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Romania: First Review Under the Stand-By Arrangement and Request for Waiver and Modification of Performance Criteria—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Romania

In the context of the first review under the Stand-By Arrangement and request for waiver and modification of performance criteria with Romania, the following documents have been released and are included in this package:

- the staff report for the first review under the Stand-By Arrangement and request for waiver and modification of performance criteria, prepared by a staff team of the IMF, following discussions that ended on August 4, 2004, 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 September 13, 2004. 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 of September 22, 2004, updating information on recent developments.

- a Press Release summarizing the views of the Executive Board as expressed during its September 22, 2004 Executive Board discussion of the staff report that completed the review and request.

- a statement by the Executive Director for Romania.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Romania*
Memorandum of Economic and Financial Policies of the authorities of Romania*
Technical Memorandum of Understanding
*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

ROMANIA

First Review Under the Stand-By Arrangement
and Request for Waiver
and Modification of Performance Criteria

Prepared by the European Department

(In consultation with other departments)

Approved by Susan Schadler and John Hicklin

September 13, 2004

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I. INTRODUCTION

1. **The 24-month Stand-By Arrangement (SBA) for Romania in the amount of SDR 250 million, or 24.27 percent of quota, was approved on July 7, 2004**. The authorities have not made a purchase so far and intend to continue treating the arrangement as precautionary. Discussions on the first review were held in Bucharest during July 26-August 4, 2004 and continued via correspondence.[1]

2. **Upon approving the SBA, Executive Directors welcomed Romania's commitment to stabilization and reform, but emphasized the need for strong policy implementation.** They noted that continued disinflation and containing the external current account deficit at a safe level would require further efforts to reduce the budget deficit over the medium term, eliminate losses from quasi-fiscal activities in the state-owned enterprises (SOEs), and implement a strict wage policy. Directors encouraged the authorities to complete the privatization agenda and step up their efforts to improve the business climate, especially governance.

3. **Macroeconomic developments and the implementation of the agreed policies—except on arrears—are broadly in line with the program.** With the exception of the performance criterion (PC) on private sector arrears, all other quantitative PCs for end-June were observed and it is also expected that they will be observed at end-September. The end-June performance criterion on the ceiling of arrears of private enterprises to the general government was not observed and the authorities have requested a waiver, based on agreed corrective actions presented in the attached letter to the Managing Director (Attachment). They are also requesting a modification of this PC for end-September and end-December, to allow time for the corrective measures to take hold. The government's other structural reform measures are on track and all structural PCs and benchmarks have been met. In line with their decision to tighten fiscal policy, the authorities have requested a modification of the end-December ceiling of the deficit of the general government.

4. **The government remains committed to the SBA-supported program that it sees as crucial for EU accession.** The authorities in particular attach importance to the next EU accession report which will evaluate whether Romania meets the functioning market economy criterion. With presidential and parliamentary elections scheduled for end-November, spending pressures will be building up in the months ahead.

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[1] The mission team comprised Messrs. Mates (head), Westphal, Christou, Gueorguiev, Tieman (all EUR), Mr. Walsh (PDR), and Ms. Van de Ven (administrative assistant, EUR). The Fund's resident representative, Mr. Justice, assisted the mission. The mission met with the President, Prime Minister, the Minister of Public Finance and other key economic ministers, the Governor of the National Bank of Romania (NBR), and opposition politicians. The mission closely coordinated its work with World Bank staff.

II. BACKGROUND TO THE DISCUSSIONS

5. **Macroeconomic developments are in line with the program.** Output growth remains favorable, disinflation is proceeding, the current account deficit is in line with the program's target, and the balance of payments is strengthening. Credit growth in general has slowed, but its foreign currency denominated component has picked up again. Net wage growth remains high, fueling consumption, but labor costs are not deviating substantially from productivity growth. Specifically:

- **Economic activity remains strong and disinflation is on track.** On account of strong exports (20 percent up in euro terms in the first half of the year, Figure 1) and persistently strong domestic demand, staff estimates real GDP growth at 5¾-6 percent in 2004—the authorities are even more optimistic citing in particular the very good agricultural season.[2] Meanwhile, CPI inflation stood at 12.1 percent in July, about ¼ percentage point below the targeted path (which takes administrative price adjustments into account), with the end-year target of 9 percent within reach (Figure 2).

- **Developments in the external current account are broadly in line with the program and the balance of payments is strong.** The seasonally adjusted current account deficit fell to 4.2 percent of annualized GDP in the first quarter of the year, and increased to 5.7 percent of GDP in the second quarter, mirroring developments in private sector credit (Figures 3 and 4). Worker remittances and capital inflows are stronger than expected, the latter reflecting higher FDI and foreign borrowing by banks, which are increasing their credit portfolios on the back of improved business sentiment and the still low indebtedness of households and enterprises. Recent developments in the real effective exchange rate (Figure 5), as well as export performance, do not suggest that Romania has a competitiveness problem.[3]

- **Continued upward pressure on the exchange rate has prompted the central bank to act.** To prevent nominal appreciation and bring the exchange rate closer to the targeted path (Figure 6), the NBR has intervened massively by purchasing more than €1.9 billion since Q2 of 2004 (Figure 7), while sterilizing about two thirds of the effect on reserve money, at substantial costs. As a result, the NFA target for end-June was substantially overshot, and an even larger margin is projected for end-2004. In tandem with foreign exchange interventions, the NBR cut the policy interest rate in

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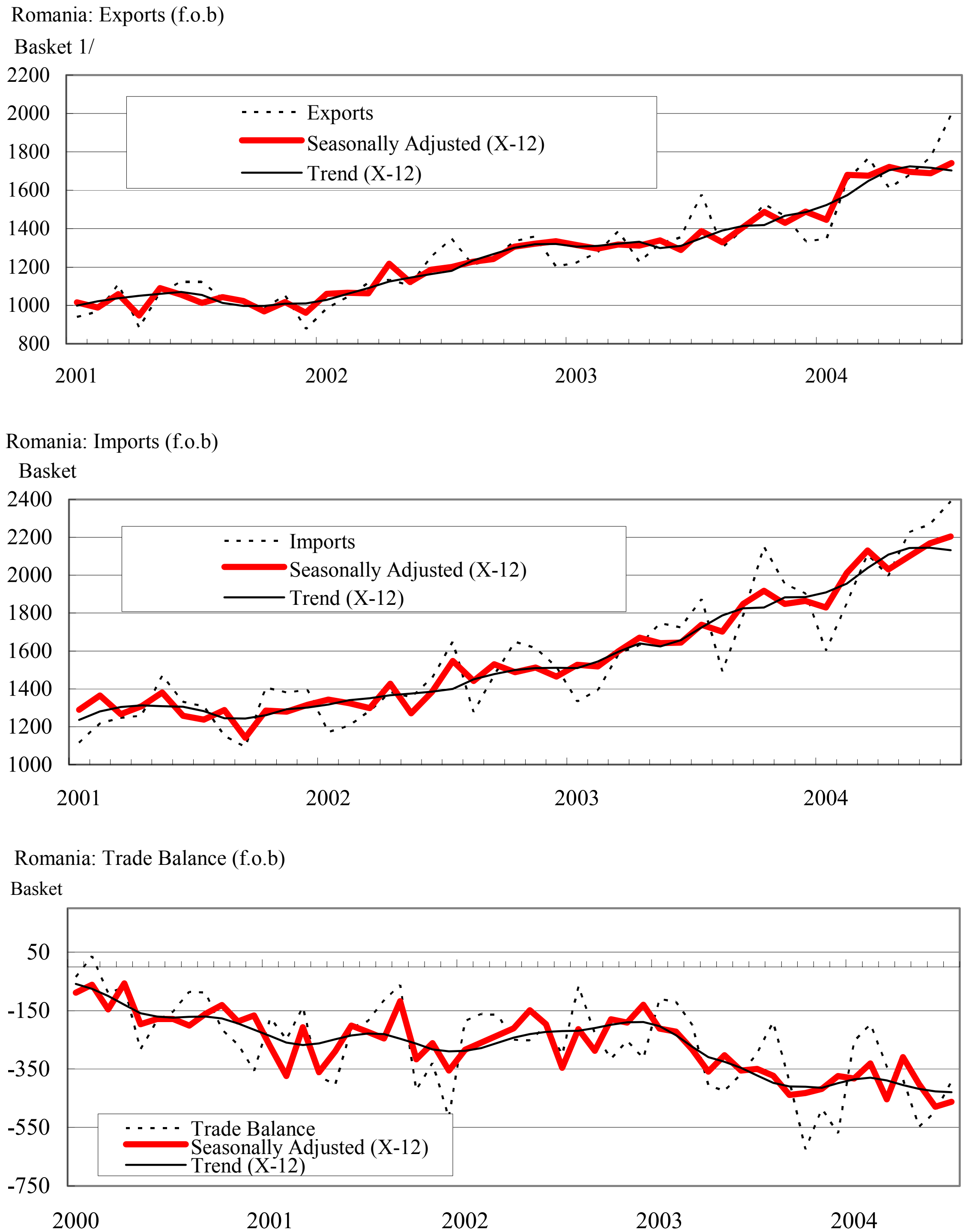
[2] The latest national accounts data indicate real GDP growth of 6.6 percent in the first half of 2004, with consumption up by 8.8 percent and investment by 10.4 percent over the same period of 2003.

[3] The competitiveness issue was discussed in detail in the Staff Report for the 2004 Article IV consultation (IMF Country Report No. 04/221).

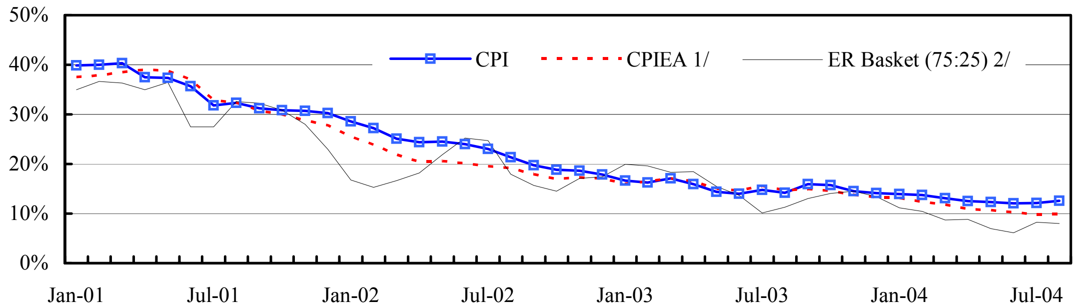
Figure 1. Romania: Exports, Imports and Trade Balance, 2000-2004



Source: Romanian authorities and Fund staff estimates.

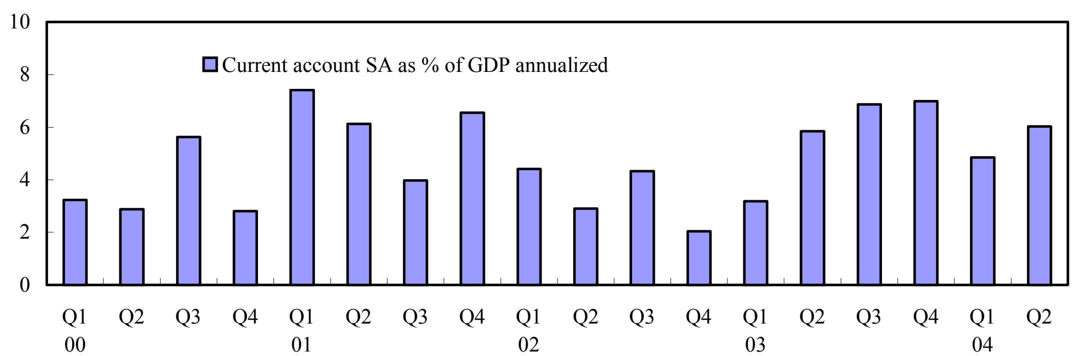
1/ Composed of 40 percent U.S. dollar and 60 percent Euro, to approximate volume growth.

Figure 2. Inflation and Exchange Rate Movements, 2001-04
12-month percent change



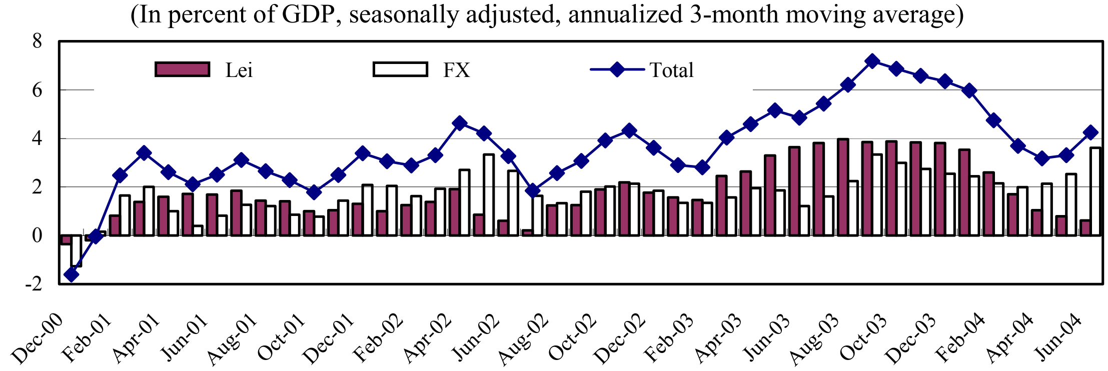
Sources: Romanian authorities and Fund staff estimates.
1/ CPIEA excludes administered prices.
2/ The exchange rate basket consists of 75 percent euro and 25 percent U.S. dollar, which approximates the nominal effective exchange rate.

Figure 3. Current Account Deficit, 2000-04



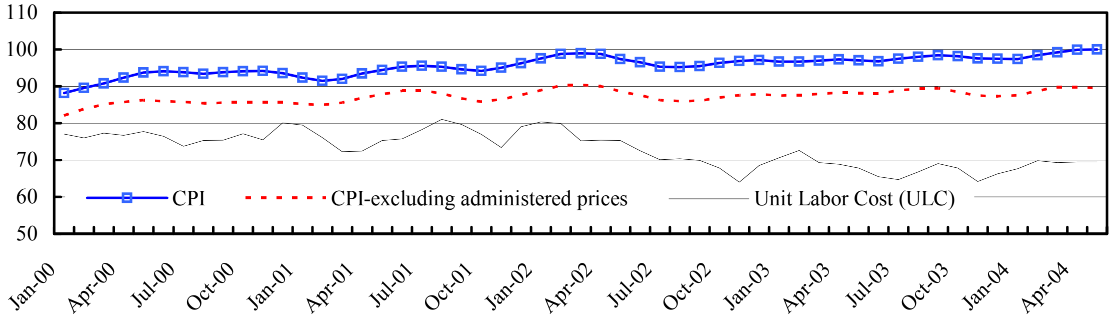
Source: Romanian authorities and Fund staff estimates.

Figure 4. Romania: Credit Flows, 2001-04
(In percent of GDP, seasonally adjusted, annualized 3-month moving average)



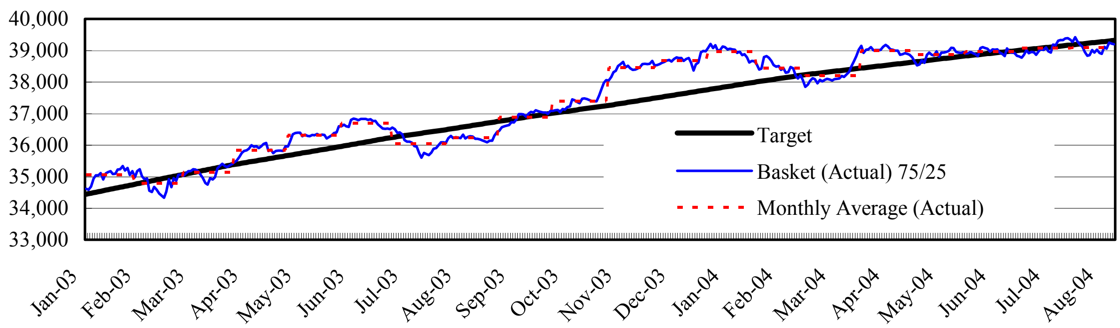
Source: Staff estimates.

Figure 5. Romania: Real Effective Exchange Rates, 2000-04
(3-Month Moving Average; 1998=100)



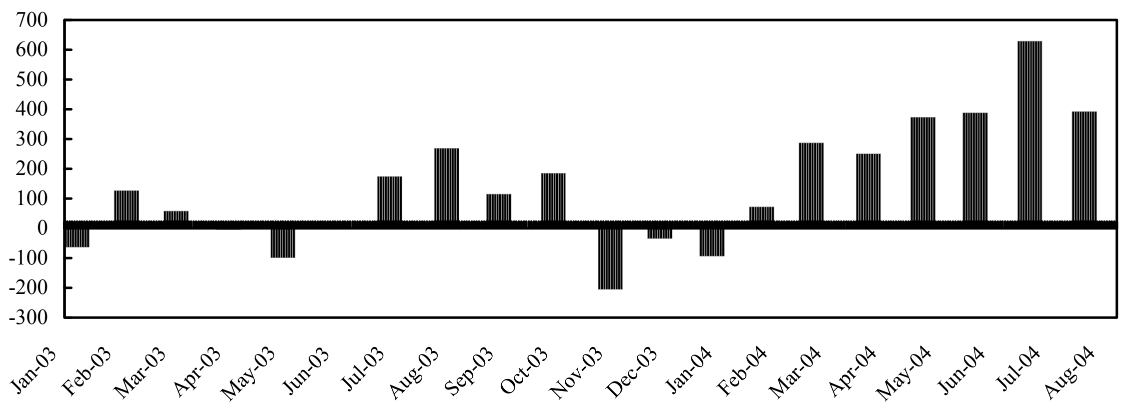
Sources: Romanian authorities; and Fund staff estimates. CPI based measures use INS weights, while ULC based REER includes advanced economy partners only.

Figure 6. Romania: Daily Targeted And Actual Exchange Rate Path, 2003-04
(Lei against basket 75 percent euros/25 percent U.S. dollars)



Sources: Romanian authorities; and Fund staff estimates.

Figure 7. Romania: Net Purchases of Foreign Exchange by the National Bank of Romania, 2003-04
(In millions of euro)



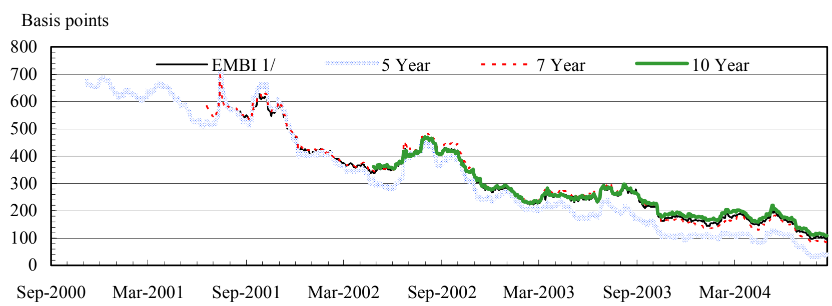
Sources: Romanian authorities.

three steps from 23.4 percent (compounded) to 21 percent in June-August, taking comfort from strong demand for lei deposits and recent much lower lei credit growth (see below).

- **Private sector credit growth has slowed substantially relative to the flows in the second half of 2003.** In total, seasonally adjusted, net flow of credit in the first half of 2004 was much below flows in the second half of 2003 (Figure 4). Growth in lei credit practically came to a halt, reflecting high interest rates and the effects of the regulatory measures approved in late 2003. However, the foreign currency denominated credit has started to pick up again, driven by strong mortgage demand and a switch for some consumer durables from lei to foreign currency credit.

- **Romania's ratings remain unchanged, but bond spreads have narrowed significantly** (Figure 8). Investment banks reacted favorably to the recent acceleration in energy-sector privatization, particularly of Petrom, and prudent fiscal policy, while warning of political and external-sector risks. Spreads over comparable German securities fell sharply during the second quarter of 2004, in line with developments in most emerging markets; those on five- and ten-year bonds have fallen by more than 100 basis points since mid-May, with five-year spreads in early August at below 30 basis points.

Figure 8. Romania: Bond Spreads Against Comparable-Maturity German Bonds, 2000-04

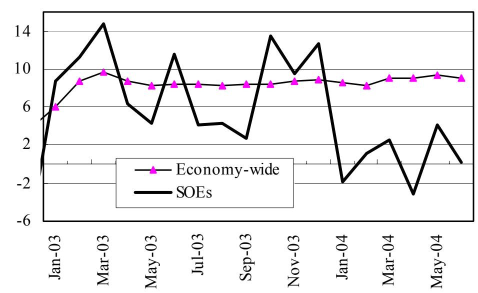


Sources: Romanian authorities; Fund staff calculations and Bloomberg.

1/ J.P Morgan Global EMBI+, excluding Latin American Bonds.

- **Economy-wide net real wages continue to grow strongly.** Reflecting the robust economy, net wages grew by about 9 percent in real terms in the first half of 2004, despite zero real wage growth in many SOEs (Figure 9). The national collective labor contract is unlikely to be signed this year, as one labor union is pushing for a contractual minimum wage

Figure 9. Romania: Economy-Wide Net Real Wages and in Monitored SOEs (12-month growth rate)



Sources: Romanian Authorities; and Fund staff estimates.
1/ Net of withholding taxes.

that is substantially higher than the statutory minimum wage, which has not been accepted by other parties. Collective contracts in branches will therefore be based on the statutory minimum wage.

