International Monetary Fund

Romania and the IMF

Press Release:
IMF Executive Board Approves New €1.98 Billion Precautionary Stand-By Arrangement for Romania
September 27, 2013

Romania: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

September 12, 2013

Country's Policy Intentions Documents

E-Mail Notification
Subscribe or Modify your subscription

ROMANIA: LETTER OF INTENT

Bucharest, September 12, 2013

Mme. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431
U.S.A.

Dear Mme. Lagarde:

1. Under two consecutive economic programs supported by the International Monetary Fund (IMF), the European Union (EU), and the World Bank (WB) we have made significant progress in reducing macroeconomic imbalances and rebuilding fiscal and financial buffers. However, structural reforms in key areas are ongoing and Romania remains vulnerable to external shocks and turmoil in international capital markets. We therefore request approval of a new 24-month Stand-By Arrangement (SBA) totaling SDR 1,751.34 million (about €2 billion, 170 percent of quota), which we intend to treat as precautionary. The new SBA will support our comprehensive economic program for 2013–15 to maintain sound macroeconomic policies and financial sector stability, and continue structural reforms in an environment of significant external uncertainties. In conjunction with precautionary financial assistance of €2 billion under the EU's balance of payments facility and €1 billion under a Development Policy Loan (DPL DDO) provided by the WB, this arrangement will signal the international community's continued support for our policies and provide a buffer against external shocks.

2. The program will be monitored through quantitative performance criteria and indicative targets, structural benchmarks and consultation clauses, during quarterly reviews in the first year and semi-annual reviews afterwards. Table 1 in the attached Memorandum of Economic and Financial Policies (MEFP) sets out specific quarterly targets that are to be observed under the SBA for the general government overall balance, the change in arrears for the central government and social security, CPI inflation, and net international reserves, as well as for the issuance of new government guarantees on behalf of the nonfinancial private sector and public enterprises. In addition, there will be indicative targets on the current primary expenditure of the general government, net of

disbursements of pre- and post-accession EU structural funds, arrears of state-owned enterprises (SOEs) under the control of the central government, the operating balance of key SOEs, local government arrears, and net lending to beneficiaries of EU-funded projects. Table 2 attached to the MEFP sets out proposed prior actions for approval of the SBA and structural benchmarks under the SBA. The first review of the program will take place by December 20, 2013 and the second review by March 28, 2014.

3. We believe that the policies and measures set forth in the attached MEFP are adequate to achieve the objectives of our economic program. We also remain committed to preserving the achievements of the preceding two programs and adhering to previously made commitments. We stand ready to take additional measures as appropriate to ensure achievement of these objectives. We will consult with the IMF and European Commission (EC) before modifying measures contained in this Letter and the attached MEFP or adopting new measures that would deviate from the goals of the program, and will provide the IMF and the EC with the necessary information for program monitoring.

4. We recognize the importance of completing a safeguards assessment by the first review under the SBA. The National Bank of Romania will provide the information required to complete the assessment by the first review and will receive as safeguards mission from the IMF as necessary.

5. We authorize the IMF and the EC to publish the Letter of Intent and its attachments, and the related staff reports. This letter is being copied to Mr. Olli Rehn.

Sincerely,

/s/	/s/	/s/
Daniel Chiţoiu	Mugur Isărescu	Liviu Voinea
Deputy Prime Minister and Minister of Public Finance	Governor of the National Bank of Romania	Minister Delegate for Budget

ROMANIA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIESRECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

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

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

Fiscal Policy

3. In 2013, the fiscal deficit target of 2.3 percent of GDP (in cash terms, including PNDI) will be preserved, consistent with ESA deficit target of 2.4 percent of GDP. This would imply a reduction in the ESA structural deficit by at least 0.5 percent of GDP in line with the commitments under the EU's Stability and Growth Pact (SGP). In the first half of the year, the deficit reached 1.1 percent of GDP, in line with projections. However, revenues have underperformed primarily reflecting bank losses, declining imports and increase in VAT export refunds. The revenue shortfalls have been largely offset by lower than expected social transfers and spending on EU corrections. While reimbursable

spending on EU funded projects remains low, spending on national cofinancing and net lending for EU projects is in line with projections. Arrears have continued to decline at the local government level, but has started to rise again in the central government level.

