any new major economic policy intention with the European Commission staff and with the EFC if Commission staff determines that the policy materially impacts the repayment capacity.

The modalities of PPS have been agreed with the Romanian authorities. After consulting the authorities and the EFC, the Commission proposed to focus the post-programme surveillance on (i) macroeconomic developments, (ii) fiscal policy, (iii) monetary policy and financial sector developments, and (iv) structural reforms outstanding from the programmes. This agreement has been formalised in letters sent on 30 September 2015 to the Romanian Minister of Finance and the Governor of the Central Bank. The agreed minimum reporting requirements can be found in Annex 5.

⁽⁴⁾ Council regulation EC 332/2002 established the facility providing medium-term financial assistance for Member States' balance of payments which supported the three BoP programmes for Romania. The regulation, does not *per se* lay down a procedure for PPS. These were established by the EFC in 2011, with the update of the complementary "EU procedures for providing financial assistance for non-euro area EU Member States", commonly referred to as the "Green File".

Initially, PPS missions will be launched every six months. With the end of the programme on 30 September 2015, the first post-programme surveillance mission is tentatively scheduled for spring 2016. A second mission would normally take place in the autumn, depending on the electoral calendar.

The ECB will maintain its observer status and cooperation with the IMF and the World Bank will continue. As in the past, ECB staff will participate in the missions. The modalities for cooperation with the IMF and the World Bank will be defined in the coming months given that Romania's outstanding credit with the IMF (see Annex 2) has already fallen well below the threshold for IMF post-programme monitoring.

The Commission will report to the EFC after each mission. Reporting will include a review of economic and financial developments, the state of play of the loan repayment, and major new policy intentions. These reports could also be published as staff working documents.

Alongside PPS, Romania will be subject to the EU regular surveillance mechanisms. The Commission will ensure coherence between PPS and the procedures embedded in the Macroeconomic Imbalances Procedure and the Stability and Growth Pact. This interplay with regular surveillance is not new to Romania. In 2013, in light of the imminent expiration of the 2011-2013 BoP programme, Romania was fully reintegrated in the European Semester and received Country-Specific Recommendations. Since then, this approach has been maintained, and in 2015 an In-Depth Review was prepared on the Romanian economy ⁽⁵⁾. The Commission will build further on this experience with a view to streamlining procedures and easing the reporting burden on the authorities.

⁽⁵⁾ European Commission (2015), *Country Report Romania 2015*, European Staff Working Document, 26 February. http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_romania_en.pdf

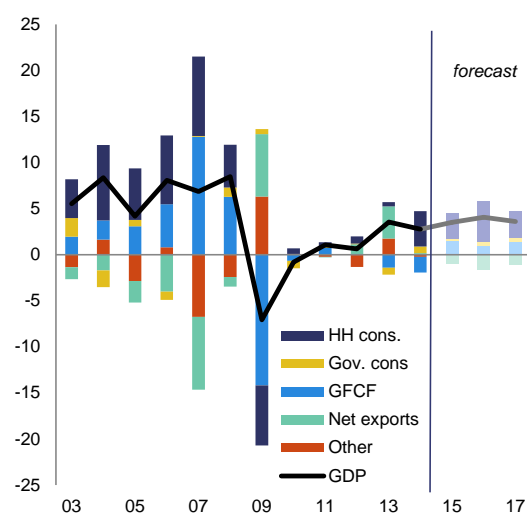
2. MACROECONOMIC DEVELOPMENTS

Economic growth has been robust since the start of the programme and is projected to stay above potential ⁽⁶⁾. Romania's economy expanded by 3.5% in 2013, mainly due to a stellar export performance owing to a robust automotive industry and an abundant harvest. Domestic demand (excluding change in inventories) had a significant negative contribution to growth in 2013 on account of (i) low consumer confidence, (ii) constrained private and public consumption in response to programme measures, and (iii) a plunge in investment on account of weak investor confidence. With growth drivers switching gradually from net exports to domestic demand, real GDP growth eased slightly to 2.8% in 2014 and is forecast to reach 3.5% in 2015. The significant fiscal stimulus planned for 2016 is expected to boost growth to 4.1%. It is projected to moderate to 3.6% in 2017, but still to remain above potential, reflecting the sustained improvement in consumer and investor confidence and the payoff of product and labour market reforms implemented under the financial-support programmes in Romania. Despite the projected positive effect on growth, the significant tax cuts planned for 2016 and 2017 pose risks to fiscal consolidation – a major achievement of the programme – as well as fiscal and macroeconomic sustainability in the medium term.

Consumption was still subdued in 2013, but rebounded in 2014 and is expected to be the main growth driver in 2015-17. The reform of the labour code under the previous programme started producing results in 2013, albeit slowly, and the labour market showed initial signs of improvement. However, the cleaning of the banks' balance sheets after a long period of deteriorating asset quality entailed tighter credit standards, leaving credit growth in negative territory in 2013. At the same time, households still suffered from strong deleveraging pressures with high debt-service-to-income ratios due to high interest rates and low incomes. The cumulative impact of these developments substantially constrained private consumption in 2013. Public consumption remained contained by the need to stabilise public accounts within programme conditionality and the

rules of the stability and growth pact. In 2014, consumer confidence and private consumption recovered substantially as real disposable income started increasing on the back of wage increases, growing employment and moderate inflation. Private consumption registered 6.2% real growth for the year. Programme measures seeking to limit households' deleveraging needs and progress with the balance-sheet cleaning, in addition to lower interest rates, permitted a recovery of credit to households into positive rates as of January 2015. Consumption gained further momentum in the first half of 2015 driven by strong real wage increases and the cut on VAT for food products from 24% to 9% as of June 2015. It is projected to reach a post-crisis peak in 2016 as a consequence of a 4 pps. cut of the standard VAT rate as of January (see section 3) and low inflation. As the impact of the VAT cuts fades out and inflation picks up, consumption growth is projected to moderate somewhat in 2017 and return to its 2014-15 growth rates.

Graph 2.1: GDP and components



Source: European Commission

After two years in negative territory, investment is on the path of solid recovery. Investment was a major drag on growth both in 2013 and 2014, when it contracted, respectively, by 5.4% and 7.2% in real terms. These significantly negative growth rates reflected a drop in housing construction due to deleveraging needs, low investor confidence, and a reduction in public capital expenditure coupled with still-low EU-funds absorption. As credit conditions improved

⁽⁶⁾ See European Commission (2015), *European Economic Forecast, Autumn 2015*. http://ec.europa.eu/economy_finance/eu/forecasts/2015_autumn_forecast_en.htm

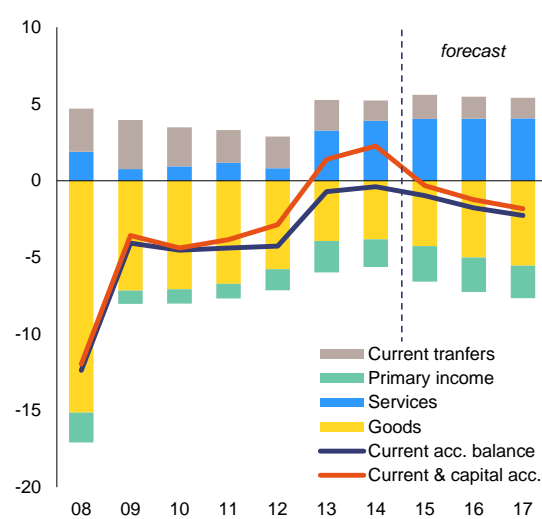
and economic growth remained strong for two consecutive years (2013 and 2014), investor confidence bounced back. Higher investor confidence, together with a tax exemption for reinvested profits (as of July 2014) and a cut in social-security contributions (from 1 October 2014) freed up resources that allowed businesses to boost investment in the second half of 2014. Investment ended 2014 on a positive note (+1.4% y-o-y in the last quarter). Gross fixed capital formation rebounded substantially in the first half of 2015 to almost pre-crisis growth rates of 9.2% y-o-y. Private investment is expected to continue growing over the forecast horizon, driven by a stable recovery of housing construction and supported by lower borrowing costs, growing disposable income, new tax incentives and robust economic-growth prospects. Public investment is growing in 2015, the last year of the 2007-2013 EU structural funds programming period, but is still likely to underperform compared to the initial 2015 budget. It is projected to drop again in 2016 on account of low absorption of EU funds at the beginning of a new programming period. Investment is forecast to pick up again in 2017 in response to tax incentives in the new fiscal code.

Annual average HICP inflation has been on a declining trend since 2013 and is forecast to remain negative until mid-2016. A sharp drop in food prices due to the abundant harvest in 2013 and the cut in VAT on flour and bakery products (from 24% to 9% as of September 2013) caused a significant decline in inflation to 3.2% on annual average. In 2014, these price dampening effects were reinforced by falling global oil prices and another strong agricultural year bringing about an annual average inflation of 1.4%. Annual average inflation is expected to reach -0.4% in 2015, owing to the VAT cut for all food items as of 1 June, continuously low energy prices, and the persistence of low inflation in the EU. The deflationary impact of the reduction of the VAT rate for food is projected to wear out by mid-2016, when strong domestic demand is expected to push inflation back into positive territory. Annual average inflation, however, is projected to remain negative at -0.3% in 2016, as the approved 4 pps. reduction in the standard VAT rate in January will suppress prices. The impact of the additional 1 pp. VAT cut in 2017 is expected to be much smaller than that of the previous VAT reduction. Inflation

is thus expected to re-enter the central bank's target range (2.5%±1 p.p.) in 2017.

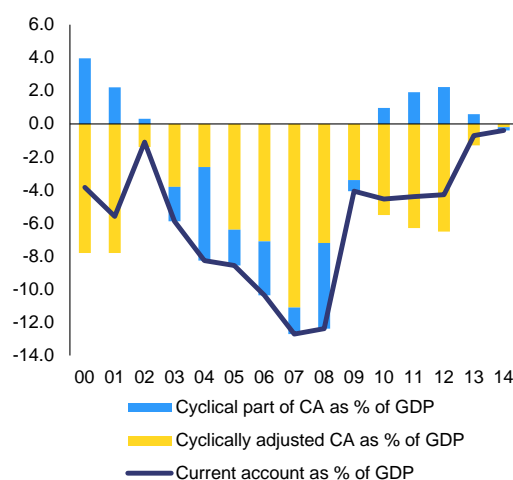
The current-account deficit decreased significantly since the crisis. From an average of 10.5% of GDP during the boom period (2004-2008), the current-account deficit contracted to an average of 4.6% of GDP in 2009-2012 (Graph 2.2).

Graph 2.2: Current account balance by components



Source: European Commission

Graph 2.3: Cyclical and non-cyclical current account balance

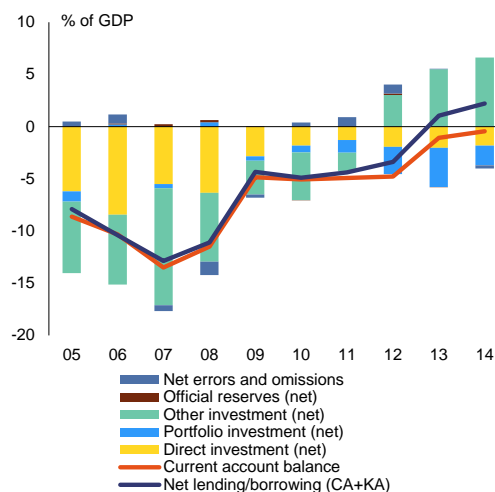


Source: European Commission

It further improved in 2013-14, to 0.8% of GDP, driven by a fast improving trade balance still supported by subdued imports and strong exports. Romania registered the third highest export market share growth in the period post-2011 among EU member states. Going forward, the current account deficit is estimated to increase progressively, on the back of consumption-driven growth, but to be still below 3% of GDP in 2017. The relative evolution of the cyclical and non-cyclical components of the current account deficit confirms this analysis (Graph 2.3).

The financing structure of the current account deficit has changed after 2012, the main sources being now portfolio and foreign direct investments. Until 2011, the current account deficit was financed through a mix of foreign direct investment and other sources of investment (Graph 2.4). From 2012 onwards, portfolio investment became the main financing source of the current account deficit, alongside foreign direct investment.

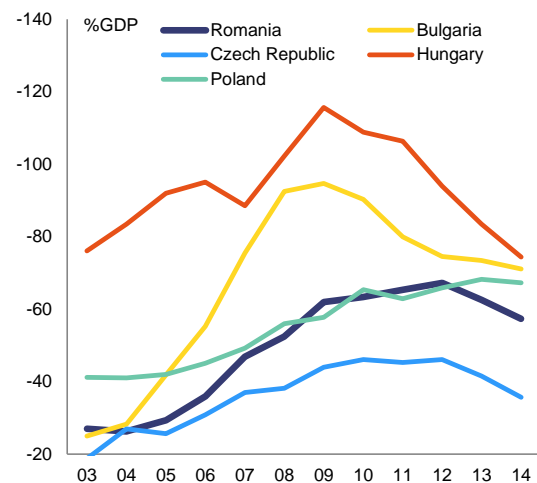
Graph 2.4: Current account financing



Source: European Commission

After reaching a peak in 2012, Romania's net international investment position (NIIP) is on a decreasing path. Romania's negative NIIP reflects the accumulation of current-account deficits in the pre-2010 period, financed by capital inflows. The NIIP hit a record -68% of GDP in 2012 but has been improving since as a result of a low current-account deficit and strong nominal GDP growth (Graph 2.5).

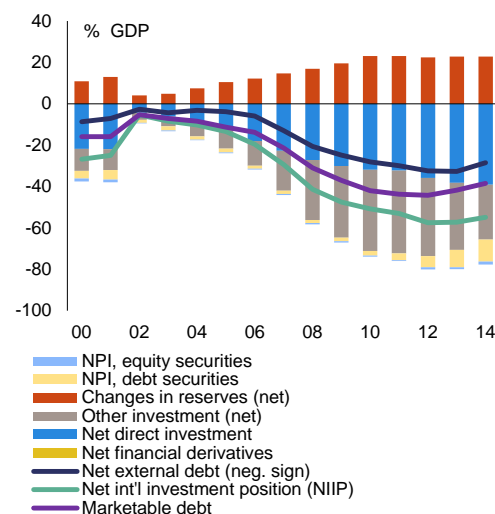
Graph 2.5: NIIP in Romania and peer countries



Source: European Commission

In stock terms, foreign direct investment is recovering its role as the main source of funding. The composition of NIIP confirms the persistence of volatile financing sources but foreign direct investment has been gradually increasing ⁽⁷⁾ (Graph 2.6).

Graph 2.6: NIIP financing



Source: European Commission

⁽⁷⁾ European Commission (2015), *Country Report Romania 2015*, European Staff Working Document, 26 February. http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_romania_en.pdf

In 2014, foreign direct investment recovered its role as the main source of external funding for the Romanian economy (39% of GDP), overcoming net portfolio investment (debt and equity securities sum up to 38% of GDP) for the first time since 2007.

In spite of recent positive developments, mid-term challenges may arise in the external sector.

The programmes have contributed to the correction of the current account deficit in recent years. However, the significant demand increasing measures taken recently and envisaged for 2016 and 2017 (see section 3) are expected to substantially boost imports. Exports, in turn, are forecast to grow at a slower pace, affected by the global trade slowdown. Consequently, the current account deficit is estimated to increase to around 2.6% of GDP by 2017.

3. FISCAL ISSUES

The programme sought to promote fiscal consolidation and a further strengthening of the fiscal governance framework. The main fiscal target was the achievement of the medium-term objective (MTO) of a structural deficit of 1% of GDP by 2015 and its maintenance thereafter. The programme also aimed at preserving the achievements of the previous two programmes, including a unified wage law and the pension reform, the medium-term sustainability of the public sector wage bill, and the reduction of payment delays in the health sector. In terms of fiscal governance the programme sought to further improve the fiscal governance framework by supporting the implementation of the fiscal responsibility law and promoting reforms in the areas of expenditure management and tax collection.

3.1. FISCAL POLICY

At the beginning of the programme, a gap of around 0.5% of GDP was opening in the 2013 budget. In 2013, in line with the authorities' commitment in the previous programme and the spring 2013 update of the convergence programme, a deficit of 2.4% of GDP in ESA terms was targeted. This was estimated to correspond to a structural improvement of 0.5% of GDP. In autumn 2013, a fiscal gap of around 0.5% of GDP was identified mainly linked to lower than budgeted revenues and also included the costs of the reduction of the VAT rate for flour and bakery products in September. In the second half of 2013, in the context of the second budget rectification, compensatory expenditure side measures were agreed and implemented, including a lower budget for the underperforming capital expenditures and a reduction of various transfers. In October 2013 adjustors worth 0.2% of GDP for co-financing EU funds absorption were agreed for both 2013 and 2014 ⁽⁸⁾. If fully used, this would have implied a budget deficit of 2.6% of GDP in ESA terms (rather than the previously envisaged 2.4%). The outcome of a deficit of 2.2% of GDP in ESA-terms

⁽⁸⁾ The EU funds adjustor was granted to support an increase in the EU funds absorption towards the end of the 2007-2013 programming period. The adjustor is only fully maintained if national EU funds co-financing (net of corrections, non-eligibles and top-up) was executed in line with the agreed allocation in the budget.

represented a slight over-achievement of the original budgetary target. Similarly, the structural deficit improved by 0.6% of GDP, i.e. 0.1% pp. above the target.

In 2014, a deficit of 2.0% of GDP in ESA terms was agreed (plus an adjustor of up to 0.2% of GDP for co-financing of EU Funds), consistent with a gradual convergence to the MTO in 2015. Preventing the increase of arrears and ensuring a sustainable public wage bill were also among the goals. At the time of the formulation of the 2014 budget a fiscal gap of around 1% of GDP was identified. In October 2013, following intensive negotiations, the authorities decided on various measures to fill the gap, including higher excise duties, the introduction of a special construction tax, and increased taxes on natural resources, on the revenue side, as well as limited increases in public wages and lower expenditures on goods and services. The authorities also committed to sizeable buffers to cover for potential deficit increasing developments. An across the board cut of the social security contribution was also considered, depending on availability of fiscal space later in the year.

In the course of 2014 several negative developments and risks emerged, pointing to a higher deficit. Some tax revenues, in particular VAT, under-performed in the first half of 2014. Additional risks included a three month delay in the increase of excise duties, pressure for a cost-increasing reform of the health-care system, plans to increase spending for defence in the context of the Ukrainian crisis, higher outlays related to court decisions, higher envisaged support for police and the public rail company, and potential expenditure slippages linked to the electoral cycle. Despite these developments, the government unilaterally decided to proceed with a 5 p.p. cut of social security contributions paid by employers as from October 2014, while insisting that budgeted capital expenditure should not be reduced despite a significant under-execution. This was a key impediment to conclude the June-July 2014 review mission.

Under-execution of the budget and strengthening revenue collection towards year-end allowed for reaching the 2014 target. Systematic and significant under-execution of

capital expenditure and expenditure in goods and services, savings on social assistance, improving revenue collection, and better-than-expected income from the special construction tax and the tax on carbon emission created fiscal space towards the end of the year. This allowed for advancing some expenditure from 2015, such as VAT refunds, court-enforced wage claims and the payment of arrears. General government arrears were significantly reduced in 2014 (from RON 1.7 billion in 2013 to RON 1 billion 2014) and kept unchanged in the first half of 2015. Eventually, also in light of the original in-built buffers, the ESA deficit target was over-achieved. It improved to 1.5% of GDP, which meant a structural balance of 1.0% of GDP. Consequently, the MTO was achieved already in 2014, one year ahead of target. In turn, the EU funds adjustor of 0.2% of GDP was not used due to delayed execution of EU funds co-financed activities.

In 2015, the programme targeted a deficit consistent with the MTO. At the time of the first discussions of the 2015 budget, i.e. in the middle of 2014, a 2015 headline deficit of 1.3% of GDP in both cash and ESA terms and a structural effort of 1.5% of GDP seemed to be necessary to achieve the MTO. Underlying factors were the full-year effect of the cut of the social security contributions by 5 p.p., accelerating absorption of the EU-funds, outlays linked to court-enforced wage and property claims. During the first EU review mission in June 2014 it was not possible to reach an agreement with the authorities on all points necessary for a successful conclusion. The main obstacle was the government's determination to cut social-security contributions by 5 p.p. as of October 2014 without adequate compensatory measures, or a clear view on how the MTO would be attained in 2015.

By the time of the submission of the draft 2015 budget the earlier identified fiscal gap had significantly narrowed. The draft budget proposed by the government included various budget improving measures, such as the general freezing of public wages, a more realistic estimate of domestically financed capital expenditures, reshuffling of investments from domestically financed capital expenditures to EU-fund co-financed projects, and lower expenditure on goods and services. These measures permitted to credibly target the MTO while ensuring contingency buffers. The budget targeted a headline deficit of

1.2% of GDP in ESA terms plus an EU-funds adjustor of ¼% of GDP.

Strong revenue performance and continued under-execution of capital investment seem to balance out several ad-hoc deficit increasing measures adopted outside the budget process.

The deficit increasing measures included the VAT rate cut from 24% to 9% for food products from mid-year, the reduction of the special construction tax from 1.5 to 1%, doubling of the child benefits, and significant wage increases in selected public sectors.. The deficit impact of these measures is being off-set by higher than projected tax revenues, reflecting stronger economic growth and enhanced tax compliance, a significant under-execution of domestically financed capital expenditures, low absorption of the EU-funds, and limited expenditure on goods and services. Accordingly, the 2015 deficit target seems to be achievable and the structural deficit is expected to be kept at the MTO. In addition, fiscal space may allow advancing payments of some future liabilities to 2015.

The deficit outlook beyond 2015, i.e. following the end of the Programme, entails significant sustainability risks.

In spring 2015, the government put forward a new Fiscal Code entailing significant tax cuts, not being matched by compensatory measures. The programme partners as well as the National Bank of Romania and the Fiscal Council underlined the strong negative impact on the 2016 budget deficit and risks for fiscal sustainability in Romania in the medium term. Nonetheless, during the last attempt to conclude a review under the 3rd BoP programme the government informed the programme partners that VAT would not be reduced to 20% but to 19%. The Parliament adopted the corresponding draft fiscal code on 24 June. This was the main obstacle to conclude the on-going review. Eventually, after the President returned the fiscal code, the Parliament adopted a reviewed fiscal code on 3 September, which still includes tax cuts amounting to 2.4% of GDP but over two years instead of one. In 2016, the deficit increasing impact is estimated to be close to 1½% of GDP, which mainly reflects the cut of the standard VAT rate from 24% to 20% as of 1 January 2016. Adding to this, the government decided in October to advance the reduction of the tax on dividends from 2017 to 2016. On a no-policy-change

assumption, the headline deficit in ESA terms is expected to increase significantly in 2016 while the structural deficit could exceed the MTO by 1¼-2% of GDP. For 2017, the new fiscal code included further tax cuts of around 1% of GDP, including an additional cut of the standard VAT rate from 20% to 19%, the abolishment of the extra excise duties on fuel, and of the abolition of the special construction tax. Consequently, the ESA deficit could increase further to well above 3% of GDP in 2017 and the structural deficit could deviate from the MTO by almost 3% of GDP. This pro-cyclical fiscal easing would be in contradiction to the country's obligations under the SGP.

3.2. FISCAL STRUCTURAL ISSUES

The fiscal framework is sound, but is not always effectively implemented. Romania has signed the Fiscal Compact (TSCG) and the Fiscal Responsibility Law (FRL), which was adopted in 2010 (Law 69/2010), was amended in December 2013 (Law 377/2013) to incorporate provisions of the Stability and Growth Pact including the obligation to reach and remain at the MTO. The FRL also provided for the strengthening of the multi-annual budgetary planning with the envisaged adoption of the medium-term fiscal strategy no later than 31 July each year. However, the fiscal strategy was adopted with substantial delay both in 2014 and in 2015 ⁽⁹⁾. At the same time major fiscal initiatives, such as the VAT cuts imbedded in the new fiscal code and a number of wage increases in the public sector, are being decided outside the budget process with no comprehensive view on revenue and expenditure needs. Respect for the integrity of the budget process is crucial, as it allows for the joint formulation of tax policy and expenditure decision.

Envisaged measures to improve transparency, data reporting, and fiscal impact assessments have been broadly implemented. A formal procedure for regular information transmission from the line ministries to the Ministry of Public Finance (MoPF) has been defined in a government memorandum. The capacity of the MoPF to estimate the structural deficit and the fiscal and

structural impact of measures has also improved. Similarly the role of the Fiscal Council has been strengthened, as well as its capacity to assess and publish macroeconomic and fiscal projections.

Capital spending and public investment management need further improvement in order to effectively contribute to a more realistic multi-annual budgetary planning. A Public Investment Evaluation Unit (PIEU) was established in 2013 under GEO 88/2013 with the objective to prepare on an annual basis the priority list of significant investment projects at the level of the central government. In May 2015, an amendment to GEO 88/2013 aligned the prioritisation process with the budget calendar. For both 2014 and 2015 the PIEU prepared a list of significant projects. The later was approved at the government level and published on the MOPF website. For the local-government projects that receive central government funding (projects in the National Programme for Local Development, PNLD) the responsibility remains under the Ministry of Regional Development. A list of projects was published on the Ministry's website. A World Bank project is on-going aiming at further improving the prioritisation criteria.