6. **Fiscal performance has been better-than-budgeted owing to large overperformance in revenue collection.** General government revenue—against an admittedly conservative projection in the budget—is on a path to overshoot the target in the first supplementary budget by at least 1 percent of GDP. Although part of the revenue overperformance is cyclical, a substantial fraction is due to the reform of tax administration and a reduction in tax evasion mainly in the area of excises.[4]

7. **While the efficiency of tax and energy sector collections has improved, the end-June PC on private sector arrears to the general government was not observed.** To contain the accumulation of private sector arrears, in the second quarter of 2004 the authorities initiated bankruptcy procedures against 65 private companies (out of the 452 private companies with the largest arrears to the budget that are monitored under this PC). Despite these efforts, the PC was not observed, which was partly attributed to liquidity problems faced by some taxpayers and the fact that AVAS (the privatization and assets recovery agency) unexpectedly granted rescheduling arrangements to some companies. The PC envisaged a reduction in the nominal stock of arrears by 1 percent from the end-March stock, while arrears came out 3⅓ percent higher than the target. The authorities are therefore requesting (i) a waiver based on corrective measures elaborated in paragraph 14 of the SMEFP, and (ii) a modification in the end-September and end-December PC. Meanwhile, collection rates in the energy sector are significantly better than envisaged under the program.

8. **The structural reform agenda has advanced on several fronts.** In July, the authorities signed the sale-purchase agreement for the privatization of Petrom and two electricity distribution companies, both in line with the program. According to legislation, the Competition Council now needs to approve these contracts. The government has selected winning bids for the two gas distribution companies, and will soon start negotiations with the winners. It has also approved an implementation plan for the heating sector strategy, while mining sector restructuring proceeds as scheduled. Finally, progress has been made in improving governance, including by parliamentary approval of a package of laws strengthening the independence and powers of the judicial system.

III. Policy Discussions

9. **Discussions focused on policies to support disinflation, contain the risks associated with the external current account deficit and rapid credit growth, and advance structural reforms.** The macroeconomic framework for 2004 and 2005 envisaged

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[4] The authorities estimated the improved profit tax collections at ¼ percent of GDP in the first half of 2004.

in the original program remains appropriate, as agreement was reached to offset the impact of the stronger-than-expected domestic demand on the current account and inflation by fiscal tightening and additional measures to moderate credit growth (Text table 1). Discussions also addressed structural reforms necessary to sustain rapid economic growth and improve the business climate.

Text Table 1. Key Macroeconomic Variables, 2003-05
(In percent of GDP, unless otherwise indicated)

	2003	2004		2005	
	Actual	Original Program	Revised Program	Original Program	Revised Program
Real GDP growth (percent)	4.9	5.0	5.8	5.0	5.0
CPI (change in percent; end of period)	14.1	9.0	9.0	6.0	6.0
Current account deficit	-5.9	-5.2	-5.3	-5.3	-5.2
General government deficit	-2.3	-2.1	-1.6	-1.9	-1.5
Reserve cover (months of imports)	3.8	3.7	4.3	3.7	4.9

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

A. Fiscal Policy

10. **The authorities agreed on the need to tighten the fiscal stance in the remainder of 2004 to slow domestic demand.** In light of the projected revenue overperformance of at least 1 percent of GDP, staff reminded the authorities of their commitment to save any revenue above that projected in the first supplementary budget. The authorities were initially reluctant to agree to a lower deficit on the grounds that the current account deficit was in line with the program. They also noted that having approved in early July a supplementary budget that reduced the 2004 deficit target from 3 percent of GDP to 2.1 percent of GDP (as envisaged under the program, Text table 2), it would be politically difficult to further reduce the deficit target to 1.1 percent of GDP. Moreover, revenue-overperformance reflected not only the strong economy and better collections, but also their prudent original revenue projection, motivated by their determination to achieve the deficit target. Admitting, however, pressures from domestic demand and the need to support disinflation objective, the authorities proposed to save about half of the overperformance. In this context, they requested a modification of the PC to cap the general government deficit at 1.6 percent of GDP. This would allow for an increase in central government spending of 0.3 percent of GDP relative to the first supplementary budget, as described in paragraph 13 of the SMEFP. Local governments, which also benefited from higher revenue, and over which the central government has limited control, are expected to increase spending by 0.2 percent of GDP relative to the first supplementary budget. The authorities committed to save any additional revenue overperformance and to consider spending cuts in the remainder of 2004 if the current account were to deteriorate.

Text Table 2. General Government Balances, 2003-05
(In percent of GDP)

	2003	2004			2005
		Original Budget	1st Suppl. Budget	2nd Suppl. Budget	Draft Budget
Total revenue	30.0	29.0	29.8	30.7	30.6
o/w Tax revenue	28.2	27.2	28.0	28.8	28.6
Total expenditure	32.3	31.8	31.9	32.4	32.1
o/w current expenditure	28.7	28.3	28.7	29.1	28.9
Overall balance	-2.3	-2.9	-2.1	-1.6	-1.5
Primary balance	-0.2	-0.8	-0.5	0.0	0.2

Sources: Ministry of Finance, and Fund staff estimates and projections.

11. **The authorities also agreed on the need for further consolidation in the broad public sector in 2005.** To keep the external current account deficit broadly unchanged, as the private sector investment rate rises and the savings rate declines in expectation of rising permanent incomes, the deficit of the broad public sector (including SOEs) is targeted to be reduced relative to GDP by about 0.7 percentage points in 2005. Most of the adjustment would come from the savings-investment balance of the SOEs, primarily by increasing energy prices and implementing a tight wage policy, both of which are expected to reduce SOEs' net borrowing.[5] The general government deficit would be targeted at 1.5 percent of GDP, or 0.1 percent less than in 2004. The authorities felt that the smaller adjustment in 2005 was appropriate owing to lower projected growth in 2005 and the limits imposed by the already announced tax reforms. Moreover, they noted that the country's fiscal performance compares favorably with that of countries in the region that have recently acceded to the EU.

12. **The authorities emphasized the importance of planned tax cuts** (Box 1)**.** They noted that the cut in the profit tax rate was in line with the recent trend in the region, and reduced pressures for introducing an exemption for re-invested profits. The reduction in the

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[5] The energy price adjustment is expected to improve the financial performance of the energy sector by 0.8 percent of GDP. In addition, wage restraint is projected to improve the financial performance of the SOE sector by another ¼ percent of GDP. However, their S-I balances are projected to improve by only 0.6 percent of GDP, as part of the improved profitability will be offset by higher investment and tax payments (which are not included in the projected general government revenue, to err on the side of caution).

Box 1. The Government's Tax Reform Program

The government's tax reform that will become effective as of January 1, 2005 features a cut in the profit tax from 25 percent to 19 percent; a reduction in the income tax for the lowest bracket from 19 percent to 14 percent, offset partly by freezing the personal exemption at the 2004 level; and a reduction in the social security contributions rate by 1¼ percent. To compensate part of the revenue loss, the authorities will simultaneously introduce a land tax, increase the tax on dividends, and sharply increase excises effective July 1, 2005.

The net revenue loss associated with the reform amounts to ½ percent of GDP compared to the baseline. However, the net revenue loss compared with 2004 is lower owing to the full-year effect of the elimination of the reduced profit tax rate for export activities, the carry-over effect of the July 2004 increases in excises, and some improvements in collections due to the reform of tax administration and a reduction in tax evasion. The effective revenue loss compared to 2004 is therefore estimated at ¼ percentage point of GDP.

	2004	2005		
	2nd Suppl. Budget	Baseline No Tax Changes	Impact of Tax Reform	Draft Budget
	(In percent of GDP)			
Tax Revenue	28.8	29.1	-0.5	28.6
Profits	2.8	2.9	-0.5	2.4
Wages and salaries	3.1	3.1	-0.1	3.0
Social security	9.6	9.7	-0.2	9.4
Other direct taxes	0.9	0.9	0.1	1.0
VAT	7.3	7.3	0.0	7.3
Customs	0.7	0.7	0.0	0.7
Excises	3.5	3.6	0.3	3.8
Other indirect taxes	1.0	1.0	0.0	1.0

Sources: Ministry of Finance, and Fund staff estimates and projections.

income tax rate for the lowest bracket was aimed at enhancing the equitable distribution of gains from recent growth, while social security contributions were still high by regional standards. The authorities saw these measures as essential to improve the business climate and strengthen Romania's competitive position. Part of the revenue loss due to these cuts will be compensated by a substantial increase in excises and the introduction of a land tax. Moreover, the 2005 budget will benefit from the full-year effect of the elimination of the reduced profit tax rate for export activities in the first quarter of 2004, which has quite dramatically improved collections already this year. The staff supported the cut in social security contributions, suggested a more gradual reduction in the personal income and profit taxes, and opposed strongly an exemption for re-invested profits. The authorities resisted a more gradual personal income tax cut mainly on the grounds that they have already made a public commitment, but agreed to postpone any increase in the personal exemption to 2006. As for the profit tax, they agreed not to introduce an exemption for re-invested profits. Staff also reiterated the importance of refraining from introducing a reduced VAT rate. To reduce the risks for the 2005 budget, the authorities agreed to monitor revenue performance closely over the coming months, and they committed to moving the scheduled adjustments in excises forward from July 1, 2005 to March 1, 2005, should this be necessary (SMEFP ¶11).

13. **The 2005 budget envisages a reduction in primary expenditure relative to GDP by 0.3 percentage points, underpinned by a number of structural fiscal reforms.** The bulk of this adjustment in expenditure comes from a reduction in subsidies to the mining sector and railways, reflecting positive effects of the ongoing restructuring on their costs. On wage policy, based on the advice of the World Bank, the wage structure will be adjusted with the objective of improving incentives for the highest skilled public servants (about 7 percent of the budget sector employees). The budget envisages an average nominal increase in wages by 12 percent, implying a broadly unchanged wage bill relative to GDP compared to 2004. A number of measures will be implemented as part of the pension reform (SMEFP ¶13), and although these measures are not expected to produce immediate savings, they are important to ensure the sustainability of the pension system. Capital expenditure will remain unchanged as a share of GDP compared with 2004, while strong efforts will be made to reduce health arrears and implement a reform of the sector.

14. **Adhering to the expenditure plans underlying the 2005 budget will require determination.** Staff raised a few concerns regarding expenditure plans, mainly their feasibility and consistency with the medium-term program. Although plans for capital spending are not yet finalized, the overall allocation might not be sufficient and consistent with the country's infrastructure needs. In a related issue, expenditures must be carefully prioritized to make room for EU accession-related investment spending. Moreover, heating subsidies to producers and low-income households could be under-budgeted. The authorities responded that they felt the expenditure plans were realistic and, if expenditure pressures materialized, they would be handled within the existing expenditure envelope.

B. Wage Policy

15. **Discussions on wage policy in 2005 focused on the proposed increase in the minimum wage and the SOEs' wage program.** Staff emphasized the negative effects of a possible large increase in the statutory minimum wage on private sector employment and growth in some sectors and noted that in the past large adjustments had typically triggered overall wage increases in public enterprises as well as influencing private-sector contracts. The authorities explained that they saw a substantial minimum wage increase as an important social commitment to offset the effects of the energy prices adjustments on low-income households. Nevertheless, they agreed on a nominal increase of 10.7 percent, which, they noted, implied a drop relative to the average wage, and as such should have little impact on economy-wide wage developments. The authorities agreed on a tight SOE wage policy that limits the annual nominal wage bill growth to 4 percent (SMEFP ¶18).

C. Monetary Policy

16. **The NBR felt confident that the end-2004 inflation target of 9 percent would be achieved.** When staff pointed out that a substantial contribution to disinflation in the past years had come from food prices, NBR officials noted that this trend, stretching through the agricultural cycle, had reflected economy-wide productivity improvements. They also took comfort from the strong export performance and high productivity growth in manufacturing (over 7 percent in the first half of 2004), which created scope for tolerating a somewhat stronger lei, and thereby consolidating the disinflation effort.

17. **Unexpectedly large interventions in the foreign exchange market have changed the monetary outlook since the program was approved.** With persistently high foreign exchange inflows and continuing disinflation, the NBR decided to reduce the lei policy interest rate, a decision helped by the slowdown in lei credit. The NBR also decided to immediately allow higher variability in the exchange rate to discourage speculative capital inflows. Staff supported these decisions, pointing out that a higher exchange rate might also be consistent with dampening demand, inter alia through demand for foreign-currency denominated credit. If very strong foreign exchange inflows continue, it was agreed that the 2005 monetary targets under the program might need to be revisited in the next review.

18. **The authorities shared the staff's concerns about the renewed strength in foreign currency denominated credit and agreed to several measures.** Most importantly, the NBR decided to increase the mandatory reserve requirement on foreign exchange liabilities from 25 percent to 30 percent as of August 24. Moreover, the authorities committed to measures for expanding the database of the NBR's credit bureau (SMEFP ¶28). Staff also suggested that the weight for foreign currency denominated credit in calculating capital adequacy requirement be increased, but the authorities stated that this would be inconsistent with EU directives. Prompted by staff inquiry, the authorities provided assurances that banks fully observed limits on open foreign currency positions. On a broader issue of risks arising from balance-sheet mismatches, the authorities pointed out that the overall indebtedness of non-financial sectors, and in foreign currencies in particular, remained modest. They agreed with staff, though, that the rapid growth in such credit increased risks, and that they would seek further advice on this issue from MFD.

19. **The authorities agreed on the need to speed up preparations for inflation targeting (IT).** To this end, they will rely on continued technical assistance from the Fund to make a number of changes in the structure of information gathering, information processing, and monetary policy decision making in the NBR prior to the adoption of IT. The NBR committed to announcing the full-scale implementation of the new framework only once two dry runs of the quarterly forecasting cycle have been successfully completed.

D. Structural Reforms

20. **The mission reviewed progress on the ambitious structural reform agenda,** and, in cooperation with the World Bank, it focused its discussions on privatization, energy sector

reforms, and governance issues. The authorities reiterated their commitment to the reform process to underpin the favorable results on macro stabilization and pave the way for EU accession.

Privatization

21. **The authorities acknowledged the need to keep up the momentum for privatization.** They noted that the signing of the privatization contracts for Petrom and two electricity distribution companies were widely seen as an important success for the government and should help improve the business climate and attract FDI. Regarding Petrom, they noted that, although the Competition Council might indeed raise some issues about the privatization contract, the government was committed to completing the deal. They also felt confident that the privatization of the two gas distributors would be finalized by end-October, and the privatization of other companies in the energy sector would proceed according to schedule (SMEFP ¶22). The new management of AVAS has committed to accelerate divesting the companies that are within their responsibility, noting that the non-observance of the structural benchmark for the privatization or liquidation of the remaining SOEs under AVAS was due to the reorganization of the agency. The revamped agency has also demonstrated commitment to address transparency issues in the recent SNTR privatization case, by initiating a new audit.

Energy, Mining, and Railway Sector Reforms

22. **The authorities reiterated their commitment to continue energy price adjustments and to implement the heating sector strategy.** As already envisaged under the program, this will include the gas price adjustment scheduled for October 2004 and January 2005. They also committed to follow the recommendations from the review of electricity prices that was conducted together with the World Bank by substantially increasing end-user electricity prices in January 2005, while abolishing the national development tax—a surcharge currently imposed on industrial users. As for the heating sector, the mission worked closely with the World Bank on setting a number of benchmarks for implementing the heating sector strategy, among which the gradual phasing out of direct producer subsidies by abolishing the National Reference Price.

23. **The restructuring of the mining and railways sectors is on track.** In line with the approved mining sector strategy aimed at containing losses and reducing subsidies and transfers to the sector, the authorities have been making progress in layoffs and tightening utility payments by the mines. On the railways, staff emphasized the importance of adhering to the program's targets on railway closure or privatization and following a tight wage policy. The authorities agreed to hold to their commitments on closure/privatization and to grant no wage increases in the railway sector in the remainder of 2004, while the 2005 wage bill will increase by no more than 8 percent.

Governance Issues and Labor Market Reform

24. **The authorities are determined to strengthen public administration, eliminate corruption, and improve the business climate.** The authorities noted that recent agreements on several privatization projects in the energy sector, conducted in a transparent manner, were well received by markets as a sign of improved governance. They also committed (SMEFP ¶14) not to accept a reorganization plan for a large refinery and to proceed with bankruptcy procedures. The authorities repeated their commitment to legislation eliminating the immunity of government officials after the expiration of their mandates, which will be approved by end-March 2005. The agreed measures (SMEFP ¶14) to reduce tax evasion also aim at improving the business climate.

25. **With the view to increasing labor market flexibility, a comprehensive overhaul of the labor code is envisaged.** To this end, in cooperation with the World Bank and within the framework of the EU acquis, the new code will be submitted to Parliament by end-March 2005, with the objective of having it come into effect on July 1, 2005. Among other elements, the code will address concerns about the binding nature of collective labor contracts for non-participating employers, the procedures to determine work load, regulations on hiring and firing, the flexibility of fixed-term contracts, and red tape.

IV. Program Monitoring and New Conditionality

26. New conditionality and modifications in quantitative PCs are explained in Box 2, the status of existing structural conditionality is presented in Table 11, while modifications in the Technical Memorandum of Understanding (TMU) appear in Box 3. The program includes six new structural PCs and five new structural benchmarks. These were added at this review to extend program goals into 2005 (e.g., budget approval and wage policy), or to reflect World Bank recommendations on the next steps in energy sector reform.

27. **The authorities have requested that the next review mission be delayed until after the November 2004 elections, which will result in a postponement of the completion of the second review until the first quarter of 2005**. Staff noted that the test dates specified by the arrangement would be preserved, while the intensive dialogue with the authorities would need to be maintained.

V. Vulnerabilities and Risks

28. **Vulnerability indicators point to low short-term risks, but medium-term prospects depend on persevering with stability-oriented policies and structural reforms.** External debt, and public and publicly-guaranteed debt-to-GDP ratios are within safe margins. The level of reserves has increased considerably in the revised program, and it is high relative to money aggregates and short-term debt, and comfortable relative to prospective imports of goods and services (Table 8). Recent monetary developments, namely renewed strength in foreign currency denominated credit, create concerns about inflationary and current-account pressures, but have been addressed with new measures. Banking system vulnerability otherwise remains low, owing to relatively high capital adequacy ratios. The

upcoming elections present risks, as an election-motivated deterioration in the fiscal stance and the postponement of structural reforms could lead to a loss of market confidence, rising sovereign spreads, weakening FDI, reversal in disinflation, and current account pressures.

Box 2. Modifications to Conditionality

Modifications to quantitative PCs

As a prior action to address the slippage in the private sector arrears PC, the authorities agreed to issue summons for forced execution against six private companies and to submit requests to courts for initiation of bankruptcy procedures against three additional private companies, selected from those with the largest outstanding stocks of arrears. In addition to direct effects the implementation of these measures is expected more generally to increase tax compliance, while their completion of these procedures will bring the program back on track. In addition, the authority of the privatization agency for granting rescheduling to already privatized companies will be restricted. However, given the time needed for the measures to have an impact, the authorities are requesting a modification in the end-September and end-December PCs.

Additional fiscal tightening in 2004 is reflected in the modified end-December PC on the general government deficit.

New conditionality for 2005

In the fiscal sector, new conditionality (the approval of the second supplementary 2004 budget, the 2005 budget, decision on pension adjustment in 2005, and on safeguarding the current VAT regime) facilitates the achievement of agreed fiscal targets, particularly where they could be put at risk by populist pressures.

As in 2004, the program includes a PC limiting the minimum wage to the agreed level (3,100 thousand lei for 2005) and requires the approval of SOEs' budgets. Both are necessary for achieving the targeted improvement in SOEs' financial performance.

Following discussions with the World Bank on the basis of its recently-completed analysis, a new PC provides for an increase in hydro-power electricity price and the elimination of the National Development Tax (an electricity surcharge for industrial users). The former improves financial performance of the state-owned sector and facilitates progress toward completing the liberalization of the electricity market by 2007. The latter eliminates an important distortion in pricing.

The program also includes updated benchmarks for privatization.

Box 3. Modifications in the TMU

Definition of consolidated general government

A number of extrabudgetary funds were excluded from the definition of the general government as those funds have either been eliminated or have been absorbed by line ministries.

Arrears of private enterprises to the state budget and the four social security funds

The definition of changes in the stock of arrears makes explicit previous implicit understandings that reschedulings, or any other reduction of the stock that does not represent a cash payment, do not count as arrears reduction.

Definition of external debt

The original program framework assumed a Eurobond issue of €600 million in 2004. Although such an issue has not taken place, the authorities will borrow €650 million to bring border controls in line with EU standards. To accommodate this, the adjuster for the non-issuance of the Eurobond has been dropped.

Adjuster on deficit of the consolidated general government

An adjuster was added so that the deficit ceiling is adjusted downwards for any higher-than-budgeted revenue of the general government (excluding local authorities).

VI. Staff Appraisal

29. **The authorities are on track to achieve the main macroeconomic objectives of the program, but spending pressures in the run-up to the November elections need to be resisted.** The program was designed with a view to continuing gradual disinflation while sustaining growth and containing the external current account deficit within a safe margin. However, strong domestic demand, fueled by rapid credit growth, is putting increased pressure on the external current account. The authorities commitment to measures to keep fiscal policy tight and limit credit growth will be important to rein in demand. Sustaining robust growth and successful accession to the EU, will require continued progress with key structural reforms. Resisting spending pressures in the run-up to the November elections will be crucial for achieving these objectives.

