International Monetary Fund

Romania and the IMF

Press Release:
IMF Completes First Review Under Stand-By Arrangement with Romania and Approves €1.85 Billion Disbursement
September 21, 2009

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Romania: Letter of Intent and Technical Memorandum of Understanding

September 8, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC, 20431
U.S.A.

Bucharest, September 8, 2009

Dear Mr. Strauss-Kahn:

Romania is facing a severe economic downturn. While implementation of our comprehensive anti-crisis program supported by the Fund, the EU, and the World Bank has succeeded in normalizing financial conditions, the contraction in economic activity has been much sharper than projected due to a combination of an unfavorable external environment and faster retrenchment of domestic demand. We anticipate that the economic environment will remain difficult for the remainder of 2009, with only a gradual improvement during 2010.

1. Notwithstanding the challenging environment, implementation by the authorities of the IMF-supported program has been strong (Tables 1 and 2):

- *Quantitative performance criteria and inflation consultation mechanism*. All quantitative performance criteria for end-June 2009 and the continuous performance criterion on non-accumulation of external arrears have been met, with the exception of the ceiling on general government domestic arrears, which was exceeded (by 0.1 percent of GDP) due to increased arrears at the central and local government levels. The indicative target on general government primary spending was also met. Inflation was within the inner band of the inflation consultation mechanism.

- *Structural benchmarks*. The end-August 2009 structural performance criterion on ratification by parliament of fiscal adjustment measures was met in April. The structural benchmark for end-June for amending deposit insurance legislation was also met, and we will consider taking further measures in order to speed up implementation and improve the financing mechanisms for the deposit guarantee.

2. In view of this performance, we request completion of the first review under the Stand-By Arrangement. On the basis of the corrective measures being taken and the additional explanations given in this Letter, we request a waiver for the end-June 2009 performance criterion on general government arrears.

3. We believe that the policies set forth in the letter of April 24, 2009 and in this letter are adequate to achieve the objectives of our economic program, and the Government stands ready to take additional measures as appropriate to ensure achievement of its objectives. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in this letter or adopting new measures that would deviate from the goals of the program, and provide the IMF and the European Commission with the necessary information for program monitoring.

Macroeconomic Framework for 2009 and 2010

4. Domestic demand had declined more than anticipated at the time the program was agreed. Real GDP contracted by 6.2 percent (yoy) in the first quarter and we expect a further drop in the second quarter. For the year, we now expect a severe contraction of -8 to -8½ percent, with only a modest recovery in 2010, as weak financial conditions in households and rising unemployment will keep domestic demand low. External demand will improve only in line with the recovery elsewhere in Europe. The sizable output gap has helped contain price increases, and inflation has been easing; we now expect 4.3 percent growth in the CPI in 2009, followed by an easing to below 3 percent in 2010.

5. The contraction in domestic demand has set off a faster correction in external imbalances. The current account deficit fell by about ¾ in the first five months of 2009 compared to the same period of 2008, with both exports and imports falling at a sharper pace than projected under the program (around 20 and 35 percent yoy, respectively). In addition, developments in the external capital and financial account have been somewhat better than projected under the program, as a slightly lower rollover of exposures by foreign banks has been more than offset by higher rollover by corporates and stronger FDI inflows. We now project that external imbalances will adjust faster than anticipated in the original program for the year as whole. The current account deficit is expected to decline to 5½ percent in 2009 (compared to 7½ in the original program) from 12.4 percent of GDP in 2008. External financing is also projected to hold up better than expected in the original program. As a result, the NFA are projected to be about €4 billion above end-2009 program targets.