4. Given the weak revenues and increasing spending pressures, we are undertaking several measures to achieve the deficit target. Public employment has been kept broadly stable as we have now removed the 1 for 7 rule and introduced a 1 for 1 rule while restructuring public administration. In June, we approved Government Emergency Ordinance 77/2013 eliminating the vacancies in public employment while maintaining a tight control on new hires and shifting employment from the central towards local governments. Nevertheless, current expenditures remain under pressure as agricultural subsidies have been frontloaded and goods and services spending has increased even as the implementation of the Payments Directive 7, shortening the settling of unpaid bills in the pharmaceutical sector, has been postponed from June to August. In addition, we have approved an Government Emergency Ordinance 42/2013 increasing the Guaranteed Minimum Income and family allowances, and increased eligibility thresholds and we also plan to simplify the asset test for these benefits to mitigate the impact of gas and energy price liberalization. Furthermore, we extended by three years the existing legislation to provide a top-up to unemployment benefits for some SOE layoffs and have so far provided the benefit to one large SOE. Spending commitments at the local government level is also on the rise as shown by increasing overdue bills. We are also reducing the VAT on bread and the production chain from September. To offset the revenue loss, we will increase excises on alcohol and luxury cars and goods. Unspent allocations for EU funds corrections will provide some savings while further cuts in domestically financed capital spending will also be needed. Moreover, all unexecuted contracts for PNDI projects have been cancelled while projects executed under the PNDI have been folded within the budget. An independent audit of the projects committed under the PNDI program will be conducted to ensure that they are properly executed and invoiced. In the event of lower than forecasted revenues, the government remains committed to achieving the annual deficit target.

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

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

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

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

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

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

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

- Improved prioritization of capital projects shifting funding away from domestic resources towards EU sources would help improve the fiscal deficit while increasing EU absorption. We will staff the Public Investment Evaluation Unit at the Ministry of Public Finance by end-September 2013 and make it functional with the support of the World Bank. This office will help strengthen quality control in the preparation, prioritization, appraisal and management of significant new public investment projects. We will approve a government ordinance defining the prioritization criteria for public investment projects (prior action). By mid-October 2013, we will approve, by government memorandum, a list of significant prioritized projects, based on the prioritization criteria, to help prepare for the 2014 budget (structural benchmark) and the 2014-2020 EU Financial Perspective. To the extent possible, we will seek to shift the projects that need cofinancing of local government projects onto EU funded projects. To this end, we will update and improve the database of prioritized investment projects for the central government and local government projects financed by the central government and the EU funds over the medium term and publish the list of projects included in the budget on the website together with their rolling three year budgetary allocations. From 2014, no new significant public investment project financed by the central administration will be approved without first vetting by the Public Investment Evaluation and

Monitoring Unit. We will prepare by mid-October 2013 an implementation mechanism to vet eligibility for EU funding as part of our medium-term budget planning.

- As the managing authorities seek to ramp up spending, better budgetary planning will be necessary to accommodate higher co-financing and needed financial corrections. We will prepare medium-term financial projections, by mid-October 2013, that properly identifies the fiscal implications of EU funded projects (structural benchmark) and allows proper monitoring of the spending on EU funded projects by managing authorities. To allow greater flexibility in financing of EU funded projects given lags in reimbursement, net lending of EU structural and cohesion fund projects will be provided within a ceiling on net lending of 3 billion lei (set as an indicative target). We will ensure that spending on non-eligible projects is limited to 2 billion RON. We will continue to implement fully the Priority Action Plan for the absorption of Structural and Cohesion Funds.
- Before contracting public-private partnerships (PPPs) and issuing guarantees for PPPs and concessions, the World Bank will assess MoPF capacity to (1) provide inputs to the PM/Line ministries unit to develop a methodology for identifying and evaluating fiscal commitment to PPPs, (2) assess the affordability of PPP fiscal commitment as an input to approval of any initiative, and (3) develop guidelines for incorporating PPP project in decision-making at the level of MoPF at various stages of PPP project life cycle (identification, preparation, bidding, implementation).