30. **The envisaged fiscal tightening in 2004 is appropriate, but the authorities need to remain vigilant and implement further fiscal consolidation if necessary, in tandem with measures to improve the structure of revenues and expenditures.** With the upturn in the economy, it is important to ensure any additional revenue is applied toward reducing the fiscal deficit even beyond the revised target for this year. Regarding 2005, the fiscal target may need to be tightened further in a case of inflationary pressure or unfavorable developments in the external current account. The authorities should monitor the revenue implications of the tax reform closely and use aggressively the available scope to improve tax

collections. Expenditures must be carefully prioritized to make room for EU accession-related investment spending.

31. **Progress in imposing hard budget constraints on state-owned enterprises is an important part of stabilization.** In the energy sector, the emphasis should be on raising gas prices to import parity and timely adjustment of electricity and heating prices in line with costs. Significant downsizing of the loss-making mining and railway sectors should be accompanied by enhancing the social safety net and programs for retraining and relocation.

32. **Improved wage discipline needs to complement these efforts.** To this end, the structure of budgetary wages should be adjusted to differentiate among skill levels. Persistent vigilance in adhering to the committed SOEs' wage policy is critical to containing the wider public sector deficit. An important part of this effort will be ensuring that the minimum wage in the national collective contract does not deviate substantially from the agreed statutory minimum wage as long as that contract is mandatory for non-participant employers.

33. **Robust growth can be sustained only with the strengthening of structural reforms.** It is encouraging that the privatization contracts for Petrom and the two electricity distribution companies have been signed, but it is crucial that any obstacles, if they arise as a result of procedures in the Competition Council, are eliminated. The remaining privatization agenda also needs to be pursued vigorously. Staff also welcomes the authorities' plans to overhaul the labor code so as to increase labor market flexibility. Comprehensive governance reforms, including stepped up efforts to fight corruption, reform the judiciary, and establish an efficient bankruptcy mechanism are necessary for further improving the business climate.

34. **Monetary policy needs to be focused on disinflation.** While the recent cuts in the policy interest rate were warranted in light of successful disinflation and strong capital inflows, the scope for further interest rate cuts depends on prospects for continued sustained reduction in inflation. Moreover, it is important that the NBR has decided to allow more flexibility of the exchange rate. Looking forward, with the completion of technical preparations, it will be appropriate to move to an inflation targeting framework.

35. **The rapid expansion of foreign-currency denominated credit remains a concern.** Recently announced measures to curb the expansion are welcome, but the authorities need to strengthen bank supervision and strictly enforce the new regulations on consumer and mortgage lending. Should rapid growth in foreign-currency denominated loans persist, additional measures will be needed.

36. **While the external current account deficit has so far been broadly on track, substantial risks remain regarding the annual program.** Imports and exports have both grown rapidly in 2004, but the larger base for imports has widened the trade deficit. To a large extent this has been compensated by rising remittances from abroad, and has been mostly financed by non-debt creating flows. Should capacity constraints in the export sector begin to bind or the rapid growth of remittances slow, the current account target will come under pressure. The authorities should therefore remain vigilant and ready to implement further corrective measures if necessary.

37. **The staff supports the authorities' request to complete the first review under the Stand-By arrangement, including the waiver of the end-June performance criterion, and the modification of the three performance criteria.** Program implementation and macroeconomic performance have been satisfactory. Nevertheless, additional fiscal tightening, necessary to contain the risk of the current account deficit exceeding the program target, is reflected in the revised end-December PC. The modification of the PCs on tax arrears by the private sector is warranted on account of the time lag needed for the authorities' corrective measures to take hold.

Table 1. Romania: Selected Economic and Financial Indicators, 2000-05

	2000	2001	2002	2003	2004 Prog.	2004 Revised Prog.	2005 Prog.	2005 Revised Prog.
Real economy (change in percent) 1/								
Real GDP	2.1	5.7	5.0	4.9	5.0	5.8	5.0	5.0
Final domestic demand	2.1	6.9	3.5	7.3	6.0	6.8	5.3	6.0
CPI (end of period)	40.7	30.3	17.8	14.1	9.0	9.0	6.0	6.0
CPI (period average)	45.7	34.5	22.5	15.3	11.5	11.8	7.2	7.3
Unemployment rate (end of period; percent)	10.5	8.6	8.1	7.2	6.5	6.5	...	6.3
Gross national saving (percent of GDP)	15.6	17.0	20.1	18.7	19.6	19.5	20.1	19.6
Gross domestic investment (percent of GDP)	19.5	22.6	23.5	24.6	24.8	24.8	25.4	24.8
Public finance (general government, percent of GDP)								
Overall balance	-4.0	-3.2	-2.6	-2.3	-2.1	-1.6	-1.9	-1.5
Primary balance	0.9	0.6	0.4	-0.2	-0.5	0.0	0.0	0.2
Total public debt 2/	29.9	27.4	26.8	26.2	26.6	...	26.2	...
Money and credit (end of year, percent change)								
Real domestic credit 3/	9.9	27.9	33.1	55.4	21.4	24.2	...	19.3
Broad money	38.0	46.2	38.1	23.3	27.2	28.9	...	19.6
Interest rates (percent)								
NBR interest rate (end of period) 4/	60.1	39.9	21.5	23.4	...	...	...	...
Treasury bill rate (end of period)	59.4	38.4	17.4	18.4	...	...	...	...
Balance of payments (percent of GDP)								
Trade balance	-4.5	-7.4	-5.7	-8.0	-7.0	-7.9	-6.8	-7.9
Current account balance (in $ terms)	-3.9	-5.5	-3.4	-5.9	-5.2	-5.3	-5.3	-5.2
External debt (in € terms)	28.5	31.2	30.8	30.9	33.2	33.6	33.1	33.0
Official reserves (end-year, US$ million)	3,466	5,090	6,975	7,994	9,664	11,017	10,323	10,760
Reserve cover (months of prospective imports, in € terms)	2.3	3.1	3.8	3.8	3.7	4.3	3.7	4.9
Exchange rate								
Lei per US$ (end of period)	25,926	31,597	33,500	33,013	…	…	…	…
NEER appreciation (+) (annual average in percent)	-22.8	-22.3	-14.4	-11.1	…	…	…	…
REER appreciation (+) (CPI-based, annual average in percent)	9.3	1.5	2.6	0.4	…	…	…	…
REER appreciation (+) (CPI excl. admin. prices , annual average in percen	6.0	1.8	1.0	0.0	…	…	…	…
REER appreciation (+) (ULC-based, annual average in percent)	-0.3	-0.9	-6.7	-5.6	…	…	…	…

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

1/ National accounts data for 1998-2004 are based on ESA95 guidelines. Revision was implemented in 2002.

2/ Including domestic public debt and external public debt (public and publicly guaranteed).

3/ Credit to nongovernment sector. From 1999 onwards, weighted average of real lei credit growth and U.S. dollar-measured foreign currency credit growth.

4/ NBR deposit auction interest rate.

Table 2. Romania: Balance of Payments, 2003-04
(In millions of euros, unless indicated otherwise)

	2003					2004				
	Q1 Act	Q2 Act.	Q3 Act.	Q4 Act.	Act.	Q1 Act.	Q2 Act.	Q3 Proj.	Q4 Proj.	Proj.
Current account	-190	-1,100	-361	-1,226	-2,877	-385	-1,249	-177	-1,075	-2,885
Ratio to annual GDP	-0.4	-2.2	-0.7	-2.4	-5.7	-0.7	-2.3	-0.3	-2.0	-5.3
Trade balance	-413	-1,144	-833	-1,565	-3,955	-720	-1,304	-762	-1,576	-4,361
Exports	3,778	3,723	4,073	4,040	15,614	4,332	4,683	4,684	4,646	18,345
Imports	-4,191	-4,867	-4,906	-5,605	-19,569	-5,052	-5,987	-5,446	-6,222	-22,706
Services account, net	-100	-354	-12	-95	-561	-90	-431	-24	-112	-657
Receipts	673	668	828	829	2,998	683	719	887	885	3,174
Of which : Interest	7	7	7	45	66	6	8	8	52	74
Payments	-773	-1,022	-840	-924	-3,559	-773	-1,150	-911	-998	-3,831
Of which : Interest	-139	-125	-106	-122	-492	-116	-138	-117	-134	-504
Unrequited transfers (net)	323	398	484	434	1,639	425	486	609	613	2,133
Of which : official	59	56	72	12	199	47	56	80	73	255
Capital account	591	604	1,316	549	3,060	600	140	1,486	911	3,136
Direct investment	405	380	328	478	1,591	407	521	526	361	1,815
Capital transfers	39	91	42	16	188	65	95	29	28	216
Portfolio investment	-14	-13	-6	10	-23	0	-130	15	15	-100
Borrowing by public sector 1/	117	122	946	28	1,213	226	-280	849	197	993
Loans (net)	117	122	246	177	662	226	-118	849	197	1,154
Disbursements	372	363	476	414	1,625	473	266	1,006	478	2,222
Of which : Direct debt	98	107	159	116	480	82	92	544	62	780
Of which : Government guaranteed	274	256	317	298	1,145	391	173	461	416	1,442
Amortization	-255	-241	-230	-237	-963	-247	-384	-157	-280	-1,068
Bonds (net)	0	0	700	-149	551	0	-162	0	0	-162
Disbursements	0	0	700	0	700	0	0	0	0	0
Amortization	0	0	0	-149	-149	0	-162	0	0	-162
Borrowing by private sector (net)	39	-16	-44	-32	-53	-98	-65	67	309	212
Medium- and long-term loans (net)	39	-16	-44	-32	-53	-98	-65	67	309	212
Disbursements	226	285	227	237	975	163	349	363	521	1,395
Amortization	-187	-301	-271	-269	-1,028	-261	-414	-296	-212	-1,183
Trade credit (net)	5	40	50	49	144	0	0	0	0	0
Of which : short-term (net)	13	43	61	78	195	0	0	0	0	0
Net errors and omissions	-595	186	-34	149	-294	127	755	0	0	882
Overall balance	-194	-310	921	-528	-111	342	-354	1,309	-164	1,133
Financing	198	306	-936	550	118	-342	354	-1,194	164	-1,018
Net foreign assets NBR (increase, -)	-77	278	-1,309	195	-913	-287	-563	-1,494	21	-2,323
Assets (increase, -)	-69	236	-1,287	100	-1,020	-258	-499	-1,477	38	-2,196
Liabilities	-8	42	-22	95	107	-29	-64	-17	-17	-127
IMF, net	-8	42	-22	95	107	-29	-64	-17	-17	-127
Purchases	0	69	0	136	205	0	0	0	0	0
Repurchases	-8	-27	-22	-41	-98	-29	-64	-17	-17	-127
Others, net	0	0	0	0	0	0	0	0	0	0
Short-term	0	0	0	0	0	0	0	0	0	0
Medium and long-term, net	0	0	0	0	0	0	0	0	0	0
Disbursements	0	0	0	0	0	0	0	0	0	0
Repayments	0	0	0	0	0	0	0	0	0	0
Net foreign assets DMBs (increase, -)	275	28	373	355	1,031	-55	917	300	143	1,305
Assets (increase, -)	137	-135	130	79	211	-173	156	0	-157	-174
Liabilities	138	163	243	276	820	118	761	300	300	1,479
Short-term	74	70	150	193	487	76	0	0	0	76
Medium- and long-term, net	64	93	93	83	333	42	0	0	0	42
Portfolio (net)	0	0	0	0	0	0	0	0	0	0
Memorandum items:										
Current account balance plus FDI	…	…	…	…	-1,098	…	…	…	…	-854
Ratio to GDP	…	…	…	…	-2.2	…	…	…	…	-1.6
Export growth (percent)	14.4	2.5	6.5	3.2	6.4	14.7	25.8	15.0	15.0	17.5
Volume growth (percent)	...	...	...	...	7.1	…	…	…	…	17.4
Unit value growth (percent)	...	...	...	...	6.4	…	…	…	…	17.5
Import growth (percent)	0.0	0.0	0.0	0.0	12.3	0.0	0.0	0.0	0.0	16.0
Volume growth (percent)	…	…	…	…	13.6	…	…	…	…	17.2
Unit value growth (percent)	…	…	…	…	-1.1	…	…	…	…	-1.0
GDP growth	…	…	…	…	4.9	…	…	…	…	5.8
GDP (in billions of €)	…	…	…	…	50.5	…	…	…	…	54.6
Terms of trade (percentage change)	…	…	…	…	7.6	…	…	…	…	18.7
External debt (in millions of €)	…	…	…	…	15,592	…	…	…	…	18,355
Of which : Public and publicly guaranteed	…	…	…	…	9,557	…	…	…	…	10,273
External debt/GDP (percent)	…	…	…	…	30.9	…	…	…	…	33.6
Net External Indebtness/GDP (percent)	…	…	…	…	13.3	…	…	…	…	11.9
Debt service (in millions of €)	…	…	…	…	2,730	…	…	…	…	3,044
Debt service ratio	…	…	…	…	14.9	…	…	…	…	14.4
Gross official reserves of the NBR 2/	7,045	6,809	8,091	7,994	7,994	8,320	8,955	10,923	10,876	10,842
(in months of imports of goods and services)	…	…	…	…	3.8	…	…	…	…	4.3
(as percent of short-term debt)	…	…	…	…	204.8	…	…	…	…	241.6

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

1/ Includes public enterprises.
2/ Includes gold.

Table 3. Romania: Summary of the Consolidated General Government, 2002-05

	2002	2003	2004			2005	2002	2003	2004			2005
	Actual 3/ 4/	Actual 4/	Budget 4/ 03-Dec-03	1st. Suppl. Budget 4/ 5/ 15-Jul-04	2nd. Suppl. Budg. 4/ 5/ 27-Aug-04	Draft Budget 13-Aug-04	Actual 3/ 4/	Actual 4/	Budget 4/ 03-Dec-03	1st. Suppl. Budget 4/ 5/ 15-Jul-04	2nd. Suppl. Budg. 4/ 5/ 27-Aug-04	Draft Budget 13-Aug-04
	(In billion of Lei)						(In percent of GDP)					
Total revenue and grants	449,012	566,727	651,975	669,807	691,229	779,908	29.7	30.0	29.0	29.8	30.7	30.6
Current	447,645	564,314	645,826	663,706	682,702	768,351	29.6	29.8	28.7	29.5	30.3	30.1
Tax	418,166	532,482	612,821	629,247	648,850	729,437	27.6	28.2	27.2	28.0	28.8	28.6
Profits	30,190	44,167	49,610	56,809	62,261	61,365	2.0	2.3	2.2	2.5	2.8	2.4
Wages and salaries	41,661	53,541	64,921	64,881	70,126	76,887	2.8	2.8	2.9	2.9	3.1	3.0
Social security	161,867	186,147	215,453	213,796	216,418	240,623	10.7	9.8	9.6	9.5	9.6	9.4
State Budget	5,700	1,692	900	900	900	820	0.4	0.1	0.0	0.0	0.0	0.0
Pension Fund	90,750	116,348	135,228	133,362	134,574	147,497	6.0	6.2	6.0	5.9	6.0	5.8
Unemployment Fund	15,304	15,584	17,641	16,613	16,662	18,914	1.0	0.8	0.8	0.7	0.7	0.7
Health Insurance Fund	52,054	53,401	62,377	65,248	66,633	71,212	3.4	2.8	2.8	2.9	3.0	2.8
Other direct taxes	14,637	17,450	21,900	20,576	19,946	24,647	1.0	0.9	1.0	0.9	0.9	1.0
VAT	104,495	136,357	156,189	157,535	164,161	186,094	6.9	7.2	6.9	7.0	7.3	7.3
Customs	9,362	12,882	13,824	14,264	14,981	16,752	0.6	0.7	0.6	0.6	0.7	0.7
Excise	32,434	60,408	68,915	79,104	78,675	97,733	2.1	3.2	3.1	3.5	3.5	3.8
Other indirect taxes	23,521	21,530	22,009	22,282	22,282	25,336	1.6	1.1	1.0	1.0	1.0	1.0
Nontax	29,479	31,832	33,005	34,459	33,852	38,914	1.9	1.7	1.5	1.5	1.5	1.5
Capital	682	1,524	1,342	1,282	3,707	4,682	0.0	0.1	0.1	0.1	0.2	0.2
Grants	685	889	4,807	4,819	4,820	6,875	0.0	0.0	0.2	0.2	0.2	0.3
Total expenditure	488,523	610,603	716,274	716,893	728,270	819,002	32.3	32.3	31.8	31.9	32.4	32.1
Current	438,494	542,261	635,777	645,231	656,006	738,010	29.0	28.7	28.3	28.7	29.2	28.9
Wages and salaries	73,555	90,888	107,159	110,501	112,027	126,218	4.9	4.8	4.8	4.9	5.0	4.9
Materials and operating expenditures	107,295	143,612	145,755	155,263	158,533	180,059	7.1	7.6	6.5	6.9	7.0	7.1
o/w: health insurance fund	47,687	61,048	63,289	65,392	67,664	74,203	3.2	3.2	2.8	2.9	3.0	2.9
Reserve	…	…	901	1,358	694	3,363	…	…	0.0	0.1	0.0	0.1
Interest 1/	45,351	40,229	46,992	36,301	36,792	43,613	3.0	2.1	2.1	1.6	1.6	1.7
Subsidies and transfers	212,293	267,532	334,970	341,809	347,961	384,757	14.0	14.1	14.9	15.2	15.5	15.1
Subsidies	29,900	43,566	47,781	52,264	53,484	54,751	2.0	2.3	2.1	2.3	2.4	2.1
Transfers	182,393	223,965	287,189	289,545	294,477	330,005	12.1	11.8	12.8	12.9	13.1	12.9
o/w: Pensions	102,185	118,182	144,141	144,259	147,744	153,826	6.8	6.3	6.4	6.4	6.6	6.0
Capital	48,864	66,226	78,621	69,781	70,389	78,992	3.2	3.5	3.5	3.1	3.1	3.1
Lending minus repayments	1,165	2,116	1,877	1,882	1,876	2,000	0.1	0.1	0.1	0.1	0.1	0.1
Overall balance (cash, excluding grants)	-40,197	-44,766	-69,106	-51,905	-41,861	-45,969	-2.7	-2.4	-3.1	-2.3	-1.9	-1.8
Overall balance (cash, including grants)	-39,512	-43,877	-64,299	-47,086	-37,042	-39,094	-2.6	-2.3	-2.9	-2.1	-1.6	-1.5
Financing	34,818	23,631	64,299	...	37,042	...	2.3	1.2	2.9	…	1.6	…
Domestic	4,383	-13,303	19,884	...	2,967	...	0.3	-0.7	0.9	…	0.1	…
External	22,826	30,636	38,215	...	20,275	...	1.5	1.6	1.7	…	0.9	…
Privatization proceeds	5,532	4,277	5,000	...	12,600	...	0.4	0.2	0.2	…	0.6	…
Bank asset recoveries	2,077	2,021	1,200	...	1,200	...	0.1	0.1	0.1	…	0.1	…
Discrepancy 2/	-4,694	-20,246	0	...	0	...	-0.3	-1.1	0.0	…	0.0	…
Memorandum items:												
Primary expenditure 4/	443,172	570,374	669,282	680,593	691,479	775,389	29.3	30.2	29.7	30.2	30.7	30.4
Primary current expenditure 4/	393,143	502,032	588,785	608,930	619,214	694,397	26.0	26.6	26.2	27.1	27.5	27.2
Primary balance (cash, including grants) 3/	5,839	-3,647	-17,307	-10,786	-250	4,519	0.4	-0.2	-0.8	-0.5	0.0	0.2
Nominal GDP (billions lei)	1,512,617	1,890,778	2,250,437	2,250,437	2,250,437	2,550,405	1,512,617	1,890,778	2,250,437	2,250,437	2,250,437	2,550,405

Sources: Ministry of Public Finance; and Fund staff estimates and projections.

1/ Including called-up loan guarantees.
2/ Difference between financing and the deficit of the consolidated general government.
3/ As the 2003 budget incorporated various extrabudgetary revenues and expenditures, the budgets for 2002 and 2003 are not fully comparable. On a comparable basis, revenues and expenditure in the 2002 budget are higher by about 0.3 percent of GDP, leaving the overall balance unchanged.
4/ Including National Administration of Roads (AND).
5/ Owing to the merger between the privatization agency (APAPS) and the asset recovery agency (AVAB) on May 1, 2004, revenues and expenditures of the consolidated general government are by lei 630 billion higher than in the budget approved by parliament on December 3, 2003, as the latter did not comprise AVAB revenues and expenditures.