Fiscal Sector

6. Despite worsening economic conditions, efforts to control expenditure in the central government allowed us to meet the general government deficit target for end-June 2009 notwithstanding overruns in some decentralized government entities. As economic conditions remain weak, however, the deficit will rise sharply in the second half of the year. Absent further measures, deteriorating growth, lower revenue yields, and overruns in current spending, notably wages, would push the deficit to a projected 8.1 percent of GDP from the 4.6 percent agreed. Revenues are expected to fall by some RON 17½ billion (3½ percent of GDP) compared to the original program, as VAT tax revenues, social contributions, and nontax revenues fall well short. On the expenditure side, bonus reductions and reduced

staffing are producing some impact on the wage bill, but carry-over from large increases last year, especially outside the central government, have led to much higher-than-programmed increases in wages and salaries. Goods and services spending, while declining relative to last year, is also well above our desired level, while other spending has fallen short of our objectives. Together, these trends would produce excess outlays of around RON 3.3 billion (0.7 percent of GDP).

7. To strike an appropriate balance between the short-term need to allow automatic stabilizers to work and the medium-term adjustment objectives, we are committed to taking additional policy actions to limit the fiscal deficit in 2009 and to reducing it in 2010. For 2009, this will imply an additional adjustment of 0.8 percent of GDP—not only by reversing the spending overruns, but bringing total expenditures to some RON 5.7 billion below the original program level—producing a deficit of 7.3 percent of GDP while improving the composition of expenditures. This implies an adjustment of 2.2 percent of GDP in structural terms. To help eliminate overruns in current expenditure, we will establish a quarterly ceiling on current spending minus certain transfers and social payments as an indicative target under the program beginning with end-September.[1] We will undertake several emergency measures to reduce the wage bill: (i) between October and the end of December 2009, all personnel spending (including in the local governments and self-financed entities) will be subject to a reduction of 15½ percent, corresponding to a reduction in working hours equivalent to 10 working days (0.3 percent of GDP); (ii) overtime hours and premia will be cut as well, yielding an additional 0.1 percent of GDP; and (iii) we will launch the restructuring of state agencies, as described in paragraph 12 below. Other current spending will be curtailed compared to the trend in the first half of the year (0.2 percent of GDP), comprising both discretionary cuts and automatic reductions in local government and decentralized entities' spending due to lack of own resources. The capital budget will be trimmed by 0.2 percent of GDP, while preserving room for a realistic investment budget in the coming months. Government approval of legislation, including a revised 2009 budget, to apply these commitments at all levels of government will be a prior action for the completion of this review. To finance the higher fiscal deficit in 2009 relative to our original program target, we intend to have half of the remaining IMF disbursements for 2009 of SDR 3.1 billion be channeled directly to the government.

8. To reduce the risk of further payments arrears, we will take a number of corrective measures at the local and central government levels. In particular, we will: (i) clear all arrears accumulated so far this year by end-September 2009 and the entire stock of remaining arrears (which turned out higher than estimated earlier) by end-2010; (ii) we will condition access of local and self-financed government entities to central government guarantees and additional transfer payments on satisfactory performance in reducing or eliminating such arrears; and

[1] This target will replace the primary spending ceiling indicative target established previously.

(iii) we will initiate a review of the commitment control systems with a view to strengthening it during 2010 (see ¶14 below). We will increase the ceiling on public guarantees to RON7.7 billion in 2009 and RON 8.6 billion in 2010, but will insist that the increase in guarantees relative to the original ceiling of RON 6 billion be devoted exclusively to financing the counterpart payments of investment projects financed by the EU or other multilateral institutions. We are aware of an increase in delays in payments for VAT refunds to exporters, and are undertaking steps to sharply reduce these delays, and clear the stock of existing arrears by end-September 2009. We have set-up national guidelines for VAT refund applicable to all local tax administrations, ensuring that claims are processed in the order they are received and within 45 days. We are implementing an online follow-up system that will allow exporters to verify the status of their claims. We will also implement recommendations of the recent IMF technical assistance mission on improving the VAT refund processes (see ¶16).