A more effective commitment control system to better control expenditure and prevent the accumulation of payment arrears was established. The commitment control system covers expenditures on goods and services, as well as investments. The system is now in place at the Ministries of Public Finance, Telecommunications, Interior, and Health and at District 6 of Bucharest.. It is planned to be rolled out to other central and local government entities by mid-2016. However, the process towards full implementation will probably take longer.

The Ministry of Public Finance has set up a new unit for conducting spending reviews. The unit was created in summer 2015 with assistance from the IMF and the WB and the support of the EC. It is not yet operational. The spending reviews were planned to focus on investments in areas such as education and transport. Given the nature of these projects, significant savings are not to be expected in the short-run,

The authorities are currently revisiting their decentralisation strategy for the public

⁽⁹⁾ In 2014 the 2015-2017 fiscal strategy was adopted only in December almost simultaneously with the 2015 budget and in 2015 has not yet been adopted.

administration. In March 2015, the government submitted for public consultation an updated project for decentralisation which it is planning to finalise by end-2015. In parallel, several line ministries are developing their sectoral strategies, as required by the framework-law on decentralisation (law 195/2006). As agreed with the programme partners, the approval of the strategies will take place only after conducting a thorough fiscal impact assessment of the strategy.

The national tax agency (ANAF) has taken several measures to improve tax collection and make the administration more efficient and taxpayer-friendly. The restructuring of ANAF was broadly completed in 2014. The Anti-Fraud Department is operational and staffed at 78%; 1,458 positions out of envisaged total 1,862 have been filled in. The authorities informed the programme partners about their intention to restructure the large taxpayers unit (LTU) as an independent authority and requested IMF technical assistance. The decision finally adopted by the government on 30 September 2015 re-established the LTU in the form of an autonomous general directorate with an independent budget, under the authority of ANAF. The effectiveness of the new structure was not assessed during the programme. Collection efforts have also been stepped up on high net wealth individuals, while mandatory cash registers have been introduced to tackle tax evasion. VAT reimbursement procedures were streamlined according to the programme's conditionality. Since February 2015, a new VAT registration procedure based on pre-defined risk criteria was put in place by ANAF. The new procedure is expected to reduce VAT fraud. A service catalogue for the taxpayers has been completed but not yet published on ANAF's website. The e-filing rate was at end-May 88%, somewhat below the programme target of 93%. However, for medium and large taxpayers the e-filing rate is approximately 98%. A pilot project against undeclared work initiated in 2014 by ANAF was relatively successful and is being rolled out at national level. The tax compliance strategy is expected to be updated in early-2016 following specialised consultancy supported by the World Bank.

The authorities have decided to reform the taxation of oil and gas activities, but the new legislation is not yet finalised. The current natural

resource taxation regime includes a windfall tax and was set to expire at the end of 2014. The new taxation would seek to improve both incentives to invest and budget revenues in the long run. Technical assistance from the IMF was requested and different taxation options are being examined by the authorities. Draft legislation has been prepared, but further improvements seem to be needed. The authorities intend to work closely with all stakeholders, with the European Commission, and possibly other member states in strengthening ANAF's expertise on the implementation of the new tax regime.

The authorities have announced plans to amend the Unified Wage Law (UWL) adopted in 2010 but never entirely implemented. The current system of public sector pay suffers from a number of unresolved shortcomings and distortions. The Unified Wage Law adopted in 2010 (Law 284/2010) has targeted *inter alia* a unitary pay system in the public sector, abolishing unjustified pays and benefits. The unitary pay system has never been implemented, partly because of budgetary constraints. Distortions were exacerbated in recent years by strong increases in the statutory minimum wage, which have caused a compression of the wage distribution. An estimated 40% of public sector employees, including 70% of the local authorities' personnel, are being currently paid the minimum wage⁽¹⁰⁾. The authorities intend to establish a new unified wage grid to address these shortcomings, revising the pay scales originally defined in the UWL. A working group between national authorities (Ministry of Public Finance and Ministry of Labour) and programme partners was established to discuss the envisaged changes and the fiscal impact of the new wage grid. The new law is expected to preserve the principles of Law 284/2010, including the abolition of unjustified benefits and bonuses. The new minimum levels of basic pay would be increased so as to be above the statutory minimum wage, and the ratio between the minimum and maximum levels would be set at 1 to 18. The transition to the new pay scales would take place gradually. Current salaries would at least be preserved, implying an increase in wage expenditure. Estimates of the fiscal impact are not

⁽¹⁰⁾ Data estimated before the latest (October 2015) discretionary wage increases for certain categories of public sector employees.

yet available as it will depend on wage scales that still need to be defined and the transition pace to the new system. The implementation of this policy initiative, however, constitutes an additional risk for the fiscal targets in the coming years.

4. LABOUR MARKET AND WELFARE SYSTEM

This programme focused on the continuation of policies agreed under the previous two programmes. Tackling undeclared labour, improving the adequacy of employment protection legislation along the principles of flexicurity, developing a wage-setting system that would allow wages to better reflect productivity developments, and promoting the long-term sustainability of the pension system were the main goals of the programme with regard to the labour market.

The authorities initiated a dialogue with social partners in order to reach agreement on possible changes to the labour legislation. The authorities monitored the implementation of the new Labour Code and Social Dialogue Code, and refrained from introducing changes to the legislation without prior consultation of stakeholders or via emergency legislative procedures. Tripartite negotiations were initiated with the aim of reaching a commonly agreed and stable framework for collective bargaining, but no consensus was found among social partners with respect to possible amendments to the law.

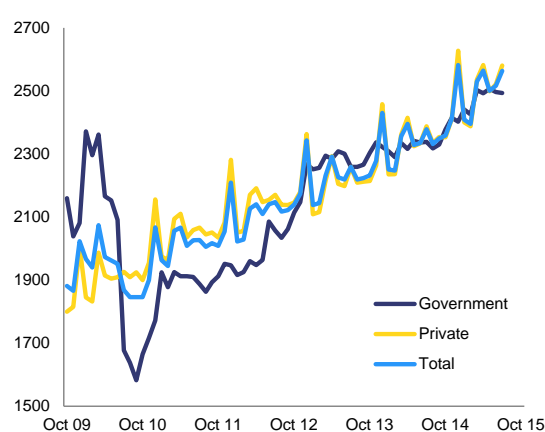
The authorities reiterated their commitment to fight undeclared labour, including by ensuring an efficient system of labour inspections. The merger of Labour Inspections with the National Agency for Payments and Social Inspections decided in 2015 intends to create synergies between the different control systems, thereby increasing efficiency and compliance. The authorities agreed to monitor and report on the performance under the new setup, seeking to realise expected synergies and to contribute to better enforcement and compliance, while avoiding disruptions of the current inspections system.

The tax burden on labour has been reduced by decreasing social security contributions, but it was not targeted to low- and middle-income earners. In Romania, the reduction of the tax burden on labour is especially relevant for low- and middle-income earners, who face relatively high taxes compared with other EU member states. Social security contributions paid by employers were reduced by 5 pps., but across the entire wage scale, with substantial budgetary costs. The decrease in contributions does not affect pension entitlements and the corresponding fall in revenues for the Social Security Fund has been compensated

with an increase in direct transfers from the State budget. No compensatory measures were presented at the time of the adoption of the measure.

The government has been asked to review the policy for setting the statutory minimum wage. The level of the statutory minimum wage has been rising strongly in recent years, from RON 700 (about EUR 160) in 2012 to RON 1050 (about EUR 234) in 2015. These increases have largely outpaced inflation and average wage growth, leading to a significant compression of the wage scales in both the public and private sectors. As a result, a growing share of the employed population is now earning the minimum wage ⁽¹¹⁾. The authorities have recognised the need to better assess the effects of recent increases and – also in light of the Country Specific Recommendation received in 2014 and 2015 – to review the minimum-wage setting process. In particular, Romania is expected to establish, in consultation with social partners, clear guidelines for setting the minimum wage so as to ensure that the underlying economic and labour market developments are properly taken into account.

Graph 4.1: Monthly average wages



Source: European Commission

The reform of the welfare system is slowly progressing, with the new Minimum Social

⁽¹¹⁾ According to the Romanian authorities, the share of minimum-wage earners among public sector employees is about 40%. This figure was estimated before the latest (October 2015) discretionary wage increases for certain categories of public sector employees.

Insertion Income scheme expected to be adopted in 2017. The draft law introducing the new Minimum Social Insertion Income is already available, being under public debate until 19 November. It is expected to come into force as of 1 July 2017, or 31 March 2018 if the administrative procedures cannot be implemented as scheduled. This new means-tested benefit will replace three existing schemes (social assistance, family allowance and heating allowance). Preliminary estimates put the costs of the new scheme at about RON 2.7 bn per year, compared to the current level of expenditure of RON 1.4 bn per year. The increase is due to an improvement in both adequacy and coverage (the threshold will be shifted from RON 142 currently up to RON 214).

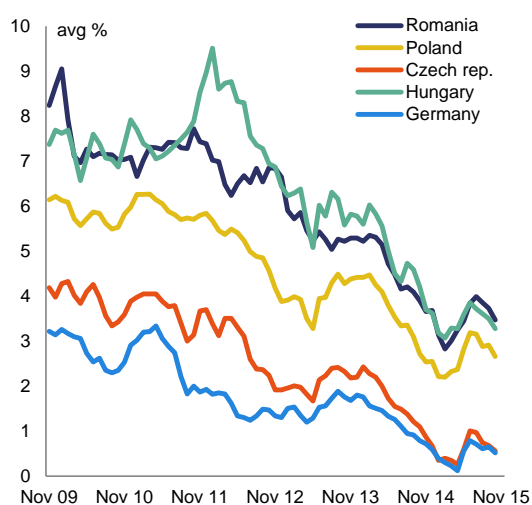
The legislation equalising the statutory retirement age for men and women has not been enacted. The legal text amending the pension legislation to bring the statutory retirement age of women from 63 years in 2030 to 65 years in 2035 (to be equal to that of men) has been approved in the Senate in December 2013 but not yet by the Chamber of Deputies. The debate remains absent from the Chamber's agenda.

Despite the commitment to preserve the unitary pension system established in 2010, several "special pensions" schemes have been reintroduced. "Special pensions" were abolished in 2010, when a uniform public pension system was introduced as part of the first BoP programme (2009-2011). However, in 2015 a number of "special" or additional pension rights have been reintroduced for certain categories of workers, such as aviation personnel, court clerks, defence, police and intelligence services personnel, and parliamentarians. The uniform pension system adopted in 2010 allowed for more favourable conditions for some categories of workers facing particularly hazardous working conditions and short career paths. The additional special treatment provided under the new separate pension regimes is therefore difficult to justify. Furthermore, the weakened link between the accumulated contributions and future pension entitlements is expected to have an adverse impact on the long-term sustainability of the pension system.

5. DEBT MANAGEMENT

Sovereign financing conditions have been generally stable and favourable during the programme period, despite recent global market jitters. Romanian sovereign yields fell steadily through 2014 and early 2015, in line with global trends. The yield curve for longer maturities shifted upwards in mid-2015, then levelled off, again in common with other sovereigns (See Graph 5.1). Both absolute yields and the spread to bunds remain lower than at the start of the programme. The benefits of the FX cash buffer are visible when market conditions are less favourable, as the debt office is in a position to adjust the size and maturity of issuances. This was the case in mid-2015 when a number of bond issues were cancelled or postponed. On October 21 Romania made its first Eurobond issuance of 2015, totalling EUR 2 bn at maturities of 10 years (at 2.86%) and 20 years (at 3.95%).

Graph 5.1: Long term government yields (Maastricht definition)



Source: European Commission

Financing requirements are now lower than in previous years and the future redemption profile looks favourable, though there are risks to the fiscal outlook. As set out in Section 6, foreign-exchange reserves have remained broadly stable despite a peak in repayments of international assistance in 2013-15. Romania has repaid nearly all IMF financial assistance. After having repaid EUR 1.5 bn of EU financial assistance in January 2015, the remaining reimbursements are due in September 2017 (EUR 1.15 bn), April/September

2018 (EUR 1.2 bn/0.15 bn) and May 2019 (EUR 1.0 bn) ⁽¹²⁾. Concerning its own issuances, Romania will face significantly lower repayments from mid-2016, once it has reimbursed two euro-denominated bonds (one external, one domestic, totalling EUR 3.0 bn). As set out in Section 3, there are significant risks to the fiscal outlook. The cash deficit is projected to increase in 2016 and 2017.

The fiscal FX cash buffer met or exceeded the target of four months of gross financing needs set out in the MoU for most of the programme period, but it has recently been below that level.

In mid-2015 Romania allowed the cash buffer (excluding privatisation receipts) to decline below three months in a context of temporarily more difficult financing conditions. The buffer currently stands at 3.4 months excluding privatisation receipts (end-September 2015) and the Romanian authorities intend to bring it back up to around 4 months. While keeping a cash buffer comes at a certain cost, sovereign financing conditions are also influenced by a large number of external factors, most notably monetary policy in other currency areas and economic developments in the euro area. These are outside the control of the Romanian authorities and might change quickly. Furthermore, the cash buffer has an important role as a stable policy anchor and provides a visible and predictable signal to markets. The appropriate level of the cash buffer also depends on forthcoming redemption requirements and market liquidity.

Significant progress has been made with the measures to further improve debt management policy set out in the MoU. The measures to increase the transparency and predictability of the government securities market, and enlarge the investor base, were implemented in the early part of the programme. A debt management strategy is published annually, with more regular updates on issuance plans. An electronic auction system for primary issuances was also put in place. The implementation of the programme conditions has contributed to Romania's progress in developing a deeper and more liquid sovereign debt market and reducing financing risks.

⁽¹²⁾ See Annex 2.

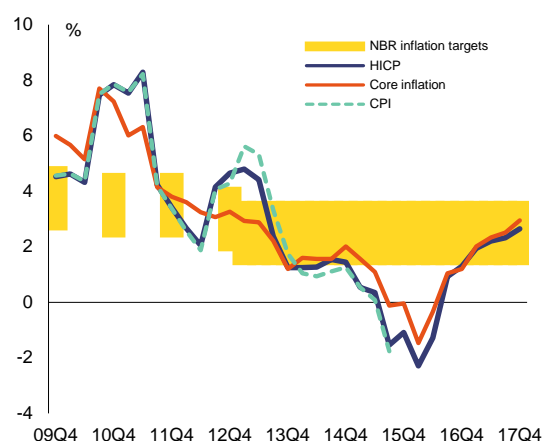
Full implementation of an electronic trading platform and liability management framework slipped from the September 2014 timetable in the MoU. An Electronic Trading Platform (ETP) for secondary trading, provided by Bloomberg, was launched on 15 May 2015. The ETP is currently operational but not fully effective as primary dealers (PDs) use the ETP without an obligation to observe minimum quoting requirements. The ETP will only become mandatory for PDs once the NBR issues the new primary market regulations that have been agreed, and the MoPF issues a ministerial order. Following consultation with the NBR and market participants, the legal and operational framework for liability management operations (buybacks, bond exchanges) on domestic and external markets was approved in April 2015. These operations will be executed on the NBR auction platform. Once all parties have given their approval, the platform will be enhanced to accommodate them. The NBR continues to work in cooperation with the MoPF to harmonise its legal framework governing the government securities market. Additionally, the MoPF is preparing a technical assistance project (16-18 months) on hedging interest rate and FX risks (not part of the MoU). The MoPF assessed the options for participating in a central counterparty (CCP) clearing house, as envisaged in the MoU. As there was no clear view from market participants or the authorities on how to design the CCP, this condition was not taken forward.

6. MONETARY POLICY

The objective for monetary policy in the 2013-15 programme was to remain geared towards price stability. The NBR aimed to contain inflation within a target band of 2.5% \pm 1 p.p. since end-2013 and to remain within that target thereafter. There was an additional objective of monitoring foreign reserves.

During the programme period there was a significant easing of monetary policy. Between June 2013 and May 2015, the NBR lowered gradually the key policy rate from 5.25% to 1.75%, a cumulative cut by 350 bps. Key rate cuts were accompanied by a substantial narrowing of the corridor around the key rate (to \pm 1.5 p.p. in May 2015, in total by 150 bps since September 2014) with a view to mitigating interbank money market rate volatility and strengthening the transmission of monetary policy. The NBR also cut the minimum reserve requirements (MRR) ratio on RON-denominated liabilities of credit institutions from 15% in January 2014 to 8% in May 2015, and the MRR ratio on foreign currency-denominated liabilities from 20% in January 2014 to 14% in November 2014. The wedge between the MRRs for FX- and RON-denominated liabilities has been maintained aiming to discourage foreign currency lending.

Graph 6.1: HICP inflation (% change)



Source: NBR and Eurostat

Inflation fell into the 2½% \pm 1 p.p. NBR target band in September 2013 and declined further in 2014 and 2015. HICP inflation declined to 1.0% by end-2014. It further dropped to below 1% (0.6% y-o-y in April) in the first months of 2015

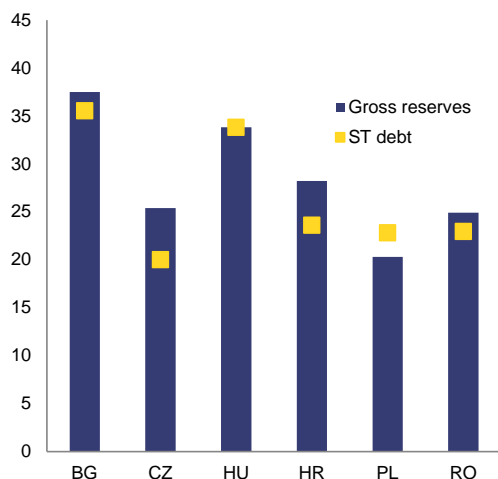
and moved into negative territory in June 2015, largely due to a VAT rate cut for food products as of 1 June 2015 (Graph 6.1). It is projected to stay below the target band until end-2016, due particularly to the transitory impact of fiscal measures (VAT cuts). However, inflation is set to pick up rapidly once the impact of temporary factors fades out, as the output gap closes and the recovery of domestic demand strengthens (see section 2).

The NBR has maintained a prudent monetary policy. The continuation of 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 already implemented measures to curb lending in foreign currency and the potential narrowing of the interest-rate differential will help to strengthen the interest channel of monetary policy. It will also contribute to reduce the external vulnerability of the Romanian economy.

The foreign-exchange reserve situation remains broadly stable despite substantial repayments of international financial assistance. The reserve-adequacy picture weakened somewhat during the programme period, but remains comparable to most regional peers. Romania's gross international reserves (foreign exchange and gold) amounted to some EUR 32.5 bn as of end-September 2015, covering around 100% of short-term external debt and around 6 months of imports of goods. This is broadly in line with the Guidotti-Greenspan rule⁽¹³⁾ and by and large within safety margins vis-a-vis other reserve adequacy indicators. The repayment of international financial assistance implied a sizeable amortisation effort. International assistance repayments peaked in 2013-15, reaching 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 future repayments without difficulties.

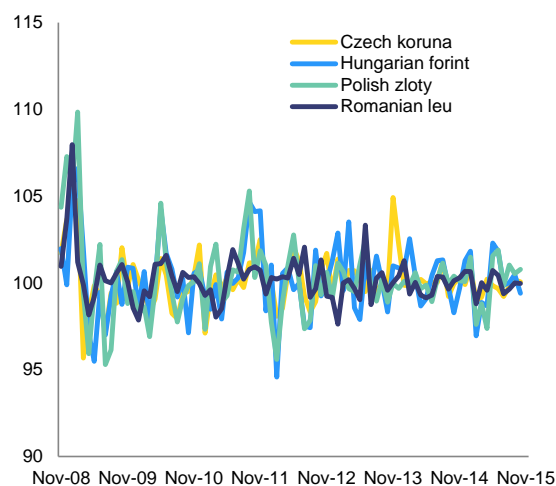
⁽¹³⁾ The Guidotti-Greenspan rule states that a country's reserves should cover its short-term external debt (i.e. with a maturity up to one year).

Graph 6.2: Adequacy of international reserves (2010-2015 average, % of GDP)



Source: Eurostat

Graph 6.3: Romania and peer countries - exchange rate to EUR (Index Jan-2010=100)



Source: Bloomberg

The RON traded within a relatively narrow range over the programme period, fluctuating along the regional trend. During 2013, the RON showed little volatility and remained relatively stable in comparison to regional peers. It came under pressure in December 2013 due to political uncertainties, and even more so by end-January 2014 when turbulence hit most emerging market currencies. However, its weakening was limited, at around 2.5%, partly due to the occasional presence of the NBR on the forex market. The trend reversed in February 2014 and the RON recouped the losses in the following months. The exchange rate showed little fluctuations since mid-2014, but weakened somewhat during December 2014, back towards its early-2014 level. This was related to increased demand for euro and an increase in risk aversion at the global level following the plunge in the price of oil and in the value of the Russian rouble. The RON started to strengthen moderately in February 2015, supported by the ECB decision to launch a bond-buying programme, though less pronounced compared to some regional currencies (Graph 6.3). It remained relatively stable throughout 2015. The real exchange rate, deflated by unit labour costs (ULC), which had weakened substantially during the crisis, strengthened by around 10% between mid-2012 and mid-2014 due to relatively higher price and cost increases in Romania compared to its main trading partners, but has broadly stabilised thereafter.

7. FINANCIAL SECTOR

The cleaning-up of bank balance sheets continued under the third programme, *inter alia*, through the write-off of fully provisioned non-performing loans (NPLs). The NPL ratio at system level declined from 21.6% at end-March 2014 to just below 14% at end-December 2014. Banks accelerated the write-off of NPLs after clarification of rules on the derecognition of financial assets to uncollectible loans ⁽¹⁴⁾. As agreed in the MoU, the NBR proposed in May 2014 a NPL resolution plan, which played a key role in speeding-up the cleaning up of bank balance sheets. It included several recommendations to banks aiming at removing fully or partially unrecoverable loans from bank-balance sheets, to be implemented by end-September 2014: (i) segregation of fully-provisioned non-performing loans into an off-balance-sheet account, followed by their write-off; (ii) full provisioning of loans more than 360 days overdue for which banks have not started legal proceedings, applicable as of end-June 2014; and (iii) provisioning up to 90% of exposures to companies in insolvency, but also taking into account bank-by-bank experiences as regards the recovery of collateral in previous insolvency proceedings. Furthermore, several banks have sold impaired assets, which also led to a lower NPLs ratio at system level. Following a pre-infringement procedure launched by the European Commission, authorities changed end-2013 the accounting treatment of bank receivables sold to debt collection companies in order to allow their recording at fair value, in line with the provisions of the EU fourth accounting directive.

As committed in the MoU, the NBR performed targeted on-site inspections focusing on the restructured loans of banks. The first on-site

inspections, completed by end-2013, covered a selected sample of 20 large, medium and small-sized credit institutions and focused on the strategies for restructured/rescheduled loans and to deal with impaired assets. Following the inspections, banks were requested to set aside additional loan-loss provisions amounting to RON 800 million. The on-site inspections for the remaining banks were completed in the first half of 2014. Furthermore, the NBR performed an asset quality review (AQR) of three banks with Romanian capital (CEC Bank, Banca Transilvania and Banca Carpatica), which was completed by mid-October 2014. The AQR had a marginal impact on the capital of the participating banks.

The NBR has stepped up the monitoring of restructured loans and conducted an analysis of asset quality in the banking sector. As committed in the MoU and building on the work done during the previous BoP programme, the NBR has collected supervisory data on restructured loans since end-2013. With some delay as compared to the MoU deadline of end-October 2013, the NBR completed a comprehensive analysis of the asset quality review in the banking sector. It included an in-depth assessment of asset quality developments, transition matrices and vintage analysis and was well received by the programme partners. An update of the analysis was completed at end-2014.

The NBR launched the internal procedures to prepare for a comprehensive asset quality review and stress test with third party involvement of the banking sector in May 2015. A Steering Committee has been set up, with international participation, which includes representatives of the European Commission and the European Banking Authority (EBA) as observers, and the IMF in advisory role for some issues.

The Parliament adopted the personal insolvency law in May 2015. Authorities committed in the MoU to refrain from adopting legislative initiatives which would undermine credit discipline in order to avoid moral hazard and safeguard financial stability. However, several legislative initiatives on personal insolvency discussed by Parliament since 2010 included provisions over-protecting borrowers, which could

⁽¹⁴⁾ Following the clarification with the Romanian Banking Association that the provisions on the write-off of loans are those included in IAS 39, the write-off of NPLs was made possible by the NBR's acceptance of the European Commission proposal to request guidance from IFRIC (Interpretation Committee of the International Accounting Standards (IAS) Board, having the responsibility of IFRS interpretations) on the application of IAS 39 rules on the de-recognition of financial assets to uncollectible loans. Based on the feedback provided by IFRIC, the Romanian Banking Association and the "big four" auditing companies (PWC, Ernst & Young, KPMG and Deloitte) have clarified that banks can apply their own write-off policies in line with IFRS provisions as long as this application is consistent over time and verified by auditors.

weaken credit discipline and induce moral hazard. At the beginning of 2015, the possibility has emerged to develop a personal insolvency law drawing upon good international practices and introducing more balanced provisions for both debtors and creditors. The personal insolvency law, which benefitted from comments by the European Commission, the IMF and the World Bank, was adopted by Parliament at end-May 2015. It will enter into force on 26 December 2015, six months after its publication in the Official Journal of Romania.