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

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

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

12. **Tax policy:** We aim to improve the efficiency and revenue-raising capacity of the tax system. In January 2013, we enacted measures to move VAT collection onto a cash accounting basis for companies with annual turnover below EUR 500,000. We will assess the performance of this new arrangement. We will initially on a temporary basis lower the VAT on bread and its production chain to 9 percent and have identified countervailing measures in excises to offset the budgetary impact, to be implemented from September 1, 2013. During 2014, we will assess the efficiency of these measures and decide whether they will be applied on a permanent basis. Before finalizing the 2014 budget we will revise the base for property taxes, which will vary depending on use of the property and not the legal status of the property owner. We have started the preparations for a strategy for a new oil and gas taxation and royalty regime by establishing an inter-ministerial working group. We will establish a new regime that takes effect from 2015 through 2024, if all stakeholders agree. We will receive IMF technical assistance for both work streams.

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

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

- The reforms will strengthen the contributions base; streamline hospital services reducing the redundant capacity for inpatient services in line with the national health strategy and shifting the delivery of health services away from hospitals to ambulatory and primary health care providers; develop capacity in Health Technology Assessments and evidence-based protocols; and allocate more resources towards primary and secondary preventive care.

Rather than adopting a new framework law, we have decided to pursue a more gradual approach based on modifying existing legislation. This should allow individual initiatives to proceed at different speeds and to be completed without necessarily relying on the success of all other initiatives. In April we formulated a strategic action plan for this year. We published the agreed plan on the ministry's website as a statement of government policy agreed with the IFIs, we will meet all the deadlines set and, in particular, will prepare the basic health package within the existing spending envelope by end-September 2013, which will also define the scope of the private health insurance in the health care system in the future (structural benchmark). We will also prepare a comprehensive health strategy covering also the revenue side, together with the MOPF, including a timetable for implementing legislative changes and progress indicators.

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

- To increase the share of spending on primary and ambulatory services in total health spending, we will revise by end-December 2013 the list of services, which can be contracted with primary care providers as part of the 2014 health care framework agreement. We will publish a revised list of compensated drugs by end-December 2013, to be approved by government ordinance, based on the methodology provided by a newly established unit conducting health technology assessments. The centralized procurement system for pharmaceuticals and medical devices for hospitals became operational in the first half of 2013. We will assess the system's performance at the end of 2013 and progress on the design of a centralized IT system.
- To avoid the future build-up of arrears in the hospital sector, we have shifted some financial resources from hospitals with limited competences to those in the network of regional emergency hospitals. This objective will be achieved through adjustments of the weighted-per case tariffs, while ensuring that arrears will not accumulate in hospitals with decreased funding. We amended the contracts of hospital managers in June 2013 so that they will be replaced automatically if the hospital has run arrears for three consecutive months.
- We will continue to monitor public hospital budgets to ensure that they are consistent with the expenditure programmed in the general government budget, will collect and analyze the cost of service provision across hospitals with the aim of developing benchmarks in the future, and have published online up-to-date financial statements of all public hospitals since October 2012. We signed a contract with the National Printing Office to produce 7½ million patient cards by end 2013 and the remainder for the eligible population by mid

2014. By September, we will decide on the mechanism for distribution of these cards. The electronic prescription system is now established, with 34m prescriptions produced by end of June 2013. To promote awareness and encourage the increased use of generic drugs, we will print from January 2014 the patient rights with respect to pharmacists' obligation to provide full information on available drugs on the printed prescription.