9. For 2010, we remain fully committed to taking further measures to bring the deficit to a more sustainable level in line with the July 104.7 Council recommendations. For that year, we plan to reduce the deficit to below 6 percent of GDP, an adjustment of about 2½ percentage points of GDP in structural terms compared to 2009. On the expenditure side, we will implement measures to reduce the wage bill further, including a freeze on wages as described in ¶12 (0.3 percent of GDP), a continuation of the replacement of only 1 of 7 departing workers and cuts in overtime and premia (0.25 percent of GDP), and structural changes to reduce employment and restructure the wage system (¶12). Savings from implementation of the pension reform law (¶13) due to a higher contribution base, better control on fraudulent disability pension claims, and fewer earlier retirements should yield another 0.1 percent of GDP. A freeze on goods and services, pensions (excluding social pensions) and certain transfers, together with increased application of electronic procurement systems and some cuts in goods and services and other expenditures, are expected to yield another 0.9 percent of GDP. On the revenue side, revaluation of the tax base on property taxes and increased excises on tobacco and fuel (already legislated) will contribute 0.3 percent of GDP. We will also continue our efforts to improve the absorption of EU funds, while ensuring they target the right growth priorities. Approval of the 2010 budget in line with these commitments will be a structural benchmark for end-2009.

10. Crucial to our fiscal strategy will be a series of measures to produce longer-term savings and improve the quality of public finances via public sector reforms. We contemplate actions in six areas: (i) restructuring the public sector to reduce government employment, together with a reform of the wage system; (ii) pension reform; (iii) implementation of a Fiscal Responsibility Law and the medium-term budgetary framework; (iv) public enterprise reform; (v) restructuring the financial relations with the local governments and self-financed entities to assure greater financial accountability; (vi) improvements in tax administration; and (vii) streamlined social assistance programs.

11. **Public employment and the compensation system**. We are firmly committed to rationalizing the structure of the civil service at all levels of government. By end-2009, we will approve legislation that will produce significant reductions of public sector wage bill to secure additional gross savings of 0.68 percent of GDP (at least 0.49 percent of GDP net) in 2010.[2] This will be achieved by: (i) applying standardized norms for personnel costs and for goods and services spending, which will be developed and applied in the coming months at all levels of government to provide for a leaner public sector; and (ii) restructuring numerous state agencies in the government sector by either abolishing or incorporating them into relevant ministries. We reaffirm our commitment to a unified wage law to produce a simpler, fairer, more transparent, and less costly pay scale for public sector employees and to reform the bonus system. This will be achieved in two stages. In the first stage, an organic public wage law will be approved by end-October laying out the guiding principles and framework for the new unified public compensation system, containing specific annual limits for the wage bill to progressively reduce it to about 7 percent of GDP by 2015 (the levels prevailing before the last few years' excesses), freezing general government wages in 2010 (except for those earning less then RON705 per month), conditioning increases in the reference value (to which the public pay scale is indexed) after 2010 on personnel cuts needed to reach the wage bill targets as a share of GDP, as well as reforming the current system of bonuses (structural benchmark for end-October 2009). In the second stage, implementing legislation will be approved by end-September 2010 detailing the elements of the unified public compensation system, including the pay scale, in a manner consistent with the organic public wage law and fully costed by independent experts to assure savings before being submitted to parliament.

12. **Pension reform**. We remain committed to approving pension reforms by law by end-December 2009. The reform will be properly costed before approval to assure adequate long-term savings. In addition to ensuring a gradual move to indexation by inflation rather than by wages, and further adjustments in the retirement age, the reform will also eliminate the costly and inequitable special regimes established for certain workers as well as revisit the conditions for early retirement to ensure that incentives provide an actuarially fair system. The reform will also include changes in the allocation of disability-related pension rights to ensure that possibilities for fraud are adequately curtailed.

13. **Fiscal responsibility law.** A draft FRL has been extensively discussed within the framework of the technical assistance from the Fund and benefited from further advice from the EC, and we reaffirm our commitment to its submission to parliament (along with an implementation plan) by end-November. We will also request further technical assistance from the Fund on the implementation of the FRL, with a particular focus on tightening

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[2] This corresponds to RON 3,585 million in gross savings, and RON 2,571 million in net savings, for the wage bill.

budget execution procedures and instituting commitment control systems, with a view to addressing weaknesses that led to the recent accumulation of arrears. The findings of this mission will guide our reform actions in this area during 2010.

