December 2000
IMF Staff Country Report No. 00/159

Romania: 2000 Article IV Consultation—Staff Report; Statement by Staff Representative; and Public Information Notice Following Consultation

As required under Article IV of its Articles of Agreement, the International Monetary Fund conducts periodic consultations with its member countries. In the context of the 2000 Article IV consultation with Romania, the following documents have been released and are included in this package:

- the staff report for the 2000 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **September 13, 2000,** with the officials of Romania on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on November 3, 2000.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement to the report,

- the Public Information Notice (PIN), which summarizes the **views of the Executive Board as expressed during the November 29, 2000, Executive Board discussion** of the staff report that concluded the Article IV consultation.

A Selected Issues report prepared by IMF staff as background to the Article IV staff report will be released separately.

Further background documentation prepared by IMF staff for the consultation may be published separately at a later date. The policy of publication of Article IV staff reports and PINs allows for the deletion of market-sensitive information.

The Article IV staff report is published—both in hard copy and on the IMF's website (http://www.imf.org)—as part of a pilot project.

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INTERNATIONAL MONETARY FUND

ROMANIA

Staff Report for Article IV Consultation

Prepared by European 1 and Policy Development and Review Departments

(In consultation with Monetary and Exchange Affairs and other departments)

Approved by Michael C. Deppler and Leslie Lipschitz

November 3, 2000

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I. INTRODUCTION

1. The 2000 Article IV consultation discussions with Romania were held in Bucharest during August 29–September 13, 2000; the discussions also included a technical consultation to assess the effectiveness of past technical assistance and possible future needs (Appendix I).[1] The concurrent discussions on policies for the second review of the Stand-by Arrangement (SBA) were not concluded. The mission met with: Prime Minister Isarescu; Finance Minister Remes; other Ministers; National Bank of Romania (NBR) Governor Ghizari; former President Iliescu and other opposition leaders; commercial bank and enterprise managers; and trade union leaders. Mr. Dragulin (OED) attended many of the meetings.

2. A Stand-by Arrangement in an amount equivalent to SDR 400 million (39 percent of quota) was approved in August 1999 and, following two extensions, is scheduled to expire at end-February 2001. Two purchases—jointly amounting to SDR 140 million—have been made under the arrangement (Appendix II). Romania formally accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement in March 1998, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

3. Recent Executive Board meetings on Romania have focused on the need for strong policies and their sustained implementation. In concluding the last *Article IV consultation on September 15, 1998*, Directors warned that the underlying policy mix was unsustainable, primarily because the lack of fiscal support was overburdening monetary policy, and they conditioned Fund support on up-front measures in the areas of fiscal and structural policies. In approving the *current SBA on August 7, 1999*, Directors (i) welcomed the authorities' renewed commitment and up-front fiscal strengthening and progress in bank restructuring and privatization; (ii) regretted that the authorities, despite their efforts, had not been able to obtain the desired amount of private sector financing; and (iii) called on them to work vigorously toward obtaining additional private foreign financing in support of the program. In completing the *first SBA review on June 7, 2000*, Directors welcomed the significant improvement in Romania's external position in 1999. Nevertheless, they called for strict adherence to the macroeconomic policy targets and intensified efforts in the areas of bank reform and enterprise privatization, and considered that greater clarity in the framework and objectives of monetary policy would be helpful.

4. **Following general progress under the World Bank's Private Sector Adjustment Loan (PSAL), the structural reform effort has slowed down since mid-2000** (Appendix III). The second (and last) PSAL tranche of US$150 million was disbursed in June 2000, following completion of the first SBA review. However, owing to delays and

[1] The mission comprised Mr. Zervoudakis (head), Mr. Bell, Ms. Wang, Mr. Moore (all EU1), Mr. Mulder (PDR), Mr. Frécaut (MAE), and Ms. McCollum (AA, EU1). Mr. Cossé, the Resident Representative, assisted the mission. Mr. W. Brown (PDR) assisted the team at headquarters.

procedural problems in bank restructuring and privatization initiated under the PSAL, the World Bank has postponed the start of negotiations for a follow-up adjustment loan (PSAL2). Moreover, renewed delays in the privatization of state-owned farms make it unlikely that the last US$50 million tranche of the agricultural sector adjustment loan (ASAL) will be disbursed before the expiration of the loan in December 2000.

5. **The European Union (EU) opened accession negotiations with Romania in early 2000.** The European Commission has effectively started negotiations with Romania by opening seven of the 31 "chapters" for negotiation, six of which have been successfully closed.[2] The main political parties elaborated in March 2000 a Medium-Term Economic Strategy (MTES) that describes the objectives and policies during 2000–04, consistent with improving living standards and meeting the conditions for EU membership in 2007. The MTES was fleshed out by an Action Plan that identifies economic and structural measures broadly in line with Fund- and World Bank-supported programs and EU policies. Romania is now eligible to receive EU assistance under two pre-accession aid facilities (SAPARD, relating to rural development and agriculture, and ISPA, relating to infrastructure), in addition to PHARE programs. The annual budget allocated as of 2000 for the three programs by the Commission amounts to €630 million, or some 1½ percent of Romania's annual GDP. Disbursements under the ISPA and SAPARD programs are not expected to take place before 2001.

6. **The quality and timeliness of statistical reporting by Romania are generally sufficient for surveillance and program monitoring** (Appendix IV). According to a recent multisector report prepared by the Fund's Statistics Department, data on all sectors are of generally good quality but could be further improved as follows: for the national accounts data, the availability lag should be reduced; for the price and the money statistics, the methodology should be upgraded; the fiscal data, with limited effort, could be made more consistent with the monetary data; for the balance of payments statistics, the persisting problems related to the financial account and a typically positive Errors and Omissions item (attributable in part to incomplete coverage of direct investment as well as grants and other transfers) should be addressed.

7. **Critical parliamentary and presidential elections are scheduled for November 26, 2000.** The cohesion of the cabinet has been undermined by the decision of each of the four parties in the center-right coalition to run independently in the parliamentary elections and to support their own candidate for the presidency. Following President Constantinescu's decision not to seek reelection, Prime Minister (and former NBR Governor) Isarescu is running for President. Meanwhile, leaders of the "Party of Social Democracy in Romania" (PDSR)—the main opposition party headed by former President (and presidential candidate) Iliescu—have sought to alleviate market concerns about their policy intentions

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[2] The six chapters closed pertained to small- and medium-sized enterprises; education, training and youth; science and research; external relations; common foreign and security policy; and statistics. It is reported that two more chapters—regarding competition policy and telecommunications—will be opened for negotiations by the end of this year.

should they be part of a new government, through public assurances that they will cooperate closely with the Fund and the World Bank and that they will in general pursue policies consistent with EU accession over the medium term.

II. Economic Background

8. **Romania's progress in stabilization and reform compares unfavorably with that of many other transition economies, notwithstanding some catching-up in recent years.** Among the transition economies in Central and Eastern Europe (CEE) that are also candidates for accession to the EU, Romania's inflation rate—over 40 percent—is by far the highest, while its rankings in terms of other key indicators of economic and policy performance (per capita income, change in real GDP during the 1990s, and progress in structural reform) are among the two lowest (Figures 1–3 and Tables 1–2). This situation is in part attributable to difficult initial conditions: pre-transition policies emphasized inefficiently large agricultural units, energy-wasting heavy industry, unproductive infrastructure projects, and—in the 1980s—import compression to allow early repayment of foreign debt, at the expense of equipment modernization and living standards. But, even more important, it reflects a hesitant and often weakly implemented approach to structural reform and a stop-and-go pattern of macroeconomic policies.

9. **Prior to 1997, Romania's transition performance appeared to be satisfactory, while underlying imbalances built up** (Figures 4–5). Following a typical combination of an output contraction and inflation burst in the early years of the transition, Romania started recording comfortable growth rates and declining inflation in 1994. However, this was principally the result of "remedies" (large subsidies to inefficient firms, rising fiscal and quasi-fiscal deficits, a rapid accumulation of foreign debt from negligible levels, and exchange and price controls) that aggravated the underlying macroeconomic imbalances, resulting in unsustainable conditions by late 1996.

10. **Notwithstanding some key reforms in early 1997 by a newly elected center-right coalition government, the Romanian economy veered back toward financial instability by late 1998.** In early 1997, the price, exchange and trade systems were comprehensively liberalized, quasi-fiscal subsidies through the National Bank of Romania (NBR) were terminated, and fiscal policy was tightened. However, the process of privatization stalled almost from the start; restructuring mainly took the form of labor shedding in nonstrategic, declining industries.[3] Together with the inevitable contraction in output, a reduction in monthly inflation following the surge due to the price/exchange rate liberalization measures and a buildup in foreign reserves to unprecedented levels prompted the authorities to relax macroeconomic policies, while allowing the leu to appreciate in real terms as a means of containing inflation (Figures 6–9). These policies contributed to a lowering of inflation to 41 percent by December 1998, but also to the widening of an unsustainably large current account deficit of US$3.0 billion (7.2 percent of GDP) in 1998 and a further decline in output (of a cumulative 11 percent in 1997–98). As of late 1998, foreign reserves were being drawn

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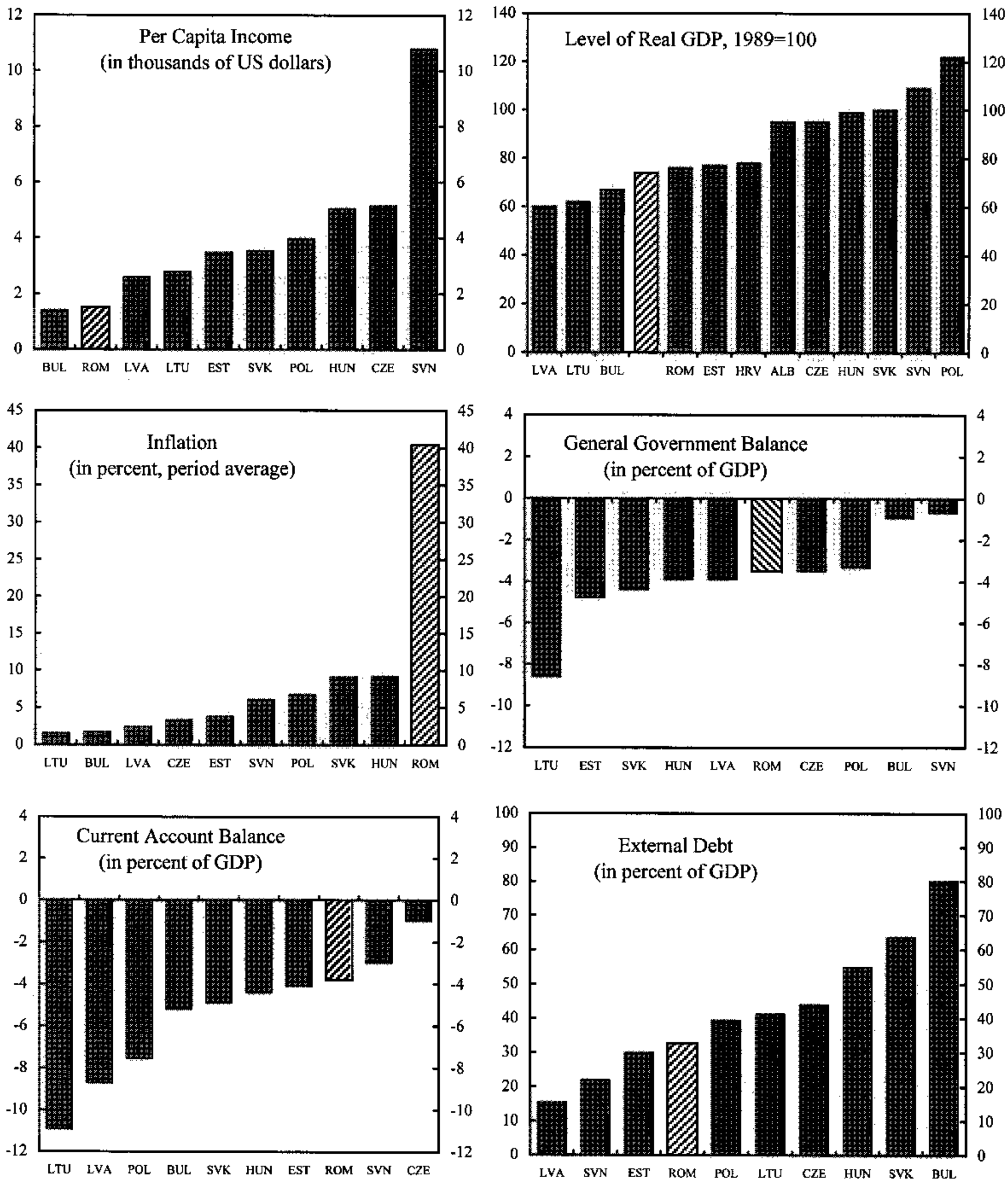
[3] Registered employment in industry has declined by about one-third since late 1996.

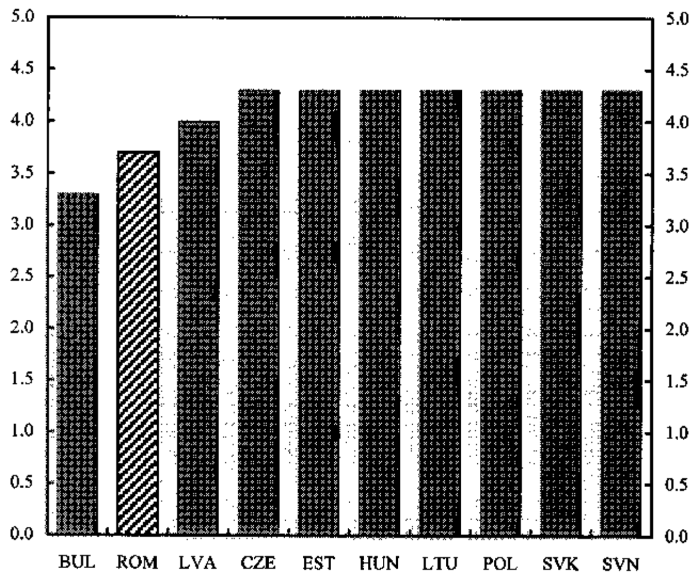
Figure 1. Romania: International Comparisons, 1999



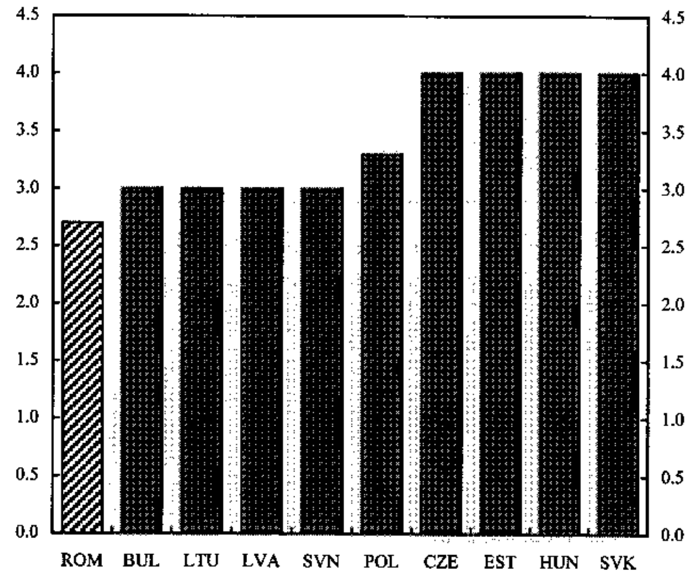
Source: World Economic Outlook.
Note: BUL, Bulgaria; CZE, Czech Republic; EST, Estonia; HUN, Hungary; LVA, Latvia; LTU, Lithuania; POL, Poland; SVK, Slovak Republic; and SVN, Slovenia.

Figure 2. Romania: International Comparisons
Role of Private Sector and Foreign Investment , 1999

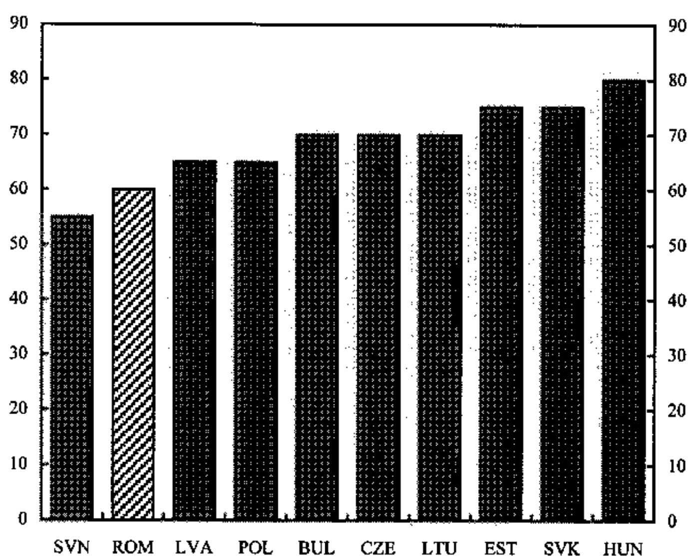
Index of Small Scale Privatisation 1/



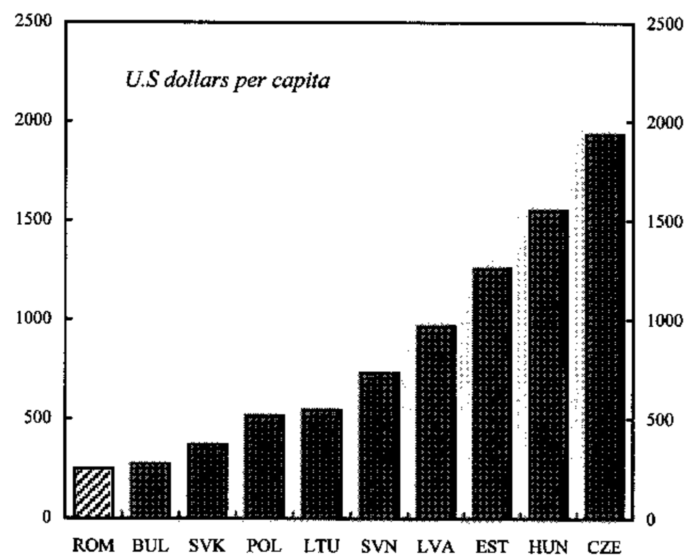
Index of Large Scale Privatization 1/



Share of Private Sector in GDP, in percent



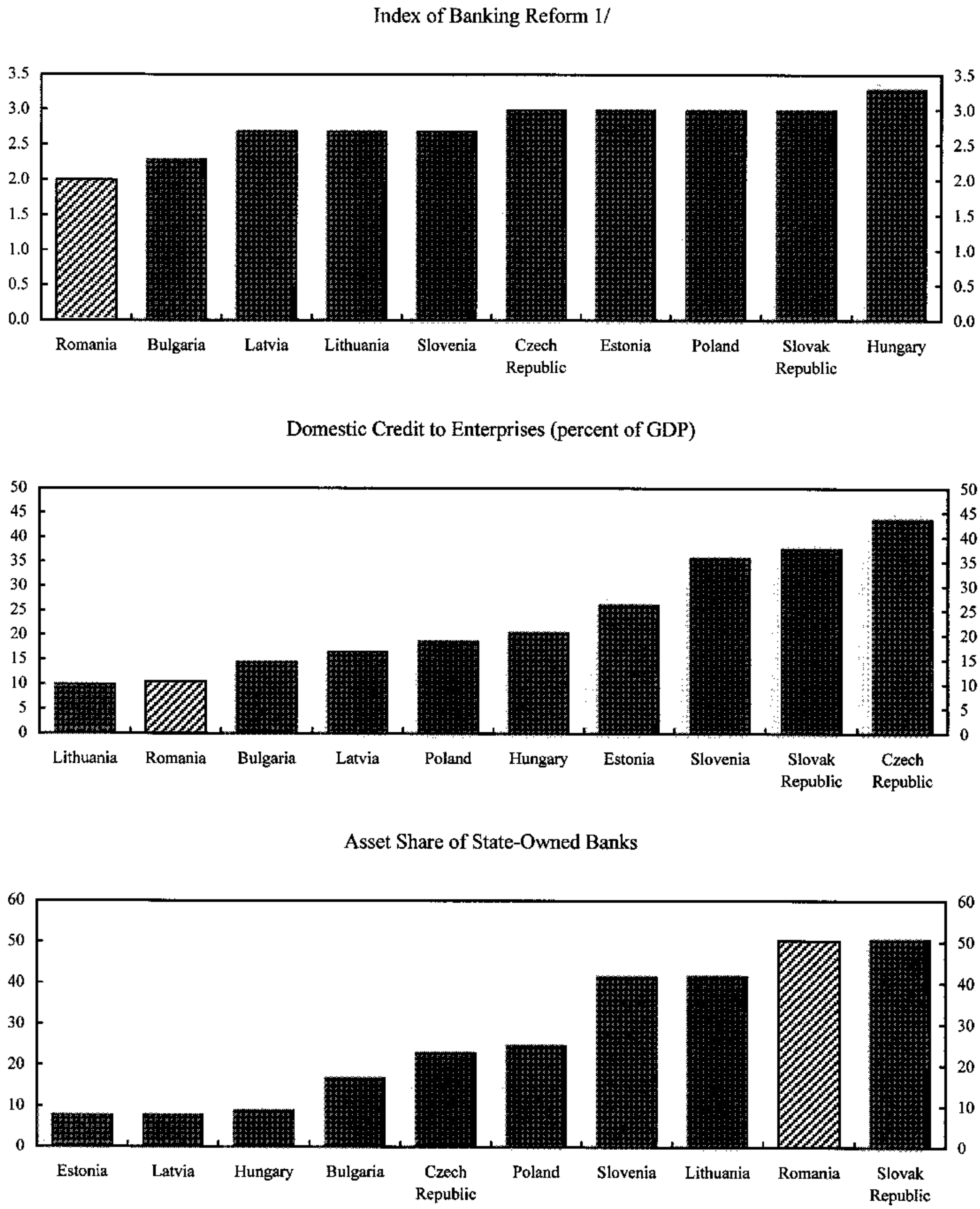
Cumulative Foreign Direct Investment in 1992-99



Sources: EBRD Transition Report; data provided by the authorities; and Fund staff estimates.

1/ Index compiled by EBRD.

