SUPPLEMENTAL MEMORANDUM OF UNDERSTANDING

(Third addendum to the Memorandum of Understanding)

BETWEEN

THE EUROPEAN UNION and ROMANIA

SUPPLEMENTAL MEMORANDUM OF UNDERSTANDING
(Third addendum to the Memorandum of Understanding)
between
THE EUROPEAN UNION and ROMANIA

1. On 6 May 2009, the Council of the European Union adopted Decision 2009/459/EC to make available to Romania medium-term financial assistance of up to EUR 5 billion. On 16 February 2010, the Council amended this Decision to address the impact on programme targets of the larger than expected recession. The assistance is provided as a medium-term loan under the balance of payments facility of Member States (based on Article 143[1] of the Treaty on the Functioning of the European Union (the "Treaty") and Regulation No 332/2002[2]). The EU assistance for Romania comes in conjunction with IMF support through a Stand-By-Arrangement (SBA) of SDR 11.4 billion (around EUR 12.95 billion), approved on 4 May 2009. Additional multilateral support of EUR 2 billion will be provided by the World Bank (EUR 1 billion) and the EIB and EBRD (EUR 1 billion).

2. The Memorandum of Understanding ("the Memorandum") laying down the economic policy criteria linked to each disbursement as well as the reporting and monitoring conditions of the loan was signed on 23 June 2009. Implementation of the fiscal, financial sector and structural reform measures foreseen in the Memorandum should enable the economy to withstand short-term liquidity pressures while improving competitiveness and supporting an orderly correction of imbalances in the medium term, hence bringing the economy back onto a sound and sustainable footing. The first instalment of EUR 1.5 billion was disbursed on 27 July 2009 following the signature of the Loan Agreement of 23 June 2009. Four other instalments were scheduled over the period covered by the remainder of the programme.

3. In August 2009, the Commission services participated in an IMF review mission, which led to the disbursement of the second instalment under the IMF programme. As no EU disbursement was planned at that time, the mission was not a formal review under the EU assistance programme. Agreement was reached with the authorities on a revision of some programme targets. In particular, the 2009 government deficit target was set at 7.8% of GDP in ESA95 terms (7.3% of GDP in cash terms), on account of the deeper than expected recession. Additional measures were identified to limit the deficit in 2010 to 6.4% of GDP in ESA95 terms (5.9% of GDP in cash terms), including measures to contain the public wage bill as a percentage of GDP and to limit expenditures on pensions and on goods and services, as well as increases in excises.

4. The Commission services carried out missions in October/November 2009 and January 2010 to assess progress made with respect to the specific conditions attached to the second instalment of EUR 1 billion under the EU financial assistance programme. These were joint missions with IMF and World Bank staff. Based on the findings of these missions and after having consulted with the Economic and Financial Committee, the economic policy criteria for disbursement of the second

[1] Ex Article 119 of the Treaty establishing the European Community.
[2] As amended by Regulation No 431/2009.

G.I M.I.

instalment of the EU loan were considered to have been fulfilled. In particular, Parliament had adopted a 2010 budget in line with programme targets and satisfactory progress had been made in other areas of structural reforms. However, taking into account the changed macroeconomic outlook and delays encountered in implementing some of the reform measures foreseen in the Memorandum, the conditions attached to the disbursement of the future instalments of the financial assistance needed to be adjusted. The agreed changes in the specific economic policy criteria were laid out in the Annex to the Supplemental Memorandum (the "first Supplemental Memorandum"), which was signed by the Romanian authorities on 18 February 2010 and by Commissioner Olli Rehn on 22 February 2010. In addition, agreement was reached on a further gradual reduction of the fiscal deficit to below the Treaty reference level of 3% of GDP in 2012. On 16 February 2010, this agreement was endorsed by the Ecofin Council, in its revised Recommendation to Romania under Article 126(7) of the Treaty.

5. The Commission services conducted a review mission together with the IMF and World Bank staff from 26 April to 10 May 2010 to assess progress made with respect to the specific conditions attached to the third instalment of EUR 1.15 billion under the EU financial assistance programme. It appeared that under unchanged policies, the 2010 fiscal deficit target of 6.4% of GDP (ESA95) would be missed by a significant margin due to a deterioration of economic conditions, difficulties in revenue collection and slippages on the expenditure side. The 2010 government deficit target was revised to 7.3% of GDP in ESA95 terms (6.8% of GDP in cash terms). To reach this new target, the Romanian Government committed itself to take additional consolidation measures amounting to 4.6% of GDP (annualised) whose adoption and implementation were conditions for the release of the third instalment of the EU loan. This was verified in July 2010. In other areas of reforms, good progress appeared to have been made, including the adoption by Parliament of the fiscal responsibility law, the adoption of a proposal for pension reform by the government, as well as the signature of the contract for the functional review of the public administration. Based on these findings and following consultation of the Economic and Financial Committee, the economic policy criteria for disbursement of the third instalment of the EU loan appeared to be broadly fulfilled and disbursement of the third instalment took place in September 2010.