The specialised court for dealing with cases involving abusive clauses in loan contracts did not become operational during the programme period. Authorities committed in the MoU to ensure that court cases involving abusive clauses are dealt with by higher ranking courts or by a unique specialised court and to take all other necessary measures to ensure a harmonised application of these provisions, such as the training of judges. Following discussions with the programme partners, the government decided to set up a specialised court for dealing with abusive clauses and passed the necessary legislation in December 2013. The Ministry of Justice has also committed to cooperate with the NBR and the banking community to ensure the training of judges which will deal with cases involving abusive clauses. The specialised court was supposed to become fully operational in March 2014, but the Ministry of Justice failed to obtain an appropriate building to host the court. Six public tenders organised in 2014 and 2015 could not identify appropriate headquarters for the court. The setting-up of this court is of outmost importance to ensure uniform jurisprudence for cases involving abusive clauses, especially regarding class actions by the Consumer Protection Agency (ANPC). If credit institutions lose one single class action, there will be a cross impact on all portfolios of the respective bank as they would include a clause judged abusive by the court.

The covered bonds law was not approved by Parliament during the programme period. In order to further develop the capital market and diversify the sources of funding for banks, authorities committed in the MoU to adopt the amendments to the covered bonds legislation by end-2013 through a Government Ordinance. Appropriate safeguards to preserve financial

stability were also to be implemented. In early 2014, the authorities decided to change the legislative process arguing that since this proposal touches upon property rights it cannot be adopted through a Government Ordinance but only through an ordinary law approved by Parliament. Following a final round of comments on the draft law from the programme partners, at the beginning of 2014 the authorities committed to have the law adopted by Parliament by end-March 2014 through an emergency procedure. After several delays, the draft covered bonds law was eventually approved by the government in June 2015 and subsequently submitted to Parliament. However, the law was not yet approved by Parliament before the end of the programme period.

The authorities complied with the commitment that any prolongation of the "Prima Casa" programme should be restricted to mortgage lending denominated in RON. Since the second half of 2013, only RON denominated mortgage loans benefit from state guarantees under the "Prima Casa" programme. This will develop a pool of long-term assets denominated in RON, thereby fostering covered bonds issuances denominated in domestic currency once the covered bonds law will be in force.

The authorities committed to amend the bank resolution framework. The main aim of the amendments, originally envisaged for end-2013, of the provisions of Government Emergency Ordinance 99/2006 on stabilisation measures and Government Ordinance (GO) 39/1996 was to include the 2013 state aid rules in the bank resolution framework. The Government Emergency Ordinance 99/2006 (i.e. the banking law) was amended to provide the NBR with more flexibility and powers to stabilise the financial system, to protect depositors and maintain public confidence in the banking sector. Since the 2013 state aid rules failed to be reflected in these amendments, the authorities committed at the beginning of 2014 to frontload the transposition of the EU bank resolution and recovery directive by end-September 2014, which is compliant with the 2013 state aid rules. However, the authorities have not met the deadline for the implementation of the EU Bank Recovery and Resolution Directive (BRRD) and the EU Deposit Guarantee Scheme Directive (DGS) into Romanian law by end-2014. During the January/February 2015 review mission,

the government committed to adopt the draft implementing laws by end-March and send them to Parliament with a view to securing approval by end-April in an emergency procedure. Since this had not been done, the European Commission decided in May 2015 to open infringement procedures regarding the transposition of BRRD. The main hurdle for the implementation of the BRRD were concerns at the Ministry of Justice regarding the compatibility with the Romanian Constitution of certain provisions on bank resolution which impact property rights. The government adopted the two draft laws in early July, but has not sent them to Parliament for adoption in emergency procedure. The Ministry of Justice has maintained its reservations, claiming that the protection of property rights under the Romanian Constitution goes beyond the protection ensured by the Charter of Fundamental Rights. This delay implies that the authorities have continued to upgrade their internal bridge bank procedures in line with the bank resolution framework included in Government Emergency Ordinance 99/2006.

The NBR has continued to update, on an ongoing basis, its strategy and planning to address potential vulnerabilities, including bank-by-bank. In order to prepare for any possible exogenous or spillover effects, plans have been prepared and discussed with both the European Banking Authority (EBA) and the Single Supervisory Mechanism (SSM). They imply an adequate ex-ante preparedness capacity on the part of the NBR.

The authorities complied with the commitment to reduce the size of the managing board and optimize the organisational structure of the Financial Supervisory Authority (ASF). In order to facilitate the decision-making process and move closer to international best practices, the Parliament amended the legislation on the setting-up of the ASF to reduce the number of Board members from eleven to nine. The amendments also strengthened the required minimum qualification for the ASF Board members and the rules aimed at avoiding conflicts of interest. In 2014, the ASF launched an institutional reform based on the conclusions and recommendations of a consultant hired in the line with the MoU requirements to optimize the size of the institution. The reform implemented by the ASF entailed an

in-depth restructuring of the ASF which is reflected in its organigram and in a significant reduction of staff. Furthermore, in order to align to international practices, the ASF increased the transparency of commissions/fees charged to the regulated entities and also reduced them, especially for the capital market sector.

The authorities performed a comprehensive balance sheet review and stress test with third party involvement of the insurance sector. The adverse developments in the insurance sector, including the difficulties of the largest insurance company, Astra, at the beginning of 2014, prompted the launch of a balance sheet review (BSR) and stress test of the insurance sector with third party involvement in the second half of 2014. Insurance penetration in Romania is relatively low (i.e. below 2% of GDP) ⁽¹⁵⁾. The insurance market has been highly dependent on the non-life insurance business, mainly compulsory motor insurance, which represented roughly 70% of total gross written premiums in 2014. The BSR and stress test, which included 13 insurance undertakings and covered roughly 82% of the insurance market, was completed in mid-July 2015. It was the first comprehensive assessment of the insurance sector performed in an EU Member State. The BSR was based on the current prudential requirements (Solvency I standards), whereas the stress test was based on the Solvency II standards, which will be applied by EU insurers as of January 2016. PWC, Ernst & Young, KPMG, Deloitte and Mazars were selected to perform the BSR, whereas Milliman, the largest provider of actuarial consultancy services worldwide, was selected as stress test consultant. The BSR and stress test was overseen by a Steering Committee including representatives of the ASF, the European Commission and the European Insurance and Occupational Pensions Authority (EIOPA) ⁽¹⁶⁾. In most cases, the adjustments made to the balance sheets of insurance undertakings following the BSR had a substantial impact on the Solvency I prudential indicators of the respective

⁽¹⁵⁾ Insurance penetration is calculated as the ratio between the gross written premiums for non-life and life insurance and nominal GDP.

⁽¹⁶⁾ The Steering Committee developed the terms of reference for the BSR and stress test, the methodological guidance for the BSR, the main assumptions and scenarios for the stress test, as well as the guidelines for the follow up actions to be implemented by the participating insurance undertakings based on the results of BSR and stress test.

undertakings. At firm level, Astra, Carpatica, EXIM and Euroins had negative solvency ratios after the BSR, whereas Groupama and Asirom had solvency ratios below 100% for the non-life business, but above 100% at composite level⁽¹⁷⁾. All the other insurance undertakings have solvency ratios exceeding 100%. The BSR found an aggregated capital shortfall under the current prudential framework (Solvency I) of RON 1.6 billion (roughly EUR 356 million), concentrated in four undertakings. Under the Solvency II framework, which will enter in force in January 2016, the results indicate that the Romanian insurance sector would not be sufficiently capitalised. Four undertakings have a Solvency Capital Requirement (SCR) ratio above 100%, whereas eight undertakings have the Minimum Capital Requirement (MCR) ratio above 100%. The earthquake and flood scenarios of the stress test were the most severe and showed that only one and three insurance undertakings, respectively, would meet the SCR ratio. Some of the participating undertakings have already implemented a number of corrective measures, which are taken into account in the action plans including the follow-up measures aimed to address the shortcomings identified during the BSR and stress test.

The Parliament adopted the insurance resolution law in September 2015. Considering the difficulties of restructuring Astra and other insurance companies in financial difficulty in the absence of insurance resolution tools similar to those in the banking sector, the authorities committed in mid-2014 to swiftly approve two draft laws: a law introducing insurance resolution tools for the ASF, and amendments to the law on the insurance guarantee fund (Fondul de Garantare a Asiguratilor) to enable the fund to finance resolution measures. However, the end-April 2015 deadline agreed during the January/February 2015 review mission for sending the two draft laws to Parliament for approval under an emergency procedure was not met. During the May 2015 mission, the government committed to adopt the draft law on insurance resolution by early-June and send it to Parliament for approval by end-June in an emergency procedure. The government adopted

the draft law on insurance resolution on 27 May and submitted it to Parliament, but the law was only approved by Parliament in September 2015, three months later than envisaged. The revision of the law on the insurance guarantee fund progressed faster. After gathering support from several members of Parliament, it was endorsed as a parliamentary initiative and adopted in June 2015.

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<http://asfromania.ro/files/engleza/comunicate/20150715%20BSR%20-%20Final%20Report%20-engl-logo.pdf>

8. STRUCTURAL REFORMS

8.1. STATE-OWNED ENTERPRISES

This third programme continued the efforts under previous programmes to reform state-owned enterprises (SOEs) and their governance. SOEs play an important role in the Romanian economy, dominating in particular the energy and rail transport sectors. However, they have higher debt-to-earnings ratios and lower profitability than their private sector counterparts⁽¹⁸⁾. SOEs suboptimal performance affects both public finances and the private sector. SOEs account for 50% of total tax arrears owed by corporates, with arrears to suppliers, employees, financial institutions and the government equivalent to 3.6% of GDP at end-2014. The main targets of the programme were to improve the operational performance of the largest railway companies and their subsidiaries, to restructure and privatise selected companies in the transport and energy sectors, and to continue the SOE's corporate governance reform. Delays and shortcomings in the implementation of reforms in this area contributed to the non-completion of the programme reviews.

SOEs corporate governance reform has progressed but important steps could not be completed during the programme period. SOEs corporate governance is in Romania regulated by Government Emergency Ordinance (GEO) 109/2011, developed with the support of the World Bank, the EC and the IMF and adopted in December 2011. The conditionality in the programme sought the effective implementation of the legislation. During the course of the programme, the authorities agreed to update GEO 109/2011 through a law to be approved by the Parliament. Full implementation of GEO 109/2011 remains challenging, with some of the most important SOEs in the energy and transport sectors still managed by interim managing boards and CEOs⁽¹⁹⁾. To support the update of GEO

109/2011, a working group was created in May 2015 with the participation of the programme partners. The amendments build on the lessons from the implementation of the GEO so far and give additional responsibilities to the MoPF to prepare legislation and oversee implementation of the SOEs corporate governance framework. Despite substantial progress, agreement was not reached by the end of the programme on remaining key elements, including the intention to exempt several SOEs from the provisions of the law, which would represent a step backward in SOE's governance. Other issues still being discussed are the remuneration of non-executive board members and of interim boards, as well as the rights of minority shareholders. In the same context, the authorities also committed to review the privatisation legislation in order to eliminate inconsistencies with i) the new law on SOEs corporate governance, and ii) state-aid rules. Major inconsistencies are linked to the status of the administrator under the privatisation law and to the consequences of the special administration status, which excludes SOEs under privatisation from forced execution by ANAF in the case of tax arrears. The project is ongoing since the revised framework was not ready by end-September 2015. Finally, a government ordinance on the remuneration of civil servants participating in the management of SOEs (GO 26/2013) was adopted at the end of 2013, as required under the programme but its content was insufficient as it departed from international good practices⁽²⁰⁾. Discussions during the programme missions have not yet led to the expected action to amend government ordinance.

Other agreed measures to improve SOEs management and to increase transparency have not yet been implemented. The programme promoted the approval of the SOEs budgets within one month of the approval of the state budget. However, in 2014 most annual budgets were

⁽¹⁸⁾ Marrez, H. (2015), "The role of state-owned enterprises in Romania" ECFIN Country Focus, Volume 12, Issue 1, January 2015.

http://ec.europa.eu/economy_finance/publications/country_focus/2015/pdf/cf_vol12_issue1_en.pdf

⁽¹⁹⁾ By end-June 2015, neither the interim members of the board nor the interim executive director in CFR Marfa had been replaced. In CFR Călători, two interim members of the board were still to be replaced; the selection process

had to be reopened because two candidates did not accept the appointment. In Tarom, one member of board is to be appointed. In Metrorex and Bucharest airport, the members of the board were appointed under GEO 109/2011 but not the executive directors. In CE Oltenia, one interim director is to be replaced in autumn.

⁽²⁰⁾ The EC and the World Bank expressed their concerns regarding the provisions of GO 26/2013 in a letter to the finance and budget ministers in December 2013.

approved with several months' delay and few of the 2015 budgets had been approved by end-June 2015 ⁽²¹⁾. The publication of audited financial statements in 2014 and 2015, agreed during the June 2014 mission, is equally still to be implemented for most SOEs ⁽²²⁾. As agreed in the MoU, a ministerial order strengthening the monitoring capacity of the MoPF over SOEs performance was finally published in May 2015.

The sale of stakes in five SOEs in the energy sector was only partially achieved. Three out of five Initial Public Offerings (IPO) foreseen in the MoU were completed with very positive results. The IPO of 10% of Nuclearelectrica (nuclear power electricity producer) and 15% of Romgaz (natural gas producer) were successfully conducted in October and November 2013, as announced in the MoU. The 51% IPO of Electrica (electricity distribution, supply and service company) was launched in June 2014, very close to the initially planned end-May 2014, and it was equally well received in the market. However, the process has lost momentum. The 15% IPO of Hidroelectrica (hydropower electricity producer) and the 15% IPO of CE Oltenia (coal mines and thermal power electricity producer), both planned for June 2014, have *de facto* been suspended. Hidroelectrica went under insolvency in February 2014, which impedes any plans for an IPO in the near future. For CE Oltenia the authorities decided to proceed with the restructuring of the company before committing to a new privatisation timetable.

CE Oltenia adopted a restructuring plan and initiated the implementation of a number of cost-cutting measures. The company entered into a dire financial situation due to the failure to adjust to the competition from lower-cost hydropower, nuclear power and renewable electricity suppliers. The missions discussed these developments and a number of actions were agreed. The actions were included in a restructuring plan adopted by the general shareholders meeting in April 2015. It was implemented broadly as envisaged. As of June

2015, staff was reduced by 1,949 employees under the provisions of an agreement with the trade unions. The dismantling of two power generation units (Turceni 1 and 6) started, while for two other inactive units (SE Chiscani 1 and 2) the company initiated the procedure for the sale of the assets by public auction. The company also closed two coal mines (Seciuri and Pesteană-Sud) in June 2015 and started the dismantling of the equipment and cleaning up of the sites and the corresponding underground coal mines. The operational performance improved in 2015 both as a result of these measures and other external factors, including increased demand due to the drought that reduced hydropower-based electricity supply. An external consultant was hired to prepare a new restructuring plan for the company. Despite initial difficulties, unlike CE Hunedoara (see below), CE Oltenia purchased the required certificates for the 2014 CO₂ emissions without state support.

The hard coal-based electricity producer CE Hunedoara had to receive rescue state aid and is in the process of preparing a restructuring plan. In June 2014 the loss-making electricity company CE Hunedoara was found in urgent need of decisive action – either liquidation or sale of assets – in order to prevent a further increase of operational losses and arrears. Actions were discussed during the missions and a plan of action was agreed. However, limited commitment led to further deterioration of CE Hunedoara's financial situation. In 2015, unable to acquire certificates for 2014 CO₂ emissions ⁽²³⁾ and to fully cover part of its operational expenses, the company applied for government rescue aid. Following the European Commission's approval, in April 2015 ⁽²⁴⁾, the government approved in May 2015 temporary rescue aid of RON 167 m (approximately EUR 37.7 m) in the form of a loan, provided that the company would first reimburse incompatible state aid granted in the past ⁽²⁵⁾. The reimbursement of

⁽²¹⁾ By end-June 2015, out of 232 central government SOEs, only 53 had their 2015 budgets approved.

⁽²²⁾ 225 SOEs had sent their 2014 financial statements to the Ministry of Public Finance by the agreed deadline of end-June, but only 35 with audit opinions without reserves. 156 were sent without audit, 25 with audit opinions with reserves, 2 with audit that could not express opinion, and 7 with an internal audit only.

⁽²³⁾ Under the Emission Trading Scheme Directive, allowances for CO₂ emissions in 2014 needed to be acquired and registered by 30 April 2015. CE Hunedoara needed to register allowances for emissions of around 1.2 m tonnes of CO₂ for around EUR 9 m, while the total fine would amount to EUR 120 m.

⁽²⁴⁾ State aid case SA. 41318, Rescue aid to Complexul Energetic Hunedoara, 21 April 2015.

⁽²⁵⁾ State aid case SA.33475, opened in 2012, concluded that Hidroelectrică paid electricity prices above market level to Electrocentrale Deva and Termoelectrică; providing the latter two an undue economic advantage in breach of EU state aid rules. CE Hunedoara as the legal and economic

the past illegal state aid was concluded in June 2015, after the allocation of a treasury loan to the company. The final government decision to implement the rescue aid was adopted on 24 June 2015. The first tranche of the loan was disbursed in July 2015, allowing the company to cover short-term liquidity needs and to acquire, with substantial delay, of the CO2 certificates for 2014. In light of the eventual acquisition of the certificates the national authority did not impose the corresponding fine. According to the provisions of the European Commission decision of April 2015, the authorities must submit to the European Commission (DG COMP) a restructuring plan that will restore the viability of the company. The process is ongoing.

The authorities adopted decisive measures to downsize heavy water supplier Regia Autonoma Pentru Activitati Nucleare RA (RAAN). The company was accumulating losses and large arrears. The authorities decided in May 2015 to take decisive action, also because RAAN's production capacity became redundant. The state reserve of heavy water is sufficient for nuclear power production in Romania in decades to come. As the sole buyer of heavy water from RAAN, the government adopted a decision in June 2015 (GEO 433/2015) that in practice terminated the procurement of heavy water from the company as of end-June. Although not leading to immediate definitive closure, the decision amounted to a major downsizing. By end-September 2015, the number of employees was reduced to around 800 (from almost 2,300 in June). At the end of the closure process, only 200 employees will remain in a new entity charged with the maintenance of the heavy water stock.

Plans were presented to improve the financial situation of the insolvent state-owned chemical producer Oltchim. The company entered insolvency in January 2013 and its financial situation continued to deteriorate. The continued accumulation of arrears led the authorities to recognise, in June 2014, the need for action. In April 2015, the company proceeded to a write-off

of outstanding debts (arrears) of around RON 2 billion accumulated the period before it entered insolvency. The decision was part of the reorganisation plan approved by all categories of creditors and the syndic judge. The write-off included mainly public entities. State-aid concerns raised by the EC were not clarified by the authorities until end-September 2015. Also, in May 2015 the authorities informed the programme partners of envisaged measures to reduce costs and arrears and attract investors through a special purpose vehicle (Oltchim SPV). The actions are still being implemented.

Developments at the railway companies were not in line with programme commitments. The operational results of the three rail companies (CFR Marfă, cargo transporter, CFR Infrastructura, railway network operator, and CFR Calatori, rail passengers) improved during the programme but were still negative at end-September 2015. Arrears continued to increase, contradicting a programme commitment to clear arrears in the sector. The programme also promoted the majority sale of CFR Marfă. However, the initial target of a majority sale to a strategic investor in October 2013 was abandoned when it was not possible to conclude the sale to the only bidder within the timeframe defined in the privatisation strategy. Since then, privatisation was repeatedly postponed, as were measures to address in a sustainable manner CFR Marfă's poor financial and operational performance. A programme of redundancies carried out in 2014 in agreement with the trade unions was insufficient to halt the deteriorating operational performance of the company. The privatisation would *inter alia* alleviate concerns with a debt-equity swap performed in June 2013, ahead of the failed privatisation attempt of October 2013. However, the latest privatisation plan, announced during the mission for end-June 2015, had not been presented to DG COMP by the end of the programme. An IPO, rather than a strategic partner, seems to be now the government's favoured option; but the latest deadline announced, May 2016, seems hardly feasible. The option raises serious doubts. A strategic partner could bring into the company needed know-how and capital. An IPO is also more likely to be undermined by the company's poor financial performance and might be insufficient to effectively withdraw political control.

successor of Termoelectrica and Electrocentrale Deva, must pay back the incompatible aid received, which amounts to RON 26.27 m (approx. EUR 6 m) excluding interest. No new rescue aid could be conceded before the state was redressed of this amount.

8.2. ENERGY

The main objectives of the programme in the energy sector were to preserve the achievements of the previous two programmes and to implement outstanding measures agreed under those programmes. The programme focused on: i) the implementation of the roadmaps for gas and electricity market liberalization, ii) the development of gas and electricity trading platforms, iii) the unbundling of energy transmission and dispatch operators, and iv) improving cross-border integration of energy networks and providing for security-of-supply measures. The performance of SOEs in the energy sector, also part of the conditionality, is discussed under section 8.1, above.

The gas market for non-residential consumers has been liberalised since January 2015. The authorities, in June 2014 tried to defer the implementation of the roadmap for the deregulation of the gas market for non-residential consumer. However, ANRE, the national regulator, concluded after a risk assessment that a further regulatory price adjustment of the wholesale gas price for non-residential consumers was not needed as domestic producer prices of gas reached the level of prices in European gas hubs. The regulator proposed to deregulate gas prices for non-residential consumers from July 2014 with a transition period of maximum three months, i.e. by end-September 2014 at the latest. To facilitate the full phasing-out of the regulated tariff, the regulator required suppliers to publish standardized non-discriminatory offers to continue to supply priority customers who do not switch suppliers. The government was reluctant to phase out the tariff for the non-residents in October 2014, but committed to do so, by end-2014, as agreed in the programme's roadmap.

The authorities adopted a new roadmap for gas price liberalisation for residential consumers by 2021. In September 2014, the authorities unilaterally decided by law to postpone the deregulation of the gas market for households from 2018, as had been agreed under the programme, to 2021. In December 2014 this decision was complemented by a gas price freeze until 1 July 2015, in violation of the commitment to resume the deregulation as soon as possible. Taking into account the amended law, which stipulates gradual

price convergence by 2021, as well as the draft roadmap presented by the authorities in May 2015, a new roadmap was adopted in July 2015 envisaging the following steps: from the level of 53.3 lei/MWh since December 2014 to 60 lei/MWh as of 1 July 2015, 66 lei as of July 2016, 72 lei as of April 2017, 78 lei as of April 2018, 84 lei as of April 2019, and 90 lei as of April 2020. This end-point is expected to bring the wholesale gas price in Romania's regulated market in line with the outlook for wholesale gas prices in Europe. A reassessment of the price roadmap is to be performed by ANRE before April 2018. The roadmap will be adjusted if by then judged not to be sufficient to ensure full price convergence.

The liberalisation of the electricity market is being implemented and trading on electricity platforms is increasing. Electricity markets liberalisation started under the previous programmes. Electricity price liberalisation for corporate consumers was concluded at end-2013 and prices for households are on track to be fully liberalised by end-2017, as planned. The over-the-counter market in electricity became operational in August 2013 while the trading platform for large electricity consumers on the OPCOM electricity exchange was put in place in October 2013. The volumes of electricity traded on OPCOM increased substantially and are well above the 50% of total sales target defined in the programme. The intra-day trading for electricity was launched on 15 January 2014 over the programme period. First trades were reported but renewable energy producers, presumed to be the most likely beneficiaries, have yet to participate actively.

The Romanian gas trading market is still marked by a lack of liquidity. Trading of gas is available since 2014 via the auction platforms of OPCOM and the Romanian Commodity Exchange (RCE). Whereas the government had adopted an emergency decree that allowed ANRE to oblige producers to offer a certain quantity of domestic production (currently 30%) via either of these platforms, trading remained slow and limited to RCE auctions, as market participants appear to prefer bilateral contracts. The European Commission will continue to monitor the effectiveness of this measure. Higher liquidity may result from the implementation of the gas balancing network code (Reg. 312/2014) by the gas Transmission System Operator (TSO)

"Transgaz" (October 2015 deadline). The balancing code requires, among other measures, the possibility for daily settlement of long and short positions between gas trading participants (currently only month-ahead settlement) and the setting-up by the TSO of a balancing platform for the procurement of balancing services.

Some progress was made in unbundling transmission system operators. The separation of production and supply of energy, on the one hand, and its transmission, on the other hand, started under the previous programme and was continued in the third programme. The effort is pursuant to the rules on unbundling in the Gas and Electricity Directives of the Third Energy Package. Transelectrica and Transgaz, Romania's TSOs for electricity and gas, respectively were certified by ANRE as unbundled under the Independent System Operator (ISO) model in December 2013 and January 2013, respectively. Pursuant to the ISO model, ownership of the transmission network can remain with a vertically integrated undertaking, while operation of the network is transferred to an independent operator. For both TSOs, the European Commission expressed doubts as to the choice of unbundling model and recommended a transition to ownership unbundling. Following a reorganisation in the RO public administration (in particular the establishment of a separate Ministry for Energy), Transelectrica recently applied for re-certification under ownership unbundling rules. The Commission Opinion on the corresponding draft re-certification decision of ANRE was adopted on 14 October 2015, urging ANRE to re-assess certain steps taken by the RO authorities towards complying with the unbundling requirements. The re-certification of Transgaz is still outstanding.