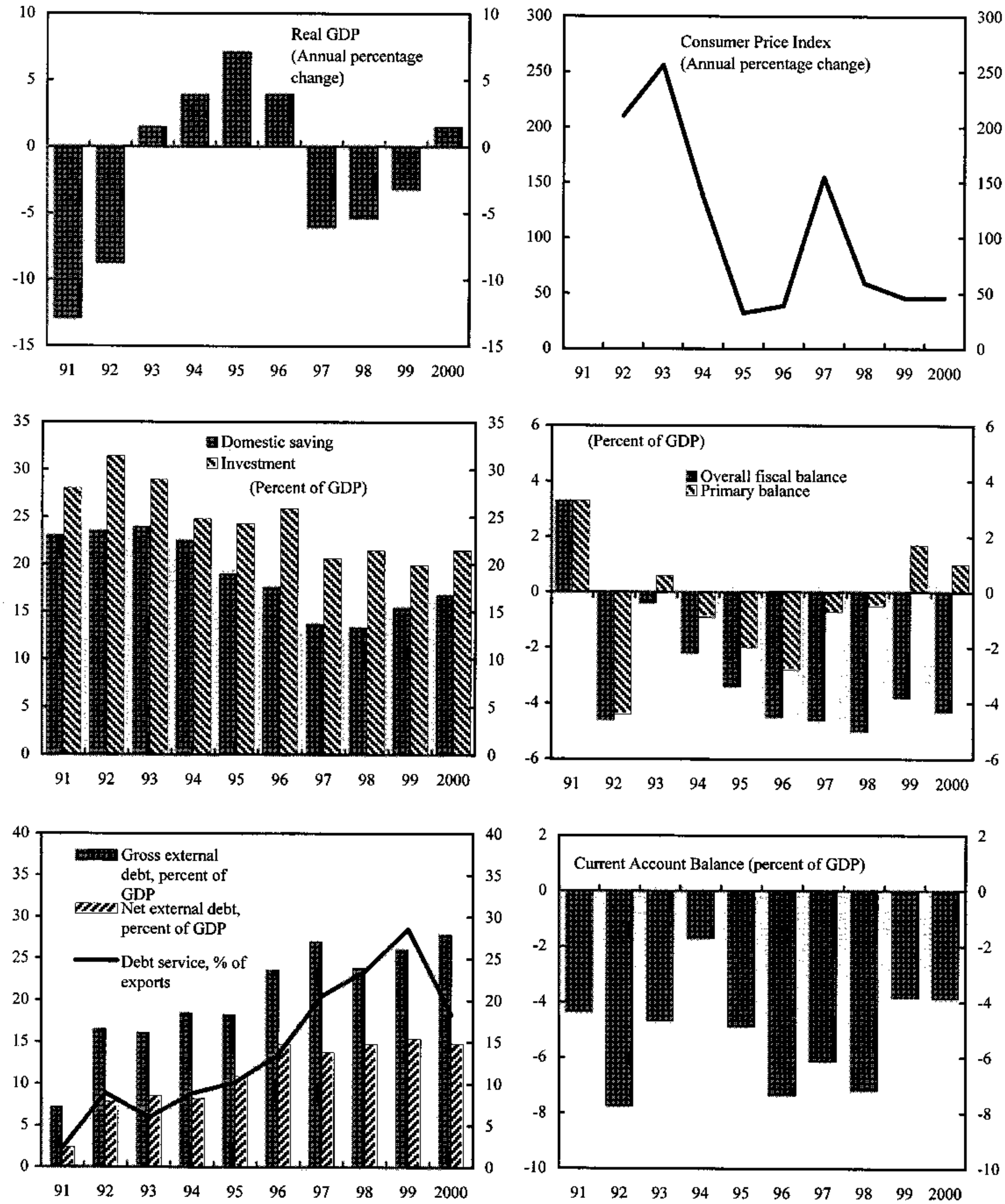
Figure 3. Romania: International Comparisons, Banking Systems, 1999



Sources: EBRD Transition Report; data provided by the authorities; and Fund staff estimates.

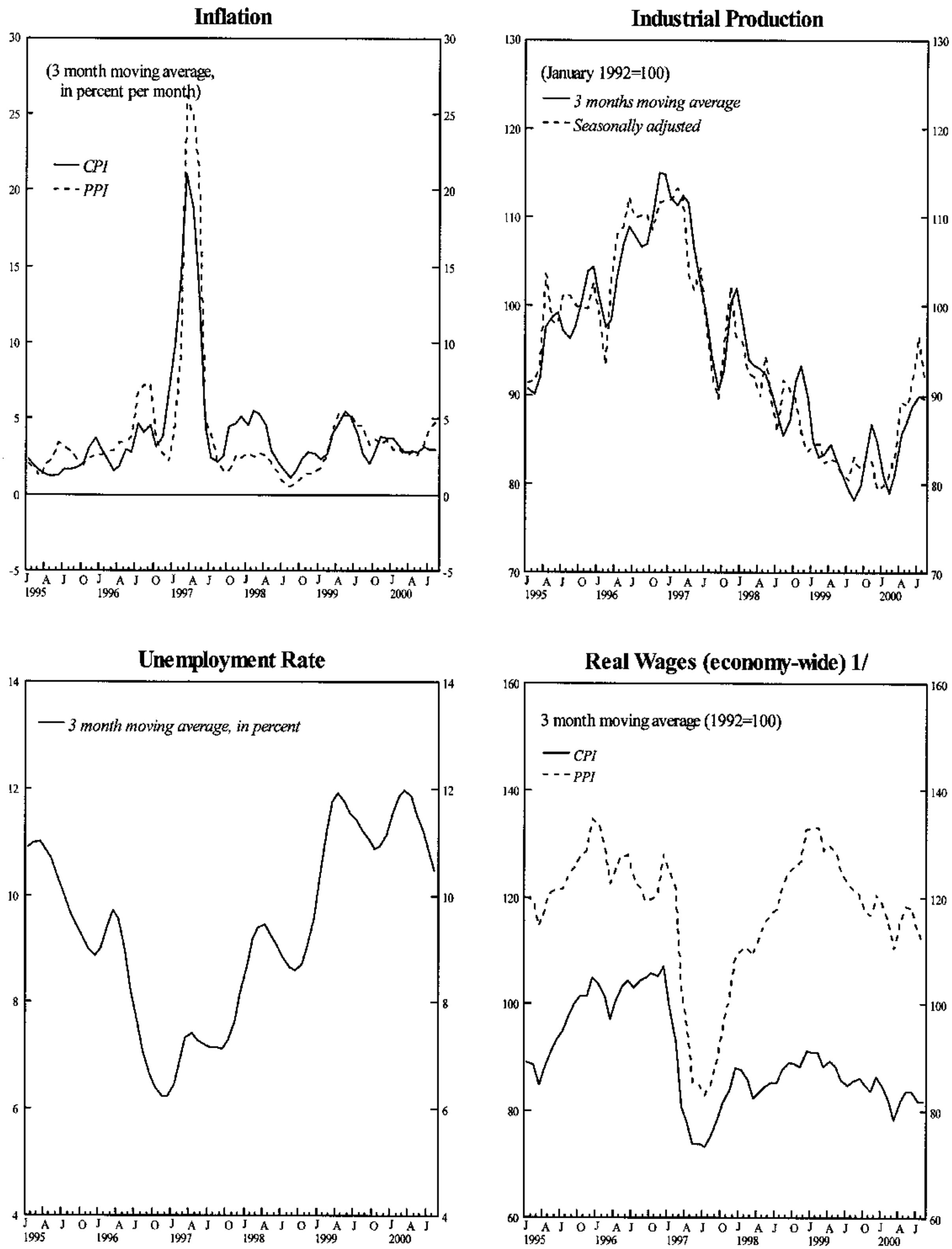
1/ Index compiled by EBRD.

Figure 4. Romania: Selected Economic Indicators, 1991-2000 [1/]



Sources: Romanian authorities; and Fund staff estimates and projections.
1/ Projections for 2000.

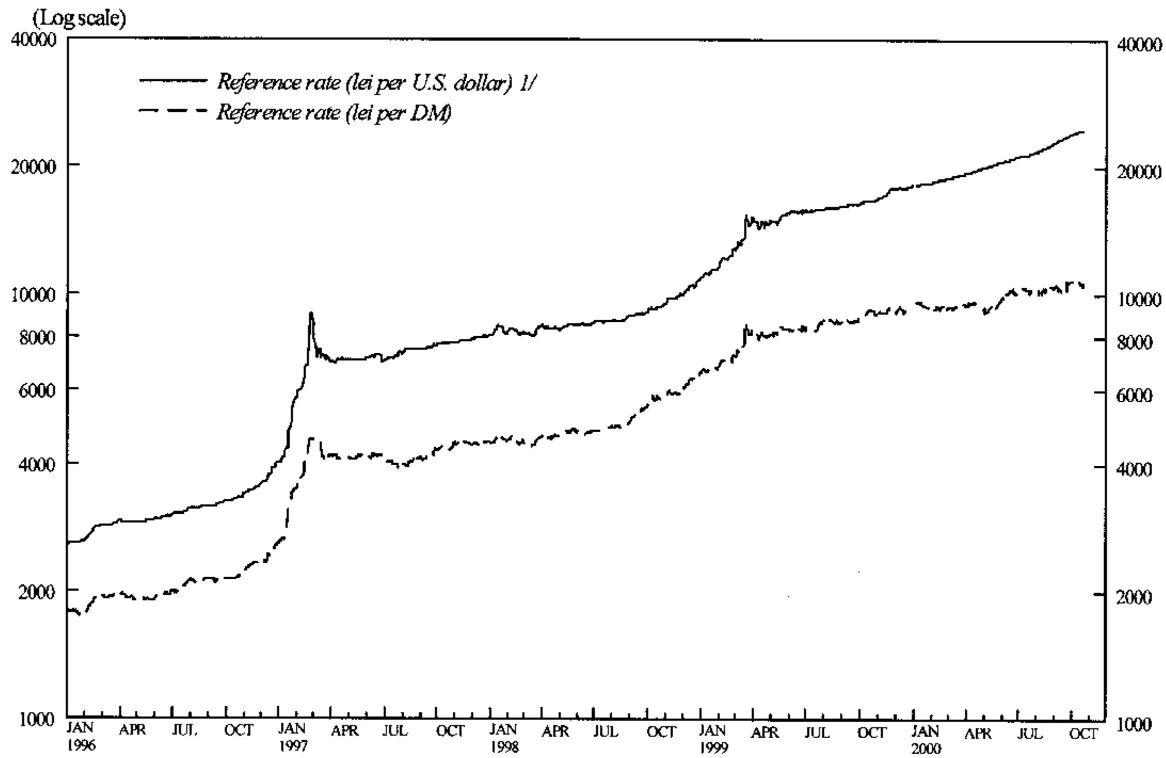
Figure 5. Romania: Economic Indicators, 1995-2000

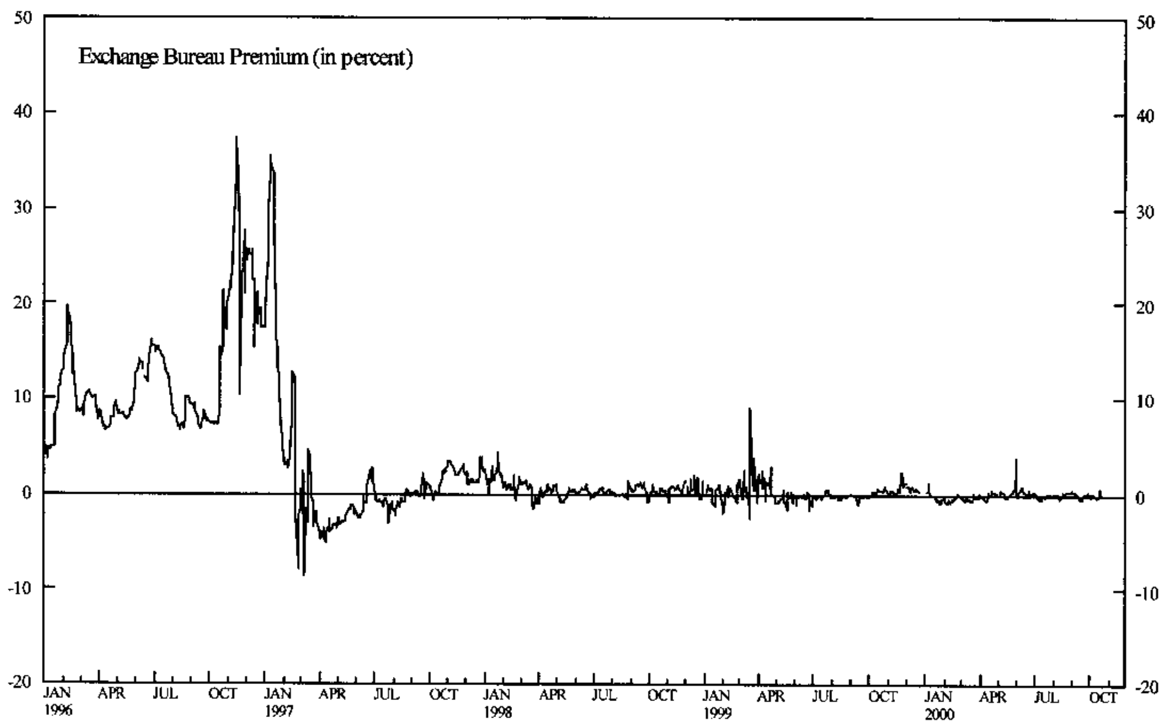


Source: Data provided by the Romanian authorities.

1/ Monthly average wage deflated by the consumer and producer price indices.

Figure 6. Romania: Exchange Rate Developments, 1996-2000



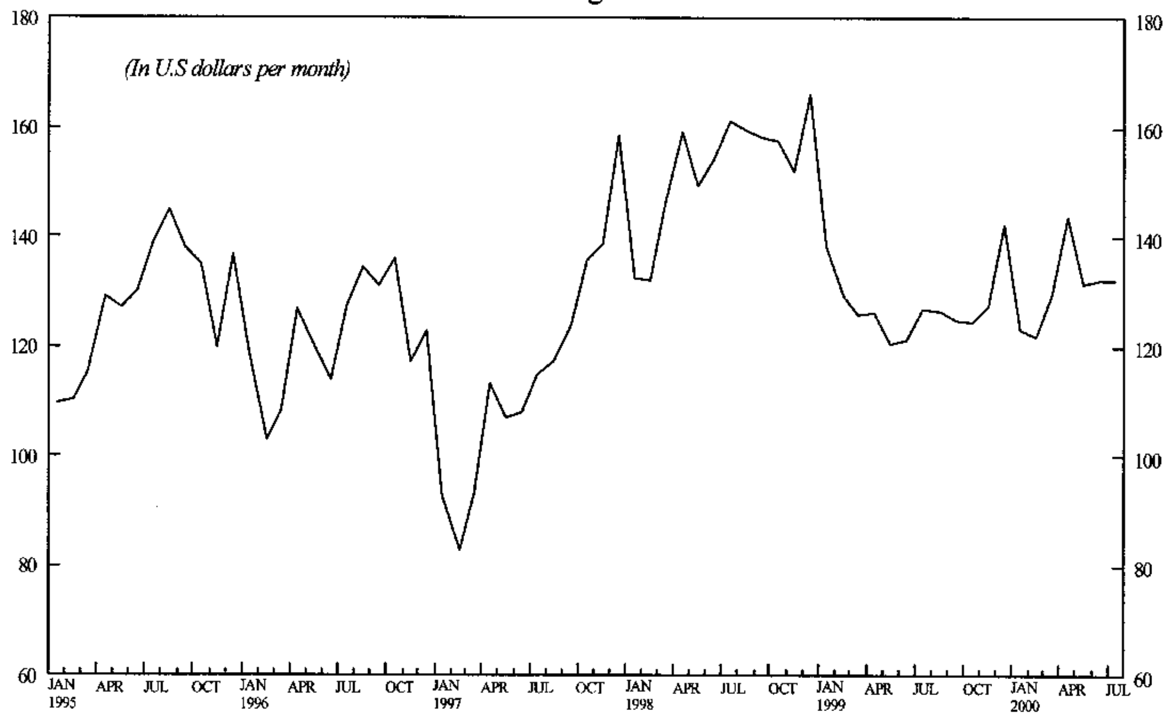


Source: National Bank of Romania.

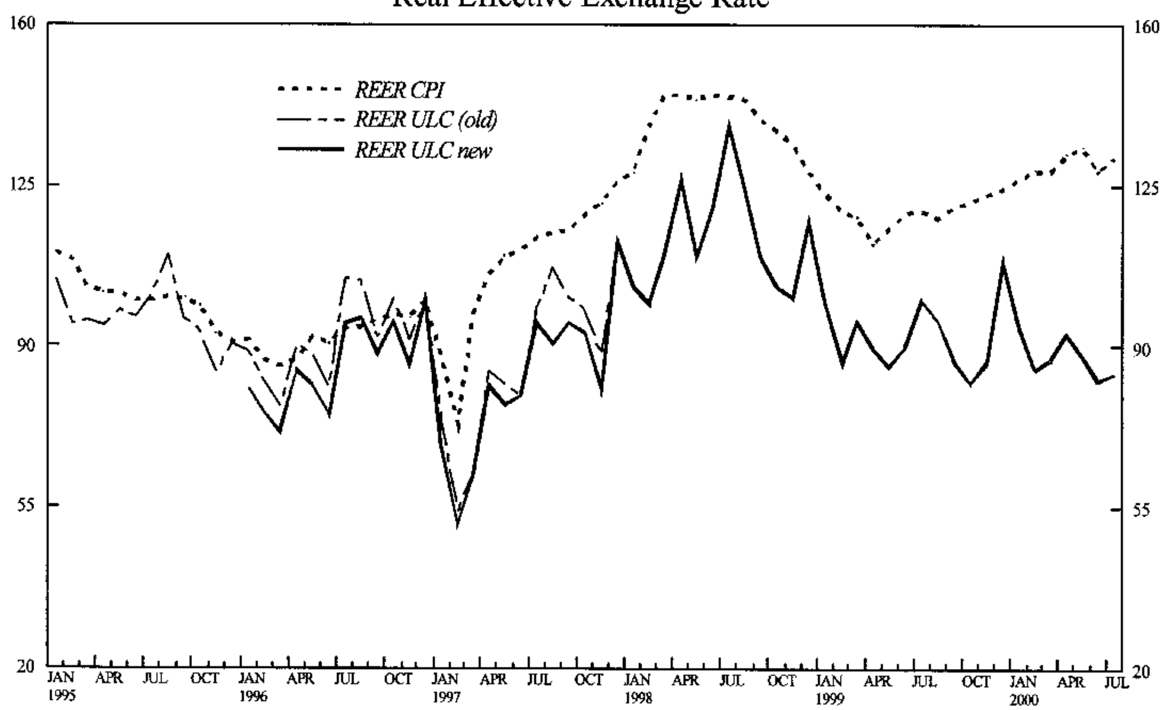
1/ The official reference rate is published by the National Bank of Romania, computed as a weighted average based on the daily reports of foreign exchange operators.

Figure 7. Romania: Wages and Real Effective Exchange Rate, 1995-2000

Wages



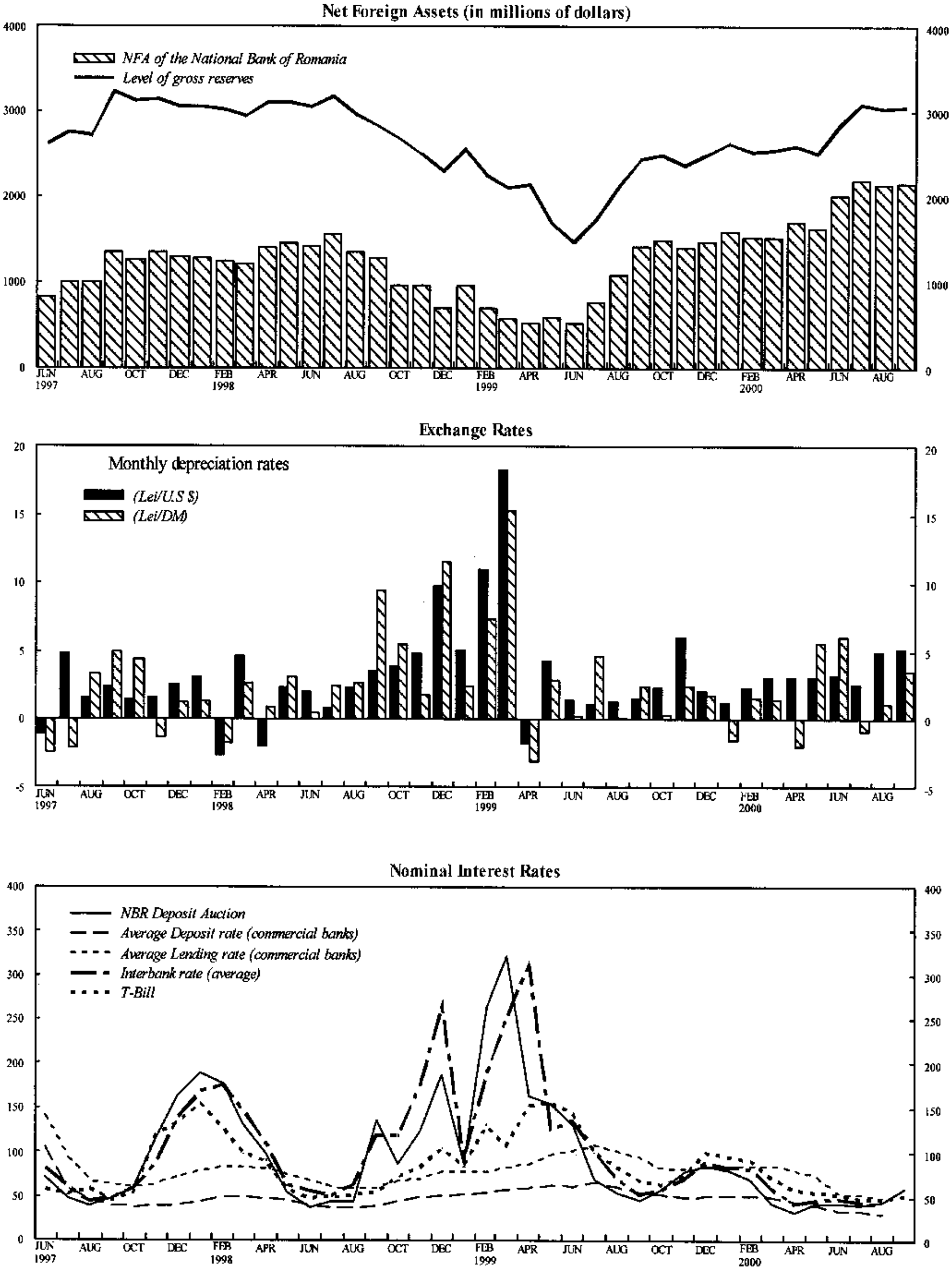
Real Effective Exchange Rate



Sources: Data provided by the Romanian authorities; and Fund staff estimates.

Figure 8. Romania: Reserves, Exchange Rates, and Interest Rates, 1997-2000

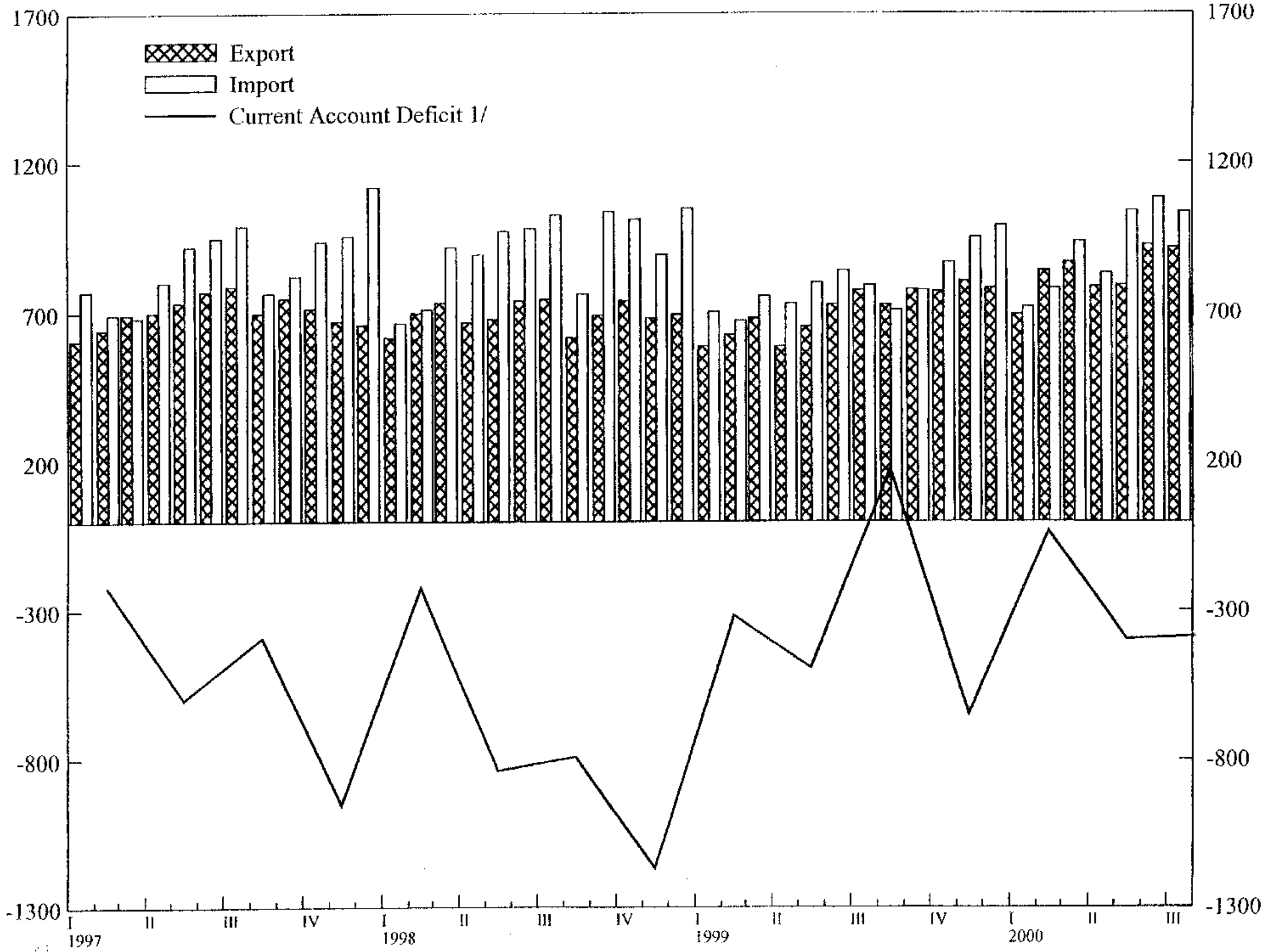
(In millions of U.S dollars)



Source: Data provided by the Romanian authorities.