6. The Commission services conducted a further review mission together with the IMF and World Bank staff from 20 October to 1 November 2010 to assess progress made with respect to the specific conditions attached to the fourth instalment of EUR 1.2 billion under the EU financial assistance programme. Based on the information available at the time of the mission, the mission considered that the budget implementation for 2010, targeting a general government deficit of 7.3% of GDP in ESA terms (6.8% of GDP in cash terms), was on track. At the time of the mission, however, there remained considerable uncertainty on a number of key reforms that are of major importance for the agreed fiscal consolidation path in 2011 and 2012. Specifically, even though the Parliament adopted the revised pension legislation on 15 September, the law was subsequently sent back to Parliament by the President asking for the reconsideration of one article so as to increase the retirement age for women to 63 and not to 65 years as proposed by the Government. Furthermore, delays have occurred in the adoption of the Unified Wage Law, which would rationalise the public wage system and underpin a lower public wage bill in the years ahead following the emergency 25% wage cut applied for the second semester of

G.I M.I.

2010. At the time of the mission, this law, which is key to the agreed fiscal consolidation path as it would provide for a structural reduction in the public wage bill in the years ahead, had not yet been enacted. Furthermore, at the time of the mission it appeared that the health sector would accumulate substantial arrears by the end of 2010 which would require major action to meet the agreed fiscal consolidation path (general government deficit of 4.4% of GDP for 2011 and of below 3% of GDP in ESA terms for 2012). To match expenditure to available budgetary resources and thus avoid the accumulation of arrears in the future, structural reforms in the health sector (including the introduction of co-payments) became essential. The government is committed to a broad set of health care reforms. In light of the issues identified above and other remaining uncertainties, the Romanian Government agreed that additional measures would have to be taken (Annex 1) before the release of the fourth instalment of the EU loan.

7. The agreed changes in the specific economic policy criteria linked to the disbursement of the fifth and last instalment of the financial assistance programme are laid out in the Annex to this third Supplemental Memorandum of Understanding (the "third Supplemental Memorandum"), which is the third addendum to the Memorandum of Understanding. These changes were made in view of adjusting the conditions posed in earlier Memoranda on which further action is needed, and the developing situation implying new policy priorities.

8. Articles laid down in the Memorandum and the first and second Supplemental Memoranda (including their annexes) remain valid and in force, unless explicitly amended in this third Supplemental Memorandum.

9. Disbursements of the remaining tranches under the programme are conditional on the Romanian authorities implementing measures in line with the current SMoU. These measures must be fully consistent with the EU Treaty.

10. Based on the fulfilment of conditions in the Memorandum and the second Supplemental Memorandum and following the consultation of the Economic and Financial Committee, the European Commission will decide on the release of the fourth instalment of EUR 1.2 billion subject to the implementation of the measures spelled out in Annex 1 (section "Actions to be taken before disbursement of fourth instalment of the EU loan") and the signature of the third Supplemental Memorandum by the parties and its entry into force.

11. The Romanian authorities commit to consult the staff of the European Commission 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.

12. The Annex forms an integral part of this third Supplemental Memorandum.

13. All notices in relation with the third Supplemental Memorandum shall validly be given if in writing and sent to:

G.I. M.I.

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, Piata 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

Apolodor Street, 17

Sector 5, 050741 Bucharest

Fax No.: +40 21 312 16 30

For the National Bank of Romania

National Bank of Romania

Lipscani Street, 25

Bucharest 030031

Fax No.: +40 21 312 62 60

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

GUVERNUL ROMANIEI PRIM-MINISTRU

G.I. M.I.

Done in Brussels on 19. January 2011 and in Bucharest on January 12, 2011 in five originals in the English language.

ROMANIA

Represented by

Emil Boc

The Prime Minister

Gheorghe Ialomițianu

Minister of Public Finance

Mugur Isarescu

Governor of the National Bank of Romania

EUROPEAN UNION

Represented by

EUROPEAN COMMISSION

Olli Rehn

Member of the European Commission

G.I. M.I.

ANNEX 1
SPECIFIC ECONOMIC POLICY CRITERIA

(Amendments and additions to Annex I of the MoU and Annex 1 of the second SMoU)

Delays incurred in the implementation of a number of reforms that are critical to the success of the programme. In the light of the foregoing, the specific economic policy criteria spelled out in the Annex I to the Memorandum and Annex 1 to the first and second Supplemental Memoranda shall be augmented by the following actions:

Actions to be taken before disbursement of the fourth instalment of the EU loan

- Parliament adoption of a budget for 2011 targeting a general government deficit of 4.4% of GDP in cash terms (below 5% of GDP in ESA terms), based on agreed macroeconomic assumptions and supported by adequate measures agreed under the programme—providing a sound basis for the attainment of the 2012 deficit target (below 3% of GDP in ESA terms). In connection with this, adoption of the Medium Term Budgetary Strategy for 2011-13. The Medium Term Budgetary Strategy should present the main expenditure and revenue items (notably the total wage bill), as well as consolidation measures consistent with a sustainable fiscal consolidation path that would allow a budget deficit of 4.4% of GDP to be reached in 2011 in cash terms (below 5% of GDP in ESA terms) and a deficit below 3% of GDP in 2012 in ESA terms, as committed to by the authorities in the context of the EDP procedure. The authorities will consult European Commission staff on the consistency of these measures and figures before submitting the 2011 Budget to Parliament. Within the budget envelope, additional resources will be allocated to investment in the first half of the year so as to improve absorption of EU funds. If absorption improves sufficiently, solutions will be sought to create greater fiscal space for investment from mid-2011. The European Union will provide expert assistance for the utilisation of resources from the EU, from the European Investment Bank, and from the World Bank, including the use of innovative financing solutions.

- Enactment of the Unified Wage Law (framework law and implementing law for 2011) with a view to: i) introducing a unitary salary system for the employees working for budgetary entities who are paid by the general government; and ii) limiting the public sector wage bill in 2011 to RON 39 billion (excluding the payment of social security contributions for the military worth RON 1.6 billion under the new pension law) and ensuring continued control of the public sector wage bill in subsequent years; as will be specified in the medium term budgetary strategy. The Unified Wage Law should provide the necessary framework and legal underpinning for the government to keep the total wage bill on the path set out in the medium-term budgetary strategy. The authorities will consult European Commission staff on this matter.

- Enactment of the revised pension legislation agreed with the European Commission, IMF and WB staff.

- Working with the parliament to ensure that emergency ordinance 50 of 2010 improves transparency and protects consumer rights while safeguarding the stability of the financial system and guaranteeing compliance with EU Directive 2008/48/EC. At the same time,

G.I. M.I.

ensuring that the National Bank is the only agency authorised to regulate banks' lending activity.

Fifth instalment

A: Fiscal consolidation

- Budget execution for 2011 on track to reach the 4.4% of GDP target in cash terms (below 5% of GDP in ESA terms) and providing an adequate basis for attaining the 2012 fiscal target of a general government deficit below 3% of GDP (ESA).

- Implementation of provisions in the budget ensuring that the public wage bill in 2011 does not exceed RON 39 billion in 2011 (excluding the payment of social security contributions for the military worth RON 1.6 billion under the new pension law).

- Prevent re-emergence of arrears in the health care sector based on effective measures being in place to address their root causes.

- The local government arrears issue to be looked into further with a view to improving financial management including management of EU co-financed projects in local administrations, with help from the EU and World Bank experts.

- Approval of legislation to introduce a means-tested co-payment system for medical services developed in cooperation with the World Bank.

B: Fiscal governance and structural fiscal reform

- Approval and publication by the Ministry of Public Finance of a medium-term debt management strategy for the period 2011-2013 with a view to securing appropriate cash management (around 4 months of financing needs) and extending the maturity profile.

C: Financial sector regulation and supervision

- Amend Government Emergency Ordinance 39/1996 regarding the setting up and operation of the Deposits Guarantee Fund in the Banking System by: *(i)* eliminating the stand-by credit lines from banks; *(ii)* introducing an incompatibility clause according to which neither members of the board nor employees of credit institutions are represented in the managing board of the DGF. The amended legislation should become effective by end-December 2010.

- Considering the difficulties associated with the enforcement of collateral and the ongoing deterioration in asset quality, authorities will continue maintaining the current prudent regulatory framework for provisioning.

- Preserving credit discipline and avoiding moral hazard among debtors contributes significantly towards enhancing financial stability and creating favourable conditions for the revival of credit activity. Therefore, authorities will refrain from promoting legislative initiatives (such as the personal insolvency law) which undermine credit discipline.

G.I. M.I.

- Make the necessary legislative amendments aiming at clarifying the damage compensation regime for creditors of banks placed under special administration to ensure an effective implementation of the recently amended legislation on the resolution of credit institutions in financial distress. This legislation should be effective by end-December 2010.

- Enactment of the Law on the independence of non-banking financial sector regulators by end-December 2010.

D: Structural reforms

- Each of the ten largest loss-making publicly-owned enterprises to submit, by mid January 2011, concrete and timed plans towards the reduction of arrears. The plans should notably involve cuts in operating expenditure, including personnel, increases in tariffs, and if needed, structural reforms of the business model.

- Signature, by mid December 2010, of a multi-annual performance agreement between the Ministry of Transport and the implementing agencies. The agreement must take into account, and be in line with, the Government's medium term budgetary framework. The Ministry of Transport shall consult with the Commission services on the appropriate documentation to be used.

- Completion of the second stage of the functional review of the Romanian public administration by end April 2011. Progress with implementation by the Government of the action plan based on the outcome of the first stage of the review by end April 2011.

- Measures being prepared to improve the absorption of EU funds.

GUVERNUL ROMÂNIEI * PRIM-MINISTRU

G.I. M.I.