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

Monetary and Exchange Rate Policy:

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

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

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

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

Financial Sector

21. The Romanian banking sector maintains reassuring capital buffers and provisioning but faces continues pressures on asset quality, and from foreign bank deleveraging, while also remaining vulnerable to external shocks. Annual credit growth to both corporates and households remains negative. Non-performing loans (NPLs) rose to 20.3 percent of total loans at end-June 2013 (compared to 14.3 percent at end-2011) reflecting the difficult economic environment, slow credit growth, deteriorating quality of loans, and difficulties in removing NPLs from bank balance sheets. However, provisions (with a prudential filter) were sufficient to cover a comfortable

88.3 percent of NPLs while the IFRS provisioning ratio stood at 62.8 percent at end-June.[1] The provisioning requirements along with the high cost base led to a loss in the banking system in 2012 but allowed for a small profit in the first half of 2013. In light of the still difficult economic environment, in particular as regards corporate and household balance sheets as well as low credit demand, prospects for bank profitability remain challenging. The capitalization of the banking sector remained strong at 14.7 percent at end-June 2013 albeit with some differences between banks. Overall, system household and corporate deposits have only increased by around 10 percent since end-2011. While the liquidity situation has improved for the banking system, funding conditions are still uneven among some banks. The pace of foreign-owned bank deleveraging has accelerated in line with regional developments but remains orderly so far with a parent funding decline of 26 percent since 2011. Risks from continuing parent funding retrenchment remain elevated and could be an impediment to the credit growth recovery should credit demand pick up sizably. The system-wide loan-to-deposit ratio stood at around 114 percent at end-June 2013, declining from 117 percent at end-2012 and at end -2011.

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

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

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

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

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

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

27. Given the substantial NPL overhang, the authorities will remove, where possible, impediments to corporate and household out-of-court debt restructuring and NPL resolution. The NBR has clarified in a letter to the banking system that under the IFRS framework banks do not necessarily have to exhaust all legal means to remove fully-provisioned NPLs from their balance sheets. The NBR will hence urge banks within the IRFS framework to remove fully-provisioned NPLs (especially for unsecured consumer loans) from their balance sheets in a timely manner. To maintain a prudent provisioning stance on collateral treatment, the NBR will not consider additional collateral deductions unless significant progress on banks' NPL removal of unsecured (consumer) loans has been made. Any agreed further changes to the current regime will be agreed with the IMF and EC. As part of the prudential arrangements that would continue to apply in 2013, the prudential filter will remain in place in the current form, in line with evolving EU regulatory developments.

28. To foster the development of a viable distressed debt market, we will resolve possible discrepancies in the fiscal code and accounting rules on the treatment of NPLs sold to domestic debt management companies in line with the outcome of the pending EC infringement case structural benchmark, by end-December 2014. We will also conduct an impact study on the fiscal

costs from the tax deductibility of the sale of intra-group bank receivables (by end-December 2013) and of non-bank receivables (by end-August 2014).

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

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

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

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

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

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

Energy and transportation sector reforms

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

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

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

the public service obligations (PSO) and removed the international and inter-city trains from the PSO. We also closed the most unprofitable routes for passenger traffic.

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

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

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

we will authorize through a General Shareholders Meeting the current interim board to take decisions in accordance with law 31/1990 (prior action). More broadly, we will undertake and publish an independent government-wide assessment of the implementation of the Government Emergency Ordinance (109/2011). Following the assessment, we will develop guidelines for its implementation across all ministries. We will also seek passage of the SOE corporate governance law in parliament by end-September 2013 which gives legal responsibility to the MOPF to supervise its proper implementation. The Fiscal Council plans a report on the operations and its fiscal implications in SOEs. Moreover, we will take steps, with support from the World Bank, to improve the monitoring function of the SOE oversight directorate in the Ministry of Public Finance.

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

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

- **Nuclearelectrica (**nuclear energy producer): Launch an initial public offering (IPO) of 10 percent of the government’s shares by end-September 2013.