Table 4. Romania: Monetary Survey, 2002-05

(In billions of lei, unless indicated otherwise, actual/program exchange rates)

	2002	2003				2004				2005			
	December actual	March actual	June actual	September actual	December actual	March actual	June actual	September program	December program	March program	June program	September program	December program
Monetary Survey													
Net foreign assets (including valuation changes)	222,271	212,784	201,431	230,180	247,028	268,973	279,502	317,280	315,159	321,291	320,185	330,849	325,704
In millions of U.S. dollars	6,635	6,411	6,101	6,985	7,579	8,043	8,350	9,314	9,153	9,243	9,163	9,454	9,307
Of which : Commercial banks	87	-216	-246	-668	-1,242	-1,139	-2,138	-2,738	-2,988	-3,038	-3,338	-3,588	-3,788
NBR 4/	6,548	6,627	6,347	7,653	8,821	9,182	10,488	12,052	12,141	12,281	12,501	13,042	13,095
Net domestic assets	151,441	156,667	187,068	184,289	213,723	212,488	227,102	230,568	278,600	281,614	310,493	333,892	384,262
Domestic credit	200,221	215,324	246,397	242,184	300,943	324,105	345,861	352,051	385,579	398,400	425,684	452,271	488,965
Government	21,493	18,505	22,871	-18,126	-1,936	-926	-5,602	-21,541	-11,099	-14,277	-15,538	-10,657	-1,174
Non-government	178,728	196,819	223,525	260,310	302,879	325,031	351,464	373,592	396,678	412,677	441,222	462,928	490,139
In foreign currency	111,999	119,710	128,407	146,269	167,839	181,458	205,329	222,590	240,141	249,382	270,611	284,141	299,364
(in millions of U.S. dollars)	3,343	3,607	3,889	4,439	5,149	5,426	6,134	6,534	6,974	7,174	7,744	8,119	8,554
In lei	66,729	77,109	95,118	114,041	135,040	143,573	146,135	151,003	156,537	163,295	170,611	178,787	190,774
Other items net	-48,780	-58,657	-59,328	-57,895	-87,220	-111,617	-118,760	-121,484	-106,979	-116,786	-115,191	-118,379	-104,702
Broad money	373,712	369,451	388,499	414,468	460,751	481,460	506,603	547,848	593,759	602,905	630,678	664,741	709,967
Of which : Lei denominated (M2)	226,901	223,134	235,809	254,848	289,583	293,250	325,638	363,679	404,160	408,024	431,277	459,792	499,768
Currency in circulation	45,578	45,868	52,535	58,143	57,978	57,773	68,904	80,745	80,918	81,695	91,257	102,084	100,061
Lei deposits	181,322	177,267	183,274	196,706	231,604	235,477	256,735	282,934	323,242	326,329	340,021	357,707	399,708
Foreign currency deposits	146,812	146,317	152,691	159,620	171,169	188,211	180,965	184,168	189,598	194,881	199,400	204,949	210,198
In millions of U.S. dollars	4,382	4,409	4,625	4,844	5,251	5,628	5,406	5,406	5,506	5,606	5,706	5,856	6,006
Memorandum items: 1/													
Broad money (M2X) growth	38.2	34.2	29.1	30.6	23.3	30.3	30.4	32.2	28.9	25.2	24.5	21.3	19.6
NFA contribution 1/	18.6	12.5	1.3	6.6	6.6	15.2	20.1	21.0	14.8	10.9	8.0	2.5	1.8
NDA contribution 1/	19.5	21.7	27.8	24.0	16.7	15.1	10.3	11.2	14.1	14.4	16.5	18.9	17.8
Lei-denominated money growth (M2)	46.6	41.5	33.7	34.5	27.6	31.4	38.1	42.7	39.6	39.1	32.4	26.4	23.7
Growth of currency in circulation	27.9	37.3	32.6	37.3	27.2	26.0	31.2	38.9	39.6	41.4	32.4	26.4	23.7
Real broad money growth	17.2	14.6	13.2	12.7	8.1	15.3	16.4	19.2	18.2	15.9	15.3	13.9	12.8
Real lei-denominated money growth (M2)	24.4	20.8	17.3	16.1	11.9	16.3	23.3	28.7	28.0	28.7	22.6	18.7	16.6
Real growth of currency in circulation	8.5	17.2	16.3	18.6	11.5	11.4	17.1	25.2	28.0	30.8	22.6	18.7	16.6
Growth of lei credit to nongovernment, adjusted 2/	40.4	49.4	76.5	92.9	99.3	83.5	54.4	32.7	15.9	13.7	16.9	18.5	22.1
Growth of lei credit to nongovernment, adjusted, real 2/	19.1	27.6	54.8	66.5	74.7	62.3	37.9	19.7	6.3	5.2	8.2	11.3	15.1
Growth of foreign currency credit, adjusted, in US$ 2/	40.4	37.8	29.1	36.1	38.2	39.6	49.3	42.1	37.1	31.7	26.2	23.8	22.2
Growth of credit to nongovernment, composite 2/ 3/	32.4	33.7	40.3	49.9	55.4	50.2	44.3	32.5	24.2	20.6	18.8	18.7	19.3
CPI inflation	17.8	17.1	14.0	15.8	14.1	13.0	12.0	10.9	9.0	8.1	8.0	6.5	6.0
Average exchange rate (lei/$)	33,654	33,134	32,616	33,799	33,013	32,646	33,584	33,998	34,373	34,718	34,926	34,996	34,996
Exchange rate (lei/$, e.o.p.)	33,500	33,189	33,014	32,952	32,595	33,440	33,473	34,066	34,433	34,761	34,944	34,996	34,996
M2X (Broad Money) velocity	4.4	4.9	4.8	4.7	4.4	4.6	4.4	4.2	3.9	4.2	4.0	3.9	3.7
M2 (Domestic Broad Money) velocity	7.2	8.2	7.9	7.6	7.0	7.5	6.9	6.3	5.8	6.1	5.9	5.6	5.2
M2X+Tbill velocity	3.9	4.4	4.3	4.2	4.0	4.1	3.9	3.7	3.5	3.7	3.6	3.5	3.4
M2X+Tbill growth	38.0	32.8	25.9	27.2	21.6	28.8	31.9	33.4	30.3	25.2	23.0	20.1	18.3

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

1/ All changes are 12-month rates of change, unless indicated otherwise. The NFA/NDA contribution rates are adjusted for the change in the EUR/US$ exchange rate from December 2003.
2/ Adjusted for write-offs in the last 12 months and changes in the US$/EUR exchange rate.
3/ Real lei credit growth and foreign currency credit growth, weighted by their respective shares.
4/ Numbers before and after December 2003 are not strictly comparable, owing to an update in the US$/EUR exchange rate used to convert EUR stocks in US$-equivalent.

Table 4. (continued) Romania: Balance Sheet of the National Bank, 2002-05 1/

(In billions of lei, unless indicated otherwise, actual/program exchange rates, monthly averages)

	2002	2003				2004				2005			
	December actual	March actual	June actual	September actual	December actual	March actual	June actual	September program	December program	March program	June program	September program	December program
National Bank of Romania													
Net foreign assets (including valuation) 2/	175,723	174,404	158,913	204,352	235,773	234,013	277,653	325,044	330,660	337,797	346,464	364,515	364,795
In millions of U.S. dollars	5,221	5,264	4,872	6,046	7,142	7,168	8,267	9,561	9,620	9,730	9,920	10,416	10,424
Net domestic assets	-83,337	-76,640	-55,941	-91,251	-104,211	-122,235	-155,280	-186,751	-190,129	-184,521	-184,392	-189,675	-191,020
Total credit	-55,273	-54,444	-38,184	-73,538	-61,127	-72,062	-97,823	-122,242	-127,023	-123,103	-123,342	-125,133	-133,131
Credit to banks	-47,844	-45,305	-34,195	-48,101	-46,913	-61,663	-84,003	-95,151	-113,203	-101,982	-100,113	-105,532	-119,311
NBR refinancing (including to DGF and Law 101)	3,114	3,095	2,757	2,737	2,094	2,084	1,746	1,746	1,746	1,746	1,746	1,746	1,746
Deposit taking operations and CDs 5/	-50,910	-48,399	-36,952	-50,838	-49,007	-63,747	-85,749	-96,897	-114,949	-103,728	-101,859	-107,278	-121,056
Reverse repo	-48	0	0	0	0	0	0	0	0	0	0	0	0
Credit to government	-7,429	-9,139	-3,989	-25,438	-14,214	-10,400	-13,821	-27,091	-13,821	-21,121	-23,229	-19,601	-13,821
Treasury balance (+deficit, -surplus)	-9,916	-11,401	-3,995	-25,443	-14,219	-10,406	-13,827	-27,097	-13,827	-21,127	-23,236	-19,608	-13,827
Treasury overdraft	-3,693	-9,760	-1,897	-12,698	-4,309	-8,520	-6,936	-6,936	-6,936	-6,936	-6,936	-6,936	-6,936
Treasury deposits	6,223	1,641	2,098	12,745	9,910	1,887	6,891	20,161	6,891	14,191	16,299	12,671	6,891
Treasury bills	2,487	2,262	6	5	5	6	6	6	6	6	6	6	6
Other items net	-28,064	-22,196	-17,757	-17,713	-43,084	-50,173	-57,457	-64,510	-63,106	-61,418	-61,050	-64,542	-57,889
Lei reserve money 5/	92,385	97,764	102,972	113,101	131,562	111,778	122,374	138,292	140,531	153,275	162,072	174,840	173,775
Currency	50,592	50,215	55,780	63,342	66,753	63,455	74,352	86,527	90,579	89,569	98,472	109,394	112,007
Bank deposits 5/	41,793	47,549	47,192	49,759	64,808	48,323	48,022	51,766	49,952	63,707	63,600	65,446	61,768
Memorandum items: 3/													
Real reserve money growth (adjusted) 4/	19.2	23.7	20.4	19.6	24.8	15.9	21.2	25.5	25.7	26.9	22.6	18.7	16.6
Memorandum items:													
Nominal reserve money growth (adjusted) 4/ 5/	40.5	44.8	37.3	38.5	42.4	31.0	35.8	39.2	37.0	37.1	32.4	26.4	23.7
NDA contribution	-44.3	-24.7	23.7	-15.9	16.1	16.8	-27.1	-12.8	-35.1	-55.7	-23.8	-2.1	-0.6
NFA contribution	84.9	69.6	1.8	42.9	14.5	14.2	62.9	50.6	72.1	92.8	56.2	28.5	24.3
CPI inflation	17.8	17.1	14.0	15.8	14.1	13.0	12.0	10.9	9.0	8.1	8.0	6.5	6.0

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

1/ For program purposes, all values are defined on a monthly average basis.
2/ Program definition excludes deposits of commercial banks to meet required reserves against foreign currency deposits. This, and the fact that the figures here are monthly averages, explain the differences from the monetary survey.
3/ All changes are 12-month rates of change, unless indicated otherwise.
4/ Adjusted for changes in minimum reserve requirements.
The minimum reserve requirement for lei deposits was decrease
5/ Adjusted to correspond to a 25 percent reserve requirement until end-2003 and 18 percent afterwards. CDs are central bank certificates of deposits.

Table 5. Romania: Implicit Subsidies and Losses in the Energy Sector, 2000-05

	2000 Actual	2001 Actual	2002 Actual	2003 Actual	2004 Program	2005 Program
			Losses at Termoelectrica and the externalized units			
HEATING						
Cost recovery price ($/Gcal) 1/	19.2	20.2	20.2	22.9	24.5	26.2
Current prices ($/Gcal, year-average)	11.2	12.3	16.6	21.0	23.8	26.1
Termoelectrica's heating output sold (million Gcal)	22	23	23	23.4	23.4	23.4
Termoelectrica's losses from heating ($m)	181	180	84	45	16	2
Collection rate (%)		86	81	83	90	90
Losses from non-collection ($m)		41	75	82	56	61
ELECTRICITY						
Cost recovery price ($/Mwh) 1/	35.4	38.1	38.4	44.1	48.1	51.4
Actual prices ($/Mwh, year-average)	34.2	32.2	36.3	40.8	46.5	53.5
Termoelectrica's electricity output sold (million Mwh)	26	28	28	28	28	28
Termoelectrica's losses from electricity ($m)	30	165	58	92	44	-57
Collection rate (%)		86	94	90	98	98
Losses from non-collection ($m)		131	57	119	26	30
Total losses from operations ($m)	210	346	142	137	60	-56
In percent of GDP	0.6	0.9	0.3	0.2	0.1	-0.1
Total losses from non-collection ($m)	208	171	132	200	82	91
Total losses including non-collection ($m)	418	517	273	337	142	35
In percent of GDP	1.1	1.3	0.6	0.6	0.2	0.0
			Profits at Hidroelectrica			
Cost recovery price ($/Mwh) 1/			10.9	10.9	11.9	12.1
Actual prices ($/Mwh, year-average)			5.4	5.4	12.2	24.4
Hidroelectrica's electricity output sold on the regulated market (million Mwh)			9.3	8.5	6.2	6.2
Hidroelectrica's profits from electricity on the regulated market ($m)			-51.4	-46.6	1.5	76.1
In percent of GDP			-0.11	-0.08	0.00	0.10
			Implicit Subsidies from Natural Gas			
NATURAL GAS PRODUCTION						
Import price (average, $/tcm)	124	130	110	137	141.5	139.8
Domestic wellhead price (average, incl. excise tax, $/tcm)	35	35	40	35.6	61.2	85.0
Domestic output (million tcm)	14.0	13.0	12.1	12.7	12.5	12.5
Loss from low prices ($m)	1246	1230	842	1286	1003	685
Total supply to end-users, incl. transp. & dist. ($m)	566	974	981	1248	1569	1824
Collection rate (%)	87	86	99	99	98	98
Losses from non-collection ($m)	74	141	12	16	27	32
Total losses and implicit subsidy ($m)	1320	1371	854	1302	1031	717
In percent of GDP	3.6	3.4	1.9	2.3	1.5	1.0
TOTAL IMPLICIT SUBSIDIES AND LOSSES	1738	1888	1178	1686	1171	676
In percent of GDP	4.7	4.7	2.6	3.0	1.7	0.9
Change in losses relative to the previous year	...	0.0	-2.12	0.39	-1.22	-0.82
Estimated change in saving - investment balance of public enterprises 2/	...	0.0	0.71	-0.19	0.61	0.41
Memorandum item:						
GDP (in USD Mill.)	37,060	40,188	45,760	56,950	67,179	73,153

Sources: ANRE (electricity regulatory agency), Termoelectrica and Distrigaz Nord and Sud; World Bank; Fund staff estimates and projections.

1/ Cost recovery price estimates based on WEO fuel price projections.
2/ The reduction in losses only partially translates into an improvement in the saving-investment balance, owing to three offsetting factors: (i) increase in losses in other public eterprises, (ii) higher tax payments of the energy sector, (iii) higher investment in the energy sector. For 2003 and 2004, this effect is estimated at 1/2.

Table 6. Romania: Medium-Term Balance of Payments Outlook, 2000-08

(In millions of euros, unless indicated otherwise)

	2000 Act.	2001 Act.	2002 Act.	2003 Act.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.
Current account	-1,494	-2,488	-1,623	-2,877	-2,885	-3,152	-3,202	-3,386	-3,642
Ratio to GDP	-3.7	-5.5	-3.3	-5.7	-5.3	-5.2	-4.7	-4.4	-4.3
Trade balance	-1,867	-3,323	-2,752	-3,955	-4,361	-4,771	-5,036	-5,332	-5,629
Exports	11,273	12,722	14,675	15,614	18,345	20,546	22,285	24,143	26,196
Imports	-13,140	-16,045	-17,427	-19,569	-22,706	-25,317	-27,321	-29,475	-31,824
Services account, net	-260	-444	-483	-561	-657	-763	-825	-902	-1,001
Of which: interest, net	-363	-405	-433	-426	-430	-497	-539	-590	-653
Unrequited transfers	937	1,279	1,612	1,639	2,133	2,382	2,659	2,849	2,987
Capital account	2,922	3,650	3,733	3,053	3,136	4,600	4,083	4,316	4,775
Direct investment	1,161	1,312	1,194	1,591	1,815	2,365	2,299	1,971	1,973
Capital transfers	38	106	95	188	216	211	224	317	349
Portfolio Investment	-7	69	24	-23	-100	50	50	50	50
Borrowing by public sector 1/	1,008	1,381	1,273	1,213	993	1,534	814	1,092	1,429
Loans (net)	837	485	890	662	1,154	1,234	961	1,172	978
Disbursements	1,510	1,524	2,034	1,625	2,222	1,992	2,294	2,611	2,950
Of which: direct debt	906	525	773	480	780	779	933	1,087	1,241
Of which: government guaranteed	603	1,000	1,261	1,145	1,442	1,213	1,361	1,524	1,710
Amortization	-673	-1,039	-1,144	-963	-1,068	-758	-1,333	-1,439	-1,973
Bonds (net)	171	896	383	551	-162	300	-147	-80	451
Disbursements	297	896	680	700	0	600	600	600	600
Amortization	-126	0	-297	-149	-162	-300	-747	-680	-149
Borrowing by private sector	816	630	638	-53	212	440	697	887	974
Medium- and long-term loans (net)	816	630	638	-53	212	440	697	887	974
Disbursements	1,154	1,216	1,639	975	1,395	1,744	2,180	2,617	3,009
Amortization	-338	-586	-1,001	-1,028	-1,183	-1,305	-1,484	-1,730	-2,035
Short-term (net)	31	211	443	195	0	0	0	0	0
Credit extended	-124	-59	66	-58	0	0	0	0	0
Net errors and ommisions	95	818	-869	-294	882	0	0	0	0
Overall balance	1,523	1,981	1,242	-118	1,133	1,448	882	930	1,132
Financing	-1,523	-1,981	-1,242	118	-1,018	-1,323	-747	-785	-977
Net foreign assets NBR (increase, -)	-1,015	-2,030	-1,986	-913	-2,323	-1,638	-1,069	-1,114	-1,313
Assets (increase, -)	-1,022	-1,667	-1,894	-1,020	-2,196	-1,580	-976	-981	-1,231
Liabilities	7	-363	-92	107	-127	-58	-93	-132	-82
IMF, net	18	-56	8	107	-127	-58	-93	-132	-82
Purchases	123	75	112	205	0	0	0	0	0
Repurchases	-105	-131	-104	-98	-127	-58	-93	-132	-82
Other, net	-11	-307	-100	0	0	0	0	0	0
Short-term	-11	-1	-100	0	0	0	0	0	0
Medium- and long-term, net	0	-306	0	0	0	0	0	0	0
Net foreign assets DMBs (increase, -)	-508	49	745	1,031	1,305	315	322	329	336
Assets (increase, -)	-359	-110	550	211	-174	-17	-17	-17	-18
Liabilities	-149	159	195	820	1,479	332	339	346	354
Short-term	3	166	137	487	76	0	0	0	0
Medium- and long-term, net	-122	-5	60	333	42	0	0	0	0
Financing gap	0	0	0	0	-115	-126	-135	-145	-155
Export growth (percent)	21.9	12.9	15.4	6.4	17.5	12.0	8.5	8.3	8.5
Import growth (percent)	19.1	22.1	8.6	12.3	16.0	11.5	7.9	7.9	8.0
Net Resource Balance/GDP (percent)	-3.0	-4.8	-2.3	-4.5	-4.0	-3.9	-3.4	-3.2	-3.0
External debt/GDP (percent)	28.5	31.2	30.8	30.9	33.6	33.0	32.0	31.4	31.1
Public and publicly guaranteed debt/GDP (percent)	18.6	19.6	18.7	18.9	18.8	18.7	18.0	17.3	16.9
Net External Indebtedness/GDP (%)	16.1	16.2	14.3	13.3	11.9	13.8	10.7	11.3	11.8
Debt service ratio	13.3	17.4	18.4	14.9	14.4	12.7	16.8	17.0	16.8
Gross reserves of NBR (in millions of US$) 2/	3,466	5,090	6,975	7,994	10,842	10,622	13,420	14,270	15,355
(over short-term debt by remaining maturity)	151.3	155.6	241.7	204.8	241.6	228.8	265.5	264.0	255.8
(in months of imports of following year)	2.3	3.1	3.8	3.8	4.3	4.9	4.2	4.9	..

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

1/ Including public enterprises.

2/ Includes gold.

Table 7. Romania: External Financing Requirements and Sources, 2000-09

(In millions of euros)

	2000	2001	2002	2003	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.	2009 Proj.
Gross financing requirements	**4,007**	**6,188**	**5,513**	**5,924**	**7,795**	**7,169**	**7,851**	**8,366**	**9,130**	**10,059**
External current account deficit	1,494	2,488	1,623	2,877	2,885	3,152	3,202	3,386	3,642	3,972
Debt amortization	1,027	1,792	2,442	2,140	2,412	2,363	3,564	3,849	4,157	4,698
Public sector	688	1,207	1,441	1,112	1,229	1,058	2,080	2,119	2,122	2,314
of which: Bonds and notes	126	279	297	149	162	300	747	680	149	0
Private sector	338	586	1,001	1,028	1,183	1,305	1,484	1,730	2,035	2,384
Repayment of arrears	0	0	0	0	0	0	0	0	0	0
Gross reserves accumulation	1,380	1,777	1,344	809	2,370	1,596	993	999	1,249	1,361
IMF repurchases and repayments	105	131	104	98	127	58	93	132	82	29
Available financing	**3,642**	**6,246**	**5,325**	**5,660**	**7,678**	**7,295**	**7,986**	**8,511**	**9,285**	**10,226**
FDI and capital transfers (net)	1,199	1,418	1,289	1,779	2,031	2,576	2,523	2,287	2,322	2,453
Public sector borrowing	1,434	2,420	2,545	2,275	1,990	2,592	2,894	3,211	3,550	3,913
Loans	1,137	1,524	1,865	1,575	1,990	1,992	2,294	2,611	2,950	3,313
Bonds	297	896	680	700	0	600	600	600	600	600
Private sector borrowing	1,005	1,375	1,834	1,795	2,874	2,076	2,519	2,962	3,363	3,810
Other flows 1/	4	1,033	-343	-189	782	50	50	50	50	50
Financing gap	364	-58	188	264	117	-126	-135	-145	-155	-167
Balance of payments financing	365	-58	188	264	231	0	0	0	0	0
IMF	123	75	112	205	0	0	0	0	0	0
Other 2/	242	-133	76	59	231	0	0	0	0	0
Accumulation of arrears (exceptional)	0	0	0	0	0	0	0	0	0	0
Residual financing gap	0	0	0	0	-115	-126	-135	-145	-155	-167

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

1/ Includes all other net financial flows, and errors and omissions.

2/ Includes World Bank PSAL2 and EU loans.