14. **Local governments**. Persistent overestimation of revenues and excessive current spending in local governments present a risk to macro-fiscal stability. After consultations with the local authorities, we will change the appropriate legislation to introduce several institutional reforms to mitigate this risk: (i) all local governments requesting extra resources or breaching fiscal rules will be required to sign an adjustment program with the central government stipulating the measures they plan to take to tackle overruns and fiscal imbalances and achieve the consolidation within a reasonable amount of time, with sanctions and restructuring if the agreed conditions are not met; (ii) standard costing norms will be applied across local governments to insure fairness and improve efficiency (to be legislated by end-2009, ¶12); (iii) movement of resources allocated for capital spending into current expenditure will be prohibited; (iv) a legal framework for local government insolvency will be established; and (v) the local government oversight unit at the Ministry of Public Finance, in collaboration with the Ministry of Administration and Interior, will be strengthened to monitor and analyze activities of local governments (structural benchmark for end-June 2010).

15. **Public enterprises**. To minimize the burden on public finances from state-owned enterprises (SOEs) as a result of higher subsidy requirements and lower dividend transfers, we will undertake the following legislative changes: (i) SOEs will be required to submit draft budgets to the government within 15 working days of the publication of the central government budget and collective bargaining negotiations will not be permitted until the SOE's annual budget (including its respective wage bill limits) has been approved; (ii) the total wage bill in each SOE receiving subsidies or other transfers from the budget will be established by the central government; (iii) movement of resources allocated for capital spending into current expenditure will be prohibited; (iv) automatic sanctions (personal and institutional) will be introduced for the nonobservance of the budget or of the management performance contracts; and (v) all SOEs requesting extra resources from the budget or breaching fiscal rules will be required to sign an adjustment program with the central government stipulating the measures they plan to take to improve their financial performance, with sanctions and restructuring if the agreed conditions are not met (structural benchmark for end-June 2010). We will continue to refine the monitoring system of the most problematic SOEs, with a view to setting semiannual targets on their performance at the next review.

16. **Tax administration**. Progress in revenue administration is essential to recouping the loss in revenue yield related to the economic cycle and meeting our fiscal objectives. Following recommendations from a recent IMF technical assistance team, our efforts will focus on addressing VAT non-compliance and fraud, improving management of growing tax

arrears, and increasing control of the largest taxpayers. First, on VAT we will refocus our audit program on higher-risk refund claims (including by scaling down the universal ex-ante and ex-post audit of cash refund claims and implementing a fast-track process for low-risk exporters) and will redirect staff to high-risk VAT refund *offset* claims, underreporting of sales and input credit over claims by taxpayers in a debit situation. Second, the growth in tax arrears will be addressed by improved debt management practices, including (i) the reintroduction of the authority to enter into installment agreements with taxpayers, under appropriate safeguards and in line with EU practice and (ii) amending the penalty system for noncompliance to establish separate interest and late payment charges designed to protect the real value of tax payments and to discourage nonpayment early on. Third, control of the largest taxpayers will be strengthened by: (i) ensuring that increases in taxpayers assigned to the large- and medium-size taxpayer offices are accompanied by increases in assigned audit staff; (ii) introduction of the authority to use indirect audit methods to determine taxpayers' correct tax liabilities when the records are inadequate; and (iii) directing attention toward individuals and firms where tax collection potential is highest. To improve administrative efficiency, electronic filing will be encouraged by reducing the security costs imposed on taxpayers and introducing a lower cost alternative. We will conduct further discussions with Fund staff on a timetable to direct efforts towards those taxpayers with highest tax collection potential, and approval of the necessary internal regulations and legislation to implement the remaining reforms discussed above will be a structural benchmark for end-March 2010.