- **Romgaz** (natural gas producer)**:** Launch an IPO of 15 percent of the government's shares by mid-November 2013 (structural benchmark). In advance, we will obtain approval of the Financial Supervision Authority (FSA) for use of global depository receipts and complete an environmental impact study. A decision to expand the size of Romgaz's board following the IPO has also been taken. As a prior action, we will clarify the tax treatment of securities bought in Romgaz traded on the foreign stock exchange and adopt, if needed, the necessary legal basis.
- **Electrica** (electricity distribution, supply, and service)**:** Launch an initial public offering of a majority of the government's shares, after the planned capital increase, by end-May 2014 (structural benchmark). In preparation, we will hire a transaction advisor for the IPO by mid-September 2013. Work is currently underway to determine what to do with five of Electrica's six regional service companies. At least three, but possibly all five may have to be separated from Electrica for eventual liquidation. Electrica's minority shareholdings in already privatized distribution companies could be a major area of uncertainty for the IPO and these share holdings will be taken out of Electrica prior to the IPO. We will also address the issue of non-payment by CFR for its electricity purchases from Electrica ahead of the IPO.
- **Oltenia** (thermoelectric generator)**:** In view of Oltenia's investment needs, we planned ahead of majority privatization an IPO of a 15 percent of the government's shares, prior to the planned capital increase, by end-October 2013 and hired a transaction advisor for this in May 2013. Subsequently, we decided to delay the IPO until end-June 2014 (structural benchmark) after the audited financial statements for 2013 are available and a study of the coal reserves is conducted.
- **Hidroelectrica** We planned an IPO of a 10 percent of the government's shares, after the planned capital increase, by end-October 2013. However, a court challenge to the government decision to conduct the IPO and the government's subsequent appeal of the court decision has delayed the process. The Ministry of Economy, the General Secretariat of the Government and Hidroelectrica submitted to the Court of Appeal the withdrawal of their respective appeals and asked for the Court to consider the withdrawal requests on an expedited basis. We will issue a new government decision for an IPO of 10 percent, in accordance with all required procedures. The government will sign a contract with the transaction advisor selected through a competitive process already in 2012 for the IPO which will be launched by end-June 2014 (structural benchmark), provided a Court decision is made by end-September, 2013.

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

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

43. A high quality and extensive road network is a critical infrastructure component of a welcoming business environment for investment and a well functioning economy. To focus our efforts on increasing the absorption of EU funds in the 2014–2020 funding period, we will create an agency within the government dedicated to the development of highways eligible for EU funding.

The state-owned roads company also intends to minimize capital spending on existing projects in 2013, with a view to reducing arrears towards zero. The company will not lengthen the invoice certification procedures outside legal requirements.

Labor Markets

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

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

Table 1. Romania: Quantitative Program Targets

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

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

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

Table 2. Romania: Proposed Conditionality

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

ROMANIA: TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This Technical Memorandum of Understanding (TMU) defines the variables included in the quantitative performance criteria and indicative targets set out in the Memorandum of Economic and Financial Policies (MEFP), the key assumptions, the methods to be applied in assessing program performance, and the reporting requirements to ensure adequate monitoring of economic and financial developments. The quantitative performance criteria and indicative targets, and structural benchmarks for 2013 and 2014 are listed in Tables 1 and 2 of the MEFP, respectively.

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

3. For the purposes of the program, the *general government* includes the entities *as defined in the 2013 budget*. These are: the central government (state budget, self-financed state entities included in the budget, etc.), local governments, social security funds (pension, health, and unemployment), and the road fund company. This definition of general government also includes any new funds, or other special budgetary and extra budgetary programs that may be created during the program period to carry out operation of a fiscal nature as defined in the IMF's *Manual on Government Finance Statistics 2001*. The authorities will inform the IMF staff of the creation of any such new funds or programs immediately.

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

A. Floor on the Change in Net International Reserves

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

5. NIR of the NBR are defined as the euro value of gross foreign assets of the NBR minus gross foreign liabilities of the NBR; and will be measured on the basis of the NBR's operational rather than accounting definitions. Non-euro denominated foreign assets and liabilities will be converted into euro at the program exchange rates and gold price.