Table 8. Romania: Indicators of External Vulnerability, 2000-05 1/

(In percent of GDP unless otherwise specified)

	2000	2001	2002	2003	2004 proj.	2005 proj.
Financial Indicators						
Public sector debt	35.8	37.7	36.5	36.3	38.6	33.2
Broad money (percent change, 12-month basis)	38.0	46.2	38.1	23.3	28.9	19.6
Credit to non-government (percent change, 12-month basis) 2/	32.4	54.8	51.9	68.6	31.0	23.6
Real credit to non-government (percent change, 12-month basis) 2/	7.4	26.0	29.6	55.4	24.2	19.3
Monthly weighted average T-bill rate	62.4	38.4	17.4	18.4	17.6 4/	...
Monthly weighted average real T-bill rate 3/	15.4	6.3	-0.3	3.7	5.0 4/	...
External Indicators						
Exports (percent change, 12-month basis in €)	21.9	12.9	15.4	6.4	17.5	12.0
Imports (percent change, 12-month basis in €)	19.1	22.1	8.6	12.3	16.0	11.5
Terms of Trade (percent change, 12-month basis)	2.7	2.5	16.2	7.6	18.7	10.1
Current account balance	-3.7	-5.5	-3.3	-5.7	-5.3	-5.2
Current account balance after FDI	-0.7	-2.4	-0.7	-2.2	-1.6	-0.9
Errors and omissions	0.2	1.8	-1.8	-0.6	1.6	0.0
Gross official reserves (in € millions)	3,725	5,776	6,651	6,329	8,806	10,386
(in months of imports GNFS of the following year)	2.3	3.5	3.6	3.0	3.7	4.1
Central Bank short-term foreign liabilities (in € millions)	109	112	0	0	0	0
Gross reserves of the banking system (in € millions)	4,980	6,714	8,049	8,857	11,879	11,676
(in months of imports GNFS of the following year)	3.2	4.1	4.4	4.2	5.0	4.6
Short term foreign liabilities of the commercial banks (in €)	244	415	522	1,070	1,350 4/	...
Open foreign currency position of the commercial banks (in €)	345	397	404	357	508 5/ 10/	...
Official reserves/Broad money (M2)	52.2	67.5	59.6	44.8	51.2	51.4
Official reserves/Narrow money (M0) 6/	201.5	274.3	288.2	176.3	186.3	180.8
Total short term external debt by remaining maturity 7/	6.2	8.1	6.3	6.9	6.7	6.3
In percent of reserves	61.5	56.6	43.4	61.7	51.0	44.7
In percent of total debt	20.0	23.4	19.2	25.0	24.5	23.2
Total external debt (in € millions)	11,445	13,985	15,014	15,592	18,355	20,018
Of which : Public and Publicly guaranteed debt	7,477	8,778	9,127	9,557	10,273	11,368
Total external debt (in percent of exports of G&S)	86.8	93.3	87.6	85.3	86.7	85.1
Total external debt/ GDP	28.5	31.2	30.8	30.9	33.6	33.0
External interest payments (in percent of exports of G&S)	3.8	3.8	3.0	2.7	2.4	2.5
External amortization payments (in percent of exports of G&S)	9.5	13.6	15.4	12.2	12.0	10.3
Exchange rate (per US$, period average)	21,688	29,056	33,055	33,201	...	...
Exchange rate (per €, period average)	26,002	31,210	37,523	40,999	...	...
REER appreciation (+) (12-month basis)	9.5	1.6	2.7	0.4	...	...
Financial Market Indicators						
Foreign currency debt ratings						
Moody's	B3	B2	B1	Ba3	Ba3 8/	...
Standard and Poor's	B-	B	B+	BB	BB 8/	...
Spread of benchmark bonds (basis points, end of period)	406	400	282	161	78 8/ 9/	...

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

1/ All stocks are reported as of end of period.

2/ Adjusted for bad loans written off. Real credit growth is weighted average of real lei credit growth, and U.S. dollar-measured foreign currency growth.

3/ The real rate is based on the ex-post 12-month CPI inflation.

4/ Actual as of June 2004.

5/ Actual as of June 2004.

6/ Narrow money is defined as currency plus lei-denominated sight deposits.

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

8/ Actual as of August 9, 2004.

9/ In 1998-2000, the benchmark bond is the '02; in 2001-2003, it is the '05; in 2004, it is the '08.

10/ On-balance-sheet only. The overall open currency position, including off-balance-sheet items and capital paid in foreign exchange, was US$88 million short as of end-July 2004.

Table 9. Romania: Indicators of Fund Credit, 2000-08

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Outstanding Fund Credit									
(end of period)									
In millions of SDRs	347.9	308.0	314.9	400.4	340.9	377.0	312.0	184.0	76.4
In millions of U.S. dollars	458.8	392.1	407.8	546.9	463.3	510.9	421.5	247.7	102.4
In percent of quota	33.8	29.9	30.6	38.9	33.1	36.6	30.3	17.9	7.4
In percent of GDP	1.2	1.0	0.9	1.0	0.7	0.7	0.5	0.3	0.1
In percent of exports of goods and services	3.8	2.9	2.5	2.6	1.8	1.8	1.4	0.8	0.3
In percent of official reserves	13.2	7.7	5.8	6.8	4.3	4.8	3.1	1.7	0.7
Debt service due to the Fund									
(in millions of SDRs)	91.2	113.4	85.9	88.3	126.2	116.3	133.6	137.7	113.8
(in millions of U.S. dollars)	120.3	144.4	111.3	120.6	171.5	157.6	180.5	185.4	152.6
In percent of quota	8.9	11.0	8.3	8.6	12.3	11.3	13.0	13.4	11.0
In percent of GDP	0.3	0.4	0.2	0.2	0.3	0.2	0.2	0.2	0.2
In percent of exports of goods and services	1.0	1.1	0.7	0.6	0.7	0.6	0.6	0.6	0.5
In percent of official reserves	3.5	2.8	1.6	1.5	1.6	1.5	1.3	1.3	1.0

Sources: IMF Finance Department, and Romanian authorities.

Table 10. Romania: Medium-Term Projections, 2000-08
(in percent of GDP unless otherwise specified)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
							Proj.		
Income and prices									
Nominal GDP (in trillions of lei)	803.773	1,167.687	1,512.617	1,890.778	2,253.130	2,550.434	2,833.117	3,118.781	3,421.657
Nominal GDP (in billions of US dollars)	37.060	40.188	45.760	56.950	67.179	73.153	80.645	88.386	97.002
Real GDP	2.1	22.0	5.0	4.9	5.8	5.0	5.0	5.0	5.0
Domestic Demand	4.3	8.4	3.8	7.2	6.9	5.8	5.2	5.3	5.5
Household consumption	-0.8	6.9	5.2	7.3	7.0	5.3	4.6	4.6	4.6
Government consumption	12.3	3.6	-9.6	4.9	3.8	6.0	3.2	4.5	5.0
Gross fixed investment	5.5	10.1	8.2	9.2	8.1	8.7	9.0	9.1	9.2
of which: non government	7.7	10.9	8.2	8.8	9.5	9.0	9.0	9.0	9.0
of which: government	-11.2	3.6	8.3	12.8	-5.3	4.9	8.8	10.6	11.1
Increase in stocks (contribution) 1/	2.2	1.6	0.3	0.0	0.4	-0.1	0.1	0.0	0.0
External Demand (contribution)	-2.3	-3.1	0.9	-2.8	-2.0	-1.5	-1.0	-1.1	-1.3
Exports of goods and services	23.4	12.1	17.6	11.1	15.7	9.6	6.4	6.3	6.5
Imports of goods and services	27.1	18.4	12.0	16.3	16.0	10.1	6.5	6.6	7.0
GDP deflator, p.a.	44.2	37.4	23.4	19.2	12.7	7.8	5.8	4.8	4.5
CPI, e.o.p.	40.7	30.3	17.8	14.1	9.0	6.0	5.0	4.0	4.0
CPI, p.a.	45.7	34.5	22.5	15.3	11.8	7.3	5.5	4.5	4.0
Saving and investment balances									
Total domestic saving	14.2	14.9	17.8	16.7	16.9	16.9	17.7	18.3	18.9
Net factor receipts and transfers from abroad	1.4	2.1	2.3	2.0	2.6	2.6	2.6	2.5	2.3
Total national saving	15.6	17.0	20.1	18.7	19.5	19.6	20.4	20.8	21.2
Non-government	16.6	17.1	19.5	17.5	18.0	18.0	18.6	18.9	19.2
Government	-1.0	-0.1	0.6	1.2	1.5	1.6	1.8	1.9	2.1
Total investment	19.5	22.6	23.5	24.6	24.8	24.8	25.2	25.6	25.9
Non-government investment	16.4	19.4	20.3	21.1	21.6	21.7	22.1	22.3	22.4
Government investment	3.0	3.1	3.2	3.5	3.1	3.1	3.2	3.3	3.5
Gross fixed capital formation	18.9	20.7	21.3	22.5	22.8	23.4	24.0	24.8	25.5
Increase in stocks	0.6	1.9	2.2	2.1	2.0	1.4	1.2	0.8	0.4
Savings - investment balance (in $ terms)	-3.9	-5.5	-3.4	-5.9	-5.3	-5.2	-4.9	-4.7	-4.7
Non-government	0.1	-2.3	-0.8	-3.6	-3.6	-3.7	-3.4	-3.3	-3.3
Government	-4.0	-3.2	-2.6	-2.3	**-1.6**	**-1.5**	**-1.4**	**-1.4**	**-1.4**
Estimated change in the saving-investment balance of the state-owned sector	...	0.0	0.8	-0.6	0.7	0.4	0.3	0.3	0.0

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

1/ Includes statistical discrepancy.

Table 11. Romania: Status of Existing Structural Conditionality

Measures	Status
Structural Performance Criteria:	
Continuous:	
• The minimum wage will not exceed lei 2.8 million during 2004 (para. 21).	Observed so far
By July 20:	
• Approval of supplementary state budget in line with the revised deficit target (para. 12).	Done
• Government Decision to increase the National Reference Price for heating by 12 percent, effective August 1, 2004 (para. 25).	Done
• Approval of legislation to eliminate the extraordinary appeal procedure of the Attorney General for all cases (para. 41).	Done
By September 30:	
• Increase in the end-user gas prices by 5 percent, effective October 1 (para. 23).	
• Implementation of 4,000 layoffs in the mining sector (para. 33).	
• Repayment of the amount of health system arrears accumulated in 2002 as identified in the protocols agreed with the suppliers (para. 17).	
By December 31:	
• Increase in end-user gas prices as per the new pricing mechanism, effective January 1, 2005 (para 23).	
• Adjustment of end-user electricity prices, effective January 1, 2005 to maintain them to cost-recovery levels (including return on capital for distribution companies) Adjustment of Termoelectrica's electricity and heating prices, effective January 1, 2005, to keep them at cost-recovery levels. The relevant decisions of the regulator(s) will be shared with Fund staff (para. 24).	
• Subordination of the customs administration and the Financial Guard to the Minister of Public Finance effective January 1, 2005 (para. 15).	
Structural Benchmarks:	
Continuous:	
• The largest industrial nonpayers to the four utilities will stay disconnected or on minimum supply until full payments for all bills from December 2002 onwards have been received by the utilities. The bills for companies on minimum supply will be paid by the government (para. 26).	Observed so far

Table 11. Romania: Status of Existing Structural Conditionality

Measures	Status
	Observed so far
(Continued)	
• The government will refrain from introducing tax holidays or any other new distortionary tax incentives or postponing the discontinuation of expiring ones (para. 14).	Observed so far
• The regulatory agency in the electricity sector will produce biannual reports on the needed adjustments in electricity and heating prices and share them with Fund staff (para. 24).	Observed so far
• Should any parts of Roman not pay energy bills or taxes, the utility companies or the Ministry of Finance will immediately start foreclosure proceedings (para 30).	
	Done
By May 31, 2004:	
• Appointment of liquidators by AVAS for 15 non-payers to the utilities (including Republica, CUG and Turnu), as per paragraph 29.	Done
By June 30, 2004:	
• AVAS will privatize or liquidate 6 large companies (para. 29).	
By September 30, 2004:	
• AVAS will privatize or liquidate another 6 large companies (para. 29).	

ROMANIA—RELATIONS WITH THE FUND
(As of July 31, 2004)

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

II. General Resources Account:

	SDR million	% Quota
Quota	1,030.20	100.00
Fund holdings of currency	1,367.21	132.71

III. SDR Department:

	SDR million	% Allocation
Net cumulative allocation	75.95	100.00
Holdings	3.03	3.99

IV. Outstanding Purchases and Loans:

	SDR million	% Quota
Stand-By Arrangements	337.00	32.71

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-By	07/07/04	07/06/06	250.00	0.00
Stand-By	10/31/01	10/15/03	300.00	300.00
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
Stand-By	05/29/92	03/28/93	314.04	261.70
Stand-By	04/11/91	04/10/92	380.50	318.10

VI. Projected Payments to Fund (Expectations Basis)[6]
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2004	2005	2006	2007	2008
Principal	51.65	102.80	113.67	68.89	
Charges/interest	5.53	8.93	5.49	2.50	1.39
Total	57.17	111.73	119.16	71.39	1.39

Romania is repaying the Fund on an expectations basis.

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[6] This schedule presents all currently scheduled payments to the IMF, including repayment expectations where applicable and repayment obligations otherwise. The IMF Executive Board can extend repayment expectations (within predetermined limits) upon request by the debtor country if its external payments position is not strong enough to meet the expectations without undue hardship or risk.

VII. Exchange Rate Arrangements

From August 1994, a decentralized direct dealing interbank market has been in operation. The official reference rate published by the NBR is an average of rates reported for interbank and client transactions. Romania has accepted the obligations of Article VIII, Sections 2, 3, and 4, with effect from March 25, 1998. Romania’s exchange system is free of restrictions on the making of payments and transfers for current international transactions. Romania maintains de jure a managed floating exchange rate regime with no preannounced exchange rate path, while the de facto regime is an unannounced crawling band.

VIII. Article IV Consultation

Romania is on the 24-month consultation cycle subject to the provisions of the decision on consultation cycles approved by the Board on July 15, 2002. The last consultation was concluded on July 7, 2004.

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. The implementation of a comprehensive tax administration reform designed in line with the recommendations of several technical assistance missions of the Fund’s Fiscal Affairs Department has started in January 2003. A report on the observance of standards and codes (ROSC) on fiscal transparency was completed on November 6, 2002 (IMF Country Report No. 02/254). Furthermore, in 2003 an FSAP was completed, while technical assistance by the Fund’s Monetary and Financial Systems Department on inflation targeting is ongoing.

X. Safeguards Assessment

Under the Fund's safeguards assessment policy, the National Bank of Romania (NBR) is subject to full safeguards assessment with respect to the Stand-By Arrangement approved on July 7, 2004. The assessment was completed on June 17, 2004 and concluded that safeguards in place at the NBR appear generally adequate. However, certain weaknesses were identified in the internal audit and control system, and the safeguards assessment recommended measures to address them.

XI. Resident Representative

The Fund has had a resident representative in Bucharest since 1991. Mr. Graeme Justice assumed the post in January 2003.

September 13, 2004

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

The attached Supplementary Memorandum on Economic and Financial Policies (SMEFP) specifies understandings reached with staff in discussions during the first review of the Stand-By Arrangement (SBA) that was approved by the IMF Board on July 7, 2004.

In the first half of 2004, our main economic objectives were met. All performance criteria (PCs) were observed, except for the end-June quantitative PC on reducing private sector arrears to the general consolidated budget. On the basis of the corrective actions specified in the SMEFP (paragraph 14), we request a waiver for the nonobservance of this PC and a modification of the September and December PCs on the same indicator. In addition, continuing strong growth in domestic demand, only partly compensated by rapid output growth, necessitates some adjustments of program policies. In line with our decision to tighten fiscal policy, we request a modification of the PC on the general government deficit. The SMEFP also specifies the main elements of macroeconomic policies in 2005.

The Government believes that the policies set forth in the attached SMEFP are adequate to achieve the objectives of its program and ensure sustainable macroeconomic developments in 2004–06, but it will take any further measures that may become appropriate for this purpose. Romania will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the SMEFP, in accordance with the Fund's policies on such consultation.

Yours sincerely,

/s/	/s/
Adrian Nastase	Mugur Isarescu
Prime Minister	Governor
Government of Romania	National Bank of Romania

Attachment

SUPPLEMENTARY MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES FOR 2004–06

I. INTRODUCTION

1. This memorandum supplements the Memorandum on Economic and Financial Policies for 2004-06 (MEFP) finalized at the onset of the Stand-By Arrangement (SBA), which was approved by the IMF Board on July 7, 2004, and describes additional policy objectives and measures agreed in the context of the first review under the arrangement.

II. BACKGROUND

2. **Fiscal and monetary policies continue to be in line with the program, but domestic demand has remained stronger than expected.** Fiscal tightening, reduction in losses in state-owned enterprises (SOEs), and prudent monetary policies contributed to a reduction in inflation from 14 percent at end-2003 to around 12 percent in July 2004. Moreover, disinflation was achieved without adverse effects on GDP growth, which accelerated to above 6 percent in the first half of 2004. Romania's external position strengthened further, with official reserves increasing to 4.6 months of prospective imports at end-June 2004 from about 3.9 months at end-2003. However, growth in domestic demand has not subsided as expected. As a result, the current account deficit, after declining in Q1, picked up again in Q2. This suggests a need for some additional measures in the remainder of the year to prevent overheating.

3. **Fiscal policy has remained on track.** The rectified budget approved on July 15 envisaged a general government deficit of 2.1 percent of GDP in 2004. Revenue performance is impressive, owing to our stepped-up efforts to improve collections and the strong economy. To contain accumulation of tax arrears, we have initiated bankruptcy procedures against 65 tax nonpayers among the 452 private companies with the largest arrears to the budget. Despite our efforts, however, we did not observe the corresponding end-June quantitative performance criterion under the program. Corrective measures are described in paragraph 14.

4. **Monetary policy has been successful in reducing inflation and increasing foreign reserves.** In response to the large surplus in the foreign exchange market of some €1.9 billion in January-June, the NBR lowered the policy interest rate by cumulative 250 basis points since May. However, inflows remain strong, and another €1 billion was purchased in July. Credit growth slowed in most of H1 of 2004, but recently foreign currency-denominated credit picked up again.

5. **Further progress has been achieved in structural reforms,** particularly in the energy sector. In July, sales-purchase agreements were signed for the privatization of Petrom and the two electricity distribution companies. Moreover, final bids for the two gas distribution companies have been received, and negotiations are near completion. Preparations for the sale of two additional electricity distribution companies and three energy generation complexes are proceeding. Owing partly to the restructuring of the Privatization Agency, only four large loss-making SOEs were sold or liquidated in Q2, instead of six

envisaged by the structural benchmark under the program. In line with our determination to restructure state-owned sector, in H1 of 2004, employment in the 72 largest SOEs monitored under the program was reduced by 15,600 employees, or by 3.6 percent. The collections of heating bills have recently increased, but still require attention.

6. **We have made decisive progress in improving our governance legislation.** In May-June, parliament approved a package of laws strengthening the independence and powers of the judicial system. We have also strengthened the legislation on declaration of assets by government officials and parliamentarians and their close relatives.

III. Economic and Financial Policies in 2004 and 2005

A. Objectives and Strategy

7. **Our main objective for the remainder of 2004 is to moderate growth in domestic demand to support disinflation and contain the current account deficit**. For this purpose, we have decided to save part of the revenue overperformance and implement further measures to slow growth of foreign currency-denominated credit. Meanwhile, structural reform will continue according to schedule.

8. **In 2005, the main elements of our macroeconomic policy package will be as follows**: the S-I balance of the broad public sector will be improved by about ¾ percentage point of GDP. This will be achieved by a prudent budget policy, a modest nominal increase in the minimum wage, a prudent wage program for SOEs, and further reforms in the energy, railway and mining sectors. Monetary policy will monitor vigilantly developments in credit and implement further measures if necessary. As always, we stand ready implement additional measures if our current account or disinflation targets come under strain.

B. Fiscal Policy

9. **In 2004, we will save part of the revenue overperformance relative to the projection in the first supplementary budget.** To this end, we approved a second supplementary budget, which limited additional spending to lei 11,400 billion (prior action). Local governments, over which the central government has only limited control, are expected to increase spending by lei 4,300 billion, reflecting their higher revenue collections. To avoid incurring arrears following higher than expected spending in H1 of 2004, the central government budget allocation for public health will be increased by lei 2,272 billion, while we will take measures to improve spending controls. We will increase subsidies for the mining companies by lei 300 billion, which will facilitate severance payments for further reducing employment. Additional expenditures of lei 2,978 billion will be allocated to the pension fund to compensate for less-than-full CPI-indexation for pensioners that retired before April 1, 2001 and the change in the indexation scheme in 2005. Specifically, pensions will be increased by 5¼ percent for pensioners who retired under law 3/1997 and who receive a pension lower than three times the average gross economy-wide wage. The increase in pensions will be accompanied by shifting the indexation entirely to a CPI basis. Other

expenditures will be increased by lei 1,550 billion. The revised deficit target appears in Table 1. We are committed to saving any additional revenue overperformance to further reduce the deficit of the general consolidated budget (excluding local authorities), as demonstrated by the deficit target adjustor (TMU, section III), and will not initiate or approve a third budget rectification of the 2004 budget. If the current account deficit worsens, we will implement additional measures, including expenditure cuts.