Figure 9. Romania: Current Account Developments, 1997-2000

(In millions of U.S dollars)



Source: Data provided by the Romanian authorities.

down rapidly, owing to developments in the current account and difficulties in accessing the international capital markets, which were due to a weakening of investor confidence exacerbated by the Russian crisis; and the market became increasingly concerned about the risk of a default on US$0.8 billion of privately held bonds falling due in May–June 1999.

11. **Confronted with the threat of an impending crisis, the authorities took decisive policy measures in early 1999 to stabilize the economy.** The economic program encompassed strong fiscal correction, an improvement in external cost competitiveness, tight monetary and incomes policies, and the closure of a large insolvent state bank (Bancorex), whose operation complicated the conduct of monetary policy and undermined confidence in the banking system. These policies succeeded in reducing the current account deficit to a sustainable level (US$1.3 billion or 3.8 percent of GDP, as compared to the SBA target of US$2.2 billion or 6.9 percent of GDP) and strengthening foreign reserves since mid-1999, thereby helping restore market confidence (Text Table 1).[4] However, the market outlook remained cautious, and gross foreign borrowing from the private sector (which otherwise would have largely offset the repayments of the privately held bonds in mid-1999) remained low. Owing in part to burden-sharing considerations, but also to slippages in the policy and reform agenda adopted by the government, there was also a shortfall in disbursements from official creditors. Meanwhile, output declined by a further 3.2 percent in 1999, and CPI inflation rose to 55 percent at end-1999.

12. **In 2000, on the back of the previous year's policy corrections, Romania has witnessed an export-led economic recovery, but policy slippages have taken their toll on inflation.** After having declined by around 14 percent during 1997–99, real GDP grew by 2.1 percent in 2000H1 (year-on-year), thanks to buoyant exports and stock-building. Exports rose by 25½ percent in dollar terms in January–August 2000 (year-on-year), reflecting strong foreign demand, the coming on stream of new export activities, and the lagged effects of last year's improvement in cost competitiveness. Imports have also picked up strongly, rising by 21 percent in dollar terms over the same period, mainly on account of strong demand for intermediate and capital goods as well as higher fuel prices. Gross official foreign reserves reached US$3.1 billion (2.7 months of total imports or about 120 percent of short-term debt by remaining maturity) at end-July 2000. However, the 12-month CPI inflation rate amounted to 45½ percent in August, well above targeted levels, owing to exogenous factors (mainly the effects of a drought on food prices) as well as policy slippage in the areas of state sector wages and domestic arrears.[5]

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[4] The considerably stronger-than-programmed current account performance reflects in part the authorities' tighter policies (including a larger than initially targeted leu depreciation) to offset a combined shortfall of official and private financing of US$1.1 billion.

[5] The drought is roughly estimated to have added 5 percentage points to inflation in 2000; however, the effect of higher international fuel prices has been largely offset by the decline in the euro vis-à-vis the U.S. dollar (the fuel excises are euro-denominated) and increased excise evasion. (There has been a large shortfall in excise collection in 2000.) On the other

(continued...)

Text Table 1: Overview of Macroeconomic Developments, 1998-2000

	Current Estimates			SBA Estimates			Revisions		
	1998	1999	2000	1999	2000		1999	2000	
					Orig.	Rev.		Orig.	Rev.
Real sector (percent change)									
Real GDP	-5.4	-3.2	1.5	-3.5	2.5	1.3	0.3	-1.0	0.2
CPI (end of period)	40.6	54.8	40.0	38.3	15.0	27.0	16.5	25.0	13.0
(period average)	59.1	45.8	45.9	41.4	18.6	39.0	4.4	27.3	6.9
Nominal wages (end of period)	38.7	45.8	48.3	...	...	33.5	...	...	14.8
(period average)	60.3	44.3	46.1	27-34	...	39.5	...	...	6.6
Dollar wages (period average)	31.9	-16.1	3.3	-20.0	...	4.0	3.9	...	-0.7
Public finances (percent of GDP)									
Revenues (excluding grant)	30.2	33.3	32.2	33.5	32.6	32.6	0.4	-0.4	-0.4
Primary expenditure	30.7	30.4	31.1	29.3	29.5	30.5	1.9	1.6	0.6
Interest and bank restructuring expenditure	4.5	6.2	5.3	7.9	5.0	5.6	-1.8	0.3	-0.3
Primary balance	-0.5	2.5	1.0	4.3	3.1	2.1	-1.7	-2.1	-1.1
Overall balance	-5.0	-3.8	-4.2	-3.6	-1.9	-3.5	0.1	-2.3	-0.7
External accounts (in billions of US$)									
Current account	-3.0	-1.3	-1.5	-2.2	-2.0	-1.4	0.9	0.5	-0.2
(in percent of GDP)	-7.2	-3.9	-4.3	-6.9	-6.2	-3.9	3.0	1.9	-0.4
Current account plus foreign direct investment	-0.9	-0.4	-0.5	-0.8	-0.6	-0.2	0.4	0.1	-0.3
Exceptional official financing (in billions of US$)	0.0	0.3	0.5	1.0	...	1.0	-0.7	...	-0.5
Reserves (in months of imports of G&S)	2.4	2.3	2.8	2.8	3.4	3.1	-0.5	-0.6	-0.3
Export volume growth (in percent)	1.3	8.4	28.6	3.0	7.0	12.5	5.4	21.6	16.1
Import volume growth (in percent)	7.8	-10.1	19.4	-3.5	4.0	9.2	-6.6	15.4	10.2
Monetary base									
Lei reserve money (percent change) 2/	29.4	32.4	36.9	30.7	...	30.8	1.7	...	6.1
NFA contribution 3/	-45.5	22.6	36.4	32.2	...	47.1	-9.6	...	-10.7
NDA contribution	74.9	9.8	0.5	-1.5	...	-16.3	11.3	...	16.8

Sources: Romanian authorities; and IMF staff estimates.

1/ The SBA target for the primary balance in 1999 (a surplus of 4.1 percent of GDP) was premised on a primary deficit of 0.1 percent of GDP in 1998 which was subsequently revised to a deficit of 0.5 percent of GDP.

2/ Excluding the effects of changes in reserve requirement and assuming full compliance of reserve requirement. Minimum reserve requirement for lei deposits was increased from 15 percent to 20 percent in mid-July, to 25 percent on November 1, and to 30 percent on December 1, 1999. Minimum reserve requirement were not in full compliance in years before 2000 mainly due to non-observance of Banca Agricola and Bancorex.

3/ Excluding valuation changes.

hand, the significant deceleration of the leu in 2000 should have permitted a much larger reduction in inflation. (The leu depreciated by 32 percent against a US$/€ basket in the twelve months to August 2000 compared to 81 percent in the 12 months to August 1999; by comparison, 12-month inflation was 44½ percent in August compared with 49½ percent in August 1999.)

13. **Some of the program's key objectives for 2000 will be jeopardized by recent and prospective policy slippages.** The relaxation of wage policy in the state sector, as well as a larger than earlier envisaged fiscal deficit in 2000, will strengthen domestic and import demand and add to price pressures (see Table 3).[6] The current account deficit is thus expected to reach some US$1.5 billion (4.3 percent of GDP) in 2000, compared with a program target of US$1.4 billion.[7] Gross official foreign reserves should remain broadly at current levels (around US$3.0 billion), representing a significant shortfall from the end-year targeted level of US$3.5 billion, owing mainly to shortfalls in official financing. Inflation is expected to decelerate only slightly, if at all, in the remainder of the year, implying that the official end-year target of 27 percent will be exceeded by a large margin. As originally targeted, real GDP will probably grow by about 1.5 percent in 2000.

III. Report on the Discussions

14. The Article IV consultation discussions focused on: (a) progress in stabilization and reform over the past two years and the current situation; and (b) policies that would lower inflation and place Romania on a path of sustainable growth, consistent with progress toward EU accession. Given the proximity of elections scheduled for November 26, the discussions on the medium-term policy agenda were held with both the authorities and—at a more general level—leaders of the opposition. Meanwhile, understandings could not be reached on policies required to complete the second SBA review, owing to outstanding issues in the areas of state sector wages, domestic arrears, and a staff-estimated fiscal gap; moreover, delays occurred in the privatization of both banks and enterprises.

15. **Regarding developments in 1999–2000, the mission pointed not only to considerable policy achievements but also to missed opportunities.** Against the background of an impending financial crisis, the strong corrective measures in 1999—notably in the areas of the budget and external cost competitiveness—helped narrow the current account deficit to a sustainable level, replenished foreign reserves, and averted a financial crisis. With external competitiveness and sustainability restored, the 2000 program appropriately did not involve further corrections in the fiscal accounts and the real exchange rate, which had reached an appropriate level. Instead, the program sought to support an export-led economic recovery, lower inflation sharply, and put the economy on a sustainable path, with an emphasis on state sector wages, employment, and domestic arrears policies. The overall fiscal deficit in 2000 was to remain constant in relation to GDP and the stance of monetary policy was to be broadly unchanged. In the event, while most of the performance

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[6] Given that Romania is both a producer and importer of oil—with only relatively small net imports—the recent increase in oil prices is estimated to have resulted in only a moderate terms of trade loss of 0.4 percent of GDP. Moreover, the loss of stimulus to the economy was even lower because of the effective erosion of fuel taxes (see above).

[7] The trade deficit is now projected to be US$0.4 billion more than originally projected but this is largely offset by higher-than-expected inflows of private remittances.

criteria for end-June were observed, slippages since then will render most of them unlikely to be met for the rest of the year (see Box 1 and Table 4). Specifically, wage increases in the state sector shortly after the SBA review was completed in June 2000 have far exceeded the targeted levels;[8] implementation of employment cuts in the civil service has strayed from the original plans; the arrears targets have not been observed despite some reported improvement in recent months; and the fiscal deficit target is expected to be overshot by 0.7 percent of GDP in 2000 owing to additional spending including wage increases, and a revenue shortfall owing to large-scale excise evasion. In the area of structural reform, after good progress in 1999 and some promising steps in early 2000 under the World Bank's PSAL, privatization/ resolution of banks and enterprises has either stalled or proceeded very slowly. The mission stressed that further policy slippages should be avoided, in order to prevent a relapse into the "stop-and-go" policy pattern, which had undermined sustained growth in the 1990s.

16. **On their part, the authorities stressed that a great deal has been achieved over the past two years under difficult circumstances.** While broadly agreeing with the mission's assessment of economic developments and policies in 1999–2000, the authorities considered that the policy slippages had to be viewed in the context of an adverse social and political environment; and indeed that policies in 2000 were far more prudent than in 1996, another election year. They also pointed to a decline in inflation from 55 percent at end-1999 to 45½ percent in August 2000 as evidence of progress in disinflation, even though they acknowledged the mission's point that the drop in inflation rate reflected the more stable exchange rate following the large corrective adjustment in 1999. They also emphasized that the implementation of the Private Sector Involvement (PSI) initiative had adversely and unfairly impacted the Romanian economy by complicating access to the capital markets and inappropriately delaying completion of the review. (On the latter issue, the staff noted that policy slippages would have prevented the early completion of the review in any event.) In addition, they cited Romania's recent successful recourse to the private capital markets (through a three-year, 11 percent interest, €150 million bond issue in September) as evidence of Romania's strengthened and fundamentally viable external position.

17. **Against the background of Romania's acceptance as a candidate for EU accession, and its difficult starting position, the discussions on medium-term policies highlighted the following themes:**

- Pending improvement in corporate governance through privatization, the disinflation strategy will need to include policies to contain *wage* growth and enhance *financial discipline* in the state sector.

- The sustainability of the *fiscal consolidation*, and hence of disinflation and external adjustment, will critically depend on a rationalization of expenditures and reform of the pension system.

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[8] On the occasion of the approval of the 2000 budgets for state-owned companies in July, wage increases of 17 percent in excess of the annual limits under the SBA were granted.

- The disinflation process will be facilitated by a more explicit *monetary policy framework and exchange rate regime* (such as exchange rate or inflation targeting), to be introduced as soon as circumstances warrant.

- The institutional basis for a healthy *financial system* (both banks and nonbanks) should be set through further privatization and enhancement of the financial sector regulations and supervision, to bring them fully in line with the best international standards.

- Romania needs to catch up with progress in other CEE countries by urgently accelerating *enterprise privatization* and adopting legal/administrative measures to improve the *business environment.*

Box 1: Policy Developments Under the Stand-By Arrangement in 2000

The policy discussions for the second SBA review took place against the background of uneven policy implementation so far in 2000 and pressures for policy relaxation in the run-up to the elections. On the positive side, most of the end-June performance criteria were observed as macroeconomic policies were broadly on track—with the exception of the performance criteria relating to domestic arrears which were not observed by large margins. However, more slippages have emerged in the second half of 2000. On the basis of the latest available data, the budget has been on track through August but the program target of a fiscal deficit of 3.5 percent of GDP in 2000 is nonetheless likely to be exceeded by 0.5–0.8 percentage points, owing to government decisions to raise spending in September and large scale tax evasion. While broadly in line with the program, monetary policy was unduly eased in mid-year owing to incomplete sterilization of large foreign exchange inflows and political pressures to lower interest costs for budget financing. In the case of wage policy, serious slippages have occurred, including large increases in wages in state-owned enterprises and failure to implement employment cuts (some of which had been announced as already implemented). Measures to contain domestic arrears were delayed owing to a legal challenge to the original ordinance and its subsequent renegotiation, and arrears to utilities increased by 20 percent in real terms in the first seven months as a result. In the area of structural policies, important and tough decisions regarding restructuring and privatization of banks and enterprises have been put off; as a result the World Bank has abandoned plans to proceed with discussions on another adjustment loan before the elections. In the circumstances, it was not possible to reach understandings to address, or compensate for, slippages in a number of policy areas (state sector wages and employment, domestic arrears, a prospective fiscal gap, and bank restructuring).

A. Medium-Term Outlook

18. **The economic objectives contained in Romania's Medium-Term Economic Strategy (MTES) are generally ambitious and appropriate.** The MTES is predicated on labor-intensive, export-led growth, and on a strong rebound in investment and foreign capital

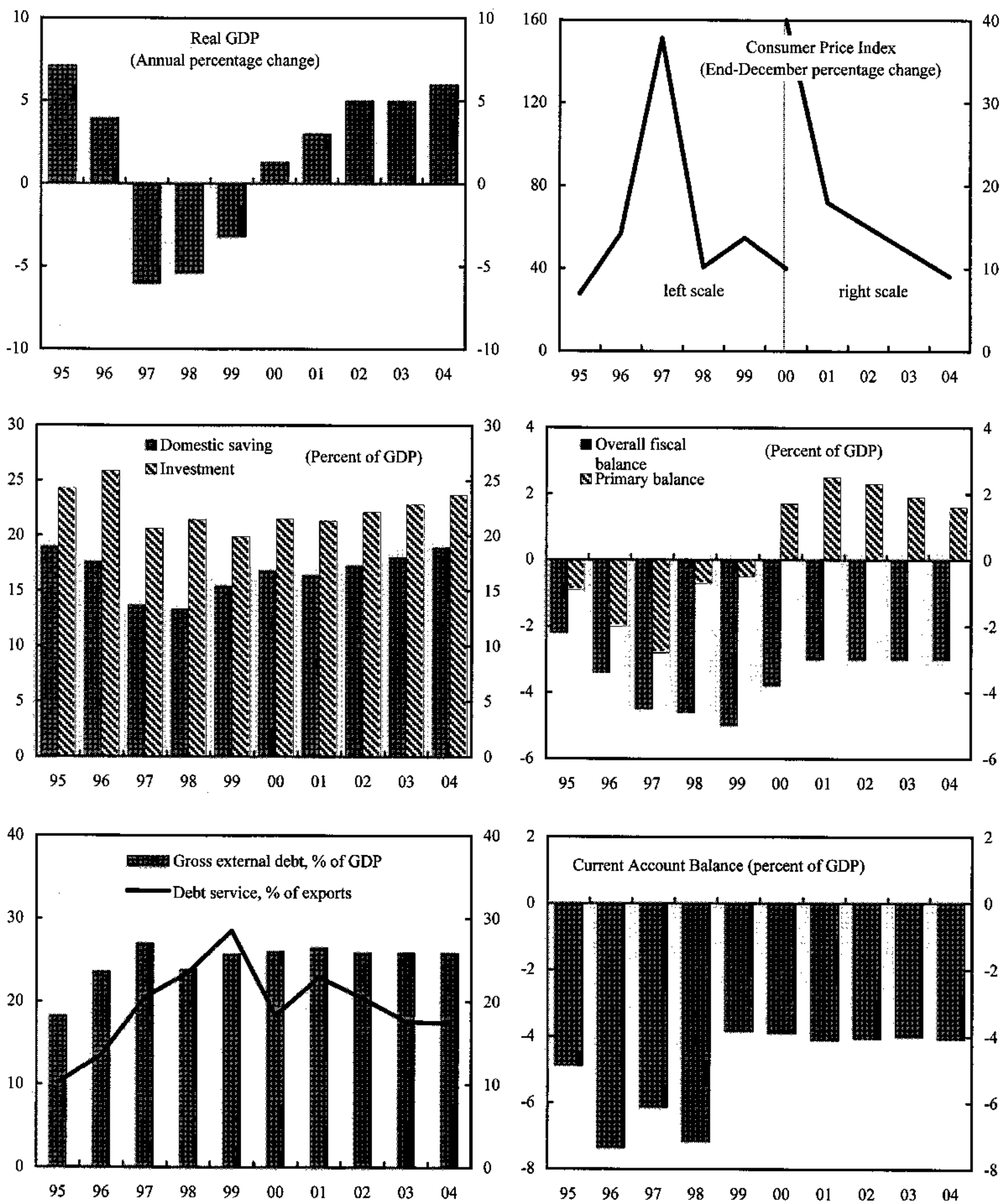
inflows. It envisages a single-digit inflation rate by 2004; real GDP growth of 3 percent in 2001, rising to about 5 percent in subsequent years; a current account deficit of around 4 percent of GDP over the medium term, broadly corresponding to projected FDI inflows; a buildup of foreign reserves to the equivalent of around five months of imports; and a roughly constant external debt in relation to GDP (Figure 10). These objectives remain generally valid in light of the latest macroeconomic developments and prospects, with the exception of the inflation rate, which will need to be revisited, as with significantly higher inflation in 2000, the objective of reducing inflation to a single-digit level by 2004 now requires an even steeper deceleration of prices through intensified policy efforts.

19. **The policy stances described in the authorities' supporting Action Plan are generally sensible but in need of further elaboration.** The Action Plan, which was submitted to the EU in May 2000, envisages a fiscal deficit of up to 3 percent of GDP (with a further consolidation of quasi-fiscal deficits) over the medium term; tight monetary policy; and structural policy measures envisaged under programs supported by the Fund and the World Bank. The mission noted that, as for specific policy measures, they are not adequately comprehensive for the period after early 2001 as they are largely based on existing undertakings vis-à-vis the Fund and the World Bank, and would therefore need to be elaborated by the next government. The authorities explained that the chief objective of the action plan was to ensure that policies were consistent with those agreed with IFIs. In this light, the action plan would be continuously updated as new lending programs and policies are agreed with the multinational lenders.

B. Fiscal Policy

20. **While there was broad agreement that fiscal policy had contributed importantly to the stabilization effort since 1999, the mission cautioned that the fiscal position remained precarious**. The fiscal adjustment in 1999 was sizable, especially in terms of the 3 percent of GDP improvement in the primary balance, and fiscal developments in January–August 2000 were broadly in line with the program target for 2000 (Text Table 2). However, the mission noted that the fiscal deficit in 2000 is likely to amount to 4.3 percent of GDP (compared with an original target of 3.5 percent of GDP) owing to higher spending in the second half of 2000 on wages and material spending and a shortfall in excise, VAT, and social security contribution receipts; in the staff's view, the authorities' own revised budget deficit of 3.7 percent of GDP reflects an underestimation of personnel spending and a considerable overestimation of revenue. Indeed, the mission emphasized that the typically difficult and protracted process of budget preparation—as well as the subsequent slippages in its implementation, which required corrective/compensatory measures to bring the fiscal program back on track—all pointed to the precariousness of the fiscal position. This situation reflected difficult-to-reconcile differences on budget priorities among the governing coalition parties and political/social pressures for fiscal relaxation. On their part, the authorities expected revenue collections to significantly pick up in the remainder of the year as tax administration could be expected to improve, with previous problems now having been identified. They also observed that high and variable inflation made frequent budget revisions unavoidable.

Figure 10. Romania: Medium-Term Projections, 1995-2004



Source: 1995-2000 - Fund staff estimates and projections.
2001-2004 - Romanian authorities' draft *Medium Term Economic Strategy*, May 2000.

Text Table 2. Key Fiscal Developments, 1998–2000

	1998	1999	2000 Orig.Prog.	2000 Rev. Prog.	2000 Staff Proj.
Revenue	30.2	33.3	32.6	32.8	32.2
Expenditure	35.2	37.1	34.5	36.1	36.4
Primary expenditure	30.7	30.9	29.5	30.5	31.1
Wages	5.1	5.0	4.6	5.5	5.6
Pensions	6.8	7.3	6.9	6.9	6.9
Other	18.8	18.6	18.0	18.1	18.6
Interest/restructuring costs	4.5	6.2	5.6	5.6	5.3
Primary balance	-0.5	2.5	3.1	2.1	1.0
Overall balance	-5.0	-3.8	-1.9	-3.5	-4.3

21. **The mission cautioned that the MTES fiscal deficit target should be treated as an upper limit.** In the authorities' view, a fiscal deficit target of 3 percent of GDP over the medium term would appear to be reasonable on fiscal sustainability considerations, given a relatively low net government debt/GDP ratio (20 percent at end-1999), projected primary surpluses, and a likely improvement in the terms of foreign financing as various EU/EIB funds become available. While not questioning this assessment, the mission on the other hand emphasized that macroeconomic conditions may require a lower deficit, as the experience of more advanced transition economies in central Europe had shown. Accordingly, the authorities should be prepared to rely on fiscal policy for stabilization purposes, e.g., to offset the effects of large capital inflows—which have typically accompanied initial success with restoring confidence in the economy—on domestic demand and inflation.