6. Gross foreign assets of the NBR are defined to include the NBR's holdings of monetary gold, SDRs, the country's reserve position at the IMF, holdings of cash, securities and deposits abroad in convertible foreign currencies. Excluded from reserve assets are: (i) precious metals other than monetary gold; (ii) assets in nonconvertible currencies; (iii) illiquid assets; (iv) any assets that are pledged, collateralized, or otherwise encumbered, unless there is also a gross foreign liability associated with it; (v) claims on residents; and (vi) claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).

7. Gross foreign liabilities of the NBR are defined as all foreign exchange liabilities to residents and nonresidents, including commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options), banks' foreign currency deposits against reserve requirements, and all credit outstanding from the IMF, but excluding government foreign currency deposits at the NBR.

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

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

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

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

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

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

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

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

9. The quarterly consultation bands around the 12-month projected rate of inflation in consumer prices (as measured by the headline consumer price index (CPI) published by the Romanian Statistical Institute), are specified below. Should the observed year-on-year rate of CPI inflation fall outside the outer bands specified below, the authorities will complete a consultation with the IMF on their proposed policy response before requesting further purchases under the program. In addition, the NBR will conduct discussions with IMF staff should the observed year-on-year rate of CPI inflation fall outside the inner bands specified for the end of each quarter in the table below.

Inflation Consultation Band

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

C. Performance Criterion on General Government Balance

10. The budget deficit will be monitored quarterly through the cash balance of the general government in GFS 1986 classification. Consistent with the national methodology, revenues and spending for EU funds will be treated on an accrual basis. Any privatization receipts will be treated below the line item. The authorities will consult with IMF staff on corrective measures in the event of shortfalls in government revenue and financing. The 2014 budget will be prepared according to the GFSM 2001 methodology. The 2013 fiscal execution data will be presented in both GFSM 2001 and the methodology described above.

Cumulative Floor on General Government Balance[1]

	(In millions of lei)
End-June 2013 (actual)	-6,621
End-September 2013 (performance criterion)	-9,181
End-December 2013 (performance criterion)	-14,700
End-March 2014 (indicative)	-4,000
End-June 2014(indicative)	-6,200

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

11. The cumulative floor on the general government balance will be adjusted downward by the spending on national cofinancing of EU funded projects (excluding cofinancing from the top-up funds) exceeding 4,221 million RON at end-September 2013 and 5,886 million RON at end-December 2013, up to a limit of 600 million RON.

12. The Ministry of Public Finance (MOPF) will also provide monthly data to measure the deficit from below the line. The balance of the general government measured from below the line will include:

+ (i) net external financing, excluding valuation gains and losses;
+ (ii) change in net domestic credit from the financial system, excluding valuation gains and losses from deposits denominated in foreign currency and including adjustments for;
  + (a) received EU funds not yet spent (advance payments);
  + (b) claims of the government on EU funds;
  + (c) property fund obligations not yet paid;
+ (iii) change in the stock of issued government securities, net of valuation changes;
+ (iv) net changes in other financing;
  of which: (a) temporary financing for EU projects;
  (b) reimbursement payments from EU for the EU projects

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

13. If the difference between the general government deficit measured from above the line and from below the line is larger than lei 200 million each quarter during 2013 and 2014, the MOPF will consult with IMF staff.

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

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

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

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

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

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

16. The performance criterion established on the stock in domestic payments arrears of the central government and social security sector (as defined in ¶3 above) contemplates their elimination during the program period. The stock will be measured net of intergovernmental arrears, but both gross and net arrears will be reported by the government. In case of need, the government will take corrective measures to prevent the accumulation of new spending arrears. For the purpose of the program, arrears mean accounts payable past due date by 90 days (in line with ESA95 definitions for expenditures). The authorities will consult with IMF staff if new arrears are disputed following an audit by the Central Harmonisation Unit for Financial Management and Control Systems. As a memorandum item, arrears of central government hospitals will be reported separately.

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

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

17. The general government will not accumulate external payment arrears during the program period. For the purposes of this performance criterion, an external payment arrear will be defined as a payment by the general government that has not been made within seven days of falling due. The performance criterion will apply on a continuous basis.