Limited progress was made in the area of gas interconnections, while cross-border integration of electricity networks has been successful. As to gas inter-connections, physical gas exports to Hungary became technically possible as of February 2014, though at very limited quantities due a difference in operational pressure. The construction of the interconnector with Bulgaria at Giugiu-Russe has suffered repeated delays. The revised deadline is December 2016. Further investments in new compressor stations will be required to enable flows beyond 0.5 bcm/y. This lack of interconnection limits Romania's ability to

contribute to the security of gas supply in the region. As to electricity networks, the coupling of the Romanian electricity market with Slovakia, the Czech Republic and Hungary (themselves coupled since 2012) has been established since November 2014. Romania is also seeking to participate in the North West Europe – Central East Europe (NWE CEE) Flow-Based Market Coupling Project.

Romania is finally taking steps to increase security of supply by adopting the delayed Emergency Plan and Preventive Action Plan. Romania is the only Member State not to have adopted the Emergency and Preventive Action Plans required under the Gas Security of Supply Regulation No 994/2010 (deadline was 2012), which provides measures to mitigate the impact of a gas supply disruption. An infringement procedure is pending. A draft Emergency Plan was finally submitted to the European Commission in July 2015. The European Commission services provided preliminary comments, as well as comments to the previously notified Preventive Action Plan. According to the draft plans, Romania considers that its gas infrastructure would remain fully functional during a failure of the single largest infrastructure (N-1 test) and the gas supply to protected customers (households, district heating) would be ensured in different crisis scenarios (supply interruption; cold spell).

8.3. TRANSPORT

In the area of transport, the programme focused on unfulfilled commitments from the previous programme and on supporting the framework for the 2014-20 EU funds programming period. This included further improving the regulatory framework of the rail sector and defining an integrated approach to investment in the transport sector, in the form of the adoption of a General Transport Master Plan (GTMP). The performance of SOEs in the transport sector, also part of the conditionality, is discussed under section 8.1, above.

The envisaged changes to the regulatory framework were achieved, albeit with delays. All these elements of the conditionality had failed to be completed during the 2011-13 programme and were given a new end-2013 deadline. They were eventually all completed in the first half of

2014. The formula for compensation for public services obligations (PSO) was adjusted in spring 2014. The weight of the number of passengers transported has been increased, and kilometres travelled decreased, in order to promote a more passenger-friendly network. Amendments to CFR Infrastructura's activity contracts were approved also in spring 2014 to create incentives to reduce unit costs and the charges made to users of the rail infrastructure. Performance schemes penalising delays have been introduced in the access contract of each rail operator.

Starting in January 2015, the missions sought to facilitate the development and adoption of a General Transport Master Plan (GTMP). The GTMP is a key step in the rationalisation of transport infrastructure spending in Romania. Its development, in close cooperation with the European Commission, and adoption by the government was an ex ante conditionality for EU funding of transport infrastructure in Romania during the 2014-20 EU funds programming period⁽²⁶⁾. EUR 9.4 bn are available to Romania for transport infrastructure, sustainable urban transport, environment, energy, and risk prevention. With national co-financing included, total investment could top EUR 11.8 billion until 2020. Taking into account the substantial delays accumulated during 2014, as from January 2015, the missions sought to support the close work between the authorities and DGs REGIO and MOVE. The GTMP is in the last stages of finalisation and the Large Infrastructure Operational Programme was signed in July 2015. Formal approval is expected by December 2015.

8.4. PUBLIC ADMINISTRATION

Building on the previous programmes, a major effort has been done to promote a rethinking of Romania's public administration. The public administration remains instrumental for the modernization of Romania and well-being of its citizens. Its structure and efficiency have an impact on the quality of legislation and overall continuity and predictability of public policies. Under the previous BoP programmes, the World Bank

conducted functional reviews of key institutions in the central administration and helped the authorities drawing action plans to address the weaknesses identified. These action plans were reviewed and updated during the first months of the programme, as agreed. Starting end-2013, the authorities decided to extend that effort. A project has been launched to identify the root sources of weak administrative capacity in Romania and develop an overarching strategy to improve the administrations' efficiency and effectiveness. The missions supported this effort, which was not part of the programme's agreed measures, but was made an ex-ante conditionality for the new EU-funds programming period (2014-20). Despite some delays in taking off, the strategy and an action plan for its implementation were completed in July and adopted by the government in October 2014⁽²⁷⁾. Implementation has been slow ever since, however, weakened by low priority in an unstable political environment. Furthermore, actions by line ministries often do not seem to be coordinated with the strategy. One such example is the disconnect between the new Unified Wage Law and the Strategy for Civil Servants. The preparation of the latter is based on the mechanisms set up for the implementation of the public administration strategy, but is not informing the preparation of the Unified Wage Law. A "Public Administration Platform", created in September 2015 with the support of the European Commission, will seek to assist implementation and widen support for the reforms proposed in the strategy⁽²⁸⁾. As agreed in the MoU, the authorities reported on progress to the EPC and the EFC every six months.

The programme promoted several additional initiatives to improve Romania's administrative capacity. A central delivery unit (DU) was established in autumn 2013, with technical assistance from the World Bank and financed from the European Regional Development Fund. The DU sought to facilitate policy implementation in priority areas and to help improving Romania's capacity to address the EU's Country Specific Recommendations (CSR). The reinforcement of the CSR monitoring capacity was tested with a

⁽²⁶⁾ For more information see: http://ec.europa.eu/regional_policy/en/atlas/programmes/2014-2020/romania/2014ro16m1op001.

⁽²⁷⁾ <http://www.anfp.gov.ro/R/Doc/2015/Formare/Hot%C4%83r%C3%A2re%20909%202014.pdf>

⁽²⁸⁾ The Platform includes representatives of the various political parties, social partners, and the civil society.

pilot project in spring 2015, but will require political drive to unfold into a widely used mechanism. With the end of the DU project, in November 2015, a more permanent body for strategic planning and coordination at the centre of the government is currently being considered, possibly with technical support from the World Bank. This step was one of the elements informally agreed with the authorities during the January/February 2015 review mission.

Starting in January 2015, the programme missions supported efforts to develop a strategy for public procurement. Systemic deficiencies in public procurement have been recurrently identified, resulting in insufficient execution of public investment projects and low absorption of EU funds. As from January 2015, following-up on progress achieved during the second programme, the missions sought to support the working group of the Romanian authorities with DGs GROW and REGIO aiming at strengthening the efficiency of the public procurement system in Romania. The joint work resulted in a public procurement strategy and action plan, adopted in July 2015. The strategy and its detailed action plan are the benchmarks against which Romania will be surveyed in 2017, during the mid-term assessment of the 2014-2020 financial programming period, with respect to fulfilment of the public procurement ex-ante conditionality for EU funds. The implementation stage started in September 2015.

8.5. BUSINESS ENVIRONMENT

Romania's business environment has long been seen as a drag on growth and competitiveness. At the start of the programme, Romania position in the World Bank's "ease of doing business" global ranking was a low 72nd and largely unchanged since 2008 ⁽²⁹⁾. Improving the business environment was, thus, seen as key to promote domestic and foreign investment and to generate sustainable growth. Romania's position in the rank improved only slightly since then ⁽³⁰⁾, mostly on

⁽²⁹⁾ World Bank, "Doing Business 2015: Going beyond efficiency".

⁽³⁰⁾ Under a new methodology, Romania was in 2015 48th in "ease of doing business" ranking, a slight improvement on the 50th position in 2014. The latter corresponded to a rank of 74th when using the old methodology.

the account of improvements in paying taxes. Progress on other indicators was equally limited.

Online submission and payment of taxes improved markedly during the programme period. The development of online systems for filing and paying taxes by business, including income taxes, VAT and social security contributions has been set up with technical support from the World Bank and is being taken up by business. According to the World Bank ⁽³¹⁾, Romania was the best performing country in this area in the world in 2014.

There was also substantial progress with the digitalisation of the land registry and with relevant related legislation. Despite initial delays, the digital land registry is now progressing at a steady pace, reaching the (revised) target of 20% of all properties in late spring 2015. Progress is expected to accelerate as the approval of the national programme for cadastre in May 2015 ensured a coherent approach and stable financing. Progress can be verified online in real time, as requested under the programme ⁽³²⁾. Registration procedures were simplified and land property registration is now compulsory prior to any public concession or leasing. A protocol with the Notaries association will further facilitate land registration by speeding up the resolution of undebated inheritance cases.

Progress in other business environment areas is more limited. There has been no effort to streamline the "one-stop shop" and the "point of single contact" into fully-operational and interconnected electronic platforms with a single entry point. Information sharing in the administration remains rare, limiting the implementation of the "only once" principle of the EU Small Business Act of 2008. There was some progress towards interoperability, but restricted by the many delays in the approval and implementation of a roadmap for interoperability.

The quality of regulations remains limited. A better regulation strategy was approved in December 2014 as part of the strategy for the public administration, but no detailed action plan

⁽³¹⁾ World Bank, "Doing Business 2015: Going beyond efficiency".

⁽³²⁾ See <http://www.ancpi.ro/pages/home.php?lang=ro>

for its implementation has been adopted. Three pilot projects by the World Bank should lead to a simplified impact assessment methodology but have been suffering delays. The methodology shall include a simplified SMEs test to replace the one introduced in May 2014, deemed too complex. No progress was made in establishing a quality control mechanism, identifying regulatory areas for legal consolidation or introducing common commencement dates for legislation affecting business.

Most agreed measures to facilitate SME's access to finance were enacted, albeit with substantial delays and with limited impact. The functioning of the National Loan Guarantee Fund for SMEs has been reviewed, but the take-up of the funds it manages remains limited. Simplified but still complex procedures and relatively high interest rates compared with fallen market rates are seen as main obstacles. A law on business angels approved by the Parliament in April 2015 and a task force to prepare incentives for venture capital may facilitate start-ups' access to finance. An agreement to use the Ministry of EU Funds' network of offices in the 41 counties to provide integrated information on both national and EU-funding for SMEs still needs to be fully operational. Bank lending conditions continue to be seen as discouraging and lacking transparency. The programme sought to address this by promoting the cooperation between the authorities and the Romanian Banking Association, but no progress could be registered.

SMEs access to export markets remains a challenge. Exports by SMEs seem to be held back by poor knowledge of market opportunities and incipient participation in cross-border business networks. SMEs can benefit from a network of external trade counsellors placed in embassies across the world, but the quality of the service provided is reportedly uneven. Also, SMEs often lack the knowledge and resources to reach the network or to put to good use the available information. A trade portal provides relevant information and should increase the visibility of Romania's SMEs, but its modernising has been delayed. Financing was finally made available in spring 2015 and the public procurement process is on-going. A Swiss-financed "passport to exports" scheme aims to improve SMEs access to external markets with training and information on potential

markets. After substantial delays, it will take off in autumn 2015 with the hiring of a consultant to set up two pilot centres focused on organic agriculture products and wood furniture.

A new law on inventions by employees should encourage research and innovation. Romania underperforms its peers in terms of innovation. International patent applications are the lowest in the EU. A law on inventions by employees, adopted in spring 2014, is expected to make investment in R&D activities in Romania more attractive for national and international firms. The programme sought to support the use of the legislation by SMEs, public research institutes and other low administrative capacity institutions by encouraging the definition and publication of guidelines based on international good practices to complement the legislation. The guidelines were published in June 2015.

8.6. HEALTHCARE

The overall objective of healthcare conditionality has been to improve fiscal sustainability and the efficiency and effectiveness of healthcare service delivery. The programme built on actions under the previous programmes to target the reduction of payment delays in the health sector, lower risks of arrear accumulation in hospital care, and structurally improving the efficiency of the health system. These measures had been partially implemented. Conditionality under the current programme thus aimed to: i) continue implementing outstanding measures, in particular but not exclusively with reference to clearing arrears in the health sector, increasing the sustainability of pharmaceutical spending, and implementing e-health solutions; ii) redefine the publicly-reimbursable basic benefits package to be financed within the limitations of available funding and improve the funding of the health system; iii) improve efficiency and effectiveness by strengthening primary care services, devising a strategy to shift resources from hospital-based care towards primary care, and increasing funding available to the primary care sector.

MoU conditionality related to fiscal measures has been met partially. Hospitals' arrears declined significantly relative to the start of the programme,

but were not fully eliminated. Since external audits of public hospitals originally foreseen to be undertaken by February 2015 have been postponed to 2016, the causes of arrear accumulation remain unclear and risks of new arrear accumulation persist. Fiscal controls have continued and/or have been newly put in place, with monthly monitoring of hospitals' budget execution and registering of arrears, monitoring of pharmaceutical expenditure via e-prescription, and the setting of clear spending limits. Further, the e-health card was implemented in 2015, which will ensure that only delivered medical services will be reimbursed by the National Health Insurance. Higher tax deductibility for premiums paid for supplementary private insurance has been taken up in the fiscal code. This will increase revenue sources for public and private health service providers. Outside programme conditionality, the government decided to increase wages of medical personnel by around 25% starting from October 2015 to incentivise medical personnel to continue working for public hospitals. Financing for this measure in 2015 and 2016 has yet to be allocated. Overall, despite some progress throughout the programme period the health system remains underfunded and without further policy action the situation is bound to worsen in view of the outdated health infrastructure, an ageing population and related higher funding needs.

Conditionality to improve the fiscal sustainability of pharmaceutical spending has been partially met. Overspending has moderately decreased from 15% in 2013 to 13% by September-2015. While overspending is recovered via the claw-back tax and is thus budget neutral, it increases future fiscal risks and limits the scope for reimbursing new innovative medicines, without jeopardizing the medium-term fiscal sustainability of pharmaceutical spending. To counterbalance this, the government has implemented some MoU conditionality by delisting medicines, lowering reimbursement rates for cost-ineffective medicines based on a new framework for assessing their value-for-money, and decreasing pharmaceutical prices in 2015, but the fiscal effect is most probably temporary as the consumption of medicines is increasing. Moreover, new medicines were approved for reimbursement in so-called cost-volume agreements, which offer more favourable pricing conditions than traditional pricing models. This allows for previously

unavailable treatment of chronic diseases, such as Hepatitis C, but calls for additional financing in 2016, which was not secured at the end of the programme. Conditionality on the revision of the claw-back tax and on reforming financial incentives for distributors of pharmaceutical products to provide low cost medicines to patients was not met.

Structural reforms promoted through the programme have set a partial basis for improved effectiveness and efficiency of care, but the reform impact is difficult to assess. The National Health Strategy 2014- 2020 was approved. It sets the strategic frame for future health sector reforms, as well as for tapping into the Structural and Cohesion Funds. The package of publicly reimbursed benefits has been revised in 2014 and 2015, and funding of primary and ambulatory care services has been moderately increased relative to hospital care. Conditionality on improving the financing system of hospital services based on real rather than assumed costs of hospital services has not been met, which means that hospitals continue to have low financial incentive to provide more effective care to patients. The capacity of the centralised procurement unit at the Ministry of Health was enhanced and procurement is generating more savings than in the past, but centralized procurement remains far below its potential. In 2015, around 40 centralized tendering procedures have been launched mostly for procuring pharmaceuticals, but most medical devices and surgical supplies consumed in hospitals are still procured locally. Finally, a healthcare reform programme with the World Bank was initiated and should increase the efficiency of the hospital sector. The success of the structural reforms will only be measurable over time, and is difficult to assess in the short term.

Overall, in the health sector the programme was partially implemented. Various measures to improve the still fragile balance between fiscal sustainability of healthcare spending and the need to provide effective medical care to the population remain unfinished, including external audits of hospitals, the financing system of hospital services, the claw-back tax or the centralized procurement system. Corruption in the health sector has probably been reduced but remains widespread in various forms, putting serious constraints to policy

efforts to increase efficiency in the sector. The system remains underfunded and hospital-centred, and provides limited access to effective care. Fiscal risks in the sense of future arrears persist.

ANNEX 1

Financial assistance programmes 2009-2015

Table A1.1: Financial assistance programmes with Romania

2009-2011 programme

European Commission (EC): Balance of Payments programme – EU medium term financial assistance	EUR 5 bn
International Monetary Fund (IMF): Stand-By Arrangement (SBA)	SDR 11.4 bn (~ EUR 12.9 bn; 1,110.77% of Romania's IMF quota)
World Bank (WB): Loans	EUR 1 bn
European Investment Bank (EIB) & European Bank for Reconstruction and Development (EBRD) - Loans	EUR 1 bn
TOTAL financial support received from IFIs during 2009-2011	EUR 19.9 bn

2011-2013 programme

European Commission (EC): Balance of Payments programme – precautionary EU medium term financial assistance	EUR 1.4 bn
International Monetary Fund (IMF): Stand-By Arrangement (SBA) treated as precautionary	SDR 3.09 bn (~ EUR 3.5 bn; 300% of Romania's IMF quota)
World Bank (WB): development loan programme (DPL of EUR 400 million) and results based financing for social assistance and health (of EUR 750 million)	EUR 1.15 bn
TOTAL financial support available in 2011-2013	EUR 6 bn

2013-2015 programme

European Commission (EC): Balance of Payments programme – precautionary EU medium term financial assistance	EUR 2 bn
International Monetary Fund (IMF): Stand-By Arrangement (SBA) treated as precautionary	SDR 1,751.34 million (~ EUR 2 bn; 170% of Romania's IMF quota)
World Bank (WB): EUR 1 billion were made available under a development policy loan with a deferred drawdown option (DPL/DDO)	€1 bn
TOTAL financial support available in 2013-2015	€5 bn

Source: EC, IMF, and WB

ANNEX 2

Repayment schedule to the EU and the IMF

Table A2.1: 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	236.7	4,051.8	4,288.6	5,101.2
2014	151.6	-	151.6	67.0	3,881.1	3,948.1	5,708.4
2015	151.6	1,500.0	1,651.6	7.8	1,232.8	1,240.5	3,083.4
2016	104.8	-	104.8	0.2	96.1	96.3	215.9
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

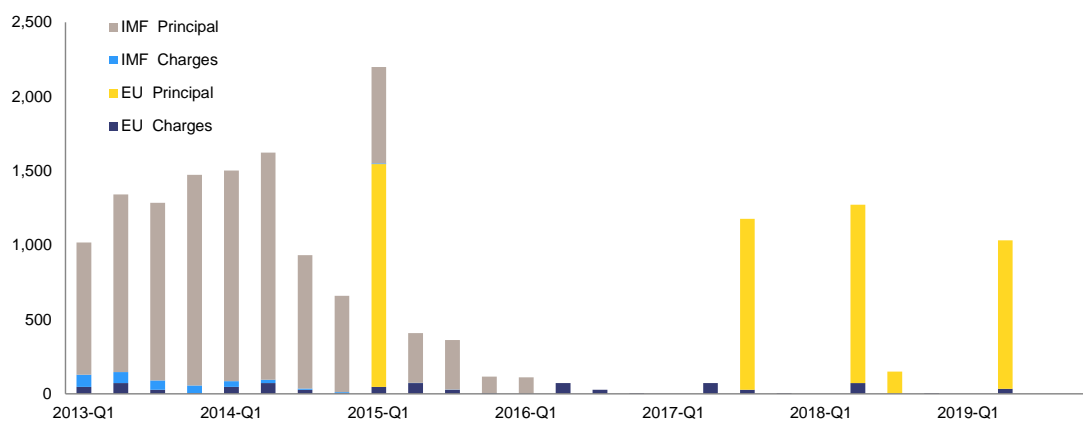
* EU BoP assistance has been in full channelled to the MoPF

**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.

Source: European Commission and the IMF

Graph A2.1: Quarterly repayment schedule to the EU and the IMF (mln €)



Source: Commission services and the IMF

ANNEX 3

Key economic indicators

Table A3.1: Overview table

	2007	2008	2009	2010	2011	2012	2013	2014	2015*	2016*	2017*
Gross Domestic Product	<i>(annual percentage change, unless otherwise indicated)</i>										
Nominal GDP (in bn RON)	418	524	511	534	565	595	637	667	700	737	783
Real GDP	6.9	8.5	-7.1	-0.8	1.1	0.6	3.5	2.8	3.5	4.1	3.6
Private Consumption	14.1	7.1	-10.1	1.0	0.8	1.2	0.7	6.2	4.3	6.7	4.4
Public Consumption	0.4	6.7	3.7	-4.9	0.6	0.4	-4.6	5.0	1.9	2.9	2.9
Gross fixed capital formation	50.5	17.6	-36.6	-2.4	2.9	0.1	-5.4	-7.2	6.2	3.9	6.0
Exports	7.8	-3.2	-5.3	15.2	11.9	1.0	19.7	8.1	6.2	5.0	5.6
Imports	28.8	0.2	-20.7	12.6	10.2	-1.8	8.8	7.4	8.1	8.3	7.5
Contribution to GDP growth											
Domestic demand	23.1	12.2	-19.9	-0.9	1.4	0.9	-1.7	2.7	4.3	5.5	4.5
Inventories	-6.1	-2.7	5.9	0.2	-0.2	-1.4	1.6	-0.1	0.0	0.0	0.0
Net exports	-10.1	-1.0	6.9	-0.1	-0.1	1.1	3.6	0.2	-0.8	-1.4	-0.9
Prices											
HICP inflation (average)	4.9	7.9	5.6	6.1	5.8	3.4	3.2	1.4	-0.4	-0.3	2.3
HICP inflation (year-end, quarterly)	6.8	6.9	4.5	7.8	3.4	4.7	1.3	1.4	-1.1	1.3	2.7
NBR target	4.0	3.8	3.5	3.5	3.0	3.0	2.5	2.5	2.5	2.5	2.5
Labour market											
Total employment	9365	9366	9181	9156	9082	8645	8569	8661	8683	8714	8754
Unemployment rate (harmonised:15-74)	6.4	5.6	6.5	7.0	7.2	6.8	7.1	6.8	6.7	6.6	6.5
General Government Accounts	<i>(in percent of GDP, cash)</i>										
Total revenues ¹⁾	30.4	31.6	30.8	31.6	32.2	32.5	31.3	32.1	32.3	n.a.	n.a.
Total expenditures ¹⁾	32.6	36.3	37.9	37.9	36.6	34.9	33.8	34.0	34.2	n.a.	n.a.
Current ¹⁾	29.2	31.5	34.1	34.3	32.5	31.6	31.1	31.5	31.6	n.a.	n.a.
Capital ¹⁾	3.4	4.9	4.3	3.6	4.0	3.2	2.8	2.6	2.6	n.a.	n.a.
Govn deficit, cash definition ¹⁾	-2.3	-4.7	-7.1	-6.3	-4.4	-2.5	-2.5	-1.9	-1.9	n.a.	n.a.
Government deficit, ESA2010 definition	-2.9	-5.6	-9.1	-6.9	-5.4	-3.2	-2.2	-1.4	-1.2	-2.8	-3.7
Gross debt, general govn, ESA2010 definition	12.7	13.2	23.2	29.9	34.2	37.4	38.0	39.9	39.4	40.9	42.8
Balance of payments	<i>(in percent of GDP)</i>										
Current account balance **	-12.7	-12.4	-4.1	-4.5	-4.4	-4.3	-0.8	-0.4	-0.8	-1.9	-2.6
Trade balance**	-14.3	-13.3	-6.4	-6.1	-5.6	-5.0	-0.8	0.1	-0.4	-1.5	-2.2
Capital and financial account balance	-12.7	-11.7	-4.7	-4.2	-3.0	-0.9	3.3	4.7	3.5	n.a.	n.a.
FDI balance	-5.5	-6.3	-2.8	-1.8	-1.3	-1.8	-2.0	-1.8	-1.4	n.a.	n.a.
Net international investment position	-43.2	-48.5	-62.1	-62.3	-64.2	-67.9	-61.7	-56.9	-52.6	n.a.	n.a.
Foreign exchange reserves (in bn Euro)	25.3	26.2	28.3	32.4	33.2	31.2	32.5	32.2	31.6	n.a.	n.a.
Gross external debt	46.8	50.8	67.4	72.9	74.1	74.7	68.0	63.2	57.6	n.a.	n.a.
Monetary and exchange rate developments											
Broad money M3 (annual % change, end of the period)	33.7	17.5	9.0	6.9	6.6	2.7	8.8	8.4	8.0	n.a.	n.a.
NBR policy rate (in %, end of period)	7.50	10.25	8.00	6.25	6.00	5.25	4.00	2.75	1.75	n.a.	n.a.
Exchange rate (lei/euro, end of period)	3.61	4.02	4.24	4.26	4.32	4.44	4.47	4.48	4.42	n.a.	n.a.
REER (Unit Labour Costs deflator, % change)	6.8	12.5	7.8	-13.0	1.1	-5.9	-5.3	-0.4	0.6	n.a.	n.a.
Financial market & banking sector developments											
Private credit growth (y-o-y)	n.a.	33.7	0.9	4.7	6.6	1.3	-3.3	-3.3	0.2	n.a.	n.a.
Capital Adequacy											
CAR	n.a.	13.8	14.7	15.0	14.9	14.9	15.5	17.6	18.1	n.a.	n.a.
Leverage ratio	n.a.	8.1	7.6	8.1	8.1	8.0	8.0	7.4	8.0	n.a.	n.a.
Ratio of level 1 own funds	n.a.	10.7	11.8	13.4	14.2	14.3	16.6	17.3	n.a.	n.a.	n.a.
Asset quality											
NPLs (90 dpd)	n.a.	n.a.	2.8	11.9	14.3	18.2	21.9	13.9	12.8	n.a.	n.a.
NPLs (60 dpd)	n.a.	6.5	15.3	20.8	23.3	29.9	32.1	32.6	n.a.	n.a.	n.a.
Profitability											
ROA (after tax)	n.a.	1.0	0.3	-0.2	-0.2	-0.6	0.0	-1.3	0.7	n.a.	n.a.
ROE (after tax)	n.a.	9.4	2.9	-1.7	-2.6	-5.9	0.1	-12.5	6.4	n.a.	n.a.
Liquidity											
Immediate liquidity	n.a.	38.7	34.4	35.3	37.8	37.2	35.9	41.5	n.a.	n.a.	n.a.