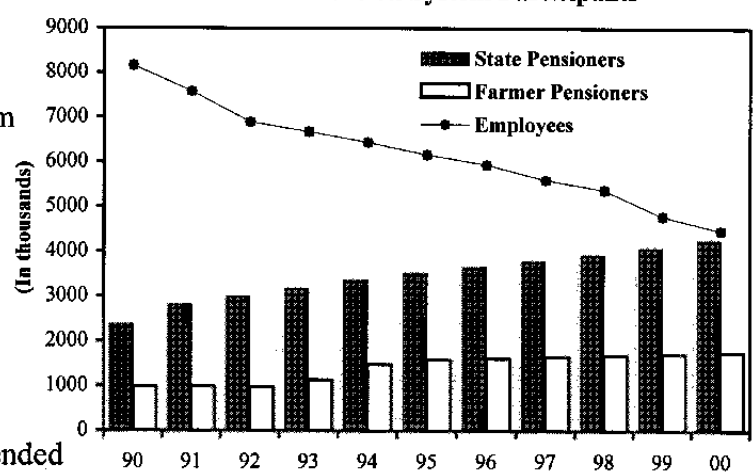
22. **Based on the staff's preliminary assessment, the 2001 budget should target a moderate tightening of the fiscal policy stance.** With final domestic demand likely to strengthen in 2001, as the export-led rise in output carries over to the rest of the economy, it would be desirable to withdraw some stimulus through fiscal policy—by reducing the fiscal deficit to no more than 3 percent of GDP compared with a projected deficit of more than 4 percent in 2000—in order to avoid undue pressures on prices and/or a widening of the current account deficit. The budget should be predicated on real GDP growth of about 3 percent and an end-of-period inflation rate of 20–25 percent, broadly in line with the MTES.

23. **The mission emphasized that fiscal policy over the medium term will be complicated by additional claims on budgetary resources related to preparations for EU accession and NATO membership, and to economic restructuring in general, as well as social pressures to raise government spending.** The EU accession process will impose additional spending commitments on the budget in the areas of the environment and social protection, and also in the form of domestic contributions to projects financed by EU structural funds; these could amount to 1 percent of GDP, according to preliminary staff estimates (see Chapter VI, Selected Issues). In addition, future budgets will likely be

burdened by the costs of financial sector restructuring, increased social transfers to mitigate the social costs of labor shedding as the pace of enterprise restructuring picks up, and likely budgetary transfers to the pension fund to alleviate severe financial pressures and allow some lowering of the unduly high contribution rates. Moreover, social pressures to raise spending on the barely adequate government services and social transfers are likely to persist, while an increase in the tax burden would not be feasible without serious adverse supply effects or further increases in tax evasion. In these circumstances, fiscal consolidation could be derailed by social pressures.

24. **In light of these prospective pressures on the budget, the mission emphasized that sustainability of the fiscal position will require expenditure and pension system reforms** (see Chapter II, Selected Issues). While important progress has been made with regard to the tax system,[9] a wide-ranging reform of the expenditure side of the budget is long overdue. Specifically, there is an urgent need for prioritization of expenditures, improved targeting of social benefits, and reduction of overstaffing. The World Bank is prepared to assist the authorities in conducting a Public Expenditure Review (PER) early next year. A key problem concerns poor expenditure control in local authorities, which gained a substantial degree of financial independence in 1999. Also, revenue has in the past been increasingly earmarked for specific expenditure purposes (in so called "special funds"), resulting in sharply curtailed budgetary room for maneuver to change expenditure priorities in line with shifting needs. Moreover, developments in the pension system since the beginning of the transition—involving a rapidly rising dependency ratio requiring ever higher outlays and contributions—are clearly unsustainable (Text Figure). To date, however, some of the tough decisions have been avoided. Accordingly, the mission recommended urgent measures to redress the problem in local authority finance; steps to free up sparse budgetary resources for higher priority spending by streamlining and eliminating special funds; and comprehensive reform of the public pension system, aimed at steadily reducing the contribution rates in the coming years. The latter will notably require effective enforcement of tightened eligibility requirements for old-age pensions. Once progress has been made in ensuring the sustainability of the public pillar, it would be appropriate to proceed with the introduction of a fully funded pension pillar.

Romania: Pension System Participants



Source: World Bank staff.

[9] The tax reform in 2000 involved a shift from direct to indirect taxes, a lowering of direct tax rates, the unification of the VAT rates, and a widening of the tax base through the elimination of many tax exemptions.

25. **The authorities indicated that these problems in government expenditures and the pension system were being addressed.** They noted that existing legislation prevented them from enforcing the needed improvement of local authority finance, and that they were looking at ways to modify legislation so as to hold localities more accountable. They also pointed to their plans to eliminate special funds. As for pension reform, they considered that the planned introduction of new regulations governing the public pension system early next year would begin restoring the viability of the system by raising retirement ages; putting statutory limits on the replacement rate; and subjecting more workers on "civil contracts" (mostly part-time) and the self employed to mandatory social security contributions. They expected that such a reform would stabilize the public pillar, thereby permitting an early introduction of a mandatory private pillar once the public pension system deficit was kept within a specific limit.

C. Wage and Financial Discipline Policies

26. **The mission noted that wage policy in 1999–2000 was problematic, thus contributing to the persistence of high inflation.** The program targets for state sector wage bills were less ambitious than warranted (especially with regard to the budgetary sector) since they had to accommodate earlier slippages, and even so, new slippages had again emerged during program implementation.[10] The staff now estimates that the 2000 wage bill in the state sector (which accounts for about 30 percent of the wage bill in the economy) will rise by at least 14 percent in real terms on the basis of the originally targeted rate of inflation, compared with the original target (set in May 2000) of a constant real wage bill. Moreover, employment cuts in the budgetary sector and régies autonomes were only partly implemented.

27. **Efforts to reduce domestic arrears have not been successful either.**[11] The targets for reducing arrears under the program—pertaining to arrears *to* the major energy utilities and to arrears *of* these utilities to the budget—have been consistently exceeded, and indeed arrears have risen significantly in real terms. This has reflected the delayed implementation

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[10] For the purposes of wage policy under the SBA, the state sector is defined to include the following: (a) the state budget, accounting for about 16½ percent of registered employment; (b) the régies autonomes and national companies (public utilities supervised by line Ministries), accounting for about 11½ percent of registered employment; and (c) 27 large loss-making state-owned commercial enterprises, accounting for about 2 percent of registered employment, and in the portfolio of the State Ownership Fund (SOF).

[11] As of end-1999, domestic arrears to the big utilities amounted to the equivalent of 2½ percent of GDP, while the tax arrears of the big utilities to the consolidated budget were equivalent to about 1½ percent of GDP, and total tax arrears to the consolidated budget are estimated to have exceeded 10 percent of GDP. However, a large portion of the latter arrears are nonrecoverable, representing claims on enterprises that are either insolvent or likely to have their tax arrears written off upon privatization. Total inter-enterprise arrears in the economy amounted to 40 percent of GDP at end-1999.

of legislation to address the problem and weak governance in the major utilities which are not effectively supervised by the line Ministries.

28. **Against this record, there was broad agreement on the need for renewed emphasis on wages and arrears policies in support of the disinflation effort.** Inflation in Romania has persisted unabated in recent years largely on account of rapid wage growth, fueled by financial indiscipline and arrears accumulation, especially in the state sector.[12] This points to the need for measures to control the growth in wages not only in the budgetary sector but also in state-owned enterprises, where corporate governance is very weak pending their restructuring and privatization. Such a policy would also have a desirable demonstration effect for the private sector, for which direct wage control would be neither effective nor desirable. As envisaged under the current Fund-supported program, the "automatic financing mechanism" for high wages through arrears accumulation needs to be broken, and wage control in the state sector will need to be supported by measures to improve financial discipline, including proper financial incentives for managers. As recent experience has shown, firm implementation of these measures will require political consensus and resolve.

D. Monetary, Exchange Rate, and Trade Policy

29. **The mission commended the NBR for the considerable tightening of monetary policy since early 1999, which nevertheless had little apparent effect on inflation.** Following an accommodating monetary policy during 1998, which effectively sterilized the effects on reserve money of large foreign exchange outflows, credit conditions have been considerably tightened since early 1999 (see Text Table 3, Table 5 and Chapter III, Selected Issues). However, inflation has remained high, influenced by the pass-through to prices of the sharp real depreciation in early 1999, and fueled by wage growth and accumulation of domestic arrears. In its conduct of monetary policy, the NBR has been faced with the difficult challenge of sterilizing large foreign exchange inflows and liquidity support to problem banks (especially to Bancorex in 1999 and, to a lesser extent Banca Agricola (BA)), against the background of an uncertain money demand during this period. In certain instances, e.g., mid-2000, monetary policy was unduly relaxed, owing to incomplete sterilization and pressures to lower interest cost for budget financing. Following a strong depreciation in late 1998–early 1999, the path of the exchange rate has broadly stabilized, with a monthly average depreciation of 2.6 percent against the U.S. dollar between May 1999 and August 2000, compared with 8.8 percent in the first four months of 1999.

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[12] A staff study in Chapter I of the Selected Issues identifies the rapid rise in unit labor costs as a major determinant of inflation in Romania in the 1990s.

Text Table 3. Contributions to Reserve Money Growth, 1997–2000						
	1997	1998	1999		2000	
			Program	Actual	Prog.	Staff Proj.
Reserve money	87.5	29.4	30.7	32.4	30.8	36.9
NFA (excluding valuation Effects)	89.7	-45.5	17.4	22.5	47.1	36.4
NDA	-2.1	74.9	13.3	10.0	-16.3	0.5

30. **The operational environment of monetary policy has improved considerably over the past year, while—notwithstanding high reserve requirements—reliance on market-oriented instruments has increased.** The closure of Bancorex and measures to consolidate BA balance sheet have drastically reduced the need for liquidity support that seriously compromised monetary policy conduct, while market confidence has improved as indicated by a trend decline in real interest rates in the interbank market. Meanwhile, the NBR has shifted increasingly toward market-oriented instruments in its sterilization operations, the driving force behind the development in NDA. Although the minimum reserve requirements remain high (30 percent for lei deposits and 20 percent for foreign currency deposits) and need to be lowered as soon the conditions permit, the NBR now conducts most of the deposit-taking operations through auctions, and has started to rely more on reverse repo transactions.

31. **The mission endorsed the monetary authorities' intention to move toward a exchange rate and monetary policy framework that incorporates a more explicit inflation or exchange rate commitment, after some critical conditions have been met.** The authorities explained that the current exchange rate regime of a managed float—operating in practice as an unannounced crawling peg that crawls at a rate broadly in line with targeted inflation—sought to strike a balance between two potentially conflicting objectives: (a) reducing inflation expectations through a degree of exchange rate stability, and (b) safeguarding the external position, which remains relatively weak and subject to considerable uncertainty. The mission observed that in practice the latter objective had usually taken precedence over the former and stressed that this pattern reflected the core unaddressed problem of poor financial discipline and corporate governance—resulting in high wage increases. Against this background, the mission shared the NBR's view that the risks of a new framework involving an *explicit* central bank commitment to a particular exchange rate *or* inflation path—in particular for the balance of payments outlook—would outweigh the potential benefits. Noting that the Action Plan submitted to the EU envisages the introduction of inflation (or exchange rate) targeting in 2003, the mission stressed that such a framework could be adopted only after Romania had made progress in improving financial discipline and bringing wage growth under control.

32. **Romania's external vulnerability has lessened following last year's external adjustment.** The authorities and the mission agreed that both fundamental and liquidity-based indicators of vulnerability improved in 1999 (see Tables 6-9 and Chapter V, Selected

Issues). In view of the improved external fundamentals, the medium-term outlook remains positive at this stage, as reflected by Romania's recent successful Eurobond issue (its first since 1997). Sustaining capital inflows will be essential to external viability. This, in turn, will require the maintenance of sound macroeconomic policies and continued structural reform, in particular to reduce fiscal vulnerability and to strengthen the banking system. The mission observed that Romania's external position is thus likely to remain vulnerable over the medium term to sudden changes in capital flows should perceived or actual imbalances reemerge (though the contraction of the current account deficit, if sustained, somewhat lessens Romania's exposure). In addition, efforts should be made to ensure the repayment profile of public external debt is relatively smooth.

33. **There was also agreement that the improved external outlook will permit the authorities to phase out the temporary import surcharge.** A surcharge of 6 percent was introduced in October 1998 in response to imminent balance of payments pressures. After scheduled reductions in 1999 and early 2000, it currently amounts to 2 percent. The mission welcomed the authorities' intention to phase out the surcharge in January 2001.[13]

E. Financial Sector Policies

34. **The mission noted the important progress in bank reform over the past two years** (see Chapter IV, Selected Issues). As of June 2000, state-owned banks accounted for less than half (45 percent) of total liabilities of the banking system, compared with 71 percent at end-1998, whereas the distressed banks' market share was reduced from 39 percent to 8 percent over the same period. Both developments reflect important restructuring measures and balance sheet consolidation by state-owned banks (see Text Table 4 below). Key among these measures was the closure of Bancorex; the privatization of two banks, including a large one; and the closure of three private "problem banks". In the area of banking regulations and supervision, the mission welcomed the authorities' implementation of an early warning system for bank supervision, the enhanced supervision enforcement decision matrix, and the adoption of new regulations on asset classification and provisioning (effective October 1, 2000).

[13] Based on the index of trade restrictiveness prepared by the Fund staff, Romania is currently rated as "moderately restrictive" (6 on a restrictiveness scale from 1 to 10).

Text Table 4. Developments in the Banking Sector, 1998–2000			
As a share of the total liabilities of the banking system	End-1998	End-1999	Mid-2000
Distribution of ownership:			
State-owned banks	71.4 %	46.8 %	45.1 %
Bancorex	22.7 %	Closed	Closed
BCR	19.7 %	27.9 %	26.4%
Savings Bank	9.0%	10.1%	10.8 %
Romanian Development Bank	7.7%	Privatized	Privatized
Banca Agricola	7.6 %	6.1 %	5.1 %
Banc Post	3.0%	Privatized	Privatized
Eximbank	1.7 %	2.7 %	2.8 %
Private banks and branches	28.6 %	53.2 %	54.9 %
Combined size of the problem banks:	38.9 %	12.2 %	8.1 %
State-owned problem banks:	30.3 %	6.1 %	5.1 %
Bancorex	22.7 %	Closed	Closed
Banca Agricola	7.6 %	6.1 %	5.1 %
Privately-owned problem banks	8.6 %	6.1 %	3.0%
(Number of banks)	(6)	(4)	(3)

35. **Nevertheless, in the mission's view, a large part of the banking system remains financially weak; certain aspects of the legal and regulatory framework are still unsatisfactory; and undue delays have recently occurred in the privatization/resolution of state-owned banks.** The banking system as a whole is unable to carry out its intermediation function effectively, as indicated by the very low ratios of broad money (and nongovernment sector credit) to GDP and by the unusually large spreads between deposit and lending rates.[14] While the reported profitability and capital adequacy ratios are typically comfortable for most banks, these reflect in part weaknesses in the accounting system, overvaluation of collateral, and incomplete compliance with loan loss provisioning requirements. Finally, progress in the privatization/resolution of BA and the Romanian Commercial Bank (BCR) has been much slower than expected under the program. BA has been maintained in operation—at a monthly operational loss of US$5 million—even though there is apparently no serious investor interest. A decision on BA's liquidation was to have been taken by end-June under the Fund-supported program but was postponed in light of investor interest that did not translate into a firm offer. In the case of BCR, target dates for the offer of the bank for sale (end-July 2000) and a firm binding offer (end-September) were not met, while—based on information leaked to the press—the planned privatization strategy

[14] The spreads have amounted to more than 25 percentage points in the past year.

appears to be inconsistent with earlier Bank/Fund staff recommendations for privatization under terms that would improve the management prospects.

36. **Against this background, the mission called for the expeditious and effective privatization of the remaining state-owned banks; and a further enhancement of banking regulations and supervision.** While the health of the banking system fundamentally reflects that of the rest of the economy, and its improvement will be very gradual for that reason, it is important for the authorities to set the institutional basis for a healthy banking system through further privatization and—in part with the assistance of the EU and the Fund's MAE Department—enhancement of the banking regulations and supervision, to bring them fully in line with the best international standards. Specifically:

- With regard to bank privatization, the mission recommended, in close cooperation with World Bank staff: (a) the immediate privatization/resolution of BA; (b) expeditious progress toward privatization of BCR on the basis of a strategy that is consistent with improved management prospects; and (c) the establishment of an ambitious restructuring program and schedule for the eventual privatization of the Savings Bank. On their part, the authorities were noncommittal with regard to BA; were not prepared to discuss the BCR privatization strategy with Bank or Fund staff, invoking confidentiality constraints; and indicated that any decision on the Savings Bank lay with the next government.

- With regard to the legal and regulatory framework for banks, there was broad agreement that current legislation on bankruptcy and liquidation should be amended on an early basis with a view to enhancing central bank authority and facilitating early resolution of problem banks. This should allow the cleaning up of the banking sector of all unresolved problem banks by no later than end-2001. Moreover, the central bank intended to implement strictly the new loan classification and loss provisioning rules, and adopt the International Accounting Standards requirements for commercial bank reporting on an early basis.

37. **The mission stressed that it was important to elucidate all aspects of the collapse of a major mutual fund (FNI) last May, and step up the effort to improve the regulation and supervision of the nonbank financial sector.** The authorities initially acted decisively to contain the crisis triggered by the collapse of FNI, and have subsequently made some progress in the investigation of the circumstances and beneficiaries of the fraudulent operations.[15] The mission stressed that those that have improperly benefited should be prosecuted to the full extent of the law, and that the circumstances that permitted the fund's

[15] Investigators have ascertained that the FNI had operated as a pyramid scheme at least since 1998, defrauding its 250,000 investors through a vast overstatement of the real value of its assets (the value of the fund's assets was reported at lei 6.7 trillion or 0.9 percent of GDP in 2000). They have also identified some of the major beneficiaries, including the management company, which assessed a monthly management fee of 2 percent of inflated assets, and entities and individuals who withdrew significant amounts before the collapse of FNI.

illegal and prolonged operation—including the role of the Savings Bank, which had facilitated the fund's operations—be fully clarified. The authorities indicated that those found to have been involved in the scandal would be held accountable, but acknowledged that prosecution had started only against the main operators of the scheme and not the main identified beneficiaries.[16] In addition, the mission expressed concerns about administrative delays in the adoption of an action plan to address structural weaknesses in the nonbank financial sector brought to light by the FNI incident, and called on the authorities to intensify their efforts in this area with the help of the World Bank.

F. Enterprise Privatization

38. **The authorities recognized the magnitude of the privatization agenda.** Despite a significant acceleration of privatization since late 1998, the bulk of large companies remains under state control. As of now, the State Ownership Fund (SOF) still has in its portfolio commercial companies accounting for about 60 percent of its original capital, while all major utilities, with the exception of Romtelecom, remain under state ownership; this implies that only about 20 percent of all state-owned large companies have been privatized[17] since the beginning of transition.[18] While progress was made in small-scale and farm privatization in the early years of the transition, large-scale privatization, mainly in the form of management-employee buyouts, proceeded slowly during 1990–97, when the privatized commercial enterprises amounted to only about 10 percent of SOF's original capital (Figure 11). Since then—and especially since late 1998—enterprises accounting for another 30 percent of SOF's original capital have been privatized, through direct sales, tenders, and auctions, as well as involvement of investment banks. With regard to régies autonomes (mainly utilities and mining companies), the authorities have taken legal and regulatory steps since 1997 to facilitate the privatization of the utilities (conversion into national companies, break-up of the electricity and gas companies and opening up of their markets to competition) and have closed or restructured some loss-making mines.

39. **The mission urged the authorities to accelerate their privatization efforts, including the expeditious implementation of the World Bank-supported program for privatization/liquidation of major enterprises using transparent procedures.** The mission observed that following the failure of earlier privatization programs, which was

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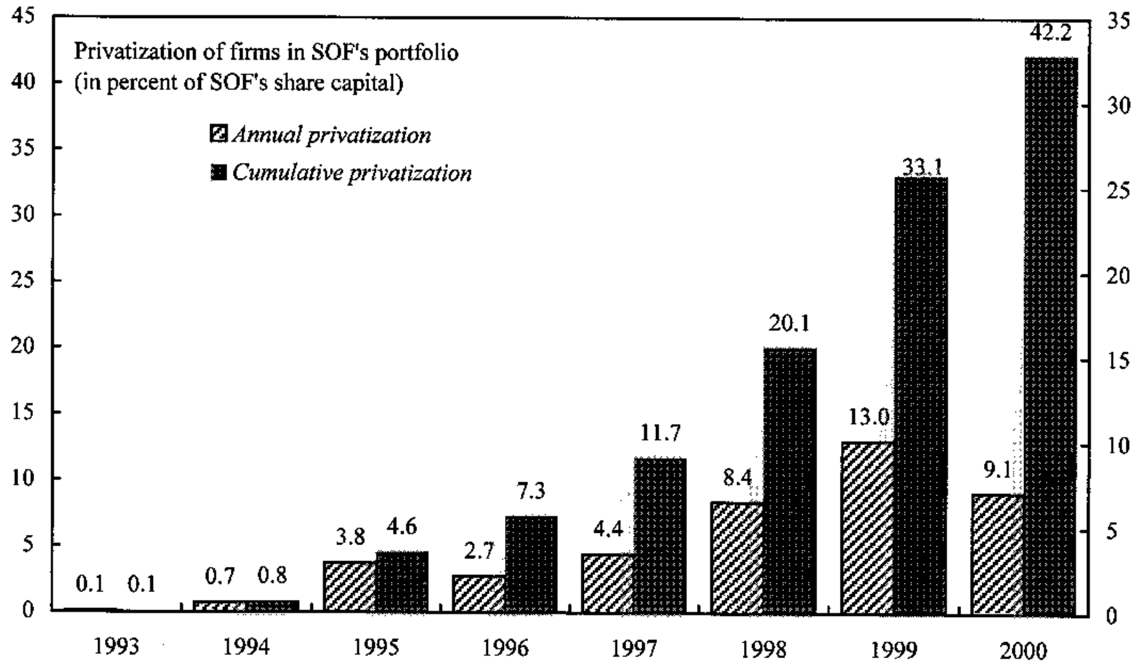
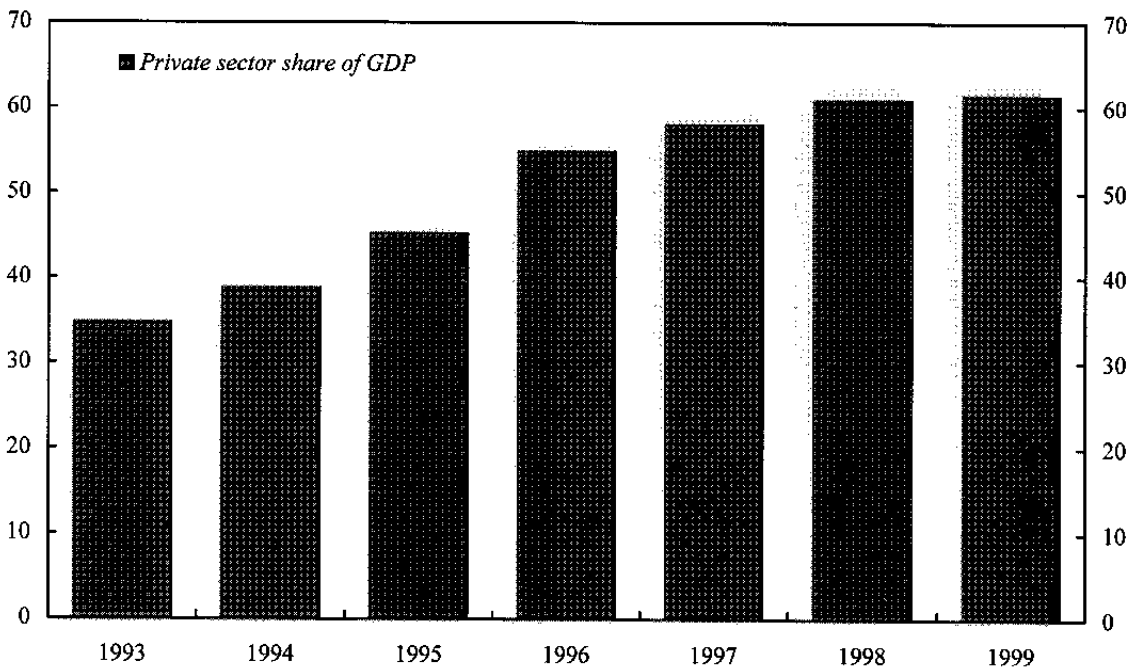
[16] In contrast to the authorities' earlier intentions not to compensate investors of the FNI scheme, the cabinet has recently initiated legislation that would grant up-front and limited compensation to all FNI investors.