17. **Social Assistance**. Legislation will be approved by end-October 2009 to streamline the social benefit system by consolidating some of the more than 200 benefits currently existing and by improving targeting of the remaining programs. At the same time, allocations for unemployment and social safety net programs will be increased to help cushion the effects of the economic downturn. We will consult with the World Bank, EU and IMF in the design of this legislation. At the time of the second program review we will discuss progress on these measures with the Fund and the EU and will take additional steps, if needed, to achieve these savings.

Financial Sector

18. The Romanian banking system has so far weathered relatively well the shock generated by the deeper than anticipated contraction in economic activity. Although non-performing loans (doubtful and loss) increased from 4.7 percent to 11.8 percent between June 2008 and June 2009, their current level is still manageable, and the system remains slightly profitable. As of end-June 2009, the average capital adequacy ratio remained broadly stable at 13.5 percent, and all banks had a ratio above 10 percent. Following the April 2009 stress-tests, banks with expected future capital needs in 2009 and 2010 are making good progress toward increases in own funds that will enable them to maintain their capital adequacy ratio above 10 percent over the entire program period. The NBR has received all 9 bilateral commitments letters from the parents of the largest foreign owned banks,

confirming their commitments made in Vienna and Brussels, including maintaining their overall exposure to Romania. Actual exposures have fluctuated however, and we are in the process of defining with the banks and implementing a comprehensive reporting format that will allow the NBR to better monitor the evolution of such exposures.

19. We continue to improve the safety net available to deal with financial distress. We have enhanced the NBR's powers to request capital increases and restrict dividend distribution for weak credit institutions, in line with the structural benchmark for June 2009. However, for the resolution of problem banks, upgrading our domestic legal norms while keeping in line with EU requirements has proved more complex than anticipated, and we now expect to complete this process in early 2010 (end-March 2010 structural benchmark). For deposit insurance, the government issued in June 2009 an ordinance to comply with the deadlines set in the EU directive to reduce the maximum payout period to 20 business days, and we are considering further improvements the financing regime, with a view to enhancing government support for deposit insurance. For overly indebted households, banks have implemented a decentralized approach to rescheduling and restructuring, with a view to preserving credit discipline. We do not consider that public action is needed at this time, but we will encourage banks to continue their restructuring efforts and will monitor the results closely.

20. The NBR is continuing to improve the banking supervisory and regulatory framework, consulting Fund staff prior to the introduction of key new or revised prudential regulations. Liquidity requirements and governance rules applicable to banks have been enhanced. Before further amending liquidity regulations we will conduct a more comprehensive impact study and consult the banking association about the results. Formally and permanently raising the minimum level of the capital adequacy ratio from 8 percent to 10 percent remains a medium-term objective. We remain committed to adopting the International Financial Reporting Standards (IFRS), and are consulting the Romanian Banking Association on the timetable.

Monetary and Exchange Rate Policy

21. Negotiation of the international support package has contributed to a reduction in pressure on the exchange rate. The leu has remained roughly stable against the euro since late March with no central bank intervention. The faster-than-projected improvement in the current account and the broadly unchanged outlook for the capital account have allowed for an overperformance on the performance criterion on net foreign assets at end-June. This overperformance will likely continue until the second review as well. Romania has received a significant SDR allocation in 2009. Given the adequate external financing provided by the multilateral support package we do not plan to use this allocation during the program period, and thus do not propose to change the NFA targets under the program.

22. With economic activity falling sharply and the exchange rate stabilizing, inflationary pressures are easing. Headline inflation fell from 6.7 percent in January to 5.1 percent by July. We expect inflation to fall further to 4.3 percent at end-2009, within the NBR's inflation targeting band. This situation has permitted the NBR to prudently relax its monetary policy stance. Since January, the central bank has reduced interest rates cumulatively by 175 b.p. in four steps, and has reduced reserve requirements on domestic and foreign currency liabilities. Looking forward, the NBR will continue to adapt its monetary policy stance as inflation and conditions in the foreign exchange market permit. However a cautious approach is warranted, as inflation in Romania remains well above the EU average and further price pressures may emerge. The NBR will continue to adequately manage liquidity with regard to evolving market conditions, in order to ensure that interest rates are appropriate for lowering inflation without jeopardizing external stability.