* Commission's 2015 autumn forecast or latest values

** Current account and trade balance are reported based on the latest forecast using National Accounts data

1) 2015 fiscal data reflect budget indicators

Source: European Commission

Table A3.2: General government accounts

	2007	2008	2009	2010	2011	2012	2013	2014
	Final	Final	Final	Final	Final	Final	Final	Final
	(% GDP, cash)							
TOTAL REVENUES	30.4	31.6	30.8	31.6	32.2	32.5	31.3	32.1
Profit tax	2.5	2.5	2.3	1.9	1.8	1.8	1.7	1.8
Income and wage tax	3.4	3.5	3.6	3.4	3.4	3.5	3.6	3.6
VAT	7.5	7.8	6.7	7.4	8.5	8.5	8.1	7.6
Excises	3.0	2.6	3.1	3.2	3.4	3.4	3.3	3.6
Social insurance contributions	9.3	9.3	9.4	8.6	9.0	8.7	8.5	8.6
Non fiscal revenue	1.9	3.0	3.0	3.7	3.3	3.1	2.7	2.6
Other fiscal taxes	1.8	2.0	1.9	2.6	1.7	2.0	1.9	2.2
Revenue from capital	0.9	0.8	0.7	0.9	1.2	1.5	1.5	2.1
TOTAL EXPENDITURES	32.6	36.3	37.9	37.9	36.6	34.9	33.8	34.0
Current expenditures	29.2	31.5	34.1	34.3	32.5	31.6	31.1	31.5
Personnel expenditures	6.1	8.7	9.2	8.0	6.8	6.8	7.2	7.5
Goods and services	6.2	6.2	5.5	5.5	5.6	5.7	6.0	5.9
Interest	0.7	0.7	1.2	1.4	1.6	1.8	1.7	1.5
Subsidies	1.6	1.5	1.4	1.3	1.1	1.0	0.8	0.9
Transfers	14.6	14.4	16.4	17.8	17.0	16.0	15.2	15.5
Social Assistance	9.2	10.3	12.5	12.9	12.0	11.2	10.7	10.7
Other transfers	5.4	4.1	3.9	5.0	5.0	4.7	4.5	4.8
Other	0.0	0.0	0.4	0.3	0.4	0.3	0.1	0.1
Capital expenditures	3.4	4.9	4.3	3.6	4.0	3.2	2.8	2.6
Other expenditure (net lending)	0.0	-0.1	-0.5	-0.1	0.1	0.1	-0.2	-0.1
Government deficit, cash definition	-2.3	-4.7	-7.1	-6.3	-4.4	-2.5	-2.5	-1.9
Government deficit, ESA2010 definition	-2.9	-5.6	-8.9	-6.6	-5.3	-2.9	-2.2	-1.5
Deficit adjustor (for co-financing EU funds)								
Gross debt, general government, ESA2010 def., EC SF14								

Source: Ministry of Public Finance

Table A3.3: Key monetary indicators

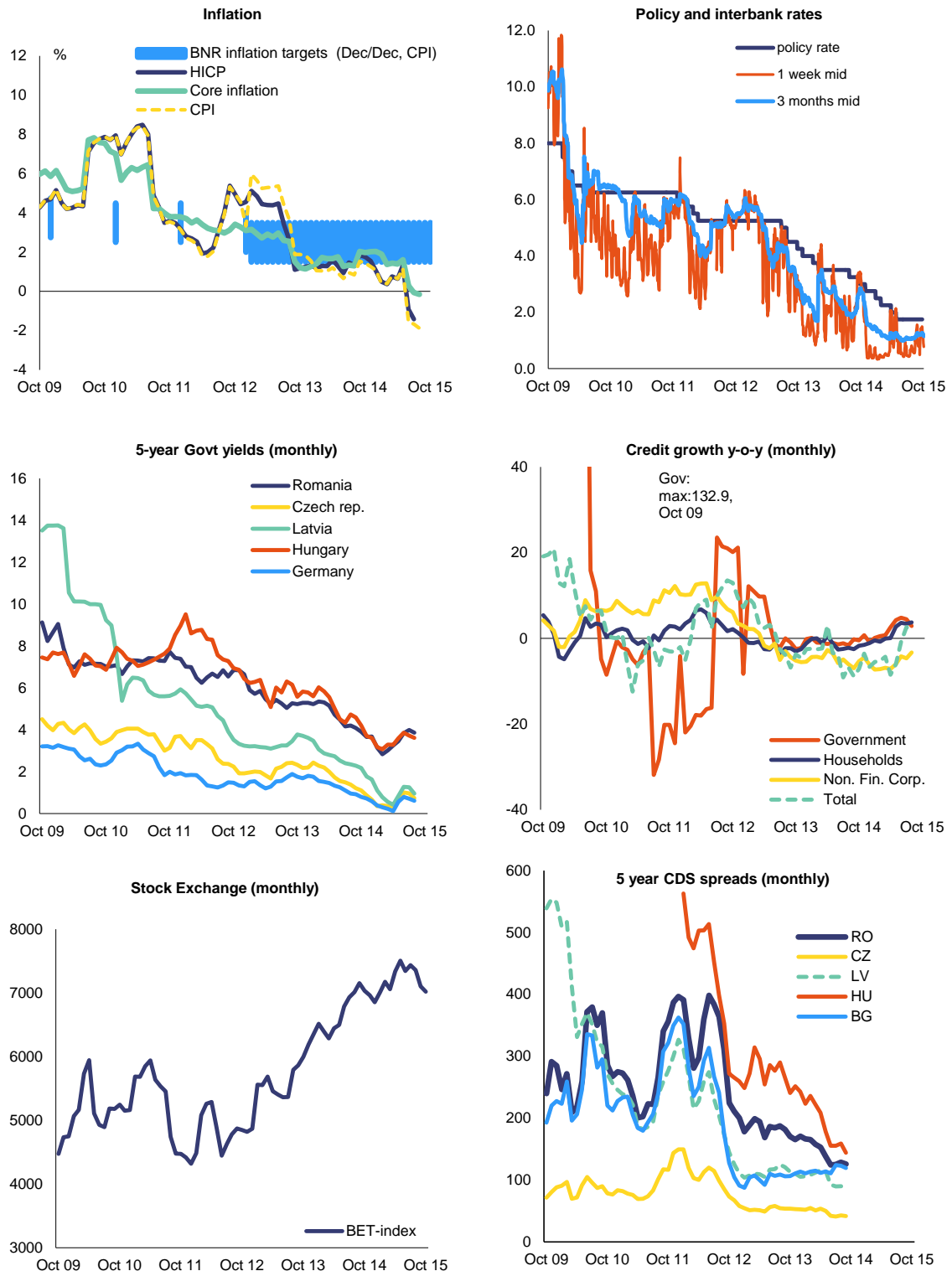
	2008	2009	2010	2011	2012	2013	2014	2015
Broad money (M3), mln RON, eop	174028	189630	202773	216208	222018	241547	261831	262296
Intermediate money (M2)	173629	188013	199572	212059	221830	241251	261573	262174
Money market instruments	399	1617	3201	4149	188	296	258	123
Narrow money (M1)	92549	79361	81592	85834	89020	100311	118582	129980
Currency in circulation	25287	23968	26794	30610	31477	34784	39890	43839
Overnight deposits	67262	55394	54799	55224	57543	65526	78691	86141
Time deposits*	81080	108652	117980	126225	132809	140940	142991	132194
Money and credit (Annual percentage change, eop)								
Broad money (M3)	17.5	9.0	6.9	6.6	2.7	8.8	8.4	8.0
- NFA contribution	-54.1	64.9	8.0	-13.4	69.8	85.8	43.8	16.1
- NDA contribution	35.2	4.3	6.8	9.3	-4.4	-5.8	-4.8	3.7
Intermediate money (M2)	17.3	8.3	6.1	6.3	4.6	8.8	8.4	8.1
Narrow money (M1)	15.8	-14.2	2.8	5.2	3.7	12.7	18.2	23.1
Currency in circulation	17.9	-5.2	11.8	14.2	2.8	10.5	14.7	15.3
Overnight deposits	15.0	-17.6	-1.1	0.8	4.2	13.9	20.1	27.5
Time deposits*	19.0	34.0	8.6	7.0	5.2	6.1	1.5	-3.5
p.m. Credit to private sector	33.7	0.9	4.7	6.6	1.3	-3.3	-3.3	0.2
Interest rates (In percent, eop)								
Robor, 3 m	15.46	10.65	6.17	6.05	6.05	2.44	1.71	1.32
Robor, o/n	14.53	8.90	2.99	4.53	6.30	1.74	0.61	0.63
NBR policy rate	10.25	8.00	6.25	6.00	5.25	4.00	2.75	1.75
NBR credit facility rate	14.25	12.00	10.25	10.00	9.25	7.00	5.25	3.25
NBR deposit facility rate	6.25	4.00	2.25	2.00	1.25	1.00	0.25	0.25
Exchange rates								
Lei per euro (end of period)	4.02	4.24	4.26	4.32	4.44	4.47	4.48	4.42
Lei per euro (average)	3.68	4.24	4.21	4.24	4.46	4.42	4.44	4.44
Real effective exchange rate (percentage change)								
HICP based	8.3	-5.0	-7.6	2.5	3.2	-5.5	4.3	0.9
ULC deflator based	12.5	7.8	-13.0	1.1	-5.9	-5.3	-0.4	0.6

Figures for 2015 are those of the last available month

* Maturity up to 2 years

Source: NBR, European Commission

Graph A3.1: Key monetary and financial market indicators



Source: European Commission, Romanian authorities

Table A3.4: EU funds absorption (billion euro), 2007-2013 programme period

Date	EAFRD	% of total EAFRD	SCF	% of total SCF	Grand total	% of total
Dec-10	1,436	17.7%	368	1.9%	1,804	6.6%
Dec-11	2,683	33.0%	1,066	5.6%	3,749	13.8%
Dec-12	3,538	43.5%	2,204	11.6%	5,742	21.1%
Dec-13	4,884	60.1%	6,430	33.7%	11,314	41.6%
Sep-14	5,176	63.7%	7,390	38.8%	12,566	46.2%
Dec-14	6,160	75.8%	9,954	52.2%	16,114	59.3%
Sep-15	6,383	78.6%	10,861	57.0%	17,244	63.4%

Legend

EAFRD: European Agricultural Fund for Rural Development

SCF: Structural and Cohesion Funds

Total EAFRD 8,124

Total SCF 19,058

Total Funds 27,182

Source: European Commission

ANNEX 4

Programme documentation

A4.1. MEMORANDUM OF UNDERSTANDING (MOU)

MEMORANDUM OF UNDERSTANDING between THE EUROPEAN UNION and ROMANIA

1. On 22 October 2013, the Council of the European Union adopted a decision making available precautionary medium-term financial assistance of up to EUR 2 billion for Romania until 30 September 2015.⁽³³⁾ The EU assistance for Romania under the Balance of Payments (BoP) facility comes in conjunction with IMF support through a Stand-by Arrangement (SBA) in the amount of SDR 1,751.34 million (about EUR 2 billion, 170% of Romania's IMF quota), approved on 27 September 2013, which the authorities will also treat as precautionary. The World Bank (WB) has made EUR 1 billion available under a Development Policy Loan (DPL) with a deferred drawdown option (DDO) valid through December 2015. In addition, the WB will continue providing earlier committed support of EUR 891 million, of which EUR 514 million is still to be disbursed mainly in support of Social Assistance Modernization project (EUR 300 million), a Revenue Modernization project (EUR 70 million), and the agricultural sector (EUR 61 million). The WB is also preparing a Health Sector Operation expected to be submitted for Board Approval late this calendar year or in the first half of 2014. A new Country Partnership Agreement between Romania and the WB is being prepared and is expected to be submitted for Board Consideration in the first half of next year. It will spell out any additional financial support that might be provided over the next 3 years to public investments or the policy agenda. The EU precautionary assistance will be conditional upon the implementation of a comprehensive economic policy programme, with a particular focus on structural reform measures including those country-specific recommendations of the EU semester aiming at reducing remaining vulnerabilities and at increasing the resilience and the growth potential of the Romanian economy. These measures relate to administrative capacity, product market reforms, the business environment, labour markets, pensions, state-owned enterprises, and healthcare. In parallel, the programme ensures the continuation of fiscal consolidation, the reform of the tax administration, improvements in public financial management and control as well as external, monetary, financial stability, and financial market reform. In its totality, the programme is geared towards: (i) Romania reaching its medium-term budgetary objective by 2015, in line with Stability and Growth Pact requirements; (ii) improving growth potential; and (iii) decreasing the future likelihood of renewed excessive structural imbalances in the Romanian economy, including through strengthening governance where needed.

2. EU financial assistance will be of a precautionary nature, i.e. the overall loan amount would only be made available, upon a request for activation from Romania, in case of an unforeseen marked deterioration in the economic and/or financial situation due to factors outside the control of the authorities, leading to the opening of an acute financing gap. The availability for activation of the assistance is subject to, amongst others, the entry into force of the present Memorandum of Understanding (MoU) and the corresponding Precautionary Loan Facility Agreement (PLFA). The parties will conclude and sign the PLFA, containing the main terms and conditions applicable to all the potential disbursements within the precautionary EU financial assistance programme, but any disbursement would be subject to the activation of the facility. The Commission will decide, after having consulted the EFC, on the activation of the programme and on the amount to be made available within the EUR 2 billion ceiling for disbursements in the form of instalments.

3. Precautionary EU financial assistance is made available for activation following the request of Romania for a support programme continuing the previous precautionary BoP facility of EUR 1.4 billion.⁽³⁴⁾

⁽³³⁾ Council Decision 2013/531/EU of 22 October 2013 (OJ L286 of 29.10.2013).

⁽³⁴⁾ Council Decision 2011/288/EU of 12 May 2011 (OJ L132 of 19.5.2011).

4. Activation of the precautionary assistance, and the subsequent provision of loan instalments, shall also be conditional on a positive assessment by the Commission of the implementation of the economic reform programme of the Romanian Government at six-monthly intervals. Specific economic policy criteria will be attached to these reviews. A detailed description of those criteria is given in Annex 1 of the MoU. The overall objectives of the programme are the following:

A: Fiscal consolidation

Following the correction of its excessive deficit, Romania is expected to reduce its structural budget balance by at least 0.5% per year until it reaches its medium-term objective of a structural general government deficit of 1% of GDP by 2015, and maintain it thereafter. Furthermore, the programme will continue efforts to prevent a new build-up of government arrears, both at central and local government level. The public sector wage bill will need to stay on a sustainable footing, limiting wage growth as well as public sector employment levels.

B: Fiscal governance and structural fiscal reform

The programme will support the Romanian government to further strengthen the fiscal governance framework. This will ensure that fiscal consolidation is politically and institutionally anchored. The implementation of the Fiscal Compact is crucial in this respect. The Fiscal Council scrutinises fiscal policy. Improvements in multi-annual budgetary planning will ensure a more sustainable fiscal policy.

Fiscal governance will strongly benefit from on-going Technical Assistance provided by the IMF and the World Bank in the area of Public Financial Management and Control. The implementation of a commitment control system, which will be rolled out in several steps, will ensure the reduction and control of arrears. In the health sector, budget control mechanisms will be strengthened through improved reporting and monitoring frameworks, in particular with regard to hospitals and pharmaceutical spending in order to avoid a re-accumulation of payment arrears. Prioritisation of public investments will be strengthened, to enhance the country's growth potential.

C: Public debt management

The authorities will carry out necessary steps to improve public debt management with a view on reducing risks and building up the yield curve for sovereign debt.

D: Financial sector regulation and supervision

In the financial sector, authorities will continue upgrading the bank resolution framework and the legislation on the Deposit Guarantee Fund by amending GO 39/1996 and GEO 99/2006. To speed up the process of balance sheet cleaning, the National Bank of Romania (NBR) has clarified the provisions applicable to the write-off of loans with the Romanian Banking Association and will produce a comprehensive analysis of the asset quality in the banking sector. In order to further develop the capital market and diversify the sources of funding for banks, authorities will amend the covered bonds legislation. Preserving credit discipline and avoiding moral hazard among debtors contributes significantly to enhancing financial stability. Therefore, the government will continue refraining from adopting legislative initiatives (such as the personal insolvency law) and promoting provisions in the debt collection law, which would undermine credit discipline. Authorities will consult extensively with all relevant stakeholders, having in view also the impact assessment finalised by the NBR, on the new provisions on abusive clauses in the law for the application of the civil procedure code and will ensure that court cases involving abusive clauses are dealt with by higher ranking courts or by a unique specialised court and will take all other necessary measures to ensure a harmonised application of these provisions. To strengthen the supervision of the non-bank financial market and foster consumer protection, authorities will ensure that the legislation on the integrated non-bank financial regulator, the

Financial Supervisory Authority/Autoritatea de Supraveghere Financiară (FSA/ASF), will be amended to comply with international best practices.

E: Structural reforms

The structural reforms aim at improving market functioning, at increasing resilience to external shocks and at strengthening Romania's long-run growth potential. The structural reform agenda of this programme covers part of the country-specific recommendations addressed to Romania in the context of the European Semester. This agenda does not exempt the Romanian government from fully implementing the country-specific recommendations of the EU semester which are not covered in this programme.

The restructuring of state-owned enterprises (SOEs), including privatisation, will be stepped up in order to reduce risks to the general government budget from accumulated arrears and operational losses, while increasing the financial viability of most of these companies' operations. Authorities will take measures to strengthen corporate governance of SOEs, including in the financial sector.

In the energy sector outstanding measures agreed under the two previous programmes will be implemented, among which the implementation of the roadmaps for the gas and electricity market liberalisation.

One of the cornerstones of this programme is the enhancement of the efficiency and effectiveness of the country's public administration. Moreover, the Romanian authorities would be invited to report every six months to the Economic and Financial Committee (EFC)/Economic Policy Committee (EPC) on the progress made in this area.

Improvement of the business environment and facilitating access to finance for the small and medium-size enterprises (SMEs) is another important pillar of the structural reform agenda of the programme. The programme aims at reducing administrative burden for the SMEs, facilitating their access to bank and equity capital, reducing the legal uncertainty by improving the land and property registration and supporting SMEs when going abroad. Furthermore, the programme supports the reform of the regulatory framework related to innovation, with the view to attract foreign direct investment in research and innovation activities.

In the field of labour markets, the programme supports the completion of the 2010 pension reform by equalising the pensionable age for men and women.

F: Monetary Policy

Monetary policy will remain geared towards price stability with a view to inflation staying within the National Bank of Romania's inflation target band (2.5% \pm 1 percentage point).

5. In case Romania requests the activation of the European Union (EU) assistance to cope with the emergence of an acute financing gap, the Romanian Government shall make this request in writing to the Commission. Any such request for activation, as well as any request for disbursement, is to be made no later than 30 September 2015. The Commission will assess financing needs in close co-operation with the International Monetary Fund (IMF). After the EFC has delivered its opinion, the Commission shall decide on the amount to be made available for disbursement in the form of instalments. The funds of the overall programme will be made available in a maximum of 2 instalments.

6. Any changes in conditionality will be specified in a supplement to this MoU (Supplemental Memorandum of Understanding).

7. In case a disbursement has taken place, the EFC shall be kept informed by the Commission of possible refinancing of the borrowings or restructuring of the financial conditions.

8. If Romania requests the disbursement of an instalment under the PLFA and such a disbursement takes place, the European Central Bank shall act as an agent to the Commission and shall transfer the proceeds of the loan to a euro account of the Ministry of Public Finance of Romania (the Treasury), held at the NBR, that will act as an agent for Romania.

9. The updates to the Romanian Convergence Programme and the Romanian National Reform Programme under the EU 2020 Strategy shall reflect and be fully in line with the objectives and actions required under the economic reform programme committed by the Romanian Government for the purposes of this EU assistance. While the balance-of-payments programme comprises specific actions that fall under the EU Council's country-specific recommendations, it does not in any way substitute for other actions covered by the country-specific recommendations to which Romania is expected to provide adequate follow-up.

10. The Ministry of Public Finance shall retain a special account with the NBR for the management of the European Union's financial assistance. This special account will be a sub-account of the euro-account of the Ministry of Public Finance within the NBR.

11. During the availability period of the assistance, the Romanian authorities shall make available to the Commission without delay all the relevant information for the monitoring of its economic and financial situation and for the assessment of progress in economic conditions and reform measures as specified in the Technical Memorandum of Understanding negotiated with the authorities and submitted by the latter together with their Letter of Intent (LoI) and the Memorandum of Economic and Financial Policies (MEFP). Prior to the acceptance of the disbursement of any instalment, there will be a compliance report by the Commission, the favourable outcome of which is a precondition for each of the instalments.

12. Investigation and satisfactory treatment of any suspected and actual cases of fraud, corruption or any other illegal activity in relation to the management of the EU financial assistance shall be ensured. All such cases, as well as measures related thereto taken by national competent authorities, shall be reported to the Commission without delay.

13. Without prejudice to Article 27 of the Statute of the European System of Central Banks and of the European Central Bank, the European Court of Auditors shall have the right to carry out any financial controls or audits in Romania that it considers necessary in relation to the management of this assistance. The Commission, including the European Anti-Fraud Office, shall thus have the right to send its own officials or duly authorised representatives to carry out technical or financial controls or audits that it considers necessary in Romania in relation to the assistance.

14. An independent ex-post evaluation of the assistance may be carried out by the Commission or its duly authorised representatives. The Romanian authorities are committed to supply relevant information for the evaluation. The draft evaluation report will be made available to them for comments.

15. The Romanian authorities will ensure, as appropriate, close co-operation with the Commission and the EFC.

16. The Romanian authorities commit to consult Commission staff before adopting new measures that may have implications for the objectives of the programme. In particular, they will consult in a timely manner and provide all necessary information regarding any measures and reforms that may have an impact on fiscal developments. The Romanian authorities will also consult the ECB on any draft

legislative provision in its fields of competence, as stipulated in Articles 127 (4) and 282 (5) of the Treaty on the Functioning of the European Union.

17. The Annexes form an integral part of this Memorandum of Understanding.
18. All notices in relation with the Memorandum shall validly be given if in writing and sent to:

For the European Union

European Commission

Directorate General for Economic and Financial Affairs, B-1049 Brussels

Fax No.: +32 2 299 35 23

For the Prime Minister

Prime Minister's Office

1, Piața Victoriei, Sector 1, 011791 Bucharest

Fax No.: +40 21 319 15 88

For the Ministry of Public Finance of Romania

Ministry of Public Finance of Romania

17, Strada Apolodor, Sector 5, 050741 Bucharest

Fax No.: +40 21 312 16 30

For the National Bank of Romania

National Bank of Romania

25, Strada Lipscani, Sector 3, 030031 Bucharest

Fax No.: +40 21 312 62 60

19. For Romania, the MoU shall become effective after completion of internal procedures required under the Laws of Romania. The MoU may be amended upon mutual agreement of the parties in the form of a Supplement. Any such supplement will be an integral part of the MoU and become effective according to the same procedures as the MoU.

Done in Brussels on 6.11.2013 and in Bucharest on 5.11.2013 in five originals in the English language.

ROMANIA

Represented by

Victor-Viorel Ponta

The Prime Minister

EUROPEAN UNION

Represented by

EUROPEAN COMMISSION

Olli Rehn

Vice-President of the European Commission

Daniel Chițoiu

Deputy Prime Minister and Minister of Public
Finance

Liviu Voinea

Minister Delegate for Budget

Mugur Isărescu

Governor of the National Bank of Romania

Annex 1 to the MoU: Specific Economic Policy Criteria

A. Fiscal consolidation

No. Measures

- 1 Continue fiscal consolidation towards the achievement of the medium term objective of a structural deficit of 1% of GDP by 2015 and respect this thereafter, in line with Stability and Growth Pact requirements.