[17] Defined as private ownership exceeding 50 percent of total shares.

[18] Under a mass privatization scheme in 1995, the equivalent of 30 percent of the capital of each of the commercial enterprises assigned to SOF was transferred to private citizens and five Private Ownership Funds (subsequently converted into five private investment funds), which operate as closed-end funds; however, this left most of the commercial enterprises in majority state ownership, and these companies are not counted as being privatized.

Figure 11. Romania: Progress in Privatization, 1993-2000
(as percent of the share capital of the State Ownership Fund, SOF)





Source: Romanian State Ownership Fund (SOF), National Commission of Statistics.

reckoned to have been due to lacking institutional capacity and transparent procedures, the explicit goal of the privatization program elaborated in early 1999—and supported by the PSAL—was to greatly improve privatization procedures. Most importantly, the authorities' privatization program under the PSAL includes 63 of the largest enterprises, accounting for about 20 percent of SOF's portfolio, to be privatized/liquidated with the assistance of reputable investment banks and the use of international tenders. Most of these enterprises were to be offered for sale by end-September, but so far the cabinet has approved privatization strategies for only 35 of these companies, and only a few of them have been offered for sale up to date. The World Bank is concerned about the delays in the preparation of the privatization strategies and some practices that contradict understandings under the PSAL (e.g., the introduction of nontransparent and dubious procedures, and the involvement of the SOF in the sales negotiations), and has postponed the appraisal of a follow-up adjustment loan until after the elections. The mission also urged progress in restructuring and privatization of the utilities, with a view to increasing competition and efficiency in this sector and—in light of their role in financing arrears accumulation—enhancing financial discipline in the economy.

IV. Staff Appraisal

40. Romania has made significant progress in stabilization and reform since the completion of the previous Article IV consultation in September 1998. Large corrections in the fiscal accounts and the exchange rate in 1999 helped narrow the current account deficit to a sustainable level and averted an imminent financial crisis. Urgently needed measures to restructure the banking system were also adopted, and the privatization process was accelerated after a long period of neglect.

41. This generally good record is being put in jeopardy in the run-up to the elections, by policy slippages in the areas of domestic arrears and wages in the state sector, which—along with exogenous shocks—have contributed to significantly higher-than-targeted inflation. Fiscal policy risks being relaxed in the remainder of this year, while the momentum on the structural policy front has been interrupted since mid-2000.

42. Notwithstanding the progress over the past two years, Romania's record—in terms of both stabilization and reform levels—still does not compare favorably with that of most other transition countries in Central and Eastern Europe. While difficult conditions at the beginning of the transition have played a role, this is mainly attributable to a "stop-and-go" approach to reform and macroeconomic policies for a large part of the past 11 years. This pattern of economic policy-making needs to be decisively broken if Romania is to achieve a sustainable improvement in living standards and prepare itself for EU accession.

43. As Romania's experience in the 1990s demonstrated, stabilization and structural reform need to be pursued simultaneously and vigorously, if durable progress is to be made in any of them. In this regard, progress in disinflation and consolidation of the external position will require wage and financial discipline in the state-owned enterprises, continued fiscal consolidation, and prudent monetary policy. Such policies need to be accompanied by strong reform measures—accelerated restructuring of the enterprise and banking sectors and

an improvement of the business environment—to enhance economic efficiency and thereby improve living standards on a sustainable basis.

44. Wage and domestic arrears policies—a persistently problematic area so far—will be key to progress in disinflation. With the bulk of large companies still remaining under state control and experiencing weak corporate governance, the wage costs in those companies should be strictly controlled, partly as a means of signaling for the rest of the economy; and efforts to reduce domestic arrears should be intensified by providing managers with proper financial incentives.

45. The fiscal position remains precarious—notwithstanding the narrowing of the budget deficit in recent years—and will need to be strengthened to achieve stabilization. Recent changes in the structure of public expenditure—significant real expenditure increases on personnel and transfers and subsidies—have marked a step in the wrong direction. Moreover, reform of government expenditures and the pension system should be pursued urgently through improved targeting of social spending, reduction of excess staffing, and further tightening of the eligibility requirements for pensions. This takes into account that government services and social transfers are barely adequate and that the budget will come under increasing pressure in the coming years owing to additional claims stemming from the EU accession process and the accelerated restructuring of the economy.

46. Along with financial discipline for the budget and state-owned companies, prudent monetary policy will be required to reduce inflation and contain the growth in domestic demand. The current level of external competitiveness and the monetary policy framework—with a managed float that aims to strike a balance between inflation and the external objectives—are adequate. However, the monetary framework has also accommodated high inflation as the external objective became paramount when wage growth and/or the fiscal deficit overshot. The adoption of a more transparent framework—involving an explicit target for the exchange rate or inflation—as a means of facilitating disinflation is nevertheless predicated on urgent improvement in financial discipline and fiscal reform.

47. With a late start in bank restructuring, a great deal remains to be done in this area. Besides a stable macroeconomic environment, the creation of an efficient and healthier banking system will require privatization of the banks remaining under state control through transparent procedures aimed at ensuring the best management prospects for the bank, and continued enhancements of the legal, regulatory, and supervisory framework for banks. The circumstances of the collapse of a mutual fund earlier this year have highlighted serious weaknesses in the regulation and supervision of the nonbank financial sector as well as broader governance problems. It is important to ensure that those involved are held accountable and to proceed expeditiously with the required institutional reforms in this area.

48. Progress in enterprise privatization is key to enhancing financial discipline as well as efficiency. With 80 percent of pre-transition state-owned companies still remaining under state control, the task facing the authorities is huge, but so are also the potential gains—in terms of productivity and governance—from the successful privatization and restructuring of these companies. In this regard, it is important to proceed expeditiously with the privatization of the 63 large commercial enterprises on the basis of the transparent procedures envisaged

under the PSAL. In parallel, the authorities should prepare for the privatization of the national companies (former régies autonomes), which are key to economic efficiency and financial discipline, owing to their pervasive role in the economy and their financing of domestic arrears.

49. Romania's statistical base is adequate for surveillance and program purposes. The staff urges the authorities to continue to improve the quality of the data, in particular the balance of payments data and the consistency of the fiscal and monetary data.

50. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Romania: Selected Economic Indicators, 1995-2000

	1995	1996	1997	1998	1999	2000 Program EBS/00/87	2000 Revised Proj.	2000 Outturn H1	
Real economy									
Real GDP	7.1	3.9	-6.1	-5.4	-3.2	1.3	1.5	2.1	
Industrial production (period average)	9.5	9.8	-5.6	-17.3	-8.8	...	...	3.7	
Real wages in economy-wide (period average, deflated by CPI)	17.3	9.3	-21.9	0.7	-0.7	...	...	-2.4	
Real wages economy-wide (period average, deflated by PPI)	14.7	1.5	-22.1	19.4	2.1	...	...	-5.4	
Unemployment rate (end of period; percent)	9.5	6.5	8.9	10.4	11.5	...	...	10.8	
Consumer prices (end of period)	27.8	56.9	151.4	40.6	54.8	27.0	40.0	45.4	a/
(period average)	32.3	38.8	154.8	59.1	45.8	39.0	46.0	47.7	b/
				(In percent of annual GDP)					
Public finance; central government budget									
Revenues	17.8	16.8	17.6	19.6	17.1	15.4	...	6.9	
Expenditures	21.9	21.7	21.2	22.7	20.7	19.8	...	9.2	
Balance	-4.1	-4.9	-3.6	-3.1	-3.6	-4.4	...	-2.3	
Public finance; general government budget									
Revenues	31.4	29.4	29.4	30.2	33.3	32.8	32.2	15.2	
Expenditures	34.7	34.0	34.0	35.2	37.1	36.1	36.4	16.8	
Balance including privatization receipts	-3.0	-2.9	-3.9	-3.5	-2.5	-2.4	-3.7	-1.5	
Balance excluding privatization receipts	-3.4	-4.8	-5.3	-5.5	-3.8	-3.5	-4.3	-1.7	
				(12-month percentage change)					
Money and credit									
Broad money (end of period)	71.6	66.0	75.9	48.9	44.9	28.6	35.2	43.5	c/
NFA contribution	-1.9	-6.7	48.3	-1.7	26.0	21.5	29.5	39.4	c/
NDA contribution	73.5	72.7	27.5	50.6	18.9	7.1	5.7	4.1	c/
Velocity (level) 1/	4.5	4.6	5.1	4.5	4.6	4.6	4.8	...	
Real domestic credit (end of period)	50.1	15.5	-52.5	21.8	-10.6	...	...	-9.8	c/
NBR interest rates (end of period; in percent) 2/	67.0	66.9	138.8	105.0	66.2	...	...	40.3	
				(In billions of U.S. dollars)					
Balance of payments									
Current account balance	-1.7	-2.6	-2.2	-1.0	-1.3	-1.4	-1.5	-0.4	
as a percent of annual GDP	-4.9	-7.4	-6.2	-7.5	-3.8	-3.9	-4.3	-1.2	
Exports	7.9	8.1	8.4	8.3	8.5	9.5	9.9	4.9	
Imports	9.5	10.6	10.4	10.9	9.6	10.6	11.4	5.4	
Gross external debt	6.9	8.6	9.5	9.9	8.8	10.3	9.3	...	
Of which: IMF	1.0	0.7	0.6	0.5	0.5	0.7	0.5	0.5	
Gross reserves (in months of imports of G&S) 3/	2.8	3.0	4.4	4.0	3.5	4.2	3.7	...	
Of which: NBR	1.3	1.5	2.8	2.4	2.2	3.4	2.5	2.3	
External debt/GDP (in percent)	19.2	24.5	26.9	23.9	25.7	29.0	26.0	...	
Debt service ratio	10.1	12.6	19.1	21.8	28.5	20.3	18.3	...	
Exchange rate									
REER (period average; CPI-based 12/1996=100)	101	93	107	139	119	...	...	129	

Sources: Romanian authorities; and Fund staff estimates.

1/ Annualized GDP at end-period prices divided by end-period broad money.
2/ Weighted NBR average interest rate; from 1997 interbank rate.

a/ 12 months to August.
b/ January-August compared with the same period a year ago.
c/ 12 months to June.

Table 2. Romania: Balance of Payments, 1996-2000

(In millions of U.S. dollars)

	1996	1997	1998	1999 Outturn	2000 EBS/00/87	2000 Staff proj
Current account	-2,611	-2,159	-3,112	-1,302	-1,375	-1,538
Ratio to GDP	-7.4	-6.1	-7.5	-3.8	-3.9	-4.3
Trade balance	-2,494	-1,980	-2,625	-1,092	-1,165	-1,441
Exports	8,061	8,431	8,302	8,503	9,469	9,922
Imports	-10,555	-10,411	-10,927	-9,595	-10,634	-11,363
Services account, net	-710	-758	-1,104	-836	-923	-942
Service receipts	1,626	1,706	1,472	1,513	1,705	1,835
Of which : Interest	65	186	204	55	177	149
Service payments	-2,336	-2,464	-2,576	-2,349	-2,628	-2,777
Of which : Interest	-360	-495	-574	-504	-616	-589
Of which : Interest, net	-295	-309	-370	-449	-439	-440
Unrequited transfers (net)	593	579	617	626	712	844
Capital account	1,221	3,004	2,263	1,154	1,687	1,792
Direct investment and capital transfers	415	1,267	2,079	1,070	1,180	999
Portfolio investment	0	270	50	-19	35	-23
Borrowing by public sector 1/	573	1,362	45	132	-8	540
Loans (net)	573	824	-58	132	142	256
Disbursements	790	1,671	769	995	879	993
Of which : Multilaterals	345	687	351	494	467	665
Of which : Government guaranteed	445	984	418	501	412	328
Amortization	-217	-847	-827	-863	-737	-737
Other public borrowing (net) 2/	0	538	103	0	-150	284
Borrowing by private sector (net)	188	141	479	189	129	279
Medium- and long-term loans (net)	188	141	479	189	129	279
Disbursements	419	567	1,171	823	952	819
Amortization	-231	-426	-692	-634	-824	-540
Credit extended (net)	0	35	31	34	-36	-18
Short-term (net)	45	-71	-421	-252	387	15
Net errors and omissions	786	1,086	714	621	-75	874
Overall balance	-604	1,931	-135	473	236	1,128
Financing	604	-1,931	135	-473	-881	-1,129
Net foreign assets NBR (increase, -)	421	-1,710	222	-673	-891	-818
Assets (increase, -)	-213	-1,665	523	-173	-954	-640
Liabilities	633	-45	-301	-500	63	-178
IMF, net	-356	28	-126	-67	235	8
Purchases	0	164	0	72	352	115
Repurchases	-356	-136	-126	-139	-117	-107
Others, net	990	-73	-175	-433	-172	-186
Short-term	-150	100	-100	114	-172	-14
Medium and long-term, net	1,140	-173	-75	-547	0	-172
Disbursements	1,285	0	0	172	0	6
Repayments	-145	-173	-75	-719	0	-178
Net foreign assets DMBs (increase, -)	184	-221	-87	200	10	-311
Assets (increase, -)	-307	-118	130	271	54	-218
Liabilities	490	-103	-217	-71	-44	-93
Short-term	391	-337	-79	33	0	-19
Medium- and long-term, net	99	234	-138	-70	-44	-44
Portfolio (net)	0	0	0	-34	0	-30
Financing gap	...	...	...	...	747	...
Memorandum items:						
Current account balance plus FDI	-2,348	-935	-1,072	-277	-195	-539
Ratio to GDP	-6.7	-2.7	-2.6	-0.8	-0.6	-1.5
Export growth (percent)	2.3	4.6	-1.6	2.4	11.4	16.7
Of which : Volume growth (percent)	3.2	13.8	1.3	5.3	12.5	28.6
Import growth (percent)	11.3	-1.4	4.8	-12.1	10.8	18.4
Of which : Volume growth (percent)	9.6	7.0	7.8	-9.4	9.2	19.4
External debt (US$)	8,597	9,467	9,903	8,784	10,276	9,347
Of which : Public and publicly guaranteed	6,507	6,855	7,001	6,169	7,197	6,936
External debt/GDP (percent)	24.5	26.9	23.9	25.7	29.0	26.0
Net External Indebtness/GDP (percent)	23.3	22.1	20.8	15.1	...	13.5
Debt service (US$)	1,309.3	2,077.3	2,293.5	2,859.1	2,463	2,150.8
Debt service ratio	13.5	20.5	23.5	28.5	20.3	18.3
Gross official reserves of the NBR 3/	1,593	3,075	2,299	2,472	3,419	3,112
(in months of imports of goods and services)	1.5	2.9	2.4	2.2	3.1	2.5

Sources: Romanian authorities; and Fund staff estimates.

1/ Including public enterprises.

2/ 2000 projection is gross borrowing.

3/ Includes gold.

Table 3. Romania: Summary of Consolidated General Government, 1997-2000

	1997	1998	1999		2000			1997	1998	1999		2000		
	Actual	Actual	Prog. EBS/99/141	Actual	Prog. EBS/00/87	Staff proj.	H1	Actual	Actual	Prog. EBS/99/141	Actual	Prog. EBS/00/87	Staff proj.	H1
	(In billions of Lei)							(In percent of GDP)						
Total revenue and grants	72,386	111,000	163,375	173,838	237,686	248,967	109,415	28.6	30.1	33.6	33.3	32.8	32.2	14.2
Current	71,802	110,867	160,234	173,337	236,414	247,423	109,214	28.4	30.1	33.0	33.2	32.6	32.0	14.1
Tax	67,000	103,992	153,799	164,026	223,822	233,099	102,506	26.5	28.2	31.7	31.4	30.8	30.2	13.3
Profits	10,780	11,067	17,922	17,037	15,069	19,595	8,816	4.3	3.0	3.7	3.3	2.1	2.5	1.1
Wages and salaries 1/	13,946	15,093	25,634	17,834	21,235	26,287	11,430	5.5	4.1	5.3	3.4	2.9	3.4	1.5
Social security 1/	17,671	33,425	43,441	57,667	83,676	87,790	38,227	7.0	9.1	8.9	11.1	11.5	11.4	4.9
VAT	11,681	22,493	27,745	32,471	46,846	46,647	21,145	4.6	6.1	5.7	6.2	6.5	6.0	2.7
Customs	3,353	5,741	8,109	7,847	7,653	8,584	3,705	1.3	1.6	1.7	1.5	1.1	1.1	0.5
Excise	4,289	8,431	17,222	16,958	27,348	22,591	8,538	1.7	2.3	3.5	3.3	3.8	2.9	1.1
Other	5,282	7,741	13,726	14,213	21,995	21,604	10,645	2.1	2.1	2.8	2.7	3.0	2.8	1.4
Nontax	4,802	6,875	6,435	9,311	12,592	14,324	6,708	1.9	1.9	1.3	1.8	1.7	1.9	0.9
Capital	584	133	2,658	297	310	605	134	0.2	0.0	0.5	0.1	0.0	0.1	0.0
Of which: Asset recoveries	0	0	2,507	0	0	0	0	0.0	0.0	0.5	0.0	0.0	0.0	0.0
Grants	0	0	482	204	963	939	67	0.0	0.0	0.1	0.0	0.1	0.1	0.0
Total expenditure	85,639	131,123	180,497	193,567	262,118	281,152	122,502	33.9	35.6	37.1	37.1	36.1	36.4	15.8
Current	71,859	115,394	168,370	177,835	241,702	258,020	...	28.4	31.3	34.7	34.1	33.3	33.4	...
Wages and salaries	12,344	18,671	25,159	26,259	40,194	43,010	20,878	4.9	5.1	5.2	5.0	5.5	5.6	2.7
Materials and operating expenditures	14,430	21,173	26,538	34,907	49,089	57,694	...	5.7	5.7	5.5	6.7	6.8	7.5	...
Reform expenditures	0	2,894	2,858	3,819	0	0	...	0.0	0.8	0.6	0.7	0.0	0.0	...
Cash payments for bank restructuring	0	0	6,697	3,815	199	211	...	0.0	0.0	1.4	0.7	0.0	0.0	...
Interest	9,659	17,450	31,620	28,796	40,577	40,828	20,925	3.8	4.7	6.5	5.5	5.6	5.3	2.7
Subsidies and transfers	35,426	55,206	75,498	80,239	111,644	116,277	...	14.0	15.0	15.5	15.4	15.4	15.0	...
Subsidies	6,364	6,211	9,722	9,303	15,474	17,436	...	2.5	1.7	2.0	1.8	2.1	2.3	...
Transfers	29,062	48,995	65,776	70,936	96,170	98,841	...	11.5	13.3	13.5	13.6	13.3	12.8	...
Of which: Pensions	17,284	25,088	36,201	37,854	50,332	53,362	...	6.8	6.8	7.5	7.3	6.9	6.9	...
Capital	12,106	13,530	11,236	15,015	19,750	22,341	...	4.8	3.7	2.3	2.9	2.7	2.9	...
Lending minus repayments	1,674	2,198	891	717	665	791	...	0.7	0.6	0.2	0.1	0.1	0.1	...
Overall balance (cash, excluding grants)	-13,253	-20,123	-17,605	-19,933	-25,394	-33,124	-13,154	-5.2	-5.5	-3.6	-3.8	-3.5	-4.3	-1.7
Overall balance (cash, including grants)	-13,253	-20,123	-17,123	-19,729	-24,431	-32,185	-13,087	-5.2	-5.5	-3.5	-3.8	-3.4	-4.2	-1.7
Financing	13,111	21,013	18,088	18,064	24,431	32,185	...	5.2	5.7	3.7	3.5	3.4	4.2	...
Domestic	3,539	14,459	-4,119	8,608	819	13,191	7,277	1.4	3.9	-0.8	1.6	0.1	1.7	0.9
External	5,198	-154	14,707	2,350	13,387	11,794	...	2.1	0.0	3.0	0.5	1.8	1.5	...
Privatization proceeds	4,374	6,708	7,500	6,859	8,000	4,700	...	1.7	1.8	1.5	1.3	1.1	0.6	...
Bank asset recoveries	0	0	0	247	2,225	2,500	596	0.0	0.0	0.0	0.0	0.3	0.3	0.1
Discrepancy	-141	890	965	-1,664	0	0	...	-0.1	0.2	0.2	-0.3	0.0	0.0	...
Memorandum items:														
Primary expenditure 2/	75,980	113,673	142,180	160,956	221,342	240,113	101,577	30.0	30.9	29.3	30.9	30.5	31.1	13.1
Primary balance (cash, excluding grants) 2/	-3,594	-2,673	20,712	12,679	15,382	7,915	7,771	-1.4	-0.7	4.3	2.4	2.1	1.0	1.0
Bank restructuring cost	61	5,182	16,013	10,434	12,508	12,508	...	0.0	1.4	3.3	2.0	1.7	1.6	...
Social transfers	20,234	33,143	46,829	47,999	66,025	...	...	8.0	9.0	9.6	9.2	9.1	9.1	...
Military expenditure	5,877	9,374	...	11,373	...	...	...	2.3	2.5	...	2.2	...	...	...
Domestic debt	15,093	32,191	50,413	52,711	53,531	65,902	65,437	6.0	8.7	10.4	10.1	7.4	8.5	8.5
Nominal GDP (billions lei) 3/	252,926	368,261	485,883	521,726	725,545	772,994	725,545	252,926	368,261	485,883	521,726	725,545	772,994	772,994

Sources: Ministry of Finance; and Fund staff estimates.

1/ 1998 and 1999 actual values adjusted for the collections of health contributions (3,484. 5 and 10,483.2 billion lei, respectively) which were previosuly classified as wage taxes under the program.
2/ Excluding cash expenditure for bank restructuring.
3/ Program GDP for EBS/99/141 adjusted for the subsequent upward change in base-period GDP.

Table 4. Romania: Quantitative Performance Criteria and Indicative Targets Under the Stand-by Arrangement, 1999-2000 1/

	1999	2000			
	December	March	June		
	Actual	Actual	Target	Adjusted Target	Actual
Performance Criteria:					
I. Ceiling on the average net domestic assets of the NBR (billion lei)	19,865 2/	19,764	15,898	21,215	21,555
II. Floor on net foreign assets of the NBR (million US$)	846	945	1,226	1,176	1,152 3/
III. Ceiling on net credit of the banking system to general government (billion lei)	43,621 2/	43,154	46,441	40,615	39,627
IV. Limits on the increase in assumption of enterprise debt to banks and guaranteeing of bank loans to enterprises from March 31, 1999 (billion lei)	...	200	0	...	0
V. Ceiling on contracting or guaranteeing of external debt of: (million US$)					
More than one-year maturity	1,502	605	1,400	1,400	1,149
One- to three-year maturity	172	6	300	300	129
VI. Ceiling on short-term external debt (stock, in millions of US$)	1.7	1.5	0.0	0.0	0.0
VII. Arrears to Conel, Romgaz and Petrom (billion lei)	15,708	18,669	18,735	...	22,366
Of which: Conel	6,557	8,060	8,091	...	9,174
Of which: Romgaz	3,351	4,361	4,237	...	5,928
Of which: Petrom	5,800	6,248	6,407	...	7,264
VIII. Quarterly cumulative floors on the net reduction of arrears of Conel, Romgaz, and Petrom to the Consolidated General Government, as at March 2000 (billion lei)	1,007	-1,388 4/	250	...	-2,778
IX. Quarterly cumulative ceilings on the wage bills for the state budget, regies autonomes, and 33 large loss-makers (performance criterion) 5/	42,766	13,443	32,480	...	32,255
Of which: State budget sector (indicative target)	22,263	7,170	19,023	...	18,485
Of which: Regies autonomes (indicative target)	19,073	5,510	11,997	...	12,163
Of which: 33 large loss makers (indicative target) 5/	1,430	763	1,460	...	1,607
Indicative Targets:					
X. Floor on net foreign assets of the banking system (million US$)	1,397	1,486	1,767	1,717	1,886
XI. Ceiling on average reserve money (billion lei)	34,658 2/	37,262	40,476	40,206	44,052
XII. Ceiling on broad money (billion lei)	134,114 2/	136,105	147,808	...	146,589
XIII. Ceiling on stock of external payments arrears (In millions US$)	24 6/	0	0	...	0

Sources: Program projections; and data provided by the Romanian authorities.