10. **Fiscal policy in the broad public sector will be tightened in 2005.** To keep the current account deficit target no greater than the 2004 one, at below 5½ percent of GDP, we will continue with measures to improve the financial performance of SOEs by adjusting energy prices and implementing tight wage policy in SOEs. The estimated improvement in SOEs' S-I balance will be equivalent to 0.6 percent of GDP. The general government deficit will be limited to 1.5 percent of GDP against the background of lower growth in output than in 2004. The submission of the draft 2005 budget to parliament in line with this fiscal stance is a structural performance criterion (PC) for October 15, 2004. We have also decided to postpone any further decisions on new motorway construction until after the World Bank has completed the study on prioritization of the motorway projects in September 2004.

11. **Tax policy in 2005 will further reduce the high tax burden on labor, reduce profit tax and the personal income tax, and facilitate a further improvement in the business climate**. We have decided to reduce the still-high social security contribution rates, which are one of the main causes of the widespread gray economy, by 1¼ percentage points. The profit tax will be cut rate from 25 percent to 19 percent, and the tax rate in the lowest bracket of the personal income tax from 18 to 14 percent. At the same time we will freeze the personal income tax exemption in nominal terms at lei 2,000,000. Moreover, we will increase the tax on dividends for resident physical persons from 5 percent to 10 percent and raise excise taxes in line with the schedule agreed with the EU. In 2005, profit tax revenue will benefit from the full-year effect of the elimination of the reduced profit tax rate for exporting activities in 2004. On this basis, we are expecting revenues in an amount of lei 780 trillion and are firmly committed to limit expenditures to lei 819 trillion. We have made the final decision on these tax reforms only after we reached understanding with staff on the details of the expenditure side of the 2005 budget. We will not grant any tax relief for reinvested profits as this would be unnecessary and inefficient, thereby threatening to undermine the success of the profit tax reform (continuous structural benchmark in the original MEFP). Furthermore, we will not broaden the scope of goods and services subject to the reduced VAT rate of 9 percent and refrain from introducing a second reduced VAT rate, including for books and newspapers (continuous structural PC). Should revenue performance deteriorate in the remainder of 2004 to the point of threatening the 2005 budget, the scheduled adjustments in excises taxes would be moved forward from July 1, 2005, to March 1.

12. **We will adjust the budget sector wage structure in 2005, which will result in differentiated wage increases, to improve incentives for the most skillful public servants**. We have commissioned a study, in cooperation with the World Bank, on the salary structure in the budgetary sector. Based on the results of this study, and in consultation with the World Bank, we will decide on salary increases, including substantial increases for the most qualified 40,000 civil servants. The average nominal increase will be 12.0 percent, with

nominal increases taking place on January 1 and October 1. All these reforms will result in maintaining constant spending on budgetary sector wages from the first supplementary 2004 budget in terms of GDP.

13. **In 2005 we will implement several measures to ensure the sustainability of the pension system.** Already in August 2004, we decided that, starting with 2005, pensions are adjusted only once per year in January, by the rate of projected average inflation in the year. In January 2005, the adjustment will be exceptionally limited to 3 percent, owing to the already implemented adjustments in 2004. (The corresponding decision is a prior action for completing the review.) By April 2005, we will approve amendments to the Pension Law that will accelerate the increase in the retirement age starting on July 1, 2005. Moreover, starting January 1, 2005, the pensions for farmers who were insured under the former farmer pension system will be paid from the state budget.

14. **We have stepped up the fight against arrears.** To address the nonobservance of the performance criterion, we have identified the 22 companies with an unjustified increase in arrears above lei 20 billion between December 2003 and June 2004 (section V of the TMU). We are determined to cover the shortfall by means of forced execution measures, by issuing a summons of forced execution to the debtor, against 6 companies, while initiating bankruptcy procedures against 3 other companies, where forced execution measures are unlikely to yield results (initiation of forced execution measures and submission of the request for initiation of bankruptcy procedures to court will be prior actions). In addition, AVAS will no longer institute or support any rescheduling or cancellation of budgetary obligations without the prior approval of the Ministry of Finance and consultation with IMF staff for already privatized companies. The Ministry of Finance and the state-owned creditors will insist on proceeding with bankruptcy procedures against the second largest refinery and oppose any kind of judicial reorganization, merger, acquisition, or other related scheme. Moreover, in the fight against tax evasion, by December 2004 we will adopt a comprehensive implementation plan to: (a) eliminate the illegal trade in petroleum products and cigarettes, areas where corruption is perceived to be pervasive; and (b) to fight corruption in customs administration. In addition, we will request technical assistance from the Fund to review the legislation on prevention, discovery, control, and sanction of tax fraud. Expenditure arrears of the budget will be reduced by paying health sector arrears incurred in 2003 by end-September, while private sector arrears are dealt with through bankruptcy procedures as specified in the MEFP (paragraph 17). Meanwhile, Ordinance 37/2004 has reduced arrears in the energy sector, as the Ministry of Public Finance has issued T-bills and bonds to pay the historical debts of the gas distribution companies and the privatized two electricity distributors.

15. **In financing the 2005 budget deficit, we will give priority to domestic borrowing to limit supply pressures for private sector credit**. Taking into account large expected privatization receipts from abroad, we will limit our Eurobond issuance to not more than €600 million in 2005. Domestic financing will aim at extending the maturity of lei-denominated securities.

16. **We will contain the issuance of all external off-budget guarantees in 2005 to 1.6 percent of GDP, somewhat below the 2004 level**. Within the ceiling, we will give

priority to projects for modernizing the energy sector. We will limit the issuance of domestic guarantees to lei 2,000 billion.

C. Wage Policy

17. **To protect the competitiveness of our economy, the minimum wage will be increased only modestly in 2005.** We will approve a government decision, stipulating an increase of 10.7 percent in the statutory minimum wage on January 1, 2005, to lei 3,100,000. We will refrain from raising the minimum wage above this level throughout 2005 (continuous structural PC). In negotiations on the national collective contract, government officials will seek to ensure that the minimum wage in this contract does not deviate from the statutory minimum wage. The system of national collective contract will be reviewed in the context of the revisions of the Labor Code as stipulated in paragraph 44 of the MEFP.

18. **Our SOE wage policy in 2005 aims at improving the financial performance of 72 large monitored companies by about ¼ percent of GDP**. The budgets of the monitored companies, limiting the annual wage bill growth to 4 percent and specifying quarterly targets, will be approved by end-December (structural PC). The target for March 2005 will be a quantitative PC. With the scheduled reduction of employment by an average 9,700 positions, this implies an average gross wage growth of about 7 percent in nominal terms. To strengthen the credibility of our wage bill target, the ministries will block payments equivalent to 4 percent of the quarterly wage bill in monitored SOEs until the last month of the quarter and will release it only after it has become clear that the respective target will be reached.

D. Energy Sector Reforms

19. **We remain committed to the energy price increases agreed in the MEFP, including the gas price adjustment scheduled for January 2005 (structural PC in the orginal MEFP)**. Moreover, we will follow the recommendations from the review of electricity prices that was performed in cooperation with the World Bank by deciding by December 31, 2004, on increasing end-user electricity prices, effective January 1, 2005 (structural PC in the original MEFP), which will facilitate an increase of the hydro-power producer price of at least 90 percent (structural PC), while at the same time deciding to abolishing the national development tax, also effective January 1, 2005 (structural PC).

20. **We will immediately initiate liquidation procedures against SOEs which do not follow ORD 37/2004 on the payment of current utility bills and the repayment of arrears**. In this regard, we will amend Government Ordinance 115/2003 in accordance with Government Ordinance 37/2004, which will result in the general consolidated budget paying the difference between the real value of shares received by Distrigaz to settle the bill and the unpaid gas bills of Roman accumulated during the period October 2003-February 2004, when most of the company was state-owned.

21. **We have approved a reform strategy for the district heating system as an annex to Government Decision 882/2004.** We will consult with the World Bank on the

implementation of all aspects of the strategy. In addition, by October 15, 2004, we will prepare reports on: (a) the schedule for reducing heat producer subsidies and increasing the National Reference Price in the period 2005-07; (b) the plans for introduction of metering by local administrations as submitted to the ministry of administration and interior (MAI); (c) the master plans on district heating reform submitted to the MAI by local administrations; (d) the restructuring of Termoelectrica's high-cost units ("stranded assets"); and (e) the action plan for implementing the heating strategy with necessary legislation to be implemented, including a thermal energy law and the two-part (binomial) tariff. On January 1, 2005, the producer heating price will be raised in line with increasing costs (structural PC in the original MEFP), while the National Reference Price (the ceiling for producer prices) will be raised in July with a view to eliminating it by end-2007. The government's plan for abolishing the National Reference price will be subject to particular attention in the context of discussions on the forthcoming review.

E. Privatization, Liquidation, and Restructuring

22. **We aim to achieve substantial further progress in the privatization of utilities, building on recommendations from the World Bank**. As the Petrom sale has to be reviewed by the Competition Council, we remain committed to resolve any issues that might arise from that review as necessary for the successful completion of the deal. The privatization of the two gas distributors is expected to result in the signing the contract by end-October 2004 (structural benchmark), while a privatization strategy for Electrica-Muntenia Sud aiming at receiving final bids by end-July 2005 will be ready by end-December (structural benchmark) and privatization strategies for energy complexes Rovinari, Turceni, and Craiova will be finalized by end-March 2005. Moreover, we will limit the floatation of minority stakes in SOEs, among which Romgaz, on the Bucharest stock exchange to 5 percent of the companies' share capital.

23. **We will make speedy progress in divesting the companies under AVAS.** In addition to the structural benchmark of privatizing or liquidating six large companies by end-September, we will divest the remaining three by end-2004. We will either privatize or liquidate 15 smaller companies in which AVAS holds a majority share package in Q3, another 20 in Q4 and at least 20 in Q1 of 2005 (the last two targets are structural benchmarks).

24. **We remain committed to instilling financial discipline in the railways.** By September 15, we will offer again for concession the remaining segments of the 3,000 kilometer railway track that was supposed to be divested by end-June. To prevent accumulation of arrears, the 2005 wage bill in the three railway companies will increase by no more than 8 percent. In addition, there will be no wage increases in the railway sector in the remainder of 2004.

25. **In 2005, we remain committed to accelerating the restructuring of the hard coal sector, and the reduction of subsidies and transfers to the mining sector in line with the approved mining sector strategy**. In addition to the 5,700 miners laid off by end-July 2004, an additional 2,300 layoffs have been initiated bringing the total reduction in mining sector

employment in 2004 to 8,000 by end-September. Utility payments are being monitored closely, and all but one heavy loss-making mine, Baia de Aries, are current on their payments. We have accelerated the closure of this mine with 400 of the 650 miners given redundancy notice on August 15, 2004.

F. Monetary Policy and Banking Issues

26. **The NBR will continue to focus on lowering inflation to single digits while managing monetary policy's transition to a new framework**. Preparations for the introduction of the new inflation targeting regime will be speeded up, and the confirmation of full-scale implementation of the new framework will follow the accomplishment of two 'dry runs' of the quarterly forecasting cycle.

27. **Overperformance on inflation, together with large foreign currency inflows in the first half of the year, indicate room for the NBR to gradually lower the policy interest rate**. Lower domestic real interest rates, on the background of continued monetary policy prudence, will improve the composition of bank lending in favor of local currency loans, thus lowering the related risks. Furthermore, a lower policy interest rate would diminish the yield differential between domestic and world markets and hence incentives for large and potentially destabilizing volatile inflows.

28. **Meanwhile, credit growth remains of concern.** To curb the recent renewed surge in foreign currency-denominated credit, we have decided to increase the reserve requirement for foreign liabilities from 25 percent to 30 percent as of September 1. As of September 1, 2004, we will expand the database of the NBR's Credit Information Bureau to include delinquent loans below lei 200 million. In addition, we will include information on (a) all debit and credit card frauds by cardholders, (b) the exposure of non-resident legal entities, and (c) the total exposure on groups of debtors.

G. Labor Market and Governance

29. **Our efforts to strengthen public administration, eliminate corruption and improve the business climate will continue in close cooperation with the EU and the World Bank**. In cooperation with the World Bank, we are evaluating the impact of the new Labor Code on the labor market and employment with a view to increasing labor market flexibility. The comprehensive overhaul of the Labor Code in early 2005 will address concerns of the stakeholders, among which are concerns about the Wage Guarantee Fund, the binding nature of collective labor contracts for non-participating employers, the procedures to determine the work load, regulations on hiring and firing, the flexibility of fixed-term contracts, and red tape. The overhaul of the code will be agreed upon with the World Bank within the framework of the EU acquis, and be submitted to parliament by end-March 2005, with a view to implementing the new code on July 1, 2005. We will follow up on the issues raised in the PricewaterhouseCoopers report on SNTR, particularly with regard to the role of the minority shareholder, and publish the results on the web site of AVAS by March 2005.

30. We will approve by end-March 2005 legislation amending Article 24, paragraph 2 of the **Law on Ministerial Responsibility** (Law 115/1999), to remove immunity for former members of the government.

IV. Program Monitoring

Owing to the forthcoming elections in November 2004, we will seek combined conclusion of the second and the third review in early 2005.

Table 1. Romania: Quantitative Performance Criteria and Indicative Targets for 2004 and 2005 1/

	End-March 2004	End-June 2004			End-September 2004				End-December 2004				End-March 2005			End-June 2005			End-September 2005			End-December 2005		
	Act.	Prog.	Adj.	Act.	Prog.	Modified	Adj.	Act.	Prog.	Modified	Adj.	Act.	Prog.	Adj.	Act.	Prog.	Adj.	Act.	Prog.	Adj.	Act.	Prog.	Adj.	Act.
1. Ceilings on the Average Net Domestic Assets of the National Bank of Romania 2/	-122,235	-146,830	-123,117	-154,815	-171,896				-162,996				-184,521			-184,392			-189,675			-191,020		
2. Floors on Net Foreign Assets of the National Bank of Romania, US$ million 2/	7,304	7,922	7,215	8,506	8,786				8,533				9,780			9,970			10,466			10,474		
3. Indicative Targets for Ceilings on Broad Money	481,460	503,615	503,615	506,269	535,999				586,105				602,905			630,678			664,741			709,967		
4. Indicative Targets on Banking Sector Exposure to State-owned Enterprises 7/	49,260	50,569	50,569	50,036	52,491				55,998				54,131			54,744			57,311			60,610		
Of which: BCR Exposure 7/	17,377	17,851	17,851	16,778	18,737				20,355				19,214			19,450			20,549			22,151		
5. Ceilings on Aggregate Wage Bills of Monitored State-owned Enterprises (cumulative)	13,581	28,378	28.002	27.480	42,621				57,698				11,420			23,970			35,970			48,270		
6. Ceilings on the Deficit of the General Government (cumulative) 4/	9,917	24,727	24,727	21,085	28,735				47,106	37,041			7,623			17,592			26,780			39,094		
7. Ceilings on Arrears of Private Enterprises to the General Government 5/	54,866	54,318	42,014	43,420	53,367	54,090			52,033	52,833			52,305			51,782			51,264			50,751		
8. Indicative Targets for Ceilings on Arrears of Monitored State-owned Enterprises to the General Government 6/	42,262	41,206	39,589	33,324	40,176				39,171				37,212			36,282			35,375			34,491		
9. Indicative Targets on Total Public Sector Financing (cumulative)	5,457	23,139	23,139	12,593	37,704				68,416				11,818			22,133			34,875			57,554		
10. Floors on Cumulative Aggregate Collection Rates of:																								
a. Distrigaz Nord and Distrigaz Sud (aggregate)	96.0	96.0	96.0	108.5	96.0				96.0				96.0			96.0			96.0			96.0		
- Distrigaz Nord (indicative target)	96.0	96.0	96.0	115.0	96.0				96.0				96.0			96.0			96.0			96.0		
- Distrigaz Sud (indicative target)	96.0	96.0	96.0	103.4	96.0				96.0				96.0			96.0			96.0			96.0		
b. Termoelectrica, including transferred units (aggregate of electricity and heating)	88.0	89.0	89.0	97.2	90.5				92.0				92.0			92.0			92.0			92.0		
- Aggregate of Termoelectrica and externalized units in electricity (indicative target)	90.0	91.5	91.5	99.2	93.0				94.5				94.5			94.5			94.5			94.5		
- Termoelectrica district heating (indicative target)	82.0	83.0	83.0	96.8	84.0				85.0				85.0			85.0			85.0			85.0		
- Heating in the externalized units (indicative target)	82.0	83.0	83.0	85.5	84.0				85.0				85.0			85.0			85.0			85.0		
c. Electrica	96.0	96.0	96.0	102.0	96.0				96.0				96.0			96.0			96.0			96.0		
11. Ceilings on Assumption of Enterprise Debt to Banks and Issuance of Domestic Guarantees Extended by Government (cumulative)	746	746	746	746	1600				1600				2000			2000			2000			2000		
12. Ceilings on Contracting or Guaranteeing of External Debt (cumulative) 3/																								
a. One-year or less maturity	0	0	0	0	0				0				0			0			0			0		
b. More than one-year but less than three-year maturity 8/	1	20	20	8	300				600				...			...			...			...		
Of which: off-budget	0	20	20	0	300				400				...			...			...			...		
c. More than one-year maturity	157	1,375	1,375	774	3,400				4,550				1000			2000			3000			4170		
Of which: off-budget	0	775	775	236	1,100				1,553				380			480			680			1170		

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

1/ The performance criteria and indicative targets envisaged under the program are defined in the Technical Memorandum of Understanding (TMU). The figures for June, September and December 2004, and March 2005 are performance criteria, unless indicated otherwise.
2/ At cross exchange rates as of December 31, 2003 (as specified in the TMU, Section II), and a mandatory reserve requirement of 18 percent.
3/ Nonaccumulation of external payments arrears of the government will be a performance criterion monitored on a continuous basis.
4/ The general government is defined in the TMU.
5/ The methodology for measuring private sector arrears is defined in the TMU. Accordingly, the adjusted figures reflect changes in the set of monitored companies as specified in the TMU.
6/ The methodology for measuring SOE arrears is defined in the TMU.
7/ Excluding the performance guarantees of BCR to Romtehnica on deliveries before 1989, which have been assumed by the state, but are still kept in BCR's accounts.
8/ To be combined in 2005 with more than one-year maturity target.

Table 2. Romania: Additional Prior Actions, Structural Performance Criteria and Benchmarks Agreed in the Supplementary Memorandum on Economic and Financial Policies of August 2004. 1/

Measures	Status

Prior Actions:

- Approval, by September 15, of a second supplementary budget which limits additional spending to lei 11,400 billion (para. 9).
- Government decision limiting pension adjustments to once a year and to 3 percent, per January 1, in 2005, as specified in para. 13.
- Initiation of forced execution measures, by issuing a summons of forced execution to the debtor, against 6 companies (listed in Section V of the TMU), as provided for in para. 14.
- Submission of requests to court for initiation of bankruptcy procedures against 3 companies (listed in Section V of the TMU), as provided for in para. 14.

Structural Performance Criteria:

Continuous:

- Refrain from broadening the scope of goods and services subject to the reduced VAT rate of 9 percent and refrain from introducing a second reduced VAT rate, as per para 11.
- Refrain from increasing the minimum wage to a level above lei 3,100,000 during 2005 (para. 17).

By October 15, 2004:

- Submission to parliament of a draft 2005 budget with a deficit of at most 1.5 percent of GDP, in accordance with para. 10.

By December 31, 2004:

- Approval of the budgets of the monitored companies, limiting the wage bill growth to 4 percent and specifying quarterly targets, in accordance with para. 18.
- Decide on the increase of the hydro-power producer price by at least 90 percent effective per January 1, 2005 (para. 19).
- Abolishing the national development tax on electricity, effective per January 1, 2005 (para. 19).

Table 2. Romania: Additional Prior Actions, Structural Performance Criteria and Benchmarks Agreed in the Supplementary Memorandum on Economic and Financial Policies of August 2004. 1/

Measures	Status
(Continued)	
Structural Benchmarks:	
By October 31, 2004:	
• Signing of the contract for the privatization of the two gas distribution companies Distrigaz Nord and Sud (para. 22).	
By December 31, 2004:	
• Produce a privatization strategy for Electrica-Muntenia Sud aiming at receiving final bids by end-July 2005 (para. 22).	
• Privatize or liquidate 20 smaller companies in which AVAS holds a majority of share capital in Q4 (para. 23).	
By March 31, 2005:	
• Privatize or liquidate at least 20 smaller companies in which AVAS holds a majority of share capital in Q1 of 2005 (para. 23).	

1/ All conditionality specified in the original Memorandum of Economic and Financial Policies (Country Report No. 04/221) remains applicable.

Technical Memorandum of Understanding for Stand-By Arrangement

I. Ceilings on the Average Net Domestic Assets of the National Bank of Romania

The average net domestic assets of the National Bank of Romania (NBR) for the indicated month are defined as the difference between average reserve money (as defined below) and average net foreign assets (as defined in Section II of this attachment), both expressed in local currency.

Average reserve money is defined as the sum of average currency in circulation outside the NBR and average deposits (required plus excess reserves) of the commercial banks at the NBR for the indicated month. Commercial bank deposits exclude required and excess reserves in foreign exchange for foreign exchange deposits. Data on reserve money will be monitored from the daily indicators data of the NBR, which shall be supplied to the IMF weekly by the NBR. The stock of average reserve money as of March 2004 was lei 111,778 billion.

The reported figures of average reserve money will be adjusted in the following circumstances:

(1) Should reserve requirements be increased/decreased from 18 percent on all required reserves held in lei, the reported reserve money figures would be increased/decreased by the product of the change in the reserve requirements and the programmed deposits for which required reserves are held in lei. The level of the programmed deposits is lei 242,609 billion for June 2004, lei 282,934 billion for September 2004, lei 323,242 for December 2004 and lei 326,329 for March 2005.