B: Fiscal governance and structural fiscal reform

No. Measures

- 2 Preserve the achievements of the previous two programmes, implement the further measures agreed under those programmes, and fulfil any remaining parts of yet unfulfilled conditionality. This applies in particular to: i) the Unified Wage Law (and the related suppression of the "stimulente"); ii) the medium-term sustainability of the public sector wage bill; iii) the pension reform; and iv) the reduction of payment delays in the health sector.
- 3 Strengthen the fiscal governance framework. Ensure the implementation and enforcement of the Fiscal Compact provisions, as well as adherence to best practice in terms of fiscal governance. Strengthen the Fiscal Council's capacity to contribute to the improvement of fiscal policy. Increase its role in assessing and publishing revenue projections after each macroeconomic forecast round (autumn and spring) and in the calculation of the deficit target ahead of the start of the budgeting process and the publication of its opinion thereon.
- 4 Further strengthen multi-annual budgetary planning. Improve the content of the Fiscal Strategy, inter alia by increasing transparency regarding assumptions and including an analysis of fiscal risks and liabilities. Ensure that the line ministers are involved in the medium-term budget planning process, by designing and implementing procedures for internal coordination arrangements. Improve the database for budget planning. Increase the capacity of the Ministry of Public Finance to estimate the structural deficit and the structural impact of measures. In order to comply with existing fiscal rules, strengthen the capacity to perform fiscal impact assessments of legislative proposals, and improve the impact assessment's quality and binding nature.
- 5 Improve the prioritisation of public investments, the enforcement of consistency of capital spending with budget envelopes and the alignment of investment planning with multi-annual budgetary planning. Set up a list of prioritised investments based on a sound cost/benefit analysis at central government level. Strengthen the Ministry of Public Finance (MoPF) with respect to the staffing of its Public Investment Evaluation Unit and to its role in project selection to enable it to guide the prioritisation and selection of investment projects. A milestone will be the government's approval of an updated list of priority investments before the end of 2013.
- 6 Establish an effective commitment control system for all levels of government in order to control overall expenditure and prevent the accumulation of payment arrears. The commitment control system will cover expenditures on goods and services as well as investments. A crucial milestone on this path is the rollout of the web based application at the MoPF and at least one additional unit at both the central and local government levels by end-January 2014.

No. Measures

- 7 Establish a regular flow of fiscally-relevant data to the Ministry of Public Finance. A protocol will be set up, also to guide reporting obligations to the European Commission (Commission) and the International Monetary Fund.
- 8 Improve tax collection by implementing a comprehensive tax compliance strategy, in line with the respective World Bank project. In particular, define a services catalogue for the taxpayers by July 2014. Further, improve the VAT reimbursement procedure by reviewing the criteria for ex-ante control, increase the e-filing rate for the tax returns for companies from 89% to 93% and improve the filing compliance by mid-2015.
- 9 Reduce arrears for state-owned enterprises through restructuring to be undertaken in line with the EU state aid rules and prevention of future losses. In particular, reduce the stock of outstanding payments not made by due date of SOEs owned by the central government from 8.2 bn lei at end-June 2013 to 5.6 bn lei at end-December 2013, as specified in the Technical Memorandum of Understanding. Also, all SOEs should file, in accordance with existing regulations, quarterly financial information with the Ministry of Public Finance by the 25th day following quarter end.

C: Public debt management

No. Measures

- 10 Update and publish, before end-March, the public debt management strategy (DMS) and the auction calendar on yearly basis, as well as quarterly announcement of the government securities auctions with indicative volumes by debt instruments (T-bills and bonds). The DMS should detail instruments, maturities, auction frequency that would be adherent to the maturity extension, risk management and cash buffer targets. It should also include a plan to improve cash management.
- 11 Continue to consolidate the financing buffer to protect against unforeseen external shocks at a level covering a number of months of gross financing. For 2013 this will cover four months of gross financing needs.
- 12 Finalise, by end-March 2014, the electronic auction system for domestic primary issuances (with the National Bank of Romania (NBR) acting as the agent of the MoPF).
- 13 Introduce, by end-September 2014, an electronic trading platform to monitor transactions in the secondary market.
- 14 In line with the measures considered in the DMS to increase the transparency and predictability of the government securities market, the MoPF should organise, as of end-2013, quarterly consultations with primary dealers, mutual funds, pension funds, and life insurance companies as well as quarterly conference calls with the international investor community and non-deal road shows.
- 15 Enlarge, as of end-2013, the investor base and facilitate the access of individuals to government securities.
- 16 To support a benchmark building strategy and increase the liquidity of the domestic government securities market, the MoPF will establish, by end-September 2014, the legal, procedural and operational framework necessary to carry out buybacks, bond exchanges, and

No. Measures

repo operations.

- 17 Establish, by end-2014, involvement of the Treasury in a central counterparty (CCP) clearing house.

D: Financial sector regulation and supervision**No. Measures**

- 18 Corporate governance of the Deposit Guarantee Fund in the Banking System will be strengthened, in particular to avoid any perceived conflict of interest for board members and executive directors. Furthermore, authorities will amend the provisions of Government Emergency Ordinance (GEO) 99/2006 on stabilisation measures and Government Ordinance (GO) 39/1996 after consultation with the Commission on the interpretation of the new EU state aid rules by end-2013 in line with CRD IV implementation deadline. Subsequently to the amendments to the banking law, the NBR will amend the internal procedures for bridge-banks by end-2013. The NBR will also continue updating its contingency planning on an on-going basis as well as the bank-by-bank contingency plans.
- 19 To speed up the process of balance sheet cleaning, the NBR has clarified with the Romanian Banking Association that the only provisions in place for the write-off of loans are those foreseen in the IAS 39 on the de-recognition of financial assets and which do not necessarily request banks "to exhaust all legal means" in order to write off. Any amendments to the current treatment of the prudential filters will be agreed with the Commission and the IMF. Furthermore, authorities will finalise by end-December 2013 an impact assessment on the fiscal cost resulting from the tax deductibility of sales of intra-group bank receivables.
- 20 The NBR will continue to closely monitor bank practices to avoid evergreening as well as the assessment of credit risk of restructured loans, so that they remain prudent and in line with good international practices. The NBR has collected supervisory data on restructured loans, including loans to SOEs, on a quarterly basis by end-September 2013. The NBR will conduct a comprehensive analysis of the asset quality in the banking sector and produce a report containing granular information, migration matrixes and a vintage analysis of the banks' non-performing loans (NPLs) by end-October 2013.
- 21 The NBR will perform by end-December 2013 on-site inspections on a selected sample of 20 large, medium and small-sized banks focused on the strategies of banks to deal with impaired assets. These inspections will cover the following aspects: (i) the adequacy of IT systems to deal with impaired assets; (ii) the NPL work-out strategies of banks; (iii) the restructuring/rescheduling policies applied by banks. The analysis of the banks' IT adequacy will be finalised by end-2013. In a second phase, on-site inspections in the remaining banks will take place until end-March 2014. In consultation with the Commission and the IMF, an NPL resolution action plan will then be agreed by end-May 2014.
- 22 In order to further develop the capital market and diversify the sources of funding for banks, authorities will adopt the amendments to the covered bonds legislation by end-2013 through Government Ordinance, while appropriate safeguards to preserve financial stability are implemented. Any possible prolongation of the "Prima Casa" programme after its expiry should be restricted to mortgage lending denominated in RON. This will help develop a pool of long-term assets denominated in RON thereby fostering covered bonds issuances denominated

No. Measures

in domestic currency.

- 23 As preserving credit discipline and avoiding moral hazard among debtors contributes significantly towards enhancing financial stability, authorities 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. Furthermore, in order to avoid threats to financial stability, authorities will consult extensively with all relevant stakeholders, having in view also the impact assessment finalised by the NBR, on the new provisions on abusive clauses in the law for the application of the civil procedure code. Authorities will ensure that court cases involving abusive clauses are dealt with by higher ranking courts or by a unique specialised court and will take all other necessary measures to ensure a harmonised application of these provisions, such as training of judges. Moreover, as corporate insolvencies are increasingly fuelling the still on-going deterioration in asset quality, the NBR together with the Romanian Banking Association will explore possibilities for setting up a database of shareholders of companies in insolvency as well as implement more effective data reporting of the Association of Insolvency Practitioners.
- 24 To strengthen the supervision of the non-bank financial market and foster consumer protection, authorities will ensure that the legislation on the ASF/FSA (Autoritatea de Supraveghere Financiară/Financial Supervisory Authority), will be amended by end-September 2013 to comply with international best practices, in particular regarding the size of the managing and council board which should be restricted to maximum 9 members, minimum required professional qualifications of ASF board members, statutory protection of supervisory staff and of the institution as well as avoidance of conflicts of interest, notably the connection of these members with Parliament. Furthermore, the ASF: (i) will swiftly complete the integration of the former three supervisory authorities for securities, insurance and pensions while ensuring the smoothing functioning of supervisory activities; (ii) will develop a human resources policy geared first and foremost towards qualified staff to perform on-site supervision, off-site analysis, validation of internal models; (iii) will further enhance transparency and public accountability by ensuring an adequate public disclosure of all fees and commissions charged to the supervised entities; and (iv) will hire, in September 2013, a professional and independent consultancy company to assess staffing levels and staff. Based on this, within two months of the consultancy company's assessment, an action plan will be developed to streamline the ASF with a view to realising the savings in 2014.
- 25 The authorities will swiftly implement the World Bank recommendations on the ROSC (Report on the Observance of Standards and Codes), and following the comprehensive public consultation in September 2013 as well as with the Commission, the IMF and the World Bank, will send the amended insolvency code draft for approval to parliament by end-October 2013. All relevant stakeholders will be consulted before the insolvency code is approved by parliament.

E: Structural reforms

No Measures

Administrative capacity

- 26 Implement the Action Plans adopted in response to the findings of the functional reviews carried out in 2010-2011 in a timely manner. Continue to report on their implementation on a

No Measures

quarterly basis. Review and update the action plans by end-2013.

- 27 Establish a central delivery unit in line with the World Bank project by December 2013 to improve the government-wide policy prioritisation, implementation and coordination with particular reference to the implementation of the EU Council's country-specific recommendations not covered in this assistance programme.

Product markets

- 28 Preserve the achievements of previous two programmes and implement outstanding measures agreed under those programmes:

- continue the implementation of the roadmaps for gas and electricity market liberalisation. Complete deregulation of electricity prices for non-residential consumers by 1 January 2014. For households, implement the deregulation steps for electricity prices in January and July 2014 and in January and July 2015, as set out in the electricity roadmap, with the share of electricity acquired from competitive market reaching 50%. For natural gas, continue price deregulation as planned in the gas roadmap with intermediary steps to be taken in October 2013, January, April, July and October 2014. If necessary, continue gas price liberalisation for non-residential consumers in 2015 as to achieve full price deregulation by end 2015. For residential consumers, continue gas price deregulation in 2015 with intermediary steps taken in January, April, July 2015 by which 52% of gas price convergence with the market should be achieved. Allow the pass-through mechanism for electricity and gas purchases by the supply companies to be applied.

- continue the development of gas and electricity trading platforms;

- continue the unbundling of energy transmission and dispatch operators;

- improve cross-border integration of energy networks and provide for security-of-supply measures.

Preserve the achievements of the previous two programmes and implement outstanding policy commitments in the transport area:

- introduce performance schemes related to delays between the infrastructure company, on the one hand, and the passenger/freight companies, on the other hand, by end-2013;

- introduce incentives for infrastructure manager to reduce unit costs and charges in CFR Infrastructure by end-2013;

- facilitate improved payment of infrastructure access and electricity charges from the state-owned passenger rail company (CFR Calatori) and CFR Marfa through reforms of those enterprises and settle outstanding debts among the three main railway companies;

- further amend the formula for calculation of the PSO to give more weight to passenger-train kilometers travelled starting in January 2014.

Business environment

No	Measures
29	Bring the national "Better regulation strategy" in line with the EU smart regulation agenda by making impact assessments of the new legislation related to business activities obligatory by end-2013. Develop a common methodology for impact assessments including the "SME test" and establish a quality control mechanism by mid-2014. Implement pilot projects in four selected ministries by end-2014.
30	Further reduce administrative burdens on SMEs by: (i) making online submission and payment of taxes fully operational by mid-2014; and (ii) simplifying procedures regarding property registration and construction permits through a reduction of 25% before end-2013 of the information obligation procedures and through making electronic submission possible by mid-2014. To reduce delays, introduce standard deadlines and automatic approval after the deadline by mid-2014. To ensure that information submitted once to the administration is not requested again by another service, introduce data sharing within the e-government system by end-2014. Streamline the "one-stop shop" and the "point of single contact" into fully-operational and interconnected electronic platforms with a single entry point.
31	Increase the number of properties registered in the digitalised national land registry from currently 15% to 25% by mid-2015. To this end: (i) by end-2013, amend the law on the cadastre to allow for simplified procedures for systematic registrations in particular by using public display as quality control; (ii) find appropriate arrangements for a swift resolution of undebated inheritance cases; (iii) strengthen project management capacities of the national agency for the cadastre and land registry by mid-2014 with the view to implement the multi-annual land registration project; and (iv) increase the number of solved land disputes per year by 10% by end-2014 including through out-of-court dispute resolutions. For concession and leasing contracts related to the state domain make land and property registration compulsory prior to contract signature.
32	By end-2013, adopt a law on inventions by employees so as to encourage investment, in particular from private sources, in patenting activities. By end-2014, provide guidelines, in line with international best practices, including on the distribution of benefits arising from the commercial exploitation of the invention.
33	To improve access to finance for SMEs, extend the duration of the Mihail Kogălnicianu programme beyond 2013 to a multi-annual programme and strengthen the existing support schemes by rendering the National Loan Guarantee fund for SMEs more effective, especially as regards the maturity, price, and rollovers of the guaranteed loans, as well as the implementation process for the guarantee execution. Together with the Romanian Banking Association, introduce minimum transparency standards defining a minimum set of information regarding bank-lending conditions, to be published by banks by mid-2014. Strengthen services, including those related to access to finance that are provided by the SME territorial offices by increasing the number of assisted companies from 2013 to 2014 by 20%. To diversify sources of SME financing, adopt legislation on equity financing with risk sharing options, in particular as regards venture capital and business angels by mid-2014.
34	Improve export promotion and development for SMEs by starting a "passport-to-exports" scheme by mid-2014 and by making fully operational the pilot regional export centres by end-2014. Reinforce the electronic trade portal and improve the effectiveness of the trade counsellor schemes outside Romania with 30% more companies assisted in 2014 than in 2013.

No Measures**Labour markets and pensions**

- 35 Preserve the achievements of the previous two programmes, in particular by monitoring the implementation of the Labour Code and Social Dialogue Code and ensuring that any further amendment to labour legislation will be undertaken in consultation with all stakeholders through ordinary legislative procedures.
- 36 Considering the funding needs of the healthcare system and the possible need to adjust health insurance contributions, conduct a comprehensive review of labour taxation with a view to reducing, in a budget-neutral manner, the effective tax burden on labour for low- and middle-income earners. To this end, a study will be submitted for review by end-2013, detailing the tax policy reform options and plans for their implementation.
- 37 Enact the necessary legislation before end-2013 to equalise the pensionable age for men and women, by increasing the pensionable age for women from 63 to 65 years by the year 2035.

State-owned enterprises

- 38 Continue the corporate governance reform of state-owned enterprises (SOEs). Strengthen Ministry of Public Finance capacities to monitor operating performance and budgets of SOEs and prepare high-quality assessments of SOE performance on an annual basis. The Fiscal Council plans a report on the operations of SOEs and their fiscal implications. All SOEs should submit their 2014 budgets one month after the approval of the state budget. Improve the operating performance of the largest railway companies and their subsidiaries (CFR Infrastructura, CFR Calatori, and CFR Marfa) so as to ensure that arrears clearance measures are complemented by reforms that improve the viability of these companies. The cumulative operating loss should not be larger than 2.3 bn lei by end-December 2013, as specified in the Technical Memorandum of Understanding.
- Appoint a supervisory board by end-November 2013 for Hidroelectrica in accordance with GEO 109/2011 (SOE Corporate Governance law).
- 39 Ensure the sale of stakes in Romgaz, Hidroelectrica, Oltenia, Nuclearelectrica, Electrica and CFR Marfa as specified in the Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU).
- 40 By end-June 2014, the government will, in agreement with the Commission, adopt legislation to regulate the remunerations obtained by public employees for attending privatisation commissions and for positions on boards of SOEs.

Healthcare sector

- 41 The authorities are to consult in a timely manner with Commission staff and provide all necessary information regarding any proposals for legislative amendments that may have material impact on the fiscal sustainability or efficiency of the healthcare sector. The authorities will start early consultations to ensure a timely implementation of the legislative process.

No	Measures
42	Preserve the achievements of the previous programmes and continue implementing outstanding measures, in particular but not exclusively with reference to: i) clearing arrears in the health sector; ii) preserving budget control mechanisms (such as the claw-back tax on pharmaceuticals and monthly hospital budget reporting); and iii) implementing e-health solutions.
43	Define, by end-September 2013, the publicly-reimbursable basic benefits package based on objective, verifiable criteria, to be financed within the limitations of available funding and establish the framework for a private supplementary insurance market aiming at increasing the share of private in total expenditure on health. As of 2015, the revision of the basic benefits package will be based on a cost-effectiveness analysis.
44	The authorities will prepare a comprehensive health strategy covering also the revenue side together with the MoPF by end-2013.
45	Improve efficiency and effectiveness in the healthcare system. This will be done by shifting resources from hospital-based care towards primary care and ambulatory care and by continuing the reduction of bed capacity in in-patient acute care hospitals in accordance with the national health strategy. Also, the budget for primary care will be increased via use of performance based payments to at least 10% of public health expenditure managed by the health house within the next 2 years.
46	Implement according to the deadlines the binding action plan for health care reform as committed to by the authorities, specifying the plan with measureable indicators, objectives and publishing supporting evidence and impact assessments of the reform proposals.
47	Continue the preparation of the reorganisation and rationalisation of the hospital network based on the government's project financed by the World Bank for health sector reform, slated for Board Approval by end-2013. This includes streamlining hospital services, shifting the delivery of health services to outpatient services, building physical and functional integrated referral networks, including regional hospitals, and the referral system that surrounds them from primary health to post-hospital care as well as patient pathways in the health system.

F: Monetary policy

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

Price stability and reserve management

No.	Measures
48	Monetary policy should remain geared towards price stability and the achievement of the NBR's inflation target (central point 2.5% with a band of ± 1 percentage point by end-2013, as of 2014, a continuous central point of 2.5% with a band of ± 1 percentage point). The NBR will conduct discussions with Commission staff should the observed year-on-year rate on consumer-price index (CPI) inflation fall outside the bands specified in the Technical Memorandum of Understanding.

- 49 Authorities to confer with Commission staff if reserve losses exceed EUR 600 million in any given day.

A4.2. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES⁽³⁵⁾

Recent Economic Developments and Outlook

1. Economic growth picked up in early 2013 with real GDP growth of 0.6 percent (qoq) in 2013:Q1 driven by a sharp turnaround in net exports while domestic demand remained weak. Exports were supported by a pick-up in sales of machinery and transportation equipment and greater external demand including from non-EU countries. At the same time, a fall in investment and a relatively mild winter contributed to a decline in imports, in particular of energy. Inflation has begun to ease as expected after headline inflation peaked at 6 percent in January 2013 on the back of volatile food prices and administered price hikes. As the effects of these shocks dissipated, inflation came down to around 4.4 percent in July. Annual core inflation has also fallen from 3.3 percent at end-2012 to 2.5 percent at the end of July. In June 2013, we also exited the EU Excessive Deficit Procedure.

2. We expect annual growth of around 2 percent for 2013 driven by net exports and a return to a normal agriculture harvest following last year's drought. Inflation is projected to drop sharply and reenter the central bank's target band by September, largely due to favorable base effects. The current account deficit is expected to improve significantly to around 2 percent of GDP from 3.9 percent of GDP in 2012 as a pick-up in imports and a moderation in exports reverses the positive current account balance recorded in the first five months of the year. Risks to the economic outlook are broadly balanced. The agriculture harvest could be better than expected, but Romania remains vulnerable to adverse developments in international markets and low growth in the euro area. Prudent policy implementation will thus be crucial in maintaining confidence and securing policy buffers.

Fiscal Policy

3. In 2013, the fiscal deficit target of 2.3 percent of GDP (in cash terms, including PNDI) will be preserved, consistent with ESA deficit target of 2.4 percent of GDP. This would imply a reduction in the ESA structural deficit by at least 0.5 percent of GDP in line with the commitments under the EU's Stability and Growth Pact (SGP). In the first half of the year, the deficit reached 1.1 percent of GDP, in line with projections. However, revenues have underperformed primarily reflecting bank losses, declining imports and increase in VAT export refunds. The revenue shortfalls have been largely offset by lower than expected social transfers and spending on EU corrections. While reimbursable spending on EU funded projects remains low, spending on national cofinancing and net lending for EU projects is in line with projections. Arrears have continued to decline at the local government level, but has started to rise again in the central government level.

4. Given the weak revenues and increasing spending pressures, we are undertaking several measures to achieve the deficit target. Public employment has been kept broadly stable as we have now removed the 1 for 7 rule and introduced a 1 for 1 rule while restructuring public administration. In June, we approved Government Emergency Ordinance 77/2013 eliminating the vacancies in public employment while maintaining a tight control on new hires and shifting employment from the central towards local governments. Nevertheless, current expenditures remain under pressure as agricultural subsidies have been frontloaded and goods and services spending has increased even as the implementation of the Payments Directive 7, shortening the settling of unpaid bills in the pharmaceutical sector, has been postponed from June to August. In addition, we have approved an Government Emergency Ordinance 42/2013 increasing the Guaranteed Minimum Income and family allowances, and increased eligibility thresholds and we also plan to simplify the asset test for these benefits to mitigate the impact of gas and energy price liberalization. Furthermore, we extended by three years the existing legislation to provide a top-up to unemployment benefits for some SOE layoffs and have so far provided

⁽³⁵⁾ As completed on 12 September 2015.

the benefit to one large SOE. Spending commitments at the local government level is also on the rise as shown by increasing overdue bills. We are also reducing the VAT on bread and the production chain from September. To offset the revenue loss, we will increase excises on alcohol and luxury cars and goods. Unspent allocations for EU funds corrections will provide some savings while further cuts in domestically financed capital spending will also be needed. Moreover, all unexecuted contracts for PNFI projects have been cancelled while projects executed under the PNFI have been folded within the budget. An independent audit of the projects committed under the PNFI program will be conducted to ensure that they are properly executed and invoiced. In the event of lower than forecasted revenues, the government remains committed to achieving the annual deficit target.

5. For 2014, we will continue the gradual adjustment process and prepare a budget consistent with a headline deficit target of 2.0 percent of GDP in ESA terms, in line with our commitments under the SGP, and 2.0 percent of GDP in cash terms. Starting January 1, 2014, the second step of the planned increase of the Guaranteed Minimum Income will be implemented. We also plan to issue the regulation on the district heating program in September including the new asset test parameters and an additional benefit for the poorest households. To compensate for these measures, we will explore revenue measures, including on property taxes. We will also assess reforms in the social security contributions to widen the base.

6. In order to lock in the benefits of the adjustment efforts, we will undertake efforts to strengthen fiscal institutions. Key areas of reforms will include:

7. **Fiscal Compact and medium-term budget:** In compliance with the EU fiscal governance requirements, we will seek to improve the Fiscal Responsibility Law to integrate structural fiscal targets and corrective actions in case of deviations. We will seek to target a structural effort of ½ percent of GDP until a Medium-Term Budgetary Objective (MTO) of a structural general government deficit of 1 percent of GDP deficit is reached. Under this path, we expect to reach the MTO by 2015. We will also seek to shift to a medium-term budgetary framework.

8. **Public financial management:** We will seek to advance the reforms currently underway with the goal of improving the fiscal reporting system, preventing arrears, and better managing fiscal risks.

- To ensure that arrears are brought fully under control, especially at the local government level, we will publish monthly arrears reports and corrective measures being taken by the central and local governments, by unit, on a quarterly basis from end-September 2013 (structural benchmark). We will seek to maintain arrears for the central and local governments at a low level consistent with the targets under the program. The Court of Accounts shall submit a schedule of audits of the disputed invoices presented to the local governments (360 million lei) with the objective of preparing the first quarterly progress report on the status of the findings by mid-November 2013. We will evaluate the possibility of central government transfers to local government units to cover the unpaid bills that represent valid liabilities of the government as verified by the Central Harmonization Unit for Financial Management and Control Systems, which in turn will be used to cover the suppliers' tax payables. In such cases, the central government will undertake stricter control of the local government unit's total spending, consistent with Government Emergency Ordinance 46/2013.
- We have made progress in the implementation of the commitment control system. We have put in place a manual commitment control for new investments for local governments. We will approve a government ordinance to provide standard definitions of commitments (prior action) so that the commitment control system under development, supported by necessary legal and procedural changes, will be fully operational and cover expenditures of the MoPF and at least one additional unit at both the central and local government levels by end-January 2014 (structural benchmark) and fully operational for all general government entities by end-June 2014 (structural benchmark).

- The consolidated fiscal reporting system would be rolled out to all government entities by June 2014 (structural benchmark) and will run in parallel with the existing system until the end of 2014. Consolidated general government accrual based financial statements and ESA95 based reports will be prepared from the system and published from June 2015 (the first sets of reports will be for the year ended December 31, 2014), be reconciled with each other and with cash-based budget execution reports (structural benchmark).
- To improve fiscal transparency and ensure more consistency with ESA, we will request that the IMF undertake a fiscal transparency assessment. We will provide the fiscal data required to transition fully to GFSM 2001 for the 2014 budget.
- By end-2013, a report on fiscal risks will be published as part of the annual budget. This will commence with the 2014 budget. The report will take into account risks, including those related to contingent liabilities, the debt composition, the banking system, all PPPs, and all SOEs.

9. **EU funds absorption and public investment planning:** A key priority of the government is to improve budgetary planning and project prioritization to increase absorption of EU funds with a view to creating fiscal space and supporting economic growth.