1/ Details of the performance criteria and indicative targets are presented in EBS/00/87 (5/17/00), Technical memorandum I-XII.

2/ December numbers are all actual, rather than program definition (presented in EBS/99/141 (7/27/99), Annexes B I-XII).

3/ The official disbursement of US$245 million in late June was deposited at the MOF's foreign currency account with the NBR, and treated as foreign liabilities of NBR in line with the SBA definition. Disregard this technical factor, NBR's actual NFA would have been US$1,397 million, exceeding the programe target.

4/ Change between March 31, 2000 and December 31, 1999.

5/ For 1999, 24 of the largest loss makers. For 2000, the set of 24 companies is replaced with the set of 33 companies due to the splitting of some into smaller companies, privatization/liquidation of some, and the addition of new large loss makers including Sidex.

6/ This refers to the DM 41 million due on bilateral debt to Germany on December 30 but was paid on January 4, 2000.

Table 5. Romania: Monetary Survey, 1999-2000
(In billions of lei, current exchange rates)

	1999				2000				
	Actual				Actual			Projections	
	March	June	September	December	March	June	September	December	
								EBS/00/87	Staff Proj.
Monetary Survey									
Net foreign assets	14,771	18,137	31,756	39,303	43,600	58,895	81,684	68,142	85,675
In millions of U.S. dollars	990	1,145	1,926	2,153	2,238	2,763	3,380	3,038	3,421
Of which : Commercial banks	420	464	495	551	541	747	1,190	541	1,000
NBR	570	681	1,431	1,602	1,697	2,016	2,190	2,497	2,421
Net domestic assets	85,990	85,360	82,415	94,811	92,504	89,614	81,585	104,320	95,660
Domestic credit	95,226	92,441	91,621	101,340	105,710	107,529	109,886	118,045	121,012
Government	23,089	30,580	34,150	43,621	43,154	40,323	36,723	44,440	51,674
Of which : T-bills for bank restructuring 1/	8,171	16,718	23,935	31,521	29,437	28,032	24,552	29,437	25,060
Of which : 1999 bancorex restructuring bonds 2/		8,548	14,738	19,457	17,373	15,969	13,020	17,373	13,509
Non-government	72,136	61,861	57,471	57,719	62,556	67,206	73,163	73,605	69,338
Of which : In foreign currency	46,472	37,030	32,660	33,275	36,590	40,647	43,051	43,739	45,079
In millions of U.S. dollars	3,114	2,338	1,981	1,823	1,878	1,903	1,781	1,950	1,800
In lei	25,664	24,831	24,811	24,444	25,966	26,559	30,112	29,866	24,259
Non-government adjusted for bank assets transferred to AVAB (incl BX)	72,419	76,343	79,941	86,588	93,274	100,634	109,550	109,727	105,460
Other items net	-9,236	-7,081	-9,206	-6,529	-13,206	-17,915	-28,301	-13,724	-25352
Broad money	100,761	103,497	114,171	134,114	136,105	148,509	163,269	172,463	181,335
Of which : Lei denominated (M2)	61,773	64,607	72,009	83,642	84,885	90,839	95,053	108,537	109,960
Currency in circulation	11,523	13,888	15,560	17,372	16,070	21,461	22,765	22,122	26,021
Lei deposits	50,250	50,719	56,450	66,270	68,815	69,378	72,288	86,415	83,939
Foreign currency deposits	38,988	38,890	42,162	50,473	51,220	57,670	68,216	63,926	71,375
In millions of U.S. dollars	2,612	2,455	2,557	2,765	2,629	2,700	2,822	2,850	2,850
Memorandum items: 3/									
Broad money (M2X) growth	57.9	49.0	52.1	44.9	35.1	43.5	43.0	28.6	35.2
NFA contribution	1.5	6.4	25.3	26.0	28.6	39.4	43.7	21.5	34.6
NDA contribution	56.4	42.6	26.8	18.9	6.5	4.1	-0.7	7.1	0.6
Lei-denominated money growth (M2)	39.2	30.8	35.5	34.2	37.4	40.6	32.0	29.8	31.5
Credit growth	77.8	53.7	31.2	26.8	11.0	16.3	19.9	16.5	19.4
Adjusted for assets trasnferred to AVAB	77.8	63.6	42.3	38.5	25.0	27.1	34.1	15.8	19.3
Credit growth to the non-government	74.6	37.0	12.7	-2.3	-13.3	8.6	27.3	27.5	20.1
Adjusted for assets trasnferred to AVAB	75.3	69.1	56.7	46.5	29.3	31.8	37.0	26.7	21.8
Growth of currency in circulation	40.6	34.8	38.5	50.7	39.5	54.5	46.3	27.3	49.8
CPI inflation	36.0	48.2	50.4	54.9	49.0	40.9	44.9	27.0	40.0
Real broad money growth	16.1	0.5	1.1	-6.4	-9.4	1.9	-1.3	1.3	-3.4
Real lei broad money growth	2.4	-11.7	-9.9	-13.4	-7.8	-0.2	-8.9	2.2	-6.1
Real credit growth adjusted for AVAB transfers	30.8	10.4	-5.4	-10.6	-16.1	-9.8	-7.4	...	...
Real credit growth to the non-government (adjusted) 4/	28.4	14.1	4.2	-5.4	-13.2	-6.4	-5.4	-0.2	-13.0
M2X velocity	4.5	5.1	4.9	4.7	5.1	5.1	5.0	4.6	4.8
M2 velocity	7.4	8.2	7.8	7.5	8.1	8.3	8.6	7.4	7.9

Sources: Romanian authorities; and Fund staff estimates.

1/ Bonds issued to restructure Bancorex and Banca Agricola, including the 1997 restructuring.

2/ Bonds issued to retire Bancorex liabilities in the run-up of its resolution in 1999 and in exchange of bad assets rejected by BCR to AVAB.

3/ All changes are 12-month rates of change, unless otherwise indicated.

4/ 1999 and 2000 figure adjusted for bad loans transferred to AVAB.

Table 5. (continued) Romania: Balance Sheet of the National Bank, 1999-2000 1/

(In billions of lei, current exchange rates, monthly averages)

	1999				2000				
	Actual				Actual			Projections	
	March	June	September	December	March	June	September	December	
								EBS/00/87	Staff proj.
National Bank of Romania									
Net foreign assets 2/	3,925	3,343	11,655	14,757	17,478	22,907	36,937	38,102	40,659
In millions of U.S. dollars	279	213	713	820	910	1,090	1,565	1,717	1,641
Net domestic assets	15,537	17,896	15,265	19,901	19,784	21,144	8,959	10,982	10,711
Of which:									
Credit to banks	4,337	7,808	3,294	112	2,136	3,771	-59	-11,493	-5,901
NBR refinancing	2,503	2,505	2,490	2,453	2,426	1,680	1,741	503	1,741
NBR credit line to Deposit Guarantee Fund						2,230	2,363	2,600	3,863
Law 101 (Bancorex) & Special credit to BA	3,898	9,186	3,844	1,737	697	1,261	1,640	0	0
Deposit taking operations	-2,064	-3,882	-3,040	-4,078	-987	-1,399	-1,676	-14,596	-7,378
Reverse repo							-4,127	0	-4,127
Credit to the government	7,907	6,530	9,429	18,912	19,094	20,068	16,661	21,214	19,906
Treasury balance (+deficit, -surplus)	-1,142	-882	-3,654	-2,139	-770	-1,279	-1,460	0	0
Treasury bills	9,049	7,412	13,083	21,051	19,864	21,347	18,121	21,214	19,906
Other items net	3,293	3,557	2,541	877	-1,446	-2,695	-7,643	1,260	-3,293
Lei reserve money 3/	19,462	21,239	26,920	34,658	37,262	44,052	45,896	49,084	51,370
Currency	12,283	13,947	15,996	17,642	17,238	22,058	23,004	22,814	25,853
Bank deposits	7,179	7,292	10,924	17,016	20,024	21,994	22,892	26,270	25,517
Memorandum items:									
Lei reserve money growth 4/	45.8	40.3	47.7	79.0	91.5	107.4	70.5	41.6	48.2
NFA contribution	-33.0	-36.5	8.5	53.2	69.6	92.1	93.9	67.4	74.7
NDA contribution	78.8	76.8	39.3	25.8	21.8	15.3	-23.4	-25.7	-26.5
Real reserve money growth	7.2	-5.3	-1.8	15.6	28.5	47.2	17.7	11.5	5.9
Memorandum items:									
Adjusted lei reserve money growth 5/	...	...	...	...	42.7	56.6	27.9	32.2	41.9
NDA contribution	...	...	...	...	-29.0	-37.0	-62.9	-53.2	-52.9
NFA contribution	...	...	...	...	71.7	93.7	90.8	85.4	94.8
CPI inflation	36.0	48.2	50.4	54.8	49.0	40.9	44.9	27.0	40.0

Sources: Romanian authorities; and Fund staff estimates.

1/ For the program, all values are defined on an average basis.

2/ Program definition excludes deposits of commercial banks to meet required reserves against foreign currency deposits. These figures differ from those of the survey by this adjustment, and due to the fact that these figures describe average levels.

3/ Indicative targets based on which the NDA PC is set. For 2000, it is assumed that all banks observe minimum reserve requirements except for reserves on Bancoop deposits, and BANCOREX deposits transferred to BCR. The reserves on these deposits will be observed in the second half of 2000, when Bancoop is out of the system and BX T-bills mature.

4/ All changes are 12-month rates of change, unless otherwise indicated.

5/ Adjusted for both (i) shortfalls in reported reserve money and (ii) changes in minimum reserve requirements.

(i) Shortfalls in reported reserve money occured in 1999 and early 2000 owing to failure of some banks to observe the reserve requirements and the time lag given to BCR to observe certain transfered deposits from former BX in the first part of 2000. Reserve requirements on all deposits are assumed to be observed at the end of 2000.

(ii) Minimum reserve requirement for lei deposits was increased from 15 percent to 20 perecnt in mid-July, to 25 percent on November 1, and to 30 percent on December 1, 1999. The adjusted reserve money assumes 15% reserve requirements.

Table 6. Romania: Medium-Term Balance of Payments Outlook, 2000-2005

(In millions of U.S. dollars)

	2000 Proj.	2001 Proj.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.
Current account	-1,538	-1,458	-1,484	-1,584	-1,726	-1,888
Ratio to GDP	-4.3	-3.9	-3.7	-3.6	-3.6	-3.7
Trade balance	-1,441	-1,603	-1,748	-1,903	-2,083	-2,276
Exports	9,922	10,723	11,589	12,524	13,661	14,901
Imports	-11,363	-12,326	-13,337	-14,427	-15,744	-17,177
Services account, net	-942	-1,022	-984	-1,011	-1,057	-1,120
Of which: interest, net	-440	-457	-381	-366	-362	-369
Unrequited transfers	844	1,167	1,248	1,330	1,414	1,508
Capital account	1,792	1,825	1,873	2,150	2,446	2,652
Direct investment and capital transfers	999	1,166	1,260	1,362	1,471	1,545
Portfolio Investment	-23	30	30	30	30	30
Borrowing by public sector 1/	540	240	186	279	305	379
Loans (net)	256	40	-14	79	105	179
Bonds (net)	284	200	200	200	200	200
Borrowing by private sector	279	302	276	348	480	523
Medium- and long-term loans (net)	279	302	276	348	480	523
Disbursements	819	1,160	1,217	1,286	1,311	1,162
Amortization	-540	-858	-941	-938	-831	-639
Short-term (net)	15	88	122	132	160	174
Net errors and omissions	949	300	300	200	100	0
Overall balance	1,129	666	689	766	820	764
Financing	-1,129	-987	-907	-921	-930	-865
Net foreign assets NBR (increase, -)	-818	-887	-801	-806	-806	-729
Assets (increase, -)	-640	-700	-700	-700	-700	-700
Liabilities	-178	-187	-101	-106	-106	-29
IMF, net	8	107	-101	-106	-106	-29
Purchases	115	229	0	0	0	0
Repurchases	-107	-122	-101	-106	-106	-29
Other, net	-186	-294	0	0	0	0
Net foreign assets DMBs (increase, -)	-311	-100	-106	-115	-124	-135
Assets (increase, -)	-218	-100	-106	-115	-124	-135
Liabilities	-93	0	0	0	0	0
Financing gap	-1	320	218	155	110	101
Memorandum items:						
Export growth (percent)	16.7	8.1	8.1	8.1	9.1	9.1
Import growth (percent)	18.4	8.5	8.2	8.2	9.1	9.1
Net Resource Balance/GDP (percent)	-4.1	-2.7	-2.7	-2.8	-2.9	-2.9
External debt/GDP (percent)	26.0	26.1	25.3	24.9	24.8	24.8
Net External Indebtedness/GDP (%)	13.5	12.8	10.3	9.1	8.5	8.2
Debt service ratio	18.3	22.9	20.1	17.2	16.8	14.2
Gross reserves of NBR (in US$ mns.) 2/	3,112	3,812	4,512	5,212	5,912	6,612
(over short-term debt by remaining maturity)	103.8	128.3	157.9	167.2	196.6	0.0
(in months of imports)	2.5	2.9	3.2	3.3	3.5	3.6

Sources: Romanian authorities; and Fund staff estimates.

1/ Including public enterprises.

2/ Includes gold.

Table 7. Romania: Medium-Term Projections, 1998-2005

	1998	1999	2000	2001	2002	2003	2004	2005
			Projections					
			(In percent of GDP)					
Saving and investment balances								
Total domestic saving	13.3	15.5	16.3	17.5	18.4	19.4	20.4	21.3
Net factor receipts and transfers from abroad	0.9	0.6	1.1	1.8	2.0	2.0	1.9	1.8
Total national saving	14.3	16.1	17.4	19.3	20.4	21.4	22.3	23.2
Non-government	15.0	16.6	18.7	19.6	20.0	20.4	21.3	22.2
Government	-0.8	-0.5	-1.2	-0.3	0.3	1.0	1.0	1.0
Total investment	21.4	19.9	21.7	23.2	24.2	25.2	26.2	27.2
Non-government	19.9	18.7	20.4	22.0	22.9	23.9	24.8	25.8
Government	1.5	1.2	1.3	1.2	1.3	1.4	1.4	1.4
Savings - investment balance	-7.2	-3.8	-4.3	-3.9	-3.8	-3.9	-4.0	-4.0
Non-government	-4.9	-2.1	-1.8	-2.5	-2.9	-3.5	-3.6	-3.6
Government	-2.3	-1.7	-2.5	-1.5	-0.9	-0.4	-0.4	-0.4
Foreign saving	7.2	3.8	4.3	3.9	3.8	3.9	4.0	4.0

Sources: Romanian authorities; and Fund staff estimates and projections.

*Includes statistical discrepancy.

Table 8. Romania: Indicators of External Vulnerability 1996-2000 1/

(In percent of GDP unless otherwise specified)

	1996	1997	1998	1999	2000 Proj.
Financial indicators					
Public sector debt	23.5	25.5	25.6	30.5	28.2
Broad money (percent change, 12-month basis)	66.1	104.8	48.9	44.9	28.6
Private sector credit (percent change, 12-month basis)	63.3	33.7	64.7	-2.3	27.5
Monthly weighted average t-bill rate	...	133.5	57.9	99.9	52.5 3/
Monthly weighted average real t-bill rate 2/	...	32.1	4.0	44.4	7.1 3/
External Indicators					
Exports (percent change, 12-month basis in US$)	2.3	4.6	-1.6	2.4	16.7
Imports (percent change, 12-month basis in US$)	11.3	-1.4	4.8	-12.1	18.4
Terms of Trade (percent change, 12-month basis)	-2.4	-0.3	0.0	0.2	-6.1
Current account balance	-7.4	-6.1	-7.5	-3.8	-4.3
Current account balance after FDI	-6.7	-2.7	-2.6	-0.8	-1.5
Errors and omissions	2.2	3.1	1.7	1.8	2.4
Gross official reserves (in US$ millions)	1,593	3,075	2,299	2,472	3,112
(in months of imports GS of the following year)	1.5	2.9	2.4	2.2	2.5
Central Bank short-term foreign liabilities (in US$ millions)	0	100	0	170	100
Gross reserves of the banking system (in US$ millions)	3,145	4,763	3,789	3,633	4,491
(in months of imports GS of the following year)	3.0	4.4	4.0	3.2	3.7
Short term foreign liabilities of the commercial banks (in US$)	602	267	188	240	221
Foreign currency liabilities of the commercial banks (in US$)	362	383	401	881	818
Official reserves/Broad money (M2)	19.7	39.5	27.2	23.7	40.8
Official reserves/Narrow money (M0)	49.9	237.7	107.1	102.5	143.4
Total short term external debt by original maturity	2.9	2.5	1.4	1.0	n/a
In percent of reserves	64.5	28.7	24.4	14.1	23.7
In percent of total debt	11.9	9.3	5.7	4.0	7.9
Total short term external debt by remaining maturity 4/	7.4	7.4	7.0	5.6	8.3
In percent of reserves	163.8	84.6	126.8	77.3	96.3
In percent of total debt	28.5	27.4	29.6	23.7	32.1
Total external debt (in US$ millions)	8,597	9,467	9,903	8,784	9,347
Of which: Public and Publicly guaranteed debt	6,507	6,855	7,001	6,169	6,936
Total external debt (in percent of exports of G&S)	88.7	93.4	101.3	87.7	79.5
Total external debt/ GDP	24.5	26.9	23.9	25.7	26.0
External interest payments (in percent of exports of G&S)	3.7	5.0	6.0	5.1	5.1
External amortization payments (in percent of exports of G&S)	9.9	15.9	18.0	23.6	13.5
Exchange rate (per US$, period average)	3,084	7,195	8,881	15,274	...
REER appreciation (+) (12-month basis)	-9.6	16.5	30.0	-14.9	...
Financial Market Indicators					
Foreign currency debt ratings					
Moody's	Ba3	Ba3	B3	B3	B3 5/
Standard and Poor's	BB-	BB-	B-	B-	B- 5/
Spread of benchmark bonds (basis points, end of period)	364	350	1,300	780	562 6/

Sources: Romanian authorities; and Fund staff estimates.

1/ All stocks are measured end-of-period.
2/ Real rate is based on ex-post CPI inflation.

3/ As of June 2000.

4/ Defined as short-term debt by original maturity basis plus amortization falling due on medium-term loans and bonds.

5/ As of October 20, 2000.

6/ As of Ocotber 17, 2000.

Table 9. Romania: Indicators of Fund Credit, 1997-2004

(In percent, unless otherwise indicated)

	1997	1998	1999	2000	2001	2002	2003	2004
Outstanding Fund Credit								
(end of period)								
In millions of SDRs	475.3	382.8	333.8	347.9	256.2	180.5	100.9	22.0
In millions of U.S. dollars	654.1	519.0	462.1	459.9	340.7	240.0	135.0	29.6
In percent of quota	63.0	50.8	32.4	33.8	24.9	17.5	9.8	2.1
In percent of GDP	1.9	1.3	1.4	1.3	0.9	0.6	0.3	0.1
In percent of exports of goods and services	6.6	5.4	4.6	4.0	2.7	1.8	0.9	0.2
In percent of official reserves	21.3	22.6	18.7	14.8	8.9	5.3	2.6	0.5
Debt service due to the Fund								
(in millions of U.S. dollars)	166.5	147.8	167.9	120.5	150.6	122.6	123.3	116.4
In percent of quota	22.1	19.6	16.3	11.7	14.6	11.9	12.0	11.3
In percent of GDP	4.7	3.6	4.9	3.4	4.0	3.0	2.8	2.5
In percent of exports of goods and services	1.7	1.5	1.7	1.0	1.2	0.9	0.8	0.7
In percent of official reserves	5.4	6.4	6.8	3.9	3.9	2.7	2.4	2.0

Sources: Treasurer's Department; Romanian authorities; and Fund staff calculations.

ROMANIA: REVIEW OF FUND-PROVIDED TECHNICAL ASSISTANCE

This appendix presents (i) a summary of technical assistance (TA) provided by the Fund since 1990; (ii) an assessment of its effectiveness from the perspective of both the authorities and the Fund's TA-providing departments; and (iii) discussion of future TA needs and plans as seen by the authorities and Fund staff. The TA-providing departments covered in this Appendix are MAE, FAD, and STA.

I. FISCAL AFFAIRS DEPARTMENT

A. Tax Policy and Tax Administration

1. Romania has received extensive technical assistance in the tax policy and tax administration areas from the Fiscal Affairs Department (FAD). Out of the 8 TA missions since 1991, 6 of them concerned various tax policy issues ranging from the establishment of the value-added-tax (VAT) system, reform of the income taxation, VAT implementation and tax administration, and the measurement of fiscal deficit. The most recent TA mission by FAD on income, value-added, and excise taxation took place in 1997.[1] There was a FIAS mission in 1999 by the World Bank with FAD participation on investment incentives.

2. Many of the recommendations from the earlier TA missions were adopted by the government. A modern profit tax was introduced on January 1, 1991, and a VAT was introduced as of July 1, 1993. Following the recommendations of the 1993 TA mission, the profit tax was further reformed to eliminate the excessively generous provisions for investment tax allowances and tax holidays. The 1994 TA mission made a comprehensive set of recommendations to establish an accurate and manageable basis for the measurement of the fiscal operations in a new stand-by arrangement. Most of the measures were implemented, including: expanding the coverage of the measure of government fiscal operations; reclassifying and presenting the general government operations in accord with GFS principles; imposing strict control on the direct borrowing by other line ministries.

3. The 1997 TA mission offered a comprehensive evaluation of the three major taxes in Romania: income, value-added, and excise taxation. Some of the key recommendations have been adopted, including; on personal income taxation: introducing a global personal income tax system in principle in 1999, reducing the number of bracket in personal income taxation to three, using a single rate for all forms of wage and nonwage income, imposing a 10 percent final withholding tax on dividends and interest; on VAT: eliminating the reduced rate, reducing the number of activities qualifying for zero rating under VAT, reducing the number of exemptions under VAT to align the Romanian VAT law more closely to the standard exemptions of the EU; on excises: increasing the petroleum excise, replacing ad valorem with foreign exchange denominated specific rates. The 1999 FIAS/FAD mission's

[1] The first TA mission was in January 1991. Several missions were requested in the period of 1992 to 1994. The only mission after 1994 was the 1997 one.

recommendations on eliminating the tax holidays and lowering profits tax rates to 25 percent were also implemented.

4. Remaining major challenges in reforming the tax system are to enforce the implementation of the global personal income tax, to improve the yield of VAT and excise taxes, to refrain from resorting to tax incentives as a substitute for structural reforms, and to lower the nonwage labor cost by reducing the reliance on wage based taxes.

B. Public Expenditure Management

5. There was one mission on public expenditure management in 1994. To accommodate the transition to, and to facilitate the function of, the government financial management system in a market economy, the mission made a full-range of recommendations on budgetary processes, intergovernmental relations, budget execution and debt and financial management.

6. The implementation record of the recommendations has been mixed. On the one hand, the Ministry of Finance (MoF) adopted staged budget preparation, put greater reliance on economic classification, improved MoF forecasting capacity, and initiated a MoF general reorganization. On the other hand, however, there are still frequent revisions to the budget during a fiscal year (partly unavoidable given the volatile macroeconomic environment), more special funds have been created, and there is no on-going program review.

7. The provision of technical assistance to the local authorities concerning their budgetary preparation and expenditure management should be viewed as a high priority. In addition, intergovernmental fiscal relations, the expenditure and revenue raising responsibilities of subnational governments, should also be among the priority areas.

C. Social Safety Net

8. A 1994 TA mission assessed and quantified the short-term adverse effects of the authorities' macroeconomic stabilization program on vulnerable population groups, and advised on short-term mitigating measures that could be implemented within the framework of the program's fiscal target. It concluded that the social protection program was adequate and some compensation measures under consideration by the authorities were appropriate. Additional measures were offered to the government on expanding the payroll tax base, curtailing payroll tax evasion, reducing the lag in the collection of payroll taxes in order to improve the revenue performance. The recommendations were well received by the authorities.