(2) The reported reserve money figures will be lowered by the shortfall in actual reserves from required reserves for any individual bank, measured from the 24th of the previous month to the 23rd of the test-date month, as provided for in the relevant NBR regulation.

Average net foreign asset stocks will be converted into lei for the purposes of calculating average net domestic assets at the average monthly lei/U.S. dollar rates specified in consultation with Fund staff. The average stock of NFA is defined as the average of the daily NFA as defined in Section II. The limits will be monitored from daily data on the accounts of the NBR supplied weekly to the IMF by the NBR. The average NDA as of March 2004 was lei -122,235 billion.

The ceiling on average net domestic assets of the NBR will be adjusted under the following circumstances:

(1) Downwards (upwards), prorated for the fraction of the month that gross foreign financing exceeds (falls short of) programmed levels, specified in Section II, by the lei equivalent of the said excess (shortfall).

(2) For any change in reserve requirements as described above. Before undertaking any such changes, the NBR will consult IMF staff.

(3) Upwards (downwards) by the lei equivalent of the decrease (increase) in the stock of foreign currency denominated Treasury bills (cumulative from end-March 2004).

(4) Downwards by the lei equivalent of the increase in foreign currency receipts from large privatizations (sale price above $10 million, cumulative from end-March 2004), excluding proceeds from the sale of BCR, as specified in Section II.

(5) Downwards by the shortfall in actual reserves from required reserves for any individual bank.

II. Targets for Floor on Net Foreign Assets of the National Bank of Romania

Net foreign assets of the NBR consist of reserve assets minus foreign liabilities. For the purposes of the program, reserve assets shall be defined as monetary gold, holdings of SDRs, any reserve position in the IMF, and holdings of foreign exchange in convertible currencies by the NBR. Excluded from gross reserves are long-term assets, NBR redeposits at the commercial banks, any assets in nonconvertible currencies, encumbered reserve assets, reserve assets pledged as collateral for foreign loans, reserve assets pledged through forward contracts, and precious metals other than gold. Monetary gold shall be valued at an accounting price of US$407 per ounce and SDRs at US$1.48597 per SDR. NFA stocks are measured at the last working day of the respective month.

For the purposes of the program, foreign liabilities shall be defined as loan, deposit, swap (including any portion of the NBR gold that is collateralized), and forward liabilities of the NBR in convertible currencies including foreign currency deposits of resident commercial banks at the NBR; IMF purchases; borrowing from international capital markets; and bridge loans from the BIS, foreign banks, foreign governments, or other financial institutions, irrespective of their maturity.

All assets and liabilities denominated in convertible currencies, other than the U.S. dollar, shall be converted at their respective exchange rates against the U.S. dollar on December 31, 2003. Specifically, €1 = US$1.26145, £1 = US$1.7847, AUD1 = US$0.750, JPY1 = US$0.00934. All changes of definition or valuation of assets or liabilities as well as details of operations concerning sales, purchases, or swap operations of gold shall also be communicated to the IMF staff.

The NFA of the NBR will be adjusted:

(i) upwards/downwards by 100 percent of the excess/shortfall of gross foreign financing[7] from the programmed levels on a cumulative basis from end-March 2004 as follows:

June 2004	*US$756.87 million*
September 2004	*US$756.87 million*
December 2004	*US$756.87 million*
March 2005	*US$756.87 million*

(ii) by the change in the stock of foreign currency denominated Ministry of Finance Treasury Bills including those issued for bank restructuring (on a cumulative basis from end-March 2004. The outstanding stock on March 31, 2004 was US$450.891 million evaluated at the program exchange rates.

(iii) upwards by the amount of foreign currency receipts from large privatizations (sale price above $10 million) (cumulative from end-March 2004), excluding proceeds from the sale of BCR, which are already included in the target.

The end-of-period NFA will be monitored on the basis of the monetary survey. Daily data will still be used, however, to calculate average NFA. All data is provided by the NBR. The end-of-period NFA figure was US$7,304 million on March, 2004.

III. Ceilings on the Cumulative Deficit of the Consolidated General Government

The consolidated general government includes the state budget; the budgets of the local authorities; the social protection funds;[8] the "Special Fund for the Development of the Energetic System", the "Authority for the Sale of State Assets" (AVAS)[9], the "National Administration of Roads (AND)"; other extra-budgetary operations of ministries financed by foreign loans; and the counterpart funds created from the proceeds of foreign loans. Any new funds created during the program period to undertake operations of a fiscal nature as defined

[7] Foreign financing is defined as disbursements of balance of payments support loans to the government with a maturity of more than a year from multilateral and bilateral creditors and resources with a maturity of more than one year raised in the international capital markets by the government. This excludes use of IMF resources.

[8] These include the State Social Security Fund, the Insurance Fund for Work-Related Accidents, the Unemployment Fund, and the Health Social Insurance Fund.

[9] AVAS emanated from the merger of the "Privatization Agency" (APAPS) and the "Asset Recovery Agency" (AVAB) on May 1, 2004. Before this merger, APAPS was a component of the consolidated general government, while AVAB was not.

in the IMF's *Manual on Government Finance Statistics* will be incorporated within the definition of consolidated general government.

Under the program, the deficit of the consolidated general government will be measured based on (a) revenue and expenditure data provided by the Ministry of Public Finance as well as (b) on "below the line" financing data, i.e., the sum of domestic and external financing of the budget as well as privatization proceeds received by all entities of the consolidated general government and proceeds from the recovery of bank asset and other state assets by AVAB. All efforts will be made to reconcile the measurement of the deficit from "below" and from "above the line". However, should these efforts not succeed in eliminating the discrepancies, the respectively higher deficit number will be used for program purposes.

For program purposes, net credit of the banking system to the consolidated general government is defined as all claims of the banking system on the consolidated general government less all deposits of the consolidated general government with the banking system. Foreign-currency denominated credit to government outstanding at December 31, 2003 will be converted in U.S. dollars at the end-December 2003 exchange rate and from dollars into lei using the rates specified in consultation with Fund staff. Foreign-currency denominated credit newly issued in 2004 will be valued at the exchange rates specified in consultation with Fund staff. Government loans to banks at an interest rate less than the reference rate of the NBR to finance on lending to economic agents are excluded from government deposits; an agreed listing of the accounts to be treated as government deposits for program purposes is contained in the FAD aide memoir "Romania: Measuring the Fiscal Deficit", Part II, Appendix 11, February 1994.

The deficit target for 2004 will be adjusted downwards by the amount of any excess revenue in the general government budget (excluding local authorities) over the amount of lei 548,246 billion, which represents the revenue estimate in the second supplementary state budget for that year.

IV. Ceiling on Aggregate Wage Bill of Monitored State-Owned Enterprises

The set of 72 state-owned enterprises, whose wages are to be monitored under Emergency Ordinance 79/2001, is specified in Government Decision 393/2004.

The wage bill targets will be adjusted as follows:

(i) downwards by the amount of savings due to "externalization" (defined as the spinning off of a unit or its transfer to another entity, or temporary/permanent transfers of employees when the sum of these transfers exceeds 100 employees per month). In each month, savings from externalization will be calculated on a company by company basis as the product of the number of externalized employees so far and the company's average gross wage.

(ii) if a company is privatized, downwards by the budgeted wage bill of the privatized company, starting with the month in which the privatization contract is signed.

The wage bills will be measured on a cumulative basis across the different sectors, on a monthly basis. The Ministry of Labor and Social Protection will undertake the responsibility of collecting data from the various line ministries (regie autonomes and national companies) and AVAS (commercial companies), and will report the wage bills and employment figures for each of the monitored enterprises (including aggregate figures for each ministry and for the overall total) to the IMF on a monthly basis. Employment reduction resulting from all forms of outsourcing will be reported in the "externalization" column of the respective tables, with a footnote, if necessary.

V. Ceiling on the Stock of Arrears of Private Enterprises to the State Budget and the Four Social Security Funds

The ceiling applies to the outstanding stock of arrears of the set of 452 private companies (fully private or with state-ownership of less than 50 percent) monitored by the National Agency for Fiscal Administration (NAFA). These 452 companies are a subset of the 549 companies (private as well as state-owned) with the largest arrears to the state budget and the four social security funds as of December 31, 2003. Data on the stock of arrears of these 549 companies are published on a quarterly basis on the external website of the Ministry of Public Finance (with a breakdown into arrears to the state budget and each of the four social security funds; separately for the stock of arrears including and excluding interest and penalties). The complete data set is provided to Fund staff on a monthly basis with a reporting lag of at most 35 calendar days following the end of the respective month. The performance criterion refers to the stock of arrears excluding interest and penalties. Changes in the stock of arrears owing to the rescheduling/cancellation of arrears or any other reduction of the stock that does not represent a cash payment to the general government will not be reflected in the data used for measuring the stock of arrears under the program. Fund staff has to be notified on a company-by-company basis about all reschedulings/cancellations of arrears and/or other arrear-reduction schemes within at most 5 business days following the approval of the rescheduling/cancellation/scheme. For changes to the set of monitored companies, the targets will be adjusted downwards/upwards by the amount of arrears of the companies removed/added to the set. In particular, in the case of the privatization of a fully state-owned company or a majority state-owned company on the above-referenced list of the 549 companies, the respective company will be added to the list of private companies (for the base date as well as for future test dates) to which the performance criterion applies. These companies will be added to the list in the moment of the final and binding signature of the privatization contract. In the case of the initiation of bankruptcy procedures against a company on the above-referenced list of 452 companies, the respective company will be removed from the list (for the base date as well as for future test dates) to which the performance criterion applies. These companies will be removed from the list in the moment in which the file requesting bankruptcy is submitted to court. The stock of arrears at end-March 2004 was lei 54,866 billion.

The following companies have increased their arrears by more than lei 20 billion between December 2003 and June 2004: CSR SA, ROMPETROL SA, TRACTORUL UTB SA, DISTRIBUTION OIL SRL (RAFO IMPERIAL OIL), ATLAS GIP, ROMAN SA, ARO SA, DIONISOS SA, TRANSPORT PRESTARI SERVICII CU UTILAJE TERASIERE ROVINARI SA, FEPA SA, UZTEL SA, INTERAMERICAN TRADING SRL FILIALA ARAD, RIENI DRINKS SA, CONSTRUCTII FEROVIARE MOLDOVA SA, NOVATEX, HIDROMECANICA SA, REMAR SA, NITRAMONIA SA, ASTESE PRODUCTION SRL, TEROM SA, MAREX SA, HIDROCONSTRUCTIA SA.

From that list, forced execution measures will be applied to the following companies: ROMAN SA, ROMPETROL SA, RIENI DRINKS SA, CONSTRUCTII FEROVIARE MOLDOVA SA, TEROM SA, NITRAMONIA SA

Bankruptcy procedures will be initiated against the following companies: ATLAS GIP SA, DIONISOS SRL, NOVATEX SA

VI. Indicative Target for Ceilings on Arrears of Monitored State-owned Enterprises to the Consolidated General Government

The ceiling applies to the outstanding stock of arrears of the set of 72 monitored state-owned enterprises, whose arrears are to be monitored under Emergency Ordinance 79/2001 and Government Decision 393/2004. Under the ordinance, arrears are defined as accounts payable past the due date stipulated explicitly in the contracts, or if no such explicit date exist, 30 days after services/products are provided. The reporting on total arrears will have the following subcategories: to the state budget, to the social security budget; to the local budget; to special funds; and to other creditors. Arrears to the consolidated general government are defined as the sum of the first four categories. Amounts reflecting tax arrears exclusive of penalties will be reported separately. For arrears which have been rescheduled/canceled or reduced by any means rather than a cash payment to the general government, the rescheduled/canceled/reduced amounts (including penalties) will not be counted as arrears reduction, and have to be reported to Fund staff on a monthly basis, as part of the regular monitoring. The report will include a breakdown of arrears to the ten largest creditors for each company. The report will also include data on overdue claims of each of the monitored companies, as reported under Emergency Ordinance 79/2001 and Government Decision 393/2004. For changes to the set of monitored companies owing to privatization or the initiation of bankruptcy procedures, the targets will be adjusted downwards/upwards by the amount of arrears of the companies removed/added to the set. Data for monitoring purposes shall be supplied monthly to Fund staff by the Ministry of Public Finance by at most 35 calendar days after the end of the respective month. The stock of arrears at end-March 2004 was lei 42,262 billion.

VII. Floors on Cumulative Aggregate Collection Rates of Distrigaz Sud, Distrigaz Nord, Termoelectrica and Electrica

Floors will be set on the cumulative collection rates of the following companies:

- the combined rate (performance criterion) of Distrigaz Nord and Distrigaz Sud (indicative targets on the individual company collection rates);

- on the combined collection rate for heating and electricity of Termoelectrica, including the production units externalized to local authorities (performance criterion). Indicative targets will be set on the collection rates for (i) electricity for both Termoelectrica and the production units externalized to local authorities; (ii) Termoelectrica's district heating; (iii) heating in the externalized units;

- on Electrica's collection rate (performance criterion).

The floors on collection rates are defined as follows:

(i) Termoelectrica and local authority units (Heating sector), Distrigaz Nord and Sud: Heating and gas bills are lagged by one month. Definition of 12-month moving collection rate c(m) for the month m=1,2..12.:

c(m) = sum(heating collections(m):heating collections(m-12) divided by sum(heating bills(m-1):heating bills(m-13)).

(ii) Termoelectrica and local authority units (Electricity sector); Electrica; Definition of 12-month moving collection rate c(m) for the month m=1,2..12:

c(m) = sum(electricity collections(m):electricity collections(m-12) divided by sum(electricity bills(m):electricity bills(m-12)).

Using these definitions, the collection rate of Termoelectrica including the externalized units at end-December 2003 was 87.9, of Electrica 98.1, and of the two gas companies 98.8. Data for these companies will be collected by the Ministry of Economy and Commerce and reported to the IMF on a monthly basis. Revenue resulting from obtaining shares through debt-equity swaps will be excluded from collections, unless the shares are sold for cash. The Ministry of Economy and Commerce will include in this report data on billings and collections registered by Distrigaz Nord, Distrigaz Sud, Electrica and Termoelectrica, as well as information on possible dis- and reconnections for the following industrial (a) and heating (b) companies.

a) SC Siderurgica, COS Targoviste, Minvest SM-Rosia Poieni, Moldomin, Minvest-SM, Balan, Snif, SC Industria Sarmei, Gavazzi Steel, Minvest-SM Baia de Aries, SC Turnu, CUG Cluj, SC Apaterm Galati, SC Tractorul UTB, SC Chimcomplex, Minvest- SM Brad, Apa Nova (RGAB), Minvest -SM Coranda Certej, Minvest -SM Poiana Rusca Teliuc, Siderca, SC Electrocarbon, Tepro, Nitramonia, Viromet, Amonil, Oltchim, Sere Codlea, US Govora, Republica, Zahar Bod, Stirom Bucuresti, Danubiana, Gerom Buzau, Colorom Codlea, Roman Brasov, Metrom Brasov, Carfil Brasov, Stiaz Azuga, Faur Bucuresti, UPSOM SA Ocna Mureş, Bicapa SA Târnăveni, SC Ind.Sârmei C.Turzii, SC Stipo SA Dorohoi, Ampellum SA Zlatna, SC Cugir SA, SC Melana Săvineşti, Letea Bacau, Rafo SA Oneşti, SC Fortus SA Iaşi, Ambro SA Suceava, Stratusmob SA Blaj, SC Sticla Turda, Iris SA Cluj, Metalurgica Aiud.

b) Radet Bucuresti, Radet Constanta, Apaterm Galati, RA Termoficare Craiova, SC Apaterm, SA Deva, Termica SA Targoviste, Termoficare Petrosani, Dalkia Ploiesti, SC Termoficare Petrosani, SC Universal Lupeni, Aptercol Braila, SC Citadin Aninoasa, RA Termoficare Cluj, SC Aqua Calor P. Neamt, RA Energomur Tg Mures, SC Energ. Temica Sibiu, Termoloc Populatie Bacau, RA Goscom Roman, Proditerm Bistrita, Rail Hunedoara, Comunala RA Satu Mare, Termica SA Botosani, Enet Focsani, Cet Braila, Cet Govora, RA Termo Craiova, Ram Buzau, RA Termo Brasov, Aquaterm Tg. Jiu, Aquaterm 98 Pitesti.

Also, to monitor actual payments in the electricity sector, the Ministry of Economy and Commerce will include in these reports the following tables on monthly payments.
a) a table containing amounts billed to Electrica by power generators, paid by Electrica to power generators, and the payment rate (i.e. the second column divided by the first column). The table will contain a separate line for amounts billed and collected related to the developments tax and hence amounts billed an collected by Electrica itself should exclude the development tax.

b) Four collection rate tables from Termoelectrica containing amounts billed to and received from electricity distribution companies. Table one contains the total amounts billed and received, table two contains amounts billed and received from Electrica, table three contains amounts billed and received from Hidroelectrica, and table four contains amounts billed and received from other TE customers. Hence the amounts in tables 2–4 should add up to the amounts in table 1. Each table should be split up according to the amounts billed and received by the various Termolectrica plants, i.e. Termoelectrica-core, Rovinari, Turnceni, Craiova, Deva.

For the period January 2004–April 2004, these tables will be compiled retrospecitively. From April 2004 onwards, these tables will be included in the monthly reports on collection rates.

The exchange rate (ROL per USD) used to calculate the annual producer gas price increase of at least $25/tcm (LoI paragraph 23) per January 1 of each of the years 2005–2007, will not be lower than the average exchange rate in the month of November preceding the date of the increase.

VIII. Ceiling on the Assumption of Enterprise Debt to Banks by the Consolidated General Government and on the Issuance of Domestic Government Guarantees on Bank Lending to Enterprises

The ceiling applies to the cumulative stock from end-March 2004 of newly guaranteed or assumed domestic debt by the consolidated general government. For program purposes, the assumption of enterprise debt to banks by the consolidated general government and the issuing of a guarantee to assume enterprise debt to banks are treated as being equivalent. This limit includes any loan on which the government pays or guarantees interest, even if the principal is not guaranteed. The consolidated general government is defined in Section III of this attachment. The criterion also applies to the use of AVAS resources for recapitalizing enterprises or as collateral for bank loans. Foreign currency denominated loans will be converted at accounting exchange rates specified in consultation with Fund staff.

This ceiling excludes:

- the contracting or guaranteeing of external debt, for which separate limits are set out in Section IX of this attachment;
- debt transferred in the process of bank restructuring, privatization or liquidation of state-owned enterprises; and
- the assumption of debt as a result of an activation of a guarantee or collateral.

Data for monitoring purposes shall be supplied monthly to the IMF by the Ministry of Finance. The stock of guarantees and debt assumed as described in this section was lei 746 billion as of end-March 2004.

IX. Ceilings on Contracting or Guaranteeing of External Debt

The ceilings apply to the cumulative flow since the beginning of each year of newly contracted or guaranteed external debt by the consolidated general government. The consolidated general government is defined in Section III of this attachment. This performance criterion applies not only to debt as defined in point No. 9 of the IMF Guidelines on Performance Criteria with Respect to Foreign debt adopted on August 24, 2000 (Executive Board Decision No. 12274–(00/85)) but also to commitments contracted or guaranteed for which value has not been received. The ceilings also apply to any assumption of loans for debt outstanding which were not previously contracted or guaranteed by the consolidated general government. Excluded from the ceilings are liabilities to the IMF and bridge loans from the BIS, foreign banks, foreign governments, or any other financial institution. Debt falling within the ceilings shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective. Loans considered concessional are also excluded from the ceilings. Off-budget debt includes all debt to non-budget entities from private sector creditors guaranteed by the Ministry of Finance. Loans for fuel imports for Distrigaz, Romgaz, Termoelectrica, and the 23 heat-producing units which were transferred from Termoelectrica to local authorities, and any further units externalized during the program, are included in the overall ceilings, and the appropriate off-budget guaranteed debt ceilings.

Concessional loans are defined as those with a grant element of at least 35 percent of the value of the loan, using currency-specific discount rates based on the commercial interest reference rates reported by the OECD (CIRRS) in effect at the time of contracting or guaranteeing the loan.

The ceiling for 2005 on contracting and guaranteeing external debt with maturity over one year includes an Eurobond in the amount of €600 million In case an Eurobond is not issued or is issued for a smaller amount, the ceiling will be adjusted downwards by 100 percent of the shortfall on a cumulative basis beginning end-March 2005 as follows:

March 2005	US$ 780 million
June 2005	US$ 780 million (indicative target)
September 2005	US$ 780 million (indicative target)
December 2005	US$ 780 million (indicative target)

For the purposes of this adjustor only, an exchange rate of US$1.3/€1 will be used.

The 2005 ceiling will also be adjusted upwards in the amount of those agreements included in the 2004 ceiling but not guaranteed during that year. Those guarantees, and the associated maximum adjustments (to be converted into US dollars at prevailing rates at the time of the transaction) , would be limited to SNR broadcasting for modernization of TVR1 and TVR2 (US$ 70 million), TAROM purchase of 4 aircraft (US$38.5 million), Electrocentrale CET Bucuresti Vest (€122 million), Unit 2 Cernavoda (€223.5 million), CFR (US$30 million), CET PALAS (US$40 million), Transelectrica Brazi Vest (JPY 3000 million), Hidroelectrica modernization of Group VI (CHF 30 million), EBRD Portile de Fer (€ 30 million), Transelectrica Gutinas (€25 millioni), and CET Deva (€33.4 million).

The ceilings shall be monitored from data supplied monthly to the IMF by the Ministry of Finance. The accumulated since January 1 flow of contracted or guaranteed debt at end-March 2004 was US$157 million for maturities over one year (US$1 million of which was off-budget), US$1 million for the subceiling of debt with maturity of one to three years (all of which was off-budget), zero for debt with less than one year maturity.