- Improved prioritization of capital projects shifting funding away from domestic resources towards EU sources would help improve the fiscal deficit while increasing EU absorption. We will staff the Public Investment Evaluation Unit at the Ministry of Public Finance by end-September 2013 and make it functional with the support of the World Bank. This office will help strengthen quality control in the preparation, prioritization, appraisal and management of significant new public investment projects. We will approve a government ordinance defining the prioritization criteria for public investment projects (prior action). By mid-October 2013, we will approve, by government memorandum, a list of significant prioritized projects, based on the prioritization criteria, to help prepare for the 2014 budget (structural benchmark) and the 2014-2020 EU Financial Perspective. To the extent possible, we will seek to shift the projects that need cofinancing of local government projects onto EU funded projects. To this end, we will update and improve the database of prioritized investment projects for the central government and local government projects financed by the central government and the EU funds over the medium term and publish the list of projects included in the budget on the website together with their rolling three year budgetary allocations. From 2014, no new significant public investment project financed by the central administration will be approved without first vetting by the Public Investment Evaluation and Monitoring Unit. We will prepare by mid-October 2013 an implementation mechanism to vet eligibility for EU funding as part of our medium-term budget planning.
- As the managing authorities seek to ramp up spending, better budgetary planning will be necessary to accommodate higher co-financing and needed financial corrections. We will prepare medium-term financial projections, by mid-October 2013, that properly identifies the fiscal implications of EU funded projects (structural benchmark) and allows proper monitoring of the spending on EU funded projects by managing authorities. To allow greater flexibility in financing of EU funded projects given lags in reimbursement, net lending of EU structural and cohesion fund projects will be provided within a ceiling on net lending of 3 billion lei (set as an indicative target). We will ensure that spending on non-eligible projects is limited to 2 billion RON. We will continue to implement fully the Priority Action Plan for the absorption of Structural and Cohesion Funds.
- Before contracting public-private partnerships (PPPs) and issuing guarantees for PPPs and concessions, the World Bank will assess MoPF capacity to (1) provide inputs to the PM/Line ministries unit to develop a methodology for identifying and evaluating fiscal commitment to PPPs, (2) assess the affordability of PPP fiscal commitment as an input to approval of any initiative, and (3)

develop guidelines for incorporating PPP project in decision-making at the level of MoPF at various stages of PPP project life cycle (identification, preparation, bidding, implementation).

10. **Unified Wage Law and functional reviews:** We will ensure the sustainability of the public wage bill and implement a more efficient and equitable public sector. Towards this objective, we will seek to implement the Unified Public Wage Law within the available budgetary envelope. We commit not to introduce a stimulative regime in any government agency and we will amend Government Emergency Ordinance 74/2013 to remove the stimulative in ANAF. We have approved Government Emergency Ordinance 77/2013 that seeks to reorient public administration towards the local governments. Staffing plans for each of the line ministries will be developed in line with the functional reviews developed by the World Bank and the strategies of the line ministries prepared since. The Ministry of Public Finance will develop its own staffing plans based on ongoing modernization efforts in Treasury and the ANAF. A methodology for determining staffing levels in subnational governments will be developed while balancing local responsibilities with fiscal prudence. We will consult with the IFIs (IMF, EC and the World Bank) before making changes in the public employment policy and the Unified Wage Law.

11. **Tax administration:** We will continue our comprehensive reforms of the tax administration (ANAF) with a view to raising revenue collection and efficiency.

- As part of ANAF restructuring and modernization, the current 221 tax offices will be consolidated to eight regional directorates by September 2013 and 47 local tax offices by 2015. We are also reallocating around 1,700 staff away, mostly from support functions to prevention and inspection, and will increase resources in Bucharest Region to combat fraud. ANAF will take over the responsibilities of the Financial Guard by November 1, 2013, which will cease to exist, adding a further 1,100 staff to ANAF's disposal. The new positions will be directed to the new prevention and fighting tax evasion and tax customs fraud structure and will be filled following strict selection procedures. We will provide additional professional training to all staff involved in combating tax evasion. We ratified the loan agreement with the World Bank concerning a project to support the modernization of the tax administration.
- We continue to make progress on our High Net-Wealth Individual (HNWI) taxpayers initiative. We started 30 prior desk audits for HNWI following the tax procedure code in the first half of the year and re-launched our notification campaign by sending out letters on the risks of non-filing foreign income to 360 individuals. We have also published our program on ANAF's website. Voluntary compliance appears to be improving. We have improved the quality of our personal income tax audits more generally. We will strengthen our auditing further using the indirect proofs method, expanding the definition of un-sourced income and clarifying the taxability of dividend payments, which are currently often disguised as non-taxable loan repayments to businesses. To help us achieve these goals, we have undertaken training programs with the assistance of partner-country tax administration specialists and IMF technical assistance in April.
- We also aim to develop taxpayer services, for example, offered through ANAF's portal (considered as a "one stop shop") by June 30, 2014 and by ensuring that the interpretation of the tax law is unambiguous. To this end we will issue a common procedure with the MoFP and set up single channel dealing with all enquiries on tax law interpretation by December 31, 2014. Moreover, we will streamline the VAT reimbursement procedures based on a risk analysis, in order to significantly diminish the time allocated tax audits in this field and for decreasing the time needed for solving refund cases by June 2014 and 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. This will be an important source of information for taxpayers and should also raise compliance by December 31, 2014. Finally we will make all efforts to ensure SME in distress are granted payments terms in instalments to clear tax arrears.

12. **Tax policy:** We aim to improve the efficiency and revenue-raising capacity 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 will assess the performance of this new arrangement. We will initially on a temporary basis lower the VAT on bread and its production chain to 9 percent and have identified countervailing measures in excises to offset the budgetary impact, to be implemented from September 1, 2013. During 2014, we will assess the efficiency of these measures and decide whether they will be applied on a permanent basis. Before finalizing the 2014 budget we will revise the base for property taxes, which will vary depending on use of the property and not the legal status of the property owner. We have started the preparations for a strategy for a new oil and gas taxation and royalty regime by establishing an inter-ministerial working group. We will establish a new regime that takes effect from 2015 through 2024, if all stakeholders agree. We will receive IMF technical assistance for both work streams.

13. We will also analyze how revenue collection could be raised and the tax wedge reduced by widening the base of the social contribution system. We will implement measures for the 2015 budget based on the tax expenditure report. By mid-October 2013, we will prepare a reform package for health contributions in order to finance the public health system based on a mix of mandatory tax, consistent with the basic health package, and a voluntary contribution payable by individuals who wish to have a supplementary health insurance system. Towards this goal, we will approve a Government Ordinance (prior action), to broaden the social contributions base by applying a mandatory tax (health contribution) on rental income of individuals, to be implemented from January 1, 2014. We will also approve legislation to restructure the social security system to widen the base by reducing the differences that exist in the pension base for the different types of performing activity (i.e., salary remuneration, freelance activity, copyright, etc). We will consult with IMF/EC staff before undertaking any further changes of the tax system.

14. **Health care:** We are preparing a comprehensive reform of the healthcare system, which should make the system financially sustainability, raise the efficiency of healthcare spending and improve health outcomes.

- The reforms will strengthen the contributions base; streamline hospital services reducing the redundant capacity for inpatient services in line with the national health strategy and shifting the delivery of health services away from hospitals to ambulatory and primary health care providers; develop capacity in Health Technology Assessments and evidence-based protocols; and allocate more resources towards primary and secondary preventive care. Rather than adopting a new framework law, we have decided to pursue a more gradual approach based on modifying existing legislation. This should allow individual initiatives to proceed at different speeds and to be completed without necessarily relying on the success of all other initiatives. In April we formulated a strategic action plan for this year. We published the agreed plan on the ministry's website as a statement of government policy agreed with the IFIs, we will meet all the deadlines set and, in particular, will prepare the basic health package within the existing spending envelope by end-September 2013, which will also define the scope of the private health insurance in the health care system in the future (structural benchmark). We will also prepare a comprehensive health strategy covering also the revenue side, together with the MOPF, including a timetable for implementing legislative changes and progress indicators.

15. Parallel to preparing and as part of a comprehensive health strategy, we will implement the following measures to address health sector financial imbalances and modernize its operations:

- To increase the share of spending on primary and ambulatory services in total health spending, we will revise by end-December 2013 the list of services, which can be contracted with primary care providers as part of the 2014 health care framework agreement. We will publish a revised list of compensated drugs by end-December 2013, to be approved by government ordinance, based on the

methodology provided by a newly established unit conducting health technology assessments. The centralized procurement system for pharmaceuticals and medical devices for hospitals became operational in the first half of 2013. We will assess the system's performance at the end of 2013 and progress on the design of a centralized IT system.

- 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. We amended the contracts of hospital managers in June 2013 so that they will be replaced automatically 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, will collect and analyze the cost of service provision across hospitals with the aim of developing benchmarks in the future, and have published online up-to-date financial statements of all public hospitals since October 2012. We signed a contract with the National Printing Office to produce 7½ million patient cards by end 2013 and the remainder for the eligible population by mid 2014. By September, we will decide on the mechanism for distribution of these cards. The electronic prescription system is now established, with 34m prescriptions produced by end of June 2013. To promote awareness and encourage the increased use of generic drugs, we will print from January 2014 the patient rights with respect to pharmacists' obligation to provide full information on available drugs on the printed prescription.

16. **Debt Management:** In line with our debt management strategy, we are improving our risk management and have reduced the share of short-term debt. We have sought to continue consolidating the fiscal buffers, to achieve our objective of four months of gross financing needs to protect against unforeseen external shocks. The net interest paid on these buffers represents a necessary cost for insurance against shocks. We are continuing our efforts to widen the investor base and improve outreach efforts. We are undertaking a project financed with European funds and implemented with support of the World Bank to strengthen the debt management department. We will ensure that increases in guarantees issued remains prudent, and will not issue guarantees for PPPs and concessions in 2013 and for bank lending with a view to repay tax liabilities.

Monetary and Exchange Rate Policy

17. Monetary policy under the SBA will be guided by the NBR's inflation targeting framework. Progress towards achieving the official inflation target will be monitored through an inflation consultation clause with consultation bands drawn symmetrically around the projected path of headline CPI inflation (see TMU). The program also aims at maintaining adequate reserve coverage. Most standard reserve metrics assess our current level of reserves as broadly adequate. A performance criterion on Net International Reserves that is consistent with this goal will be established.

18. We remain committed to reducing inflation to within our medium-term target band of 2.5 ± 1 percentage point by September and to keeping inflation in the target band from then on. Inflation has begun to ease to 4.4 percent in July 2013 after a food supply induced spike in the second half of 2012 and has continued to be very volatile reflecting the large share of food items (38 percent in CPI terms) and one-off effects of administrative price changes. For transparency and communication reasons we will continue to target headline inflation but also closely monitor core inflation as a measure of underlying inflation. We currently project headline inflation to reenter the target band in by September, mainly on account of the reversal of base effects and a significantly better harvest than in the previous year putting downward pressure on food prices. Core inflation was at 2.5 percent in July 2013.

19. We have lowered the policy rate by a cumulative 75 basis points to 4.5 percent in July and August as we expect headline inflation to continue its declining trend. Following the recent narrowing of the interest rate corridor around the policy rate, the interest rates for the NBR lending and deposit facilities stand at 7.5 and 1.5 percent, respectively. Anchoring inflation expectations and dealing with volatile international capital flows 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. We will closely monitor inflation developments following these easing steps and would consider gradually lowering the policy rate further only if inflation drops inside our target band as projected, inflation expectations remain firmly anchored, and market conditions permit. We will continue regular open market operations as needed to ensure adequate liquidity conditions in the banking system, while underpinning the good functioning of money markets and minimizing the divergence between interbank rates and the policy rate in order to strengthen interest rate transmission. Ratios for minimum required reserves are expected to remain unchanged in the coming months. Going forward, the NBR will preserve the wedge between minimum requirements for foreign and domestic currency liabilities. Moreover, any considered changes would be implemented gradually and take into account inflation expectations as well as liquidity and prudential considerations.

20. During the period of the SBA we will not, without Fund approval, introduce or intensify restrictions on the making of payments and transfers for current international transactions, nor introduce or modify any multiple currency practices or conclude any bilateral payment agreements that are inconsistent with Article VIII of the IMF's Articles of Agreement. Moreover, we will not introduce or intensify import restrictions for balance of payments reasons.

Financial Sector

21. The Romanian banking sector maintains reassuring capital buffers and provisioning but faces continues pressures on asset quality, and from foreign bank deleveraging, while also remaining vulnerable to external shocks. Annual credit growth to both corporates and households remains negative. Non-performing loans (NPLs) rose to 20.3 percent of total loans at end-June 2013 (compared to 14.3 percent at end-2011) reflecting the difficult economic environment, slow credit growth, deteriorating quality of loans, and difficulties in removing NPLs from bank balance sheets. However, provisions (with a prudential filter) were sufficient to cover a comfortable 88.3 percent of NPLs while the IFRS provisioning ratio stood at 62.8 percent at end-June.⁽³⁶⁾ The provisioning requirements along with the high cost base led to a loss in the banking system in 2012 but allowed for a small profit in the first half of 2013. In light of the still difficult economic environment, in particular as regards corporate and household balance sheets as well as low credit demand, prospects for bank profitability remain challenging. The capitalization of the banking sector remained strong at 14.7 percent at end-June 2013 albeit with some differences between banks. Overall, system household and corporate deposits have only increased by around 10 percent since end-2011. While the liquidity situation has improved for the banking system, funding conditions are still uneven among some banks. The pace of foreign-owned bank deleveraging has accelerated in line with regional developments but remains orderly so far with a parent funding decline of 26 percent since 2011. Risks from continuing parent funding retrenchment remain elevated and could be an impediment to the credit growth recovery should credit demand pick up sizably. The system-wide loan-to-deposit ratio stood at around 114 percent at end-June 2013, declining from 117 percent at end-2012 and at end -2011.

22. The NBR will continue to intensively supervise the banking system and take any necessary measures to ensure that banks maintain sufficient capital and liquidity, in light of the uncertain economic environment which could pose further challenges with respect to asset quality, profitability, and parent funding retrenchment for most banks. In that regard and in close coordination with the IMF and EC, the

⁽³⁶⁾ Including all provisions and not only those for NPL's 90 days past due, the total provisioning ratio was 102.4 percent and the IFRS provisioning ratio stood at 77.2 percent at end June.

NBR will continue to regularly conduct top-down and bottom-up solvency stress tests as well as liquidity stress tests of the banking industry.

23. The NBR and Deposit Guarantee Fund (DGF) will continue to coordinate the implementation of operational preparedness plans and the arrangements for the acquired bank resolution powers according to their competencies. An amendment to the Government Emergency Ordinance no. 99/2006 will provide the NBR with more flexibility and powers to stabilize the financial system to protect depositors and maintain public confidence in the banking sector. After clarifying the new EU state aid rules for the bank stabilization measures, the amended Government Emergency Ordinance no. 99/2006 and Government Emergency Ordinance no. 39/ 1996 will be approved by end-2013 in line with the CRDIV implementation deadline. Based on the amended banking law, the NBR will amend the internal procedures for bridge-banks by end-2013. The details of the updated NBR contingency planning framework will be agreed with the IMF and EC staff. The NBR is preparing detailed contingency plans on an ongoing basis.

24. To avoid any perceived conflict of interest of its senior management, the DGF corporate governance principles will adhere to best international practices.

25. 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. In particular, the NBR will examine in detail during onsite inspections all banks' loan restructuring practices as well as adequacy of IT systems to deal with impaired assets. A comprehensive report of the banks' loan restructuring practices and asset quality with granular information, migration matrices and a NPL vintage analysis will be shared with the IMF and EC by end-October 2013. The analysis on banks' IT adequacy will be finalized by end-2013 for a representative sample of banks. In consultation with the IMF and EC, an NPL resolution action plan will then be agreed. The NBR will ensure that following this year's collateral audit, banks with any estimated collateral gap will swiftly provide the additional provisioning.

26. The NBR will collect periodic and detailed supervisory data on restructured loans, including to SOEs, on a quarterly frequency by end September. To ensure transparency, the NBR will publish aggregate data.

27. Given the substantial NPL overhang, the authorities will remove, where possible, impediments to corporate and household out-of-court debt restructuring and NPL resolution. The NBR has clarified in a letter to the banking system that under the IFRS framework banks do not necessarily have to exhaust all legal means to remove fully-provisioned NPLs from their balance sheets. The NBR will hence urge banks within the IFRS framework to remove fully-provisioned NPLs (especially for unsecured consumer loans) from their balance sheets in a timely manner. To maintain a prudent provisioning stance on collateral treatment, the NBR will not consider additional collateral deductions unless significant progress on banks' NPL removal of unsecured (consumer) loans has been made. Any agreed further changes to the current regime will be agreed with the IMF and EC. 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.

28. To foster the development of a viable distressed debt market, we will resolve possible discrepancies in the fiscal code and accounting rules on the treatment of NPLs sold to domestic debt management companies in line with the outcome of the pending EC infringement case structural benchmark, by end-December, 2014. We will also conduct an impact study on the fiscal costs from the tax deductibility of the sale of intra-group bank receivables (by end-December 2013) and of non-bank receivables (by end-August 2014).

29. To enable much needed longer term bank funding instruments, the authorities will swiftly approve the pending covered bond legislation by end-December 2013 as a Government Ordinance, while appropriate safeguards to preserve financial stability are implemented.

30. After the current Prima Casa program ends in September, a possible continuation will only apply to RON lending. This will help to develop the RON mortgage market and also contribute to RON denominated covered bonds in the future. In addition, we will make the SME guarantee fund more effective and operational especially as regards to the maturity, price, and rollovers of the guaranteed loans, as well as the implementation process for the guarantee execution.

31. We will ensure that the legislation and institutional arrangements for the FSA will be amended by end September to comply with international best practices. This regards notably to the size of the managing and council board (to a maximum of 9 overall), minimum required professional qualifications of FSA board members, statutory protection of supervisory staff and institution, and avoidance of conflicts of interest, in particular the connection of these members with members of Parliament and political parties. Senior management and board members will have to comply with the amended corporate governance principles. The FSA will also enhance transparency and public disclosure of all fees and commissions charged to the supervised entities.

32. Because preserving credit discipline among debtors contributes significantly towards enhancing financial stability, we will take all efforts to avoid the adoption of legislative initiatives which would undermine credit discipline. Furthermore, in order to avoid threats to financial stability, the authorities will consult extensively with all relevant stakeholders having in view also the impact assessment finalized by the NBR on the new provisions on abusive clauses in the law for the application of the civil procedure code. The authorities will ensure that court cases involving abusive clauses are dealt with by higher ranking courts or by a unique specialized court and will take all necessary measures to ensure a harmonized application of these provisions, such as training of judges.

33. To increase transparency and as corporate insolvencies are increasingly fuelling the still ongoing deterioration in asset quality, the NBR together with the Romanian Banking Association will explore possibilities for setting up a database of shareholders of companies in insolvency as well as implement more effective data reporting of the Association of Insolvency Practitioners.

34. We will swiftly implement the World Bank recommendations on the ROSC, and following the comprehensive public consultation in September 2013 as well as with the IMF, EC and the World Bank, we will send the amended insolvency code draft to parliament by end-October 2013. All relevant stakeholders will be adequately consulted before the insolvency code amendment is passed in parliament.

Energy and Transportation Sector Reforms

35. Comprehensive reform of the energy and transportation sectors is a central element of our goal to increase growth in Romania. We seek to foster investment and better service delivery in these sectors by bringing prices more in line with market forces and enhancing the operational and financial performance of the state-owned enterprises that dominate these sectors. These measures will also allow us to leverage Romania's favorable geographic location.

36. We undertook some important reforms related to state-owned enterprises (SOEs) and the energy and transportation sectors last year. For example, the cumulative arrears of central-government and local-government owned enterprises were reduced by 1 percent of GDP through voluntarily placing a few companies into the insolvency or liquidation process, debt swaps, and restructuring measures. Key reforms in the energy and transportation sectors include:

- **Energy sector:** We transposed the European Union's third energy directive into national law and promulgated a law to ensure the independence of the energy regulator (ANRE). ANRE started the implementation of the electricity price liberalization roadmap in September 2012 and continued the quarterly schedule in January, April, and July 2013. After an initial delay, ANRE started the implementation of the gas price liberalization road map and has raised the domestic gas producer price by almost 40 percent in accordance with the road map. The state-owned hydro-electric producer, Hidroelectrica, exited from the insolvency process on July 1, 2013. Under insolvency, the Legal Administrator cancelled or renegotiated below market bilateral contracts with the electricity released from contracts being sold at the OPCOM Power Exchange. The Administrator also cancelled hundreds of smaller contracts and investment projects deemed to be against the interest of Hidroelectrica.
- **Transportation sector:** We initialed a sale-purchase agreement for the sale a 51 percent stake in the state-owned freight company (Marfa) for RON 905 million and took a government decision approving the sale-purchase agreement. We also approved an arrears clearance scheme in June whereby CFR Marfa's arrears would be reduced by over 90 percent upon conclusion of the sale. To help improve the financial performance of the state-owned passenger rail company (Calatori), we changed the formula for calculation of the subsidy for the public service obligations (PSO) and removed the international and inter-city trains from the PSO. We also closed the most unprofitable routes for passenger traffic.

37. Nonetheless, the reform effort remains unfinished. The corporate governance reforms are incomplete and the draft law on Corporate Governance in State-Owned Enterprises continues to languish in parliament. Planned initial public offerings in energy state-owned enterprises were delayed and, with only an interim board and management in place, Hidroelectrica risks losing the gains made under insolvency. In the railway sector, arrears accumulation remains a significant problem and the Marfa sale needs to be concluded. In addition, new challenges have arisen to the reform agenda. Pressure is building to delay implementation of the energy price liberalization roadmaps and the precarious financial state of high cost thermal electricity producers threatens to undermine the broader energy strategy.

38. Under the new program, we propose a three-pronged approach to decisively improve the financial position, operating efficiency, and overall transparency of SOEs and the pricing framework in the energy and transportation sectors. The first part is composed of strengthened measures to reduce state-owned enterprise arrears. This commitment would be reflected through an indicative quarterly target on the cumulative arrears of all central-government owned enterprises. This represents a substantial broadening of coverage of the SOE arrears target relative to the prior program. To ensure timely reporting for the target, all line ministries agree to ensure that all SOEs within their respective portfolios will file, in accordance with existing regulations, quarterly financial information with the MOPF by the 25th day following quarter end. Potential measures to reduce arrears include use of debt/equity swaps, including a measure to clear CFR Calatori's arrears with the state-owned rail network operator (CFR Infrastructura), placement of companies into the insolvency process or liquidation such as subsidiaries of CFR Calatori and CFR Infrastructura, and restructuring measures to improve financial performance. We also agree to place an indicative quarterly target on the operating performance of a the largest railway companies and their subsidiaries to ensure that arrears clearance measures are complemented by reforms that improve the viability of these companies (CFR Infrastructura, CFR Calatori, and CFR Marfa).

39. The second leg will continue measures to improve the governance, transparency, and monitoring of SOEs. We have taken note of observations made about the new boards appointed recently to energy SOEs. We will appoint a professional board in Hidroelectrica by end-November 2013 (structural benchmark) following the letter and spirit of the procedures specified in the SOE corporate governance Government Emergency Ordinance 109/2011. In the meantime, the current interim board appointed upon Hidroelectrica's exit from insolvency will continue to be in charge and we will authorize through a General Shareholders Meeting the current interim board to take decisions in accordance with law 31/1990

(prior action). More broadly, we will undertake and publish an independent government-wide assessment of the implementation of the Government Emergency Ordinance (109/2011). Following the assessment, we will develop guidelines for its implementation across all ministries. We will also seek passage of the SOE corporate governance law in parliament by end-September 2013 which gives legal responsibility to the MOPF to supervise its proper implementation. The Fiscal Council plans a report on the operations and its fiscal implications in SOEs. Moreover, we will take steps, with support from the World Bank, to improve the monitoring function of the SOE oversight directorate in the Ministry of Public Finance.

40. We will continue measures to enhance the transparency of SOE operations. All new bilateral contracts of electricity producers will be made transparently and non-discriminatorily through the OPCOM power exchange and annual reports on SOE performance will be published in accordance with provisions of the SOE corporate governance Government Emergency Ordinance. Relatedly, line ministries will have all SOEs within their respective portfolios submit their 2013 budgets for approval by end-September 2013 and the 2014 budget one month after the approval of the state budget.

41. The third part would be to continue to improve the pricing framework and efficiency of the energy and transportation sectors. We are committed to implement the electricity and gas price road maps and the pass-through mechanism for electricity and gas purchases by the supply companies will continue to be applied. For electricity, complete deregulation of electricity prices for non-residential consumers will be achieved by January 1, 2014, and for households by December 31, 2017. For natural gas, we intend to implement the remainder of the roadmap to deregulate gas prices as planned to achieve complete price deregulation for non-residential consumers at the latest by December 31, 2015, and for residential consumers by December 31, 2018. We will continue to take steps to strengthen OPCOM as an electricity and gas trading platform. We also plan to sell the majority of the portfolio of companies under the Ministry of Economy and conclude the following five privatizations of state-owned energy companies during the program period, which will generate resources for the companies and the government and support development of the local capital markets. For majority privatizations, in which we seek strategic investors, we will do so with a view to attract new investment and provide professional expertise so as to enhance the viability of operations and service delivery. We commit not to break up and/or merge the companies or the assets of the companies slated for IPOs, except as provided for in the reorganization plan of Hidroelectrica or as specified below.