9. Moving forward, more FAD assistance in the social safety area are likely given some large-scale restructuring/downsizing of industry yet to occur, the need to improve the targeting of social spending, and to streamline some big-ticket budget items such as pension and health care in the context of EU accession.

D. Authorities Assessment

10. The Ministry of Finance was very appreciative of the Fund TA.

E. Further Technical Assistance Needs and Plans

11. At this time, no further technical assistance is planned in the fiscal area.

II. Monetary and Exchange Affairs Department

A. Banking Sector Issues

12. Romania has received technical assistance in the field of banking supervision and banking sector issues from the Monetary and Exchange Affairs Department (MAE) through annual advisory missions since 1990, with an interruption in 1995 and 1996. This assistance has been reinforced since February 2000 with monthly two-week visits of a senior MAE-coordinated banking supervision expert, which are expected to continue during the rest of the year.

13. A number of other donors are also involved in financial sector issues in Romania, including the World Bank, which plays a major role in bank restructuring, USAID, the EBRD, and more recently the Banque de France as part of a twinning arrangement between central banks of existing and aspiring EU member countries. MAE plays a coordinating role vis-a-vis the other donors in view of ensuring consistency with the overall financial sector strategy and the macro-economic framework.

14. Based on past recommendations, the NBR has taken steps to gradually strengthen banking regulation and supervision over the years. On-site and off-site supervision have been united, an early warning system is now in full operation, and enforcement of banking rules has been strengthened. MAE, however, feels that substantial further improvements in the bank supervisory and regulatory framework are needed, keeping in mind the authorities' final objective of harmonization with the EU supervisory rules and regime. Required improvements include the thorough implementation of the recently adopted stronger loan loss provisioning rules, the introduction of a revised legislation concerning bankruptcy and liquidation procedures for banks, and the incorporation of the mutual credit institutions and popular banks in the supervisory framework, based on new legislation.

15. In spite of some meaningful progress in problem bank resolution, and in particular the merger of Bancorex, there are still several unresolved problem banks. Banca Agricola is now the largest, but not the only, issue of concern. MAE has recommended to pay specific attention to the current status of exit mechanisms for failed banks, and to expedite the resolution of the pending cases.

16. The Deposits Guarantee Fund was established in 1996 against general MAE advice. As expected, it was unable to meet the sizeable demands resulting from a weak and not optimally supervised banking system, and it is surviving mainly through repeated loans from

the NBR and special contributions from the banks. MAE urged the authorities, to no avail so far, to consider the fiscalization of past bank restructuring costs.

B. Monetary and Foreign Exchange Issues

17. Good progress has been made in several areas in improving the operations of the NBR. Substantial improvements, based on MAE technical assistance, were made in moving from direct to indirect, more market based instruments of monetary policy. Directed credits from the NBR to financial institutions have been discontinued, and deposit auctions have been introduced to absorb bank liquidity. However, despite technical advice to reduce the NBR's heavy reliance on reserve requirements, the compulsory reserves in Romania remain to be very high and insufficiently remunerated.

18. Since 1998, treasury balances and overdrafts at the NBR generate interest, while treasury bill auctions have been initiated and a treasury bill market has been developed in line with earlier technical advice. However, a new and clear regulation regarding government securities markets is still in the process of being drafted and, despite technical assistance, in particular the secondary market is still not very well developed.

19. In the past, the NBR has been experiencing problems in controlling reserve money, due to difficulties in forecasting the demand for currency and uncertainties surrounding the net borrowing requirement of the public sector. Following MAE advice, the NBR has begun monitoring an enlarged set of daily indicators to help forecast reserve money and implement a daily liquidity monitoring framework. Senior management of the NBR, including the governor, now meet daily to discuss monetary policy actions on the basis of detailed information on the main factors influencing the banks' liquidity. In line with technical advice, the NBR staff now meets representatives of the Ministry of Finance on a weekly basis to improve forecasts of the net borrowing requirement of the public sector.

20. The foreign exchange market has been liberalized gradually in recent years, supported by IMF technical assistance. In June 1998 the authorities accepted the obligations of Article VIII, section 2, 3 and 4 of the IMF's Articles of Agreement. The exchange rate of the leu against the U.S. dollar (the reference rate) is determined in the interbank foreign exchange market; the NBR intervenes in the market to ensure a periodic depreciation of the leu in line with the monetary program and to smooth out fluctuations in the exchange rate. During the 1990s, the NBR has benefited from both IMF and bilateral technical assistance in the area of foreign exchange management. MAE has supported the gradual replacement of bank deposits by investments in securities and repos in order to reduce counterparty risk. Recent missions have emphasized the importance of improving the accounting and auditing of foreign exchange transactions. In particular, the current system of internal control and audit is clearly inadequate, and MAE missions have advised to put in place precise rules to avoid fraudulent operations, introduce frequent and unforeseen audits on the basis of precise rules and make sure any operation needs at least double intervention.

C. Legal Issues

21. Substantial technical assistance was provided in 1997 in the area of modernizing the legal framework for the Romanian financial sector, this being the main topic of the MAE Technical Assistance mission that visited Bucharest that year. As a result, a number of important financial sector laws were adopted in early 1998, including the Law on the National Bank of Romania, the Law on Banking Activity, and the Bank Bankruptcy Law. Both MAE and the Legal Department have provided comments on drafts of these laws, and the current NBR and banking laws are overall considered satisfactory. In particular, the new Law on the NBR has strengthened the position and independence of the NBR and clarified its objectives and instruments.

22. However, major shortcomings still plague the functioning of the judicial system, creating for instance a situation in which failed banks can continue to operate even after their license has been revoked, and the enforcement of financial discipline is impaired. MAE has recommended the establishment of a special court dealing with financial sector cases.

D. Other Issues

23. The recent failure of an important investment fund (FNI) has impacted the public confidence in the financial sector and brought to light unhealthy relationships between banks and these funds. Supervision and regulation of these funds need to be urgently strengthened, with World Bank assistance, and a thorough investigation of the case to be completed in due course.

24. Romania started implementing new accounting rules and procedures for the NBR and financial institutions according to International Accounting Standards (IAS) in 1998. However, the accounting and auditing systems still need key improvements to bring them up to par with international standards. The Spring 2000 MAE mission recommended that the NBR select an internationally reputable audit firm to audit the accounts of the Bank, as is the case in industrialized countries and in practically all countries in the region.

25. Recent technical assistance has focussed on the importance of transparency of monetary and financial operations, which increases their effectiveness, promotes the efficiency of markets, and facilitates accountability of the central bank. There has been important progress in this area in terms of the publication of more detailed and frequent bulletins and the establishment of an informative website. However, there remains a need for more transparency with respect to the rules and regulations that apply to financial institutions and markets.

E. Authorities' Assessment

26. The authorities noted that the TA offered by the Fund was useful and, therefore, much appreciated.

F. Future Technical Assistance Needs

27. The National Bank of Romania indicated interest in further TA on: (a) monetary and external sector statistics (implementation of "accrual" principle); (b) legal framework, especially in the field of bankruptcy procedures for banks; (c) elaboration of an index of monetary conditions and an NBR model for the Romanian economy ; and (d) medium-term forecasting.

III. STATISTICS DEPARTMENT

A. Balance of Payments Statistics

28. A multisector technical assistance mission visited Romania during December 2–15, 1999. A number of problems were identified in external sector statistics, in particular:

- A lack of detailed information available to the National Bank of Romania (NBR) from the international transactions reporting system means that no checking or editing of the data from this source can be carried out within the NBR;

- Undercoverage of direct investment flows and positions; and

- Undercoverage of grants and other transfers to Romania from abroad.

29. A European Union (EU) project, funded under the PHARE program and starting in the first half of 2000, will address most of the issues raised by the mission. The project, which will provide a new data collection and compilation system for balance of payments and international investment position data, is expected to be completed in five years.

30. The EU consultant for this project, Mr. Hofman of de Nederlandsche Bank, was briefed on the findings of the December 1999 mission. Mr. Hofman has undertaken an initial visit to Romania to assess the current state of Romania's data collection and compilation system; however to date no feedback has been received from Mr. Hofman.

B. Government Finance Statistics

31. A technical assistance mission in government finance statistics (GFS) visited Bucharest during April 15–28, 1998 to assist the authorities in resolving methodological issues that had arisen in the course of GFS reporting by the Ministry of Finance (MOF). The mission found that the data reported to the Fund were incomplete regarding financing and debt information, and that certain classification and compilation treatments do not accord with GFS methodology. It also found that the frequency and timeliness of sub-annual data could be improved using available information. Therefore, the mission recommended the introduction of detailed financing and debt classifications in the Treasury's chart of accounts and budget classifications, and the immediate introduction of monthly reporting on financing.

32. A 1999 multisector statistics mission found that a number of recommendations of the 1998 GFS mission had not been implemented. In addition, the mission found that there was a

lack of transparency concerning the data on the operations of the Agency for Bank Asset Recovery (AVAB), which made it difficult to track the fiscal aspects of bank restructuring activity. The mission recommended that transactions involving AVAB and other units of the central government be identified in the accounting system, thereby enhancing transparency and facilitating reconciliation of monetary and fiscal data. The mission also advised on the proper treatment of the purchase of non-performing bank assets at their value net of provisions in exchange for government securities.

33. Data on foreign grants are not formally identified and included in the accounts for central government budgetary units; however, a new aid coordination unit would start collecting data on grants in 2000. Finally, the mission found that more complete reporting of financing and debt data would be possible if all MOF departments reported data to the statistical division of the Budget Department, and recommended that procedures be established to that effect.

34. No follow-up TA in GFS is envisaged for FY 2001, pending a progress report by the authorities on the implementation of the recommendations of previous missions.

C. Money and Banking Statistics

35. STA technical assistance to Romania in monetary statistics was provided in March 1994 and October/November 1995 (money and banking statistics missions by Mr. Pritchett), October/November 1997 (money and banking statistics mission by Mr. Skarzynski and Ms. Doize), and December 1999 (multisector statistics mission headed by Mr. Zieschang). In general, the authorities have implemented recommendations of past missions. To date, the National Bank of Romania (NBR) reports money and banking statistics for *IFS* publication on a regular and timely basis. There are no major data issues.

36. The 1999 multisector statistics mission, in following up on the recommendations of the 1997 STA money and banking statistics mission, made several recommendations for the financial sector[2]: (1) reclassification of deposits of international organizations with the NBR as foreign liabilities; (2) revaluation of foreign securities held by the NBR and the NBR bonds issued abroad at market prices during the accounting periods to maturity; (3) valuation of stocks of market-traded securities at current market prices and, if market prices are not available, valuation of holdings of traded securities by incorporating accrued interest into the principal value until maturity; (4) reporting of loans of the NBR and commercial banks with the historical, or "book," value of the loans in the portfolio (i.e., not adjusted for expected losses from defaults on some loans in the portfolio); (5) continuing reporting banks in liquidation in the analytical accounts as long as their assets and liabilities have not been fully disposed of within the liquidation procedures; and (6) compilation of the monetary survey on an accrual basis and inclusion of the amount of accrued interest to the underlying

[2] The 1999 report on the multisector statistics mission lists in detail the assessments and recommendations made for the financial sector.

instruments. The Article IV mission will seek to ascertain the progress achieved in the implementation of the recommendations made by the multisector statistics mission.

37. The institutional coverage of the NBR's monetary statistics is incomplete. The multisector statistics mission recommended the development of data collection and reporting procedures for around 530 deposit-issuing mutual credit-cooperatives and profit-oriented popular banks currently not included in the coverage of Romania's monetary statistics. The Article IV mission encouraged the authorities to include deposit-taking institutions, which operate under the cooperative law, in the coverage of the monetary statistics.

D. Real Sector Statistics

Background and institutional issues

38. For real sector statistics, the December 2–16, 1999 statistics multisector mission focused on documenting and assessing the current situation. This focus was taken in view of the principal concern expressed by policy users at the time that growth is being seriously mismeasured in the official statistics because of inadequate coverage of the informal sector and other indirectly measured or unmeasured economic activity. The mission did not find serious methodological issues and the mission's recommendations represented refinements on generally solid methodology in the real sector.

39. In view of the ongoing financial institution failures in Romania, overall issues for the national accounts (broadly defined to include all accounts from goods and services through the balance sheets) center principally on the need to begin developing institutional sector tables on Other changes in assets (OCA) to augment the Financial account. The Revaluations and Other changes in the volume of assets (OCVA) components of the OCA are the principal accounts in which the financial and fiscal effects of the restructuring of distressed depository and other financial institutions are shown. The Financial and OCA accounts for the General government sector are important components of the guidelines contained in the forthcoming Revised Manual on Government Finance Statistics (MGFS) being prepared by the IMF. It is important that the components of the OCA be properly recorded, particularly for banking institutions having transactions involving the government's bank recapitalization operations and its asset recovery agency, for the asset recovery agency itself, and for the Treasury in order to track the financial and fiscal aspects of financial restructuring.

40. The mission found generally high and effective levels of coordination across government agencies and institutions in the production of real, financial, and external sector data. In connection with the financial developments in the economy just mentioned, the mission supported the cooperative work ongoing between the NBR (which is responsible for the financial accounts) and the National Commission for Statistics (CNS, which is responsible for the nonfinancial accounts) to produce opening and closing balance sheets linked by the Financial and OCA accounts.

41. The production of statistics is often constrained by available resources, but the STA mission was particularly concerned about the organizational risk inherent in the low compensation rates and difficulty in retaining and recruiting staff at the CNS central office in

Bucharest. The commendably complete and methodologically sound set of real sector statistics produced by the CNS, particularly the national accounts, is in serious jeopardy unless the present and future resource needs of the central office are adequately funded. Since the STA mission, EU1 has reported that measures have been taken to remedy the resource shortfalls in the National Commission for Statistics.

Real sector assessment

42. The mission found the national accounts estimates produced by the CNS for both quarterly and annual series on Gross Domestic Product to be methodologically sound and well executed. However, updating the framework from the European System of Accounts 1979 (ESA79) to ESA95 has required development of new data sources and deepening of existing sources, as well as adoption of new methodologies. The updating process has been slowed by the difficulty the Macroeconomic Synthesis Directorate has experienced in keeping authorized positions staffed with trained personnel, owing in part to an uncompetitive compensation package. As a result of this and the requirement that preliminary annual estimates be produced within two months of the end of the year, backlogs of work on moving to ESA95 are building. The CNS does not expect to begin releasing data on an ESA95 basis until the end of 2000, and this appears optimistic.

43. The mission found that the price statistics produced by the CNS, comprising the Consumer and Producer Price Indices (CPI and PPI), follow sound methodological practices and exhibit good conventional coverage of their topical areas. As Romania is in a very dynamic period of its economic history, the principal issue regarding the CPI is the relevance of the index weights for measuring current price developments. Annual reweighting would enhance the relevance of the CPI as a current indicator, and it has been reported since the STA mission that annual reweighting is now being implemented. CNS abruptly reduced the coverage of the PPI from the value of all shipments of the covered industries to shipments for domestic uses only beginning with 1998 data. However, CNS plans to reinstate export coverage with the next index revision during 2001, which will incorporate 2000 weighting data. In addition to reintroducing coverage of exported production into the PPI, the speed of structural change in Romania indicates annual updating rather than reweighting the index every five years would improve its relevance.

44. The Industrial Production Index (IPI) was found to follow sound methodological practice and to exhibit good coverage of manufacturing, utilities, and mining activity. The mission made some suggestions that could streamline compilation with negligible loss of accuracy. Regarding labor market statistics, the mission found that the labor force, employment, and unemployment statistics, which are derived from a well-designed Labor Force Survey, are well covered in the official data.

E. Future Technical Assistance Needs and Plans

45. The authorities indicated that they envisaged a need for further Fund TA on: (a) real sector statistics, especially with a view to bringing the national accounts in line with ESA 95 and SNA 93; and (b) GDDS development.

46. STA noted that a mission to draft a GDDS metadata will visit Romania in the coming months.

List of STA mission reports and aide-mémoires

Report	6/19/00	Multisector statistics
Report	7/17/98	Government finance statistics
Report	2/10/98	Money and banking statistics
Report	1/05/98	Balance of payments and trade statistics
Report	1/18/96	Money and banking statistics
Report	3/04/94	Money and banking statistics
Report	6/12/92	Balance of payments statistics
Aide-mémoire	10/02/91	Statistical system and economic reform

ROMANIA—RELATIONS WITH THE FUND
(As of September 30, 2000)

I. Membership status: Joined 12/15/72; Article VIII

II. General resources account:	SDR million	% Quota
Quota	1,030.20	100.0
Fund holdings of currency	1,413.41	137.2

III. SDR department:	SDR million	% Allocation
Net cumulative allocation	75.95	100.0
Holdings	0.08	0.1

IV. Outstanding purchases and loans:	SDR million	% Quota
Stand-by Arrangements	257.53	25.0
Systemic Transformation	125.68	12.2

V. Financial arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	08/05/99	02/28/01	400.00	139.75
Stand-by	04/22/97	05/21/98	301.50	120.60
Stand-by	05/11/94	04/22/97	320.50	94.27

VI. Projected obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	07/31/00	2000	2001	2002	2003	2004
Principal		35.5	91.7	75.7	79.6	79.0
Charges/interest		6.3	21.5	16.5	12.6	7.6
Total		41.8	113.2	92.2	92.2	86.6

VII. Exchange rate arrangements

The foreign exchange market in Romania was unified in November 1991. From June 1992, the exchange rate was determined daily through an auction organized by the NBR in which bids and offers had to be channeled through the commercial banks; however, the price determination rule employed did not ensure that the price set in the auction was a market-clearing price. In April 1994, the auction mechanism was modified to ensure clearing of the market. From August 1994, a decentralized direct dealing interbank market was in operation. The official reference rate published by the NBR is an average of rates reported for interbank and client transactions. The market was effectively dismantled in March 1996, when the NBR revoked the licenses of 22 dealer banks (including all foreign banks), leaving only four state-controlled dealer banks. Functioning of the market was restored on February 18, 1997 when these licenses were reissued. The reference exchange rate as of September 30, 2000, was lei 24,169 per U.S. dollar. Romania has accepted the obligations of Article VIII, Sections 2, 3, and 4, with effect from March 25, 1998.

VIII. Article IV consultation

Romania is on a 12-month consultation cycle. The last consultation was concluded on September 15, 1998.

IX. Technical assistance

The transition in Romania has been supported by substantial technical assistance from multilateral agencies and bilateral donors. The Fund has provided support in a number of areas with more than 40 technical assistance missions since 1990, although the authorities have had a mixed record with regard to implementation. Expert Fund assistance has focused on a number of key areas, including: fiscal reforms; modernization of the central bank and the banking system; creating a market-oriented legal structure; training; and improving the collection and reporting of statistics.

X. Resident representative

The Fund has had a resident representative in Bucharest since 1991. Mr. Stephane Cosse assumed the post in December 1999.

Table 10. Romania: Technical Assistance Monitoring Sheet

Department	Subject/Identified Need	Action	Timing	Counterpart	Mission Chief/ Coordinator	Product	Status
INS	Course on Macro Economic and Financial policies	Mission	Oct. 90	MOF	Evers	Course	Completed
INS	Course on Macroeconomic and Financial policies	Mission	June 94	MOF	Oanes	Course	Completed
INS	Course on Fundamental Issues of the Transition (Fiscal)	Mission	June 95	NBR/MOF	Oanes	Course	Completed
INS	Financial Programming Workshop	Mission	Oct. 95	NBR/MOF	Antonaya	Course	Completed
LEG	Bankruptcy law	Mission	June 94	Min. Justice /Parliament/Council for Coordination	Schiffman	Aide-Memoire / Draft Legisl.	Completed
LEG	Bankruptcy law	Mission	Aug. 94	Min. Justice /Parliament/Council for Coordination	Schiffman	Aide-Memoire / Draft Legisl.	Completed
LEG	Bankruptcy law	Mission	Oct. 94	Min. Justice /Parliament/Council for Coordination	Schiffman	Aide-Memoire / Draft Legisl.	Completed
LEG	Bankruptcy law and enterprise restructuring	Mission	Dec. 94	Min. Justice /Parliament/Council for Coordination /Restruct. Agency	Schiffman	Aide-Memoire / Draft Legisl.	Completed
LEG	Bank privatization law	Mission	March 95	CCR	Schiffman	Draft Legisl.	Completed
MAE/LEG	General assessment; financial sector legislation	Mission	Oct. 90	NBR	Scott	Aide-Memoire	Completed
MAE/LEG	Banking supervision; foreign exchange operations	Mission	Nov./Dec. 90	NBR	Downes	Aide-Memoire	Completed
MAE/LEG	Strengthen framework, instruments and procedures for market-based monetary management, and review banking legislation	Mission	Mar. 97	NBR	Downes	Aide-Memoire	Completed
MAE	Modernization of functions and operations of NBR	Mission	Jan./Feb. 91	NBR	Downes	Report	Completed
MAE	Action plan for NBR modernization	Mission	Mar. 91	NBR	Downes	Aide-Memoire	Completed
MAE	Review of action plan for NBR modernization	Mission	July/Aug. 91	NBR	Downes	Aide-Memoire	Completed

Table 10. Romania: Technical Assistance Monitoring Sheet

Department	Subject/Identified Need	Action	Timing	Counterpart	Mission Chief/ Coordinator	Product	Status
MAE	Modernization of the monetary management system; money market development; banking supervision; clearing and payment system	Mission	Dec. 91	NBR	Vaez-Zadeh	Aide-Memoire	Completed
MAE	Foreign exchange issues; banking supervision	Mission	May 92	NBR	Nordman	Aide-Memoire	Completed
MAE	Review of action plan for NBR modernization	Staff visit	June 92	NBR	Vaez-Zadeh	Report	Completed
MAE	Foreign exchange issues	Staff visit	Sep./Oct. 92	NBR	Nordman	Aide-Memoire	Completed
MAE	Review of the NBR modernization program	Mission	Jun. 93	NBR	Bouvier	Aide-Memoire	Completed
MAE	Exchange rate policy and reserve management	Mission	May 94	NBR	Dattels	Report	Completed
MAE	Bank supervision, payment systems, monetary operations, exchange systems	Mission	Dec. 94	NBR	Bouvier	Report	Completed
MAE/LEG	Monetary operations and financial sector legislation	Mission	Mar. 97	NBR	Downes	Report	Completed
MAE	Monetary operations, foreing reserves management, and banking supervision	Mission	Feb./Mar. 98	NBR	Hilbers	Report	Completed
MAE	Strengthening key central bank operations	Mission	Feb. 99	NBR	Hilbers	Report	Completed
MAE	Strenthening Banking Supervision	Expert visits	Jan.-July 2000	NBR	Van Sluijs	Technical Advice	Ongoing
MAE	Stabilizing the Banking Sector	Mission	May 2000	NBR	Hilbers	Report	Completed
MAE	Strengthening Banking Supervision	Expert visits	Oct.-Mar. 2000	NBR	Van Sluijs	Technical notes	Underway
FAD	General assessment	Mission	Sept. 90	MOF	Mutén	Report	Completed
FAD	Reform of system of indirect taxation	Mission	Oct/Nov. 90	MOF	Gandhi	Report	Completed
FAD	Income tax system	Mission	Dec. 90	MOF	Mutén	Aide-Memoire	Completed
FAD	Budgetary forecasting methods; contingency measures; tax reform	Mission	May/June 91	MOF	Prust	Aide-Memoire	Completed
FAD	Tax administration: VAT and global income tax	Mission	Feb. 92	MOF	Cornély	Report	Completed
FAD	Budget classification	Mission	May 93	MOF	Norregaard	Report	Completed

Table 10. Romania (concluded): Technical Assistance Monitoring Sheet

Department	Subject/Identified Need	Action	Timing	Conterpart	Mission Chief/ Coordinator	Production	Status
FAD	Tax policy	Mission	Aug. 93	MOF	Shome	Report	Completed
FAD	Profits tax reform	Mission	Nov. 93	MOF	Norregaard	Aide-Memoire	Completed
FAD	Social safety net	Mission	Dec. 93	MOF	Gupta	Report	Completed
FAD	Public expenditure management	Mission	May/June 94	MOF	Diamond	Report	Completed
FAD	Fiscal seminar	Mission	June 95	MoF	Chand	Seminar	Completed
FAD	Tax policy and tax administration	Mission	Oct./Nov. 97	MoF	Ebrill	Report	
FAD/FIAS	Investment incentives	Mission	Aug.99	MoF	Tait/Bergman	Report	Completed
PDR	Exchange system reform	Mission	June 91	NBR	Gilman	Aide-Memoire	Completed
PDR	Exchange system reform	Mission	Sept. 91	NBR	Gilman	Aide-Memoire	Completed
STA	The statistical system and economic reform	Mission	Sept. 91	NBR/NCS	McLenaghan	Aide-Memoire	Completed
STA	Balance of payments statistics	Mission	Apr. 92	NBR	Hafiz	Report	Completed
STA	Balance of payments statistics (long-term)	Resident Advisor	June 93/June 94	NBR	Hussain	Report	Completed
STA	Balance of payments statistics	Mission	Sept./Oct. 97	NBR	Hussain	Aide-Memoire	
STA	Money and banking statistics	Mission	Oct./Nov. 93	NBR/NCS	Pritchett	Report	Completed
STA	Money and banking statistics	Mission	Oct./Nov. 95	NBR	Pritchett	Report	Completed
STA	Money and banking statistics	Mission	Oct./Nov. 97	NBR	Skarzynski	Aide-Memoire	
STA	Government finance statistics	Mission	Apr. 98	MoF	Shevchenko	Report	
STA	Multisector	Mission	Dec.99	MoF/NBR/NCS	Ziescheng	Report	

Romania—Relations with the World Bank

1. The World Bank has been active in Romania since 1991 and has built up a portfolio of 29 Bank-financed operations, of which 21 are active. Aggregate lending for the 29 operations amounts to US$3.1 billion. Of this, US$2.1 billion has been disbursed as of September 30, 2000. Bank operations have included policy-based balance of payments support, infrastructure development, social sector projects, and technical assistance.