Nonaccumulation of external payments arrears of the government will be a performance criterion monitored on a continuous basis. For program purposes, arrears with respect to called-up sovereign loan guarantees are defined as external payments overdue more than 30 days.

X. Indicative Targets for Ceilings on Broad Money

Broad money is defined as the liabilities of the banking system with the non-bank public. Broad money includes foreign currency deposits of residents, but excludes government deposits and deposits of foreign monetary institutions and other non-residents. For the purposes of the program, deposits which are denominated in foreign currency will be converted into lei at the program exchange rates specified in consultation with Fund staff.

Data on broad money will be monitored from the monthly monetary survey data, which shall be supplied to the IMF monthly by the NBR. The stock of broad money was lei 481,460 billion as of March 31, 2004.

XI. INDICATIVE TARGETS FOR CEILINGS ON BANKING SECTOR'S TOTAL EXPOSURE TO STATE-OWNED ENTERPRISES

Total exposure covers all loans, advances, holdings of debt and off-balance sheet exposure of resident banks to state-owned enterprises. Data on loans will also be reported separately from total exposure. State-owned enterprises are all regie autonomes, national and commercial companies with majority ownership by the general government, as defined in Section III of this attachment. For the purposes of monitoring, foreign currency denominated debt will be converted in lei at end-month leu/U.S. dollar exchange rates specified in consultation with Fund staff. Foreign currency denominated credit in convertible currencies, other than the U.S. dollar, shall be converted at their respective exchange rates against the U.S. dollar as specified in Section II. Data on banking sector lending to state-owned enterprises will be monitored from monthly data provided by the NBR.

The amount of total exposure, as reported by the NBR, will include (on a cumulative basis from end-March 2004):

(i) exposure to companies where the majority ownership shifted to the private sector. For this purpose, AVAS and the relevant ministries will provide a monthly update of their portfolio to the NBR;

(ii) any amount of debt or off-balance sheet write-offs; and

(iii) any assumption of debt or off-balance sheet items by the general government or other public bodies.

The amount of total exposure will exclude BCR's performance guarantees to the company Romtechnica, incurred before 1989, which are assumed by the state but still kept in BCR accounts as an off-balance sheet item.

Additionally, the NBR will report monthly on total exposure of the banking system to state-owned enterprises with outstanding exposure over lei 100 billion, on a company-by-company basis. The stock of banking sector exposure to state-owned enterprises at program exchange rates as of March 31, 2004 was lei 49,260 billion of which BCR's exposure was lei 17,377 billion.

XII. INDICATIVE TARGETS ON THE TOTAL PUBLIC SECTOR DEFICIT FINANCING

The Public Sector Deficit Financing is monitored on a monthly basis and compiled by the Ministry of Finance, with data also supplied to the Ministry by the NBR and the National Securities and Exchange Commission (CNVM). It consists of the financing of the consolidated general government as defined in Section III and the state-owned enterprises.

<u>The consolidated general government financing</u> consists of net external financing, non-bank financing, and bank financing. **Net External Financing** comprises sovereign bond and BOP

support loans, on-budget project financing, leasing operations of ministries and local governments, and T-bills, issued domestically, held by non-residents (computed separately in lei and foreign exchange). **Non-Bank Financing** comprises privatization receipts (total privatization receipts of all components of the general government independent of whether they are transferred to the treasury), asset recovery (AVAS receipts from asset recovery transferred to the consolidated general government), municipal bonds (bonds issued by the municipalities either domestically or internationally, computed as the difference between issuance and redemptions during the month), and T-bills and bonds held by the non-bank public (computed separately in lei and foreign exchange). **Bank Financing** is defined as the sum of T-bills and bonds in lei held by banks, T-bills and bonds in foreign currencies held by banks, bank loans in lei and foreign currencies, decrease in government deposits in lei (a positive number indicates a decline in deposits), and decrease in government deposits in foreign currencies (a positive number indicates a decline in deposits).

The state owned enterprises financing consists of net external financing, bank financing, and the accumulation of arrears. **Net External Financing** comprises of state-guaranteed bills and bonds (excluding called guarantees and including state-guaranteed fuel imports), bills and bonds without state guarantee, state-guaranteed loans (excluding called guarantees), and loans without state guarantee. **Bank Financing** is defined as the sum of the increase in credit to SOEs (computed separately in lei and foreign exchange), and decrease in SOEs deposits (computed separately in lei and foreign exchange; a positive number indicates a decline in deposits). The **accumulation of arrears** is defined as increase of arrears to the general government by the group of 72 large monitored SOEs, excluding interest and penalties as specified in the law.

The monthly flows of financing are approximated by the following methodologies:

(i) for stocks in lei—change of stocks between the end of the respective months;

(ii) foreign exchange stocks expressed in lei are first converted in U.S. dollar stocks using the end-month leu/U.S. dollar exchange rate. Then the change in U.S. dollar stocks is converted in lei by using the monthly average leu/U.S. dollar exchange rate;

(iii) foreign exchange flows expressed in U.S. dollars are converted in lei by using the monthly average leu/U.S. dollar exchange rate; and

(iv) conversion of stocks and flows in foreign currency other than the U.S. dollar in U.S. dollars is done according to the convention of the reporting institution (usually, the market exchange rate either at the time of the transaction or at the end of the month).

The principal providers of data are:

(i) the Ministry of Finance on:

- sovereign bonds and BOP support loans;
- on-budget project financing;
- privatization receipts;
- asset recovery;
- state-guaranteed bills and bonds;
- state-guaranteed loans (excluding called guarantees); and
- the accumulation of SOE arrears to the general government by the group of 72 large monitored SOEs.

(ii) the NBR on:

- leasing operations of ministries and local governments;
- T-bills, issued domestically, held by non-residents;
- T-bills and bonds held by the non-bank public;
- T-bills and bonds in lei and foreign currencies held by banks;

- bank loans in lei and foreign currencies, including to the "National Road Administration" (AND);
- decrease in government deposits in lei and foreign currencies, including deposits of the "National Road Administration"(AND) ;
- externally issued bills and bonds by SOEs without state guarantee,
- external loans to SOEs without state guarantee;
- domestic bank loans to SOEs; and
- decrease in SOEs deposits with domestic banks.

(iii) the National Securities and Exchange Commission on local government bonds.

Statement by the IMF Staff Representative
September 22, 2004

1. This statement summarizes information that has become available since the issuance of the staff report for the first review under the Stand-By Arrangement. New information underscores the importance of implementing the policies agreed under the program.

2. All prior actions have been met, with the last one, on the pension adjustment in 2005, completed on September 16, four working days before the advanced Board date. Regarding the prior action on forced execution of tax claims, in the case of one company the authorities opted for initiating bankruptcy, which achieved the same objective of strengthening collections.

3. The authorities have replaced an existing grant scheme for supporting investment in small- and medium-sized enterprises with a new scheme rebating in certain circumstances the tax paid on reinvested profits, up to US$120,000 per enterprise. While the scheme is not in line with a structural benchmark under the program on refraining from introducing distortionary tax incentives, staff considers that it will not have macroeconomic implications given the small amounts involved (0.01 percent of GDP in 2005). Nevertheless, staff regrets the introduction of this distortive scheme, which also raises transparency issues, and urges the authorities to review the scheme. Staff will raise the issue with the authorities in the context of the next review.

4. New data suggest that macroeconomic developments remain broadly in line with the program:

   - The 12-month CPI inflation rate rose to 12.4 percent in August. The outcome is somewhat higher than what could have been expected after the overperformance in reducing inflation in H1 of 2004, but still in line with the end-year target of 9 percent, owing to the one-off increases in administered prices in the same period of 2003.

   - Current account data for July 2004, at a level similar to July 2003, suggest that domestic demand pressures continue, thus confirming the staff assessment of the risk for the annual outcome.

   - Fiscal policy is on track, with the general government deficit for January-July amounting to 0.5 percent of annual GDP, including a loan to Termoelectrica equivalent to 0.3 percent of GDP to be repaid later this month—implying an underlying deficit of 0.2 percent of GDP.

   - Credit growth in July, while lower than in late 2003, continued its recent upward trend. On the positive side, credit to private enterprises is now outpacing credit to households; on the negative side, foreign currency credit growth continues to stay stronger than lei credit growth.

- In July, economy wide net wage growth fell somewhat, to 8 percent in real terms compared to a year earlier. Real wage growth in the monitored state-owned enterprises was 2 percent, in line with the program.

- To prevent nominal appreciation, the NBR has bought €250 million so far in September, bringing total purchases to €1.4 billion for Q3. It also cut its policy rate by a further 50 basis points, to 20.4 percent on a compounded basis.

- Standard and Poors upgraded Romania's long-term sovereign foreign currency debt to BB+ from BB, with a stable outlook.

- In line with the signed contract with the successful bidder, the authorities submitted to parliament a law on the sale of the controlling share in Petrom.

- Collection rates in the gas and electricity sectors utilities have remained close to 100 percent in July and August, while payment arrears are being collected.

- The government, under pressure from the unions, recently granted teachers a 23 percent wage increase. In 2004, this increase will be financed from the reserve fund; the government intends to offset the impact on the 2005 budget (0.15 percent of GDP) through employment cuts in the education and other parts of the budgetary sector. This development underscores the importance of resisting further wage pressures in the run-up to the November elections.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 04/200
FOR IMMEDIATE RELEASE
September 23, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes First Review of Romania's 24-Month Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) has completed the first review of Romania's economic performance under a 24-month Stand-By Arrangement (SBA). In doing so, the Board approved a request for a waiver for the non-observance of the end-June quantitative performance criterion on the ceiling on arrears of private enterprises to the state budget and the four social security funds. The Romanian authorities have not made a purchase so far and intend to continue treating the arrangement as precautionary.

The IMF's Executive Board approved the Stand By-Arrangement on July 7, 2004 (see Press Release No. 04/137) for an amount equivalent to SDR 250 million (about US$367 million).

Following the discussion of the Executive Board, Mr. Agustín Carstens, Deputy Managing Director and Acting Chair, said:

"Underpinned by the continuing favorable performance of the Romanian economy, the authorities' program sustains prudent macroeconomic policies, and includes a strengthening of the finances of state-owned enterprises through energy price adjustments and wage restraint, and the wide-ranging structural reforms necessary to prepare the economy for EU accession. The authorities have appropriately tightened fiscal policy in response to the recent strengthening of domestic demand, and implemented measures to slow rapid credit growth.

"The 2005 budget will introduce a far-reaching tax reform. Cuts are envisaged in the profit, income, and social security taxes, while excises will increase substantially, in line with EU requirements. To avoid risking the achievement of the 2005 deficit target, the fiscal impact of the tax reform will need to be monitored closely and revenue collections further strengthened. The budget includes welcome measures to restrain expenditures, particularly on subsidies. Looking forward, expenditures will need to be carefully prioritized to make room for EU accession-related investment spending.

"Monetary policy continues to aim at achieving gradual disinflation and averting excessive real appreciation. The scope for further interest rate cuts depends on prospects for sustained reduction in inflation. To address pressures from strong capital inflows, the National Bank of Romania has appropriately decided to allow more flexibility of the exchange rate. The authorities have moved quickly to curb rapid expansion in foreign-currency denominated credit and stand ready to take further measures, if necessary, supported by efforts to improve banking supervision.

“The authorities are confronting long-standing problems of tax arrears and a lack of hard budget constraints on state-owned enterprises. Regarding arrears, they are taking measures against private companies, including forced collection and bankruptcy procedures. For the state-owned enterprises, they need to proceed with downsizing the loss-making mining and railway sectors, supported by assistance for retraining and relocation. The privatization program will proceed, with future efforts concentrating on the energy sector. Continued adjustment of electricity and heating prices in line with costs, and adjustment of producer gas prices to import parity will be crucial for strengthening the finances of the sector.

“In 2004, the authorities have implemented important measures to improve the business climate. These include stepped-up efforts to improve governance by fighting corruption and ongoing reform of the judiciary, and a planned review of the labor code in 2005, with a view to improving flexibility in labor markets,” Mr. Carstens said.

Statement by Jeroen Kremers, Executive Director for Romania and Lucian Croitoru, Senior Advisor to Executive Director
September 22, 2004

The broad picture

The Romanian authorities appreciate the staff report, which accurately assesses both the country's performance since the beginning of the year and the program implementation. The authorities acknowledge that the report provides a realistic view of the policy challenges ahead, broadly agree with staff recommendations, and intend to continue treating the arrangement as precautionary. This program has front loaded conditionality and the authorities are pleased that the program is on track, with all performance criteria (PC) met—with the exception of the PC on private sector tax arrears to the general government. Based on corrective actions agreed with staff, the authorities requested a waiver for nonobservance of the PC and a modification in the end-September and end-December PC on private sector tax arrears, to allow time for the corrective actions to take hold. The authorities have also requested a modification of the end-December ceiling of the budget deficit, by reducing it by 0.5 percent of GDP, in line with their decision to tighten fiscal policies.

Macroeconomic developments are in line with the program and progress has been made in implementing structural reforms. With strong exports and stronger than expected domestic demand, GDP growth accelerated to 6.6 percent in the first half of 2004. Supported by tight fiscal policy, reduction in losses in state-owned enterprises (SOEs)**,** and prudent monetary policies, inflation moved down from 14 percent at end-2003 to 12 percent in August 2004. The annual 2004 target of 9 percent is likely to be met, as the bulk of disinflation is expected in September-December. After falling in the first quarter of the year, the seasonally adjusted current account deficit increased to 5.7 percent of the annualized GDP in Q2, reflecting the strong domestic demand. Capital inflows are stronger than expected, reflecting mainly increased FDI and foreign borrowing by banks. The National Bank of Romania (NBR) purchased over euro 2.5 billion so far in 2004, to prevent external competitiveness erosion and bring the exchange rate closer to the target path. Official reserves reached 4.6 months of prospective imports and the NFA target for end-June was substantially overshot. The NBR also cut the policy interest rate by 3 percentage points (on a compounded basis) in the period from June to August. Fiscal performance was better than expected. Increased efforts to improve collection and the strong economy resulted in a strong revenue performance, which resulted in a deficit of only 0.5 percent of GDP in January-July. This allows the authorities to overperform for the fourth year in a row in reducing the fiscal deficit relative to the target. The structural reform agenda has advanced, particularly in the energy sector. The sale-purchase agreements for the privatization of Petrom and for two electricity distribution companies were signed in July, in line with the program. Preparations for other privatizations in the energy sector are on course and restructuring of the heating and the mining sector proceeds as scheduled. Restructuring efforts continued in the largest 72 SOEs monitored under the program. Progress has also been made in improving governance.

Looking forward, the authorities remain committed to implementation of the Fund-supported program, which is also crucial for EU accession. They agreed with staff that fiscal prudence and additional measures to tame credit growth are needed to offset the impact of the stronger-than-expected domestic demand on the current account and inflation. The authorities also decided to move forward with structural reforms needed to secure further strong economic growth and improve the business climate.

Fiscal policy

Fiscal policy will continue to play a decisive role in disinflation and in keeping the current account deficit within safe margins. To offset the effects of the stronger than expected private demand, the authorities are committed to further tightening fiscal policy. They approved a second supplementary budget, which limits the general government deficit to 1.6 percent of GDP this year, down from 2.1 percent of GDP targeted under the first supplementary budget, and 0.7 percent points below the 2003 outcome, and requested a corresponding modification of the relevant PC. The authorities will save any additional revenue overperformance and are also ready to consider spending cuts if the current account or disinflation targets would come at risk.

The authorities will proceed further with consolidation in the broad public sector in 2005, by reducing its deficit by 0.7 percentage points. Against the background of an output growth which is slower than in 2004, and the already announced tax reform, the general government deficit was targeted at 1.5 percent of GDP, 0.1 percent of GDP less than in 2004. This means that most of the adjustment in the broad public sector deficit will come from the saving-investments balance of the SOEs *via* increases in energy prices and tight wage policy.

The 2005 general government budget envisages a reduction in primary expenditure relative to GDP by 0.3 percentage points. While this is an ambitious target, the authorities are committed to keep the capital expenditure consistent with the county's infrastructure need and with the EU accession-related investment spending. To this end, the authorities will rely on better expenditure prioritization.

On tax policy, the authorities decided to reduce direct taxation at the expense of indirect taxes, and to step up the fight against tax arrears accumulation. After reaching understanding with staff on the details of the expenditure side of 2005 budget, the authorities decided to reduce the social security contribution rates by 1¼ percentage points, to cut the profit tax rate from 25 percent to 19 percent, and to cut the tax rate in the lowest bracket of the personal income tax from 18 to 14 percent. These changes in the taxes' structure are in line with the recent trend in the region and are aimed at enhancing the equitable distribution of gains from growth. To offset the revenue loss in part, the authorities will not introduce a second reduced VAT rate, and they are committed to advance the scheduled adjustments in excises from July 1, 2005, to March 1, should the revenue performance deteriorate. Additional measures, including on the expenditure side, will be implemented if the current account worsens. The authorities' effort to contain the accumulation of tax arrears were stepped-up in the second quarter of 2004 by initiating bankruptcy procedures against 65 tax non-payers out of 452 private companies with the largest arrears to the general government. Furthermore, to address the nonobservance of the performance criterion on arrears, the authorities will cover the shortfall by means of forced execution and bankruptcy procedures against 9 companies with large debts. The Ministry of Finance and the state-owned creditors will insist on proceeding with bankruptcy procedures against the second largest refinery, and will oppose any kind of judicial reorganization or other similar scheme.

Several measures will be implemented in 2005 in line with the authorities' policy to ensure the long-term sustainability of the public pension system. It has been already decided that starting with 2005 pensions will be adjusted only once a year in January, by the rate of projected yearly average inflation. However, owing to the already implemented adjustments in 2004, in January 2005 the adjustment will exceptionally be limited to 3 percent. By April 2005, the authorities will approve amendments to the Pension Law to accelerate the medium-term stepwise increase in the retirement age starting July 1, 2005, and to equalize it for men and women.

Monetary policy

The NBR will continue to focus on lowering inflation. In consolidating the disinflation trend, the NBR will take advantage of strong exports, high growth in manufacturing productivity and large foreign currency inflows, which create room for tolerating a somewhat stronger leu.

Efforts with preparations for inflation targeting (IT) will be intensified, including by making changes in the structure of information gathering, information processing, and monetary policy decision making. To this end, the NBR will rely on continued technical assistance from the Fund. A full-scale implementation of IT will be made following the accomplishment of two "dry runs" of the quarterly forecasting cycle.

The NBR will continue to be prudent in setting the policy interest rate. In response to overperformance in inflation and unexpectedly large capital inflows, and supported by the slowdown in lei credit, NBR has gradually reduced the interest rate and intends to allow higher variability in the exchange rate to discourage speculative capital inflows. These measures will reduce the interest rates differential and improve the composition of bank lending in favor of lei-denominated credit.

Although banks fully observed limits on open foreign currency positions and the overall indebtedness of non-financial sectors remained modest, renewed strength in foreign denominated credit remains a concern. The central bank has already increased reserve requirements on foreign exchange liability from 25 percent to 30 percent as of September 1. It has also expanded the database of the NBR's Credit Information Bureau to include delinquent small loans, debit and credit card frauds by cardholders, exposure of non-resident legal entities, and total exposure on groups of debtors.

Wage policy

Wage policy for 2005 is aimed at protecting the competitiveness of the Romanian economy. For 2005, the authorities agreed on a prudent annual increase of 10.7 percent in the statutory minimum wage on January 1. The authorities estimate that this increase should have little impact on economy-wide wage developments. The system of national collective contracts will be reviewed in early 2005 in the context of the overhaul of the Labor Code, with a view to implementing the new code on July 1, 2005. By end-December 2004, the government will approve the budgets of the monitored SOEs, limiting the average gross wage growth to about 7 percent and reducing employment by 2.7 percent. To strengthen the credibility of the wage bill target, the ministries will block payments equivalent to 4 percent of the quarterly wage bill in 72 monitored SOEs until the last month of the quarter, and will release these amounts only when it is clear that the respective target will be reached.

Structural reforms and the business climate

Keeping up the momentum of privatization is a top priority of the authorities. They are confident that the privatization of the two gas-distribution companies will be finalized by Q4 of 2004, and that the privatization of other companies in the energy sector will proceed according to schedule. The new management of AVAS (the privatization and assets recovery agency) has committed to accelerate divesting the companies that are within their responsibility. Thus, AVAS will liquidate or privatize another 20 small companies in Q4 2004, and at least 20 in Q1 2005.

The authorities remain committed to the energy price increases agreed under the Memorandum of Economic and Financial Policies. In addition, following recommendations from the review of electricity prices that was performed in cooperation with the World Bank, they will increase end-user electricity prices, and will abolish the national development tax, both from January 1, 2005.

The authorities approved a strategy to implement the heating sector reform. They will consult with the World Bank on implementation of all aspects of this strategy, and will prepare reports on different components of the strategy. The National Reference Price (the ceiling for producer prices) will be raised by July 2005 with a view to eliminating it by end-2007.

The restructuring of the mining sector and the improving of financial discipline in the railway sector will continue. The authorities are committed to accelerate in 2005 the restructuring of the hard coal sector, and to reduce public funds in line with the approved mining sector strategy. In the railway sector, there will be no wage increases in the remainder of 2004, and the 2005 wage bill will increase by only 8 percent.

The authorities will continue to strengthen governance. In addition to the overhaul of the Labor Code, the authorities will approve by end March 2005 legislation amending the Law on Ministerial Responsibility, to remove immunity for former members of the government.