- **Nuclearelectrica** (nuclear energy producer): Launch an initial public offering (IPO) of 10 percent of the government's shares by end-September 2013.
- **Romgaz** (natural gas producer): Launch an IPO of 15 percent of the government's shares by mid-November 2013 (structural benchmark). In advance, we will obtain approval of the Financial Supervision Authority (FSA) for use of global depository receipts and complete an environmental impact study. A decision to expand the size of Romgaz's board following the IPO has also been taken. As a prior action, we will clarify the tax treatment of securities bought in Romgaz traded on the foreign stock exchange and adopt, if needed, the necessary legal basis.
- **Electrica** (electricity distribution, supply, and service): Launch an initial public offering of a majority of the government's shares, after the planned capital increase, by end-May 2014 (structural benchmark). In preparation, we will hire a transaction advisor for the IPO by mid-September 2013. Work is currently underway to determine what to do with five of Electrica's six regional service companies. At least three, but possibly all five may have to be separated from Electrica for eventual liquidation. Electrica's minority shareholdings in already privatized distribution companies could be a major area of uncertainty for the IPO and these share holdings will be taken out of Electrica prior to the IPO. We will also address the issue of non-payment by CFR for its electricity purchases from Electrica ahead of the IPO.

- **Oltenia** (thermoelectric generator): In view of Oltenia's investment needs, we planned ahead of majority privatization an IPO of a 15 percent of the government's shares, prior to the planned capital increase, by end-October 2013 and hired a transaction advisor for this in May 2013. Subsequently, we decided to delay the IPO until end-June 2014 (structural benchmark) after the audited financial statements for 2013 are available and a study of the coal reserves is conducted.
- **Hidroelectrica** We planned an IPO of a 10 percent of the government's shares, after the planned capital increase, by end-October 2013. However, a court challenge to the government decision to conduct the IPO and the government's subsequent appeal of the court decision has delayed the process. The Ministry of Economy, the General Secretariat of the Government and Hidroelectrica submitted to the Court of Appeal the withdrawal of their respective appeals and asked for the Court to consider the withdrawal requests on an expedited basis. We will issue a new government decision for an IPO of 10 percent, in accordance with all required procedures. The government will sign a contract with the transaction advisor selected through a competitive process already in 2012 for the IPO which will be launched by end-June 2014 (structural benchmark), provided a Court decision is made by end-September, 2013.

42. In the transportation sector, we intend to work closely with the World Bank and European Bank for Reconstruction and Development to reform the rail sector with the goal of improving the financial and operational performance of railway SOEs and the quality of rail service. We plan to revisit the terms of the Multi-Annual Infrastructure Contract. At present, this contract is not in financial balance. The amounts paid to state-owned railway infrastructure company (CFR Infrastructura) are not consistent with the responsibilities it confers to maintain and operate the network. It will likely take a combination of efficiency improvements, network reductions, and possibly subsidy increases to bring this into balance. The World Bank is working on an assessment to help quantify what needs to be done. We also plan to facilitate improved payment of infrastructure access and electricity charges from the state-owned passenger rail company (CFR Calatori) and CFR Marfa through reforms of those enterprises and to settle of outstanding debts among the three main railway companies. Measures to improve the operating and financial performance of these companies could include:

- **CFR Marfa:** We will fulfill our obligations under the sale purchase agreement for the majority sale of CFR Marfa and close the transaction (exchange of payment for shares) by the mid-October 2013. In this context, merger control approval will be sought from the relevant regulatory authority. If the privatization process encounters insurmountable obstacles, we will reopen the tender for the majority privatization of Marfa abiding to a process that follows best international practices.
- **CFR Infrastructura and CFR Calatori:** We will allow the appointed boards of these companies to implement the approved administrative plans without interference. We will complete the procedure for appointing new management in CFR Infrastructura following the letter and spirit of the procedures specified in the SOE Corporate Governance ordinance (109/2011). We also intend to lease out an additional 1,500 kilometers of inoperable track, raise passenger tariff rates in September 2013, and further amend the formula for calculation of the PSO to give more weight to passenger-train kilometers travelled starting in January 2014. More broadly, we will continue to explore measures to rationalize the network, improve absorption of EU funds, strengthen the procurement process, and reduce costs. We will address the issue of non-payment by CFR Infrastructura to Electrica ahead of Electrica's IPO which would otherwise be undermined.

43. A high quality and extensive road network is a critical infrastructure component of a welcoming business environment for investment and a well functioning economy. To focus our efforts on increasing the absorption of EU funds in the 2014-2020 funding period, we will create an agency within the government dedicated to the development of highways eligible for EU funding. The state-owned roads company also intends to minimize capital spending on existing projects in 2013, with a view to reducing

arrears towards zero. The company will not lengthen the invoice certification procedures outside legal requirements.

Labor Markets

44. The new Labor Code has improved the functioning of the labor market. Fixed term contracts helped employment growth, growing from 6 percent of total active contracts at end-June 2011 to 9 percent at end-June 2013. We will continue to monitor implementation of the Social Dialogue Law and ensure that any amendments will be undertaken in consultation with all stakeholders through the normal legislative process. We will continue our cooperation with the International Labor Organization (ILO) to ensure that the new legislation respects core ILO Conventions.

45. In view of the high youth unemployment in Romania, we have started to amend current legislation to improve the transition of young Romanians towards the labor market under the new National Job Plan to boost youth employment towards 2013 and going forward. An action plan will be developed for the implementation of measures that could qualify for support under the Youth Employment Initiative, in line with the conclusions of the European Council of June 2013. The Apprenticeship Law that introduces a dual apprenticeship model has been adopted, and we expect the necessary secondary legislation to be finalized by end-September. A law facilitating acquiring professional experience for higher education graduates was adopted by government and will be sent for approval by the Parliament by end-October 2013.

Table 1. Romania: Quantitative Program Targets

	2012	2013			2014	
	Dec	June	Sept	Dec	March	June
	Actual	Prelim.	Prog.	Prog.	Indicative	Indicative
I. Quantitative Performance Criteria						
1. Floor on the change in net international reserves (mln euros) 1/	16,344	3,922	3,922	3,922	250	0
2. Floor on the general government overall balance (mln lei) 2/	-17,430	-6,629	-9,181	-14,700	-4,000	-6,200
3. Ceiling on the stock of central government and social security arrears (bn lei)	0.027	0.04	0.02	0.02	0.02	0.02
4. Ceiling on general government guarantees issued since end-2008 (face value, bn lei)	9.8	10.9	16.0	16.0	18.0	18.0
II. Continuous Performance Criterion						
5. Nonaccumulation of external debt arrears	0	0	0	0	0	0
III. Inflation Consultation						
6. 12-month rate of inflation in consumer prices						
Outer band (upper limit)	...	...	5.1	5.3	4.6	5.0
Inner band (upper limit)	...	...	4.1	4.3	3.6	4.0
Actual/Center point	5.0	5.4	3.1	3.3	2.6	3.0
Inner band (lower limit)	...	...	2.1	2.3	1.6	2.0
Outer band (lower limit)	...	...	1.1	1.3	0.6	1.0
IV. Indicative Target						
7. Ceiling on general government current primary spending (excl. EU funds and social assistance, mln lei) 2/	134,330	70,412	106,300	147,509	36,700	74,400
8. Floor on operating balance (earnings before interest and tax, net of subsidies and one-off adjustments to income due to financial or accounting operations) of key SOEs (as defined in paragraph 22 of the TMU (bn. lei)) 2/	-3.3	-1.0	-1.6	-2.3	-0.5	-0.8
9. Ceiling on outstanding payments past due of all central-government owned enterprises (as defined in TMU, bn lei)	12.6	8.2	7.5	5.6	4.7	3.7
10. Ceiling on stock of local government arrears (bn lei)	0.84	0.14	0.30	0.30	0.30	0.30
11. Ceiling on stock of net Treasury loans for EU-funded projects (mln lei) 2/	...	1,546	3,000	3,000	3,000	3,000

1/ The end-December 2012 figure is a stock. Reported at program exchange rates and gold price.

2/ Cumulative figure during calendar year (e.g. September 2013 figure is cumulative from January 1, 2013).

Table 2. Romania: Proposed Conditionality		
	Measure	Target Date
Prior Actions		
1.	Approve a government ordinance to provide standard definitions of commitments for the commitment control system.	
2.	Approve a government ordinance defining the prioritization criteria for public investment projects.	
3.	Approve a government ordinance to broaden the social contributions base by applying a mandatory tax (health contribution) on rental income of individuals, to be implemented from January 1, 2014.	
4.	Authorize, through a General Shareholder's Meeting of Hidroelectrica, the current interim board to take decisions in accordance with law 31/1990, while it seeks to appoint a professional board in accordance with the SOE Corporate Governance ordinance.	
5.	Clarify the tax treatment of securities bought in Romgaz traded on the foreign stock exchange and adopt, if needed, the necessary legal basis.	
Structural benchmarks		
1.	Start publishing monthly arrears reports and corrective measures being taken by the central and local governments, by unit, on a quarterly basis.	End-September 2013
2.	Prepare the basic health package within the existing spending envelope which will also define the scope of the private sector in the health care system in the future.	End-September 2013
3.	Prepare medium-term financial projections that properly identify the fiscal implications of EU-funded projects, including co-financing needs, financial corrections and non-eligible spending.	Mid-October 2013
4.	Approve, by government memorandum, a list of significant priority projects, based on the prioritization criteria, to help prepare for the 2014 budget.	Mid-October 2013
5.	Launch an initial public offering of 15 percent of the government's shares in Romgaz.	Mid-November 2013
6.	Appoint a professional board in Hidroelectrica in accordance with the provisions of Ordinance 109/2011.	End-November 2013
7.	Approve Covered Bond legislation.	End-December 2013
8.	Fully operationalize the commitment control system, supported by necessary legal and procedural changes and cover expenditures of the MoPF and at least one additional unit at both the central and local government levels.	End-January 2014
9.	Launch an initial public offering of a majority of the government's shares in Electrica, after the planned capital increase.	End-May 2014
10.	Fully operationalise the commitment control system for all general government entities.	End-June 2014
11.	Launch an initial public offering of 15 percent of the government's shares in Oltenia, prior to the planned capital increase.	End-June 2014
12.	Launch an initial public offering of 10 percent of the government's shares in Hidroelectrica, after the planned capital increase.	End-June 2014
13.	Roll out the consolidated fiscal reporting system to all government entities.	End-June 2014
14.	Resolve possible discrepancies in the fiscal code and IFRS accounting rules on the treatment of NPLs sold to domestic debt management companies in line with the outcome of the pending EC infringement case.	End-December 2014
15.	Prepare and publish consolidated general government accrual based financial statements and ESA95 based reports from the system (the first sets of reports will be for the year ending 2014), and reconcile with each other and with cash-based budget execution reports.	End-June 2015

A4.3. TECHNICAL MEMORANDUM OF UNDERSTANDING⁽³⁷⁾

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 2013 and 2014 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 4.4588 = €1, to the U.S. dollar at RON 3.4151 = \$1, to the Japanese yen at RON 3.4480 = ¥100, and to the pound sterling at RON 5.2077 = £1, and the gold price is set at RON 132.1562 per gram as shown on the National Bank of Romania's (NBR's) website as of June 30, 2013. The exchange rates to other currencies, where applicable, will also be the ones shown on the NBR's website as of June 30, 2013.

3. For the purposes of the program, the general government includes the entities as defined in the 2013 budget. These are: the central government (state budget, 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.

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

A. Floor on the Change in Net International Reserves

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

5. NIR of the NBR are defined as the euro value of gross foreign assets of 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 and gold price.

6. Gross foreign assets of the NBR are defined to include the NBR's holdings of monetary gold, 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) precious metals other than monetary gold; (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

⁽³⁷⁾ As completed on 12 September 2015.

futures, forwards, swaps, and options), banks' foreign currency deposits against reserve requirements, and all credit outstanding from the IMF, but excluding government foreign currency deposits at the NBR.

Floor on Cumulative Change in NIR from the Beginning of 2013 and 2014 (in million euros)¹

	2012	2013	2013			2014	
	December stock	June stock	June actual	September PC	December PC	March Indicative	June Indicative
Cumulative change in NIR	16,344	20,266	3,922	3,922	3,922	250	0
<i>Memorandum Item:</i> Gross Foreign Assets	34,152	35,381	1,229	40	-1,371	-1,161	-2,932

¹PC = performance criterion; data for end-month. Flows are cumulative from the beginning of the same calendar year (e.g., June 2013 figure is cumulative from January 1, 2013). Current year stocks are obtained by adding the flows to the previous end-year stock.

8. The NIR targets will be adjusted (i) upward (downward) by the surplus (shortfall) in program disbursements relative to the baseline projection (Program disbursements are defined as external disbursements from official creditors (WB and the EC) that are usable for the financing of the overall central government budget) and (ii) downward by the full amount of the shortfall relative to the baseline of external bond placement by the MOPF.

External Program and MOPF Disbursements—Baseline Projections (in million euros)¹

	2013			2014	
	June actual	September PC	December PC	March Indicative	June Indicative
Cumulative change under external program	0	0	0	0	0
Cumulative change in external MOPF bond placement	1,122	1,122	2,322	1,000	1,000

¹Flows are cumulative from the beginning of the same calendar year (e.g., June 2013 figure is cumulative from January 1, 2013).

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

9. The quarterly consultation bands around the 12-month projected 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

	2013			2014	
	June actual	Sept. target	Dec. target	March indicative	June indicative
Outer band (upper limit)		5.1	5.3	4.6	5.0
Inner band (upper limit)		4.1	4.3	3.6	4.0
Actual / <i>Center point</i>	5.4	3.1	3.3	2.6	3.0
Inner band (lower limit)		2.1	2.3	1.6	2.0
Outer band (lower limit)		1.1	1.3	0.6	1.0

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. Consistent with the national methodology, revenues and spending for EU funds will be treated on an accrual basis. Any privatization receipts will be treated below the line item. The authorities will consult with IMF staff on corrective measures in the event of shortfalls in government revenue and financing. The 2014 budget will be prepared according to the GFSM 2001 methodology. The 2013 fiscal execution data will be presented in both GFSM 2001 and the methodology described above.

Cumulative Floor on General Government Balance¹

	(In millions of lei)
End-June 2013 (actual)	-6621
End-September 2013 (performance criterion)	-9181
End-December 2013 (performance criterion)	-14700
End-March 2014 (indicative)	-4000
End-June 2014(indicative)	-6200

¹ Cumulative figure during calendar year (e.g., June 2013 figure is cumulative from January 1, 2013).

11. The cumulative floor on the general government balance will be adjusted downward by the spending on national cofinancing of EU funded projects (excluding cofinancing from the top-up funds) exceeding 4221 million RON at end-September 2013 and 5886 million RON at end-December 2013, up to a limit of 600 million RON.

12. 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

The data on the beginning and ending balance of the Treasury account will also be provided.

13. 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 2013 and 2014, the MOPF will consult with IMF staff.

D. Indicative Target on the Stock of Net Treasury Loans for EU-funded Projects

14. The Ministry of Public Finance may provide net loans from the Treasury for EU funded projects, defined as the temporary financing for EU structural and cohesion fund projects minus the reimbursements from EU for the EU structural and cohesion fund projects. The net stock outstanding at the end of each quarter cannot exceed 3 billion RON (indicative target).

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

15. The issuance of general government guarantees to the nonfinancial private sector and public enterprises will be limited during the program period. The ceilings are specified in the table below.

Ceiling on New General Government Guarantees Issued from end 2008 Until:	(In billions of lei)
End-June 2013 (actual)	10.9
End-September 2013 (performance criterion)	16
End-December 2013 (performance criterion)	16
End-March 2014 (indicative)	18
End-June 2014 (indicative)	18

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

16. 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). The authorities will consult with IMF staff if new arrears are disputed following an audit by the Central Harmonisation Unit for Financial Management and Control Systems. As a memorandum item, arrears of central government hospitals will be reported separately.

Stock of Central Government and Social Security Arrears	(In billions of lei)
End-June 2013 (actual)	.035
End-September 2013 (performance criterion)	.02
End-December 2013 (performance criterion)	.02
End-March 2014 (indicative)	.02
End-June 2014 (indicative)	.02

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

17. 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.

H. Indicative Target on General Government Current Primary Spending

18. 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 and spending funded through the clawback tax.

Cumulative Change in General Government Current Primary Expenditures¹	(In millions of lei)
End-June 2013 (actual)	70.412
End-September 2013 (performance criterion)	106.300
End-December 2013 (performance criterion)	147.509
End-March 2014 (indicative)	36.700
End-June 2014 (indicative)	74.400

¹ Cumulative figure during calendar year (e.g., June 2013 figure is cumulative from January 1, 2013).

I. Indicative Target on Local Government Arrears

19. 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). As a memorandum item, arrears of local government hospitals will be reported separately on a quarterly basis.

Stock in Local Government Arrears	(In billions of lei)
End-June 2013 (actual)	.143
End-September 2013 (performance criterion)	.300
End-December 2013 (performance criterion)	.300
End-March 2014 (indicative)	.300
End-June 2014 (indicative)	.300

J. Absorption of EU Funds

20. The EU funds contribution mentioned in the 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

21. Public enterprises are defined as all companies including research institutes, incorporated under Law 31/1990 (as amended) and *regii autonome*, organized under Law 15/1990 (as amended), with a cumulative public capital share of 50 percent or more, held directly or indirectly by the central or local governments.

22. A quarterly indicative target for the third and fourth quarters of 2013 is set on the aggregate operating balance net of subsidies and the effects of one-off financial or accounting operations, accumulated per calendar year, of the following public enterprises: C.N. Căi Ferate CFR S.A. and five of its subsidiaries (S.C. Interventii Feroviare S.A., Informatică Feroviară S.A., S.C. Sere și Pepiniere S.A., S.C. Electricitate CFR S.A., and S.C. Întreținere Mecanizată S.A.) S.N. de Transport Feroviar de Marfă "CFR Marfă" S.A. and its subsidiary (S.C. Întreținere și Reparații Locomotive și Utilaje S.A.), and S.N. Transport Feroviar de Călători "CFR Călători" S.A. and its subsidiary (S.C. de reparații locomotive C.F.R. SCRL Brașov S.A.). The data shall be reported with operating results by firm. The targets will be as follows:

Floor on Cumulative Operating Balance¹	(In billions of lei)
End-December 2012 (actual)	-3.3
End-June 2013 (preliminary)	-1.0
End-September 2013 (target)	-1.6
End-December 2013 (target)	-2.3
End-March 2014 (indicative)	-0.5
End-June 2014 (indicative)	-0.8

¹ Cumulative figure during calendar year (e.g., June 2013 figure is cumulative from January 1, 2013).

23. In case one of these enterprises is placed into insolvency procedures, which occurs when it is recorded in the trade registry that the enterprise was placed into insolvency or liquidation procedures, or its majority share is privatized, which occurs when payment is received from an entity, in which the government does not have a controlling interest, in exchange for the majority shares of the enterprise, the aggregate target listed above will not 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.

24. A quarterly indicative target for the third and fourth quarters of 2013 is set on the stock of outstanding payments of public enterprises owned by the central government that were not made by the due date. The stock excludes outstanding payments past due of those public enterprises owned by the central government that are already under insolvency or liquidation procedures. The beginning date for

measuring the stock is December 31, 2012. The data shall be reported at the firm level. The targets will be as follows:

Ceiling on Outstanding Payments Past Due	(In billions of lei)
End-December 2012 (actual)	12.6
End-June 2013 (preliminary)	8.2
End-September 2013 (target)	7.5
End-December 2013 (target)	5.6
End-March 2014 (indicative)	4.7
End-June 2014 (indicative)	3.7

The end-December 2013 target will be adjusted upward by 1.2 billion lei in the event that the CFR Marfa majority prioritization is not concluded, i.e., the conditions precedent in the sale-purchase agreement were not completed and hence the transfer of a majority of shares in CFR Marfa in exchange for payment from the strategic investor could not take place by December 31, 2013.

25. In case one of these enterprises is placed into insolvency procedures, which occurs when it is recorded in the trade registry that the enterprise was placed into insolvency or liquidation procedures, or its majority share is privatized, which occurs when payment is received from an entity, in which the government does not have a controlling interest, in exchange for the majority shares of the enterprise, the aggregate target listed above will not be adjusted by the outstanding payments past due 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. However, outstanding payments past due accumulated and reported by active companies while they are under insolvency procedures will be included in the target.

L. Reporting Requirements for the Prior Actions

26. Completion of the prior action related to Hidroelectrica requires receipt by the IMF of the resolution adopted by a general shareholders' meeting with the majority votes of the Department of Energy that the shareholders of Hidroelectrica (1) reconfirmed members of the current board, while procedures for appointing a new board are undertaken in accordance with Government Emergency Ordinance 109/2011; and (2) approved a model for the contract mandate of the current supervisory board without limiting the powers generally given to supervisory boards by the Romanian companies law 31/1990. Completion of the prior action related to Romgaz requires the receipt of a signed letter from the Minister of the Budget of the Ministry of Public Finance indicating the steps taken to clarify the tax treatment of securities of Romanian firms traded on foreign exchanges and a copy of the legal document containing the clarification.

M. Reporting Requirements

27. 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 Public Finance	
Preliminary monthly data on general government accounts, including on GFSM 2001 basis	Monthly, on the 25 th day of the following month
Quarterly final data on net lending from the Treasury for EU funded projects	Quarterly, on the 5 th day past the test date
Preliminary monthly data providing a breakdown of general government expenditures on post-accession EU projects (co-financing, non-eligible spending, corrections, reimbursable funds, and EU top-ups)	Monthly, on the 25 th day of the following month
Quarterly final data on general government accounts, including public enterprises as defined by ESA95 and breakdown of general government spending on EU projects	Quarterly cash data, on the 35 th day past the test date; Quarterly accrual data, on the 55 th 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, including details of the domestic and external issuances and repayments (by currency)	Quarterly, no later than 45 days past the test date
Total accounts payable and arrears of the general government, including local governments and central and local government hospitals	Preliminary monthly, within the next month. Quarterly, within 55 days
Progress report on the status of the audit of the stock of the disputed local arrears.	Quarterly, no later than 45 days past the end of each quarter
Data on payment delays and arrears with respect to drug reimbursement by the National Health Insurance House (pharmacies and wholesale), with a particular view on the implementation of directive 7	Monthly, at the end of each month
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	Preliminary monthly data within 25 days

primary spending, net of EU disbursements	
Final quarterly data on general government primary spending, net of EU disbursements	Quarterly, within 35 days from the test date
Time lines showing the expected completion dates for key steps leading to the launching of the initial public offerings of the energy state-owned companies	Quarterly, within 10 days of the end of each quarter
Preliminary data on the operating balance, profits, stock of outstanding payments past due, and personnel expenditures for each key public enterprise as defined in ¶22	Monthly, within 30 days
Final data on the operating balance, profits, stock of outstanding payments past due, and personnel expenditures for each key public enterprise as defined in ¶22	Quarterly, end-May for the previous year and end-August for first half of the current year
Preliminary data on the stock of outstanding payments past due for each public enterprise as defined in ¶21	Quarterly, within 35 days
Final data on the stock of outstanding payments past due for each public enterprise as defined in ¶21	Quarterly, end-May for the previous year and end-August for first half of the current year
Data on EU project grants (reimbursements and advances), capital expenditures and subsidies covered by EU advances or eligible for EU reimbursement on EU supported projects specifically agreed with the EU	Monthly, within three weeks of the end of each month
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
Data on subsidies by ministries	Quarterly, one month after the end of the quarter. Additional reporting one week before review mission
Data on public employment and status of ordinance 77/2013 implementation, in particular numbers of staff reductions at central government ministries and staff increases at local governments	Monthly, at the end of each month

To be provided by the National Bank of Romania	
NIR 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 <i>banking sector</i> 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 <i>corporate sector</i> 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
Detailed bank-by-bank data on restructured loans to households and corporates including SOEs	Quarterly, 45 days after the end of each quarter
Financial soundness indicators ⁽³⁸⁾	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	Immediately, upon occurrence

⁽³⁸⁾ Data on solvency should be provided on quarterly basis.

ANNEX 5

Minimum reporting requirements under post-programme surveillance

During the implementation of the Community Post-Programme Surveillance (PPS), the following indicators and reports shall be made available to the European Commission:

Monitoring fiscal developments

Monthly reports on budgetary execution, covering the entire central government sub-sector (including the central budget, the social security funds, and the extra-budgetary funds)

Detailed cash-ESA transposition table for budget and budget rectifications

Quarterly final data on general government accounts and breakdown of general government spending on EU projects

Quarterly reports on the evolution of general government debt

Monthly report on treasury account and privatisations

Monthly report on SOE data

Monthly report on personnel

Monthly report on structural funds & EAFRD

Monthly report on debt, financing of the deficit and guarantees

Monthly and quarterly report on total accounts payable and arrears of the general government

Monitoring financial sector developments

Data on quarterly basis on financial stability indicators

Reporting on foreign exchange reserves

Bi-weekly reports to the Commission on evolution of foreign exchange reserves

The Commission should be immediately informed in case of sudden loss of reserves exceeding EUR 600 million in two weeks

External sector data

Monthly Balance-of-Payments (BoP) data and quarterly International Investment Position (IIP) data from BoP Statistics Department

Monthly data on external funding flows of the banking sector

Semi-annual BoP medium-term (8 quarters) forecast including the financial account

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