H. Indicative Target on General Government Current Primary Spending

18. The indicative target on current primary expenditure of the general government is defined as spending on personnel, goods and services excluding EU funds (specified under external grant category), subsidies, transfers to public entities, pensions (social security budget in social assistance category), state aid and other spending in other transfers category, Reserve Fund, and other expenditure as classified in the monthly reporting tables. Actual data (to which the target will be compared) should include payments related to arrears reduction plans and spending funded through the clawback tax.

Cumulative Change in General Government Current Primary Expenditures[1]	(In millions of lei)
End-June 2013 (actual)	70.412
End-September 2013 (performance criterion)	106.300
End-December 2013 (performance criterion)	147.509
End-March 2014 (indicative)	36.700
End-June 2014 (indicative)	74.400

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

I. Indicative Target on Local Government Arrears

19. The indicative target on the stock of domestic payments arrears of local governments contemplates no accumulation of new arrears and their reduction during the program period. In case of need, the government will take corrective measures to prevent the accumulation of new spending arrears. For the purpose of the program, arrears mean accounts payable past the due

date by 90 days (in line with ESA95 definitions for expenditures). As a memorandum item, arrears of local government hospitals will be reported separately on a quarterly basis.

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

J. Absorption of EU Funds

20. The EU funds contribution mentioned in the MoU conditionality is to be measured taking into account the eligible expenditure from both the structural and cohesion funds (SCF) and the European Agricultural Fund for Rural Development (EAFRD).

K. Monitoring of Public Enterprises

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

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

Floor on Cumulative Operating Balance[1]	(In billions of lei)
End-December 2012 (actual)	-3.3
End-June 2013 (preliminary)	-1.0
End-September 2013 (target)	-1.6
End-December 2013 (target)	-2.3
End-March 2014 (indicative)	-0.5
End-June 2014 (indicative)	-0.8

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

23. In case one of these enterprises is placed into insolvency procedures, which occurs when it is recorded in the trade registry that the enterprise was placed into insolvency or liquidation procedures, or its majority share is privatized, which occurs when payment is received from an entity, in which the government does not have a controlling interest, in exchange for the majority shares of the enterprise, the aggregate target listed above will not be adjusted by the original operating balance target for this firm. If any of the companies listed above is split into a new company, both companies will remain under monitoring. If some of the above companies are merged, the newly created companies will remain under monitoring.

24. A quarterly indicative target for the third and fourth quarters of 2013 is set on the stock of outstanding payments of public enterprises owned by the central government that were not made by the due date. The stock excludes outstanding payments past due of those public enterprises owned by the central government that are already under insolvency or liquidation procedures. The beginning date for measuring the stock is December 31, 2012. The data shall be reported at the firm level. The targets will be as follows:

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

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

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

L. Reporting Requirements for the Prior Actions

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

M. Reporting Requirements

27. Performance under the program will be monitored from data supplied to the IMF and EC by the NBR and the MOPF as outlined in the table below. The authorities will transmit promptly to IMF and EC staff any data revisions as well as other information necessary to monitor the arrangement with the IMF and EC.

Romania: Data Provision to the IMF and EC

Item	Periodicity
To be provided by the Ministry of Public Finance	
Preliminary monthly data on general government accounts, including on GFSM 2001 basis	Monthly, on the 25th day of the following month
Quarterly final data on net lending from the Treasury for EU funded projects	Quarterly, on the 5th day past the test date
Preliminary monthly data providing a breakdown of general government expenditures on post-accession EU projects (co-financing, non-eligible spending, corrections, reimbursable funds, and EU top-ups)	Monthly, on the 25th day of the following month
Quarterly final data on general government accounts, including public enterprises as defined by ESA95 and breakdown of general government spending on EU projects	Quarterly cash data, on the 35th day past the test date; Quarterly accrual data, on the 55th day past test date
The budget deficit of the general government using ESA95 definition	Quarterly, with a lag of three months
Preliminary data on below-the-line financing for the general government	Monthly, with a lag of no more than 35 days past the test date
Final quarterly data on below-the-line financing for the general government, including details of the domestic and external issuances and repayments (by currency)	Quarterly, no later than 45 days past the test date
Total accounts payable and arrears of the general government, including local governments and central and local government hospitals	Preliminary monthly, within the next month. Quarterly, within 55 days
Progress report on the status of the audit of the stock of the disputed local arrears.	Quarterly, no later than 45 days past the end of each quarter