2. Portfolio performance has suffered from hesitant structural reforms, poor policy environments in key sectors such as the financial sector, utilities or social policies and from unsteady macroeconomic conditions over the last few years. Agricultural reforms have also wavered, which led to significant delays in the release of the last tranche of the Agricultural Sector Adjustment Loan (ASAL). However, The Government, has also made substantial progress in several areas, such as in strengthening its approach to (and the legal foundations for) enterprise privatization, gradual improvements of the business climate and and the closure of invalid banks. In view of this substantial progress, the second and last tranche of a PSAL adjustment loan was disbursed in June 2000, and the Bank's Board approved in July a restructuring of ASAL's last tranche into a larger sub-tranche (US$100 milllion) and a smaller sub-tranche (US$50 million), before the Fund's SBA went off track. The larger sub-tranche of US$100 million was released in late July, but release of the final tranche is contingent on a remaining condition relating to the privatization of state farms, and would require that a satisfactory macroeconomic framework be in place.

3. A new Country Assistance Strategy (CAS) is currently under preparation, which would cover the three-year period FY02-FY04. The CAS will define the Bank's lending and advisory services based on Government priorities, and will build on the work initiated under the Comprehensive Development Framework, for which Romania is one of the pilot countries. It will also integrate on the work underway for EU accession.

4. The World Bank has maintained a highly collaborative relationship with its counterparts at the IMF. The last adjustment operation, the Private Sector Adjustment Loan (PSAL), approved in June 1999 and completed one year later, complemented the IMF's standby arrangement and was developed in close consultation with the IMF's Romania team and management. The PSAL aimed to support the Government's efforts to stabilize the macroeconomic situation by accelerating structural and banking sector reforms, including privatization of state-owned enterprises, and creating an environment conducive to private sector growth and development. The World Bank and the IMF are working closely with the Romanian Government in these areas, providing advice and technical assistance.

5. As of September 2000, IFC's held portfolio includes 15 projects with US$143 million for IFC's own account and US$191 million in syndicated loans. IFC has committed substantial resources in FY99 to implement a strategy intended to advance structural reform, assist in the privatization of state-owned enterprises and public utilities, and provide support for small and medium enterprises. In FY00, IFC continued to direct the majority of its resources for Romania to advisory and technical assistance work. To improve the level and the quality of water and sewerage services in Romania, IFC advised, in FY00, in the privatization of Bucharest's municipal water services. This was the first major municipal privatization in Romania and the biggest to date in Central and Eastern Europe. IFC continued to invest in the financial sector, including a twinning arrangement between a local and overseas financial institution and a leasing company to ensure sustainable lending to SMEs. If agreements with the Fund and the Bank are properly implemented and the Government ensures a stable climate for investors, IFC would likely increase the number of its investments in Romania.

Table 11. Romania: World Bank Lending Operations

	Lending Operation	Amount	Board Date
1	Technical Assistance Critical Imports	US$180 million	1991
2	Health Services Rehabilitation	US$150 million	1991
3	Structural Adjustment Loan	US$400 million	1992
4	Private Farmers & Enterprise Support	US$100 million	1992
5	Transport Sector Rehabilitation	US$120 million	1993
6	Petroleum Sector Rehabilitation	US$176 million	1994
7	Education Sector Reform	US$50 million	1994
8	Industrial Development[1]	US$175 million	1994
9	Employment and Social Protection	US$55 million	1995
10	Power Sector Rehabilitation	US$110 million	1995
11	Financial & Enterprise Sector Adjustment Loan[2]	US$280 million	1996
12	Railway Sector Rehabilitation	US$120 million	1996
13	Bucharest Water Supply	US$25 million	1996
14	Higher Education	US$50 million	1996
15	Agricultural Sector Adjustment Loan	US$350 million	1997
16	Social Protection Adjustment Loan	US$50 million	1997
17	Second Roads	US$150 million	1997
18	Schools Rehabilitation	US$70 million	1997
19	General Cadastre & Land Registration	US$26 million	1997
20	Telecommunication[3]	US$30 million	1998
21	Child Welfare Reform	US$5 million	1998
22	Cultural Heritage	US$5.0 million	1998
23	Social Development Fund	US$10 million	1999
24	Private Sector Adjustment Loan	US$300 million	1999
25	Private Sector Institution Building	US$25 million	1999
26	Mine Closure and Social Mitigation	US$45 million	1999
27	Agriculture Support Services	US$11 million	2000
28	Trade and Transport Facilitation in Southeast Europe	US$17 million	2000
29	Health Sector Reform II	US$40 million	2000

[1] of which US$55.0 million was cancelled
[2] of which US$100.0 million was cancelled
[3] of which US$7.0 million was cancelled

ROMANIA: STATISTICAL ISSUES

1. Romania's data collection and reporting is adequate for surveillance and program monitoring. The authorities have made some progress in improving their statistical base over the past two years with the help of Fund TA missions, although more needs to be done, in particular in the area of balance of payments, and the consistency between monetary and fiscal data. A GDDS mission is scheduled to visit Romania in November to assess Romania's compliance in this regard.

Real Sector

2. The national accounts statistics produced by the Commission of National Statistics (NCS) for both quarterly and annual series on Gross Domestic Product are methodologically sound and well executed. The CNS recently moved to update the framework from the European System of Accounts 1979 (ESA79) to ESA95, and data based on an ESA95 are expected to be released at the end of 2000.

3. The Consumer Price Index (CPI) is scheduled to be subject to annual re-weighting, so as to take into account the dynamic changes in Romania's economy. CNS abruptly reduced the coverage of the Producer Price Index (PPI) from the value of all shipments of the covered industries to shipments for domestic uses only, beginning with 1998 data. However, CNS plans to reinstate export coverage with the next index revision during 2001, which will incorporate 2000 weighting data. In addition to reintroducing coverage of exported production into the PPI.

Public Finance

4. Consolidated data on central government operations are routinely reported for the *GFS Yearbook* and the *IFS*, and the EU1 department receives monthly budget data. A multi-sector mission visited Romania in December 1999 and found that some of the recommendations of the previous GFS mission have not been implemented. Importantly, consolidated general government expenditures by economic classification are reported only on a quarterly basis, and with a two month lag while data on debt and financing are often inconsistent with the budgetary "above-the-line data". The multi-sector mission recommended the introduction of detailed financing and debt classifications in the Treasury's chart of accounts and budget classifications, and the immediate introduction of monthly reporting on financing. In addition, data on foreign grants are not formally identified and included in the accounts for central government budgetary units; however, a new aid coordination unit would start collecting data on grants in late 2000.

Money and Banking

5. The National Bank of Romania (NBR) reports money and banking statistics for *IFS* on a regular and timely basis. In general, the authorities have implemented recommendations of past missions. While there are no major statistical issues, the multi-sector mission in December 1999 stressed again that the institutional coverage of the NBR's monetary statistics is incomplete. The Article IV mission encouraged the authorities to include deposit-taking

institutions, which operate under the cooperative law, in the coverage of the monetary statistics.

Balance of Payments

6. The National Bank of Romania routinely reports balance of payments statistics in a timely fashion. Data collection and compilation have improved following technical assistance. The recent multi-sector mission found that a number of problems still exist including (a) a lack of detailed information available to the NBR from the international transactions reporting system; (b) under coverage of direct investment flows and positions; and (c) under coverage of grants and other transfers to Romania from abroad.

Table 12: Romania: Core Statistical Indicators
as of October 31, 2000

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	Oct. 27, 2000	Oct. 30, 2000	Sept. 30, 2000	Oct. 27, 2000	Sept. 30, 2000	Oct. 30, 2000	Sept., 2000	Aug.31, 2000	Aug. 31, 2000	Aug.30, 2000	H1 2000	Aug. 31, 2000
Date Received	Oct. 27, 2000	Oct. 30, 2000	Oct. 27, 2000	Oct. 30, 2000	Oct. 27, 2000	Oct. 30, 2000	Oct. 11, 2000	Oct. 9, 2000	Oct. 9, 2000	Sept. 27 2000	Sept. 20, 2000	Oct. 9, 2000
Frequency of Data	D	D	M	D	M	D	M	M	M	M	Q	M
Frequency of Reporting	D	W	M	W	M	D	M	M	Q	M	Q(V)	M
Source of Update	A	A	A	A	A	A	N	A	A	A	C	A
Mode of Reporting	C	E	E	E	E	C	C	E	E	E	C	E
Confidentiality	C	A	A	A	A	C	C	A	C	A	C	A
Frequency of Publication	D	M	M	M	M	D	M	M	Q	M	Q	Q

Statement by the IMF Staff Representative on Romania
November 29, 2000

1. This statement provides information on recent political and economic developments in Romania that has become available since the circulation of the staff report and selected economic issues paper for the 2000 Article IV consultation (SM/00/249 and SM/00/250). New developments do not change the thrust of the staff appraisal.

I. Political Developments

2. Early results indicate that the parliamentary elections of November 26 returned former President Iliescu's left wing PDSR party to power, but short of an absolute majority, with the nationalist Greater Romania Party recording a strong second-place finish. The parties of the current center-right coalition government suffered considerable losses. Leading PDSR politicians have announced that they will seek to form a coalition with parties of the current governing coalition. The parliamentary election outcome was mirrored in the presidential polls, in which Mr. Iliescu received the largest share of the votes but fell short of an absolute majority, so that he will face a runoff election against the nationalist party leader, Mr. Tudor, on December 10.

3. On November 9, the European Commission made public its assessment of Romania's progress toward meeting the Copenhagen accession criteria. The report states that "Romania cannot be regarded as a functioning market economy and is not able to cope with competitive pressure and market forces within the Union in the medium term" and that Romania "has not substantially improved its future economic prospects". The assessment was also critical with respect to governance issues and a lack of progress in structural reform.

II. Economic Developments

4. Recent economic data broadly confirm the picture described in the issued documentation. Preliminary data indicate that the monetary and fiscal policy stance through end-September remained appropriate, while slippages in domestic arrears and wage policy became more pronounced. Accordingly, all end-September performance criteria were met, except those regarding the public sector wage bill and domestic arrears reduction, which were missed by significant margins. Since, then, however, there has been evidence that the underlying risks to fiscal policy have materialized and that backtracking has occurred in the area of structural reform.

- Inflation has continued at relatively high levels and reached a 12-month rate of 42.9 percent in October, consistent with an end-December staff projection of 40 percent. This is largely the result of continuing slippages in reducing domestic arrears and limiting public sector wage growth, mainly as a result of a failure to implement key legislation.

- Reflecting continued buoyant export performance, the current account deficit reached 1.6 percent of GDP at end-September. In November, the authorities were able to tap international capital markets again with a €150 million issue with a 5-year maturity and an interest rate of 11.6 percent. The external performance was reflected in an increase in the National Bank's net foreign assets to US$1.7 billion at mid-November, in line with the end-December performance criterion.

- Preliminary data for September indicate that fiscal policy has remained tight, with a recorded deficit of 2.2 percent of annual GDP. Since then, however, the authorities announced—and subsequently started to implement—a number of nonbudgeted policy initiatives (*inter alia*, relating to additional expenditure on hospitals, child allowances, pensions, household heating subsidies, agricultural and mining subsidies as well as a tax amnesty, which taken together would add some ¾ of one percentage point of GDP to the deficit in 2000). In addition, the underlying imbalance of the pension system has been aggravated through higher spending, lower revenue, and announced cuts in contribution rates as of December 1.

- The authorities also backtracked on their commitment to liquidate Banca Agricola if privatization efforts were to fail. Instead, they decided to recapitalize the bank, at a cost of lei 4.6 trillion (US$185 million), with a view to keeping it in operation indefinitely.

- The banking system has witnessed a renewed test of confidence, as a foreign-owned bank has not been able to meet requests for withdrawals. The NBR has instituted special surveillance and uncovered fraudulent practices.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 00/106
FOR IMMEDIATE RELEASE
December 12, 2000

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Romania

On November 29, 2000, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Romania.[1]

Background

Romania has made important progress in stabilization and reform over the past two years, and in December 1999 was invited to begin accession negotiations with the European Union. However, Romania's economic and policy performance still compares unfavorably to that of other EU accession economies in Central and Eastern Europe: its inflation rate is by far the highest, while its rankings in terms of other key indicators (per capita income, change in real GDP during the 1990s, and progress in structural reform) are among the lowest. This situation is in part attributable to difficult initial conditions, but more importantly, it reflects a gradualist approach to structural reform and a stop-and-go pattern of macroeconomic policies over much of the last decade.

In early 1999, confronted with the threat of an impending crisis, the authorities took decisive policy measures to stabilize the economy, which were supported by a stand-by arrangement with the IMF. The economic program encompassed strong fiscal correction, an improvement in external cost competitiveness, tight monetary and incomes policies, and the closure of a large insolvent state bank.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

These policies succeeded in averting a crisis in mid-1999, reducing the current account deficit to a sustainable level (US$1.3 billion or 3.8 percent of GDP compared with US$3.1 billion or 7.5 percent in 1998) and strengthening foreign reserves since mid-1999. They have thus helped restore market confidence. Meanwhile, output declined by a further 3.2 percent in 1999, and CPI inflation rose to 55 percent toward the end of 1999 owing mainly to the "pass through" effect of the large downward exchange rate re-alignment.

In 2000, on the back of the previous year's policy corrections, Romania has witnessed an export-led economic recovery. Following output declines of 5.4 percent in 1998 and 3.2 percent in 1999, real GDP grew by 2.1% in the first half of 2000. Notwithstanding the effects of the drought on agricultural production, real GDP growth is expected to reach 1.5 percent for the whole year and prospects for the recovery in output to continue in 2001.

Exports rose by 25½ percent in dollar terms, reflecting strong foreign demand and the lagged effects of last year's improvement in cost competitiveness. Gross official foreign reserves reached US$3.1 billion (2.7 months of total imports or about 120 percent of short-term debt by remaining maturity) at end-July 2000. However, the 12-month CPI inflation rate amounted to 45½ percent in August, well above targeted levels, owing to the effects of a drought on food prices as well as policy slippage in the areas of state sector wages and domestic arrears. Inflation is expected to decelerate only slightly, if at all, in the remainder of the year, implying that the official end year target of 27 percent will be exceeded by a large margin.

Romania made important progress in structural reforms supported by the World Bank's Private Sector Adjustment Loan (PSAL) since 1998, as privatization effort were accelerated significantly. The PSAL was thus successfully completed in June 2000 when the second (and last) PSAL tranche of US$150 million was disbursed. However, delays and procedural problems in bank restructuring and privatization initiated under the PSAL have occurred since mid-2000, and a follow-up adjustment loan (PSAL2) has been postponed.

Executive Board Assessment

Executive Directors were encouraged by Romania's significant progress in stabilization and reform since the completion of the previous Article IV consultation in September 1998. Directors commended the authorities for their decisive steps to stabilize the economy, including a significant fiscal adjustment, which, together with the depreciation of the exchange rate in 1999, had helped narrow the current account deficit to a sustainable level and averted an imminent financial crisis. They also welcomed the measures taken to restructure the banking system and the initial acceleration in enterprise privatization after a long period of neglect.

Directors expressed concern that more recent developments risk putting in jeopardy the good performance achieved in the last two years. They regretted Romania's lack of success in reducing domestic arrears and the policy slippages that had occurred in the area of state sector wages.

Directors observed that Romania's stabilization and reform efforts still lag behind those of most other transition countries in Central and Eastern Europe, reflecting mainly the "stop-and-go" approach to reform and macroeconomic stability pursued for much of the past 11 years. They therefore urged the authorities to break decisively with the previous pattern of policymaking and to engage in a sustained and vigorous strategy of stabilization and structural reform, so as to at last achieve a sustainable improvement in living standards and improve prospects for a smooth integration into the European Union (EU).

Directors considered that progress in disinflation and strengthening the external position in Romania will require continued fiscal consolidation combined with the pursuit of a prudent monetary policy as well as wage and financial discipline in the state-owned enterprises. Given that most large companies still remain under state control and suffer from weak corporate governance, they stressed the critical importance of controlling wage costs in these companies and of intensifying efforts to reduce domestic arrears. In order to enhance economic efficiency, the above policies will need to be accompanied by strong reform measures, including accelerated restructuring of the enterprise and banking sectors and an improvement in the business environment.

While welcoming the narrowing of the budget deficit in recent years, Directors cautioned that the fiscal position remains precarious and will need to be strengthened to achieve stabilization. They urged the authorities to treat their medium-term fiscal deficit target of 3 percent of GDP as an upper limit. Directors expressed concern that recent changes in the structure of public expenditure—involving significant real expenditure increases on personnel and transfers and subsidies—were steps in the wrong direction, marking a relaxation of fiscal policy. In addition, they noted that the budget will come under increasing pressure in the coming years owing to additional claims stemming from the EU accession process and the accelerated restructuring of the economy. Against this background, Directors considered it urgent for Romania to reform government expenditure and the pension system through improved targeting of social spending, reduction of excess staffing, and further tightening of the eligibility requirements for pensions. They noted that these issues will be addressed extensively at an early date in the context of a Public Expenditure Review to be conducted with World Bank assistance.

Directors emphasized the importance of a prudent monetary policy, along with financial discipline for the budget and state-owned companies, in reducing inflation and containing the growth in domestic demand. They considered the current level of external competitiveness to be adequate. On the monetary policy framework, Directors noted that the managed float aims at striking a balance between inflation and external objectives. Looking forward, they agreed that a more transparent monetary policy framework—involving an explicit target for the exchange rate or inflation—could facilitate disinflation. However, implementation of such a framework will require improved financial discipline and fiscal reform.

Directors welcomed the authorities' efforts with regard to bank restructuring in the last two years, but noted that a great deal remains to be done, as underscored by the lingering presence of unresolved problem banks in the system and the continuing appearance of new cases. Besides a stable macroeconomic environment, the creation of an efficient and healthier banking system will require privatization of the banks remaining under state control through transparent procedures aimed at enhancing the prospects for their sound management. In this context, Directors regretted the authorities' decision to recapitalize Banca Agricola in the absence of firm prospects for its privatization. They also noted that recent events in the banking system underscore the urgency of further enhancing the legal and regulatory framework as well as improving supervisory practices and regulations. Directors pointed out that the circumstances of the collapse of a mutual fund earlier this year had highlighted serious weaknesses in the regulation and supervision of the nonbank financial sector as well as broader governance problems. They called on the authorities to hold those involved accountable and to proceed expeditiously with the required institutional reforms in this area.

Directors reiterated that progress in enterprise privatization is key to enhancing financial discipline as well as efficiency. They considered that, with 80 percent of pre-transition state-owned large companies still remaining under state control, the authorities face a considerable task, but that the gains from the success of privatization and the restructuring of these companies could be very large. In this regard, Directors urged the authorities to proceed expeditiously with the privatization of the 63 large commercial enterprises on the basis of the transparent procedures envisaged under the World Bank's Private Sector Adjustment Loan. They also advised the authorities to prepare the privatization of the national companies (former régies autonomes), which should contribute significantly to economic efficiency and financial discipline owing to their pervasive role in the economy and their financing of domestic arrears.

Directors observed that Romania's statistical base is of adequate quality, but encouraged the authorities to make further improvements, in particular with regard to balance of payments data and the consistency of fiscal and monetary data.

Directors noted that the discussion on policies for the second review of the Stand-By Arrangement with Romania was not concluded. They hoped that the authorities would soon commit to a comprehensive set of measures for stabilization and structural reform.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Romania: Selected Economic Indicators, 1995-2000

	1995	1996	1997	1998	1999	2000 Program EBS/00/87	2000 Revised Proj.	2000 Outturn H1	
						(Percent change)			
Real economy									
Real GDP	7.1	3.9	-6.1	-5.4	-3.2	1.3	1.5	2.1	
Real wages in economy-wide (period average, deflated by CPI	17.3	9.3	-21.9	0.7	-0.7	...	...	-2.4	
Unemployment rate (end of period; in percent)	9.5	6.5	8.9	10.4	11.5	...	...	10.8	
Consumer prices (end of period)	27.8	56.9	151.4	40.6	54.8	27.0	40.0	45.4	a/
						(In percent of annual GDP)			
Public finance; general government budget									
Revenues	31.4	29.4	29.4	30.2	33.3	32.8	32.2	15.2	
Expenditures	34.7	34.0	34.0	35.2	37.1	36.1	36.4	16.8	
Balance including privatization receipts	-3.0	-3.9	-2.1	-3.7	-2.2	-2.4	-3.7	-1.5	
Balance excluding privatization receipts	-3.4	-4.5	...	-5.0	-3.8	-3.5	-4.3	-1.7	
						(12-month percentage change)			
Money and credit									
Broad money (end of period)	71.6	66.0	75.9	48.9	44.9	28.6	35.2	43.5	b/
Real domestic credit (end of period)	50.1	15.5	-52.5	21.8	-10.6	...	...	-9.8	b/
NBR interest rates (end of period; in percent) 1/	67.0	66.9	138.8	105.0	66.2	...	...	40.3	
						(In billions of U.S. Dollars)			
Balance of payments									
Current account balance	-1.7	-2.6	-2.2	-1.0	-1.3	-1.4	-1.5	-0.4	
(as percent of GDP)	-4.9	-7.4	-6.2	-7.5	-3.8	-3.9	-4.3	-1.2	
Exports	7.9	8.1	8.4	8.3	8.5	9.5	9.9	4.9	
Imports	9.5	10.6	10.4	10.9	9.6	10.6	11.4	5.4	
Gross reserves (in months of imports of G&S) 2/	2.8	3.0	4.4	4.0	3.5	4.2	3.7	...	
External debt/GDP (in percent)	19.2	24.5	26.9	23.9	25.7	29.0	26.0	...	
Debt service ratio	10.1	12.6	19.1	21.8	28.5	20.3	18.3	...	
Exchange rate									
REER (period average; CPI-based 12/1996=100)	101	93	107	139	119	...	...	129	

Sources: Romanian authorities; and IMF staff estimates.

1/ Weighted NBR average interest rate; from 1997 interbank rate.
2/ Including gold, and excluding Bancorex deposits. Imports of goods and services of the following year.

a/ 12 months to August.
b/ 12 months to June.