Data on payment delays and arears with respect to drug reimbursement by the National Health Insurance House (pharmacies and wholesale), with a particular view on the implementation of directive 7	Monthly, at the end of each month
Stock of the central government external arrears	Daily, with a lag of not more than seven days
Public debt and new guarantees issued by the general government	Monthly, within one month
Preliminary monthly data on general government primary spending, net of EU disbursements	Preliminary monthly data within 25 days
Final quarterly data on general government primary spending, net of EU disbursements	Quarterly, within 35 days from the test date
Time lines showing the expected completion dates for key steps leading to the launching of the initial public offerings of the energy state-owned companies	Quarterly, within 10 days of the end of each quarter
Preliminary data on the operating balance, profits, stock of outstanding payments past due, and personnel expenditures for each key public enterprise as defined in ¶22	Monthly, within 30 days
Final data on the operating balance, profits, stock of outstanding payments past due, and personnel expenditures for each key public enterprise as defined in ¶22	Quarterly, end-May for the previous year and end-August for first half of the current year
Preliminary data on the stock of outstanding payments past due for each public enterprise as defined in ¶21	Quarterly, within 35 days
Final data on the stock of outstanding payments past due for each public enterprise as defined in ¶21	Quarterly, end-May for the previous year and end-August for first half of the current year

Data on EU project grants (reimbursements and advances), capital expenditures and subsidies covered by EU advances or eligible for EU reimbursement on EU supported projects specifically agreed with the EU	Monthly, within three weeks of the end of each month
The balance of the TSA in RON	Monthly, within two weeks of the end of each month
The balance of the two foreign currency accounts used for budget financing and public debt redemption purposes (average, and end-of-period)	Monthly, within two weeks of the end of each month
The balance of the privatization receipts registered in the account of the State Treasury, details on any claims on these receipts and projected net outflows.	Monthly, within two weeks of the end of each month
Reporting of progress in the implementation of the Romanian public administration's functional review	Quarterly, to be sent two weeks before each mission for each of the 12 ministries
Data on subsidies by ministries	Quarterly, one month after the end of the quarter. Additional reporting one week before review mission
Data on public employment and status of ordinance 77/2013 implementation, in particular numbers of staff reductions at central government ministries and staff increases at local governments	Monthly, at the end of each month
To be provided by the National Bank of Romania	
NIR data, by components, in both program and actual exchange rates	Weekly, each Monday succeeding the reporting week and with a 3 working day lag in the case of end-quarter data
Monetary survey data in the format agreed with IMF and EC staff	Monthly, within 30 days of the end of the month

The schedule of contractual external payments of the *banking sector* falling due in the next four quarters, interest and amortization (for medium and long-term loans)	Monthly, 45 days after the end of each month
The schedule of contractual external payments of the *corporate sector* falling due in the next four quarters interest and amortization (for medium and long-term loans)	Monthly, 45 days after the end of each month
The stock of short-term external debt of banks and corporate	Monthly, 45 days after the end of each month
Balance of payments in the IMF format currently used to report	Monthly, 45 days after the end of each month
Exposure (deposits, loans, subordinated loans) of (i) foreign parent banks to their subsidiaries in Romania; (ii) IFI and (iii) other creditors to banks in Romania (by national and foreign currency).	Monthly, 20 days after the end of each month
Detailed bank-by-bank data on restructured loans to households and corporates including SOEs	Quarterly, 45 days after the end of each quarter
Financial soundness indicators[2]	Monthly, 45 days after the end of each month
Foreign currency reserves including information on FX market interventions and swaps by the NBR	Bi-weekly
The IMF and the EC shall be immediately informed in case of sudden loss of reserves exceeding EUR 600 million	Immediately, upon occurrence

[2] Data on solvency should be provided on quarterly basis.