Program monitoring

23. The program will continue to be monitored through regular reviews, prior actions, quantitative performance criteria and indicative targets, and structural benchmarks. The quantitative targets for end-September 2009 and end-December 2009, and continuous performance criteria, are set out in Table 1; and the structural benchmarks are set out in Table 2. The understandings between the Romanian authorities and IMF staff regarding the quantitative performance criteria and the structural measures described in this memorandum are further specified in the TMU attached to this memorandum.

Gheorghe Pogea /s/
Minister of Finance

Mugur Isarescu /s/
Governor of the BNR

Attachment

Table 1. Romania: Quantitative Program Targets

	2008	2009						2010
	Dec	March	June		Sept		Dec	Dec
	Actual	Actual	Prog	Actual	Prog	Revised	Prog	Proj
I. Quantitative Performance Criteria								
1. Cumulative change in net foreign assets (mln euros) 1/	25,532	-3,500	-7,600	-5,119	-8,720	-8,720	-9,000	-500
2. Cumulative floor on general government overall balance (mln lei) 2/	-24,655	-8,300	-14,508	-14,456	-18,612	-26,900	-36,500	-31,200
3. Cumulative change in general government arrears (bn lei) 1/	1.06	0.35	0.0	0.49	0.0	0.0	-0.15	-0.91
4. Ceiling on general government guarantees issued during the year (face value, bn lei)	0.0	…	6.0	0.02	6.0	7.7	7.7	8.6
II. Continuous Performance Criterion								
5. Nonaccumulation of external debt arrears	0	0	0	…	0	0	0	0
III. Inflation Consultation								
6. 12-month rate of inflation in consumer prices								
Outer band (upper limit)	8.3	8.7	8.4	…	7.7	7.7	6.5	4.5
Inner band (upper limit)	7.3	7.7	7.4	…	6.7	6.7	5.5	3.5
Center point	*6.3*	*6.7*	*6.4*	5.9	*5.7*	*5.7*	*4.5*	*2.5*
Inner band (lower limit)	5.3	5.7	5.4	…	4.7	4.7	3.5	1.5
Outer band (lower limit)	4.3	4.7	4.4	…	3.7	3.7	2.5	0.5
IV. Indicative Target								
7. General government primary spending (excl. EU funds; mln lei) 2/	182,411	43,900	87,505	87,271	132,356			
8. General government current primary spending (excl. EU funds and social assistance, mln lei) 2/	92,327	22,149		43,238		63,725	81,015	79,604

1/ The December 2008 figure is a stock.

2/ The December 2008 figure is for the whole year.

Table 2. Romania: Structural Conditionality for the Program

Measure	Conditionality 1/	Timing	Comments
Fiscal policy			
Approval of agreed measures for 2009, including revised 2009 budget (as described in LOI¶8)	Prior action		
Ratification by parliament of fiscal measures equivalent to 1.1 percent of GDP	SB	August 31, 2009	Met in April 2009
Passage of revised public compensation legislation (as described in LOI¶12, and in ¶16 of the April 24, 2009 LOI)	SB	October 30, 2009	
Presentation of fiscal responsibility legislation and implementation plan to parliament (¶14 of the April 24, 2009 LOI)	SB	November 30, 2009	
Passage of revised pension legislation (as described in LOI¶13, and in ¶17 of the April 24, 2009 LOI)	SB	December 31, 2009	
Approval of agreed 2010 budget (as described in LOI¶10)	SB	December 31, 2009	New conditionality
Approval of legislation and internal regulations necessary to implement tax administration reforms (as discussed in LOI¶17)	SB	March 31, 2010	New conditionality
Approval of institutional reforms measures to mitigate fiscal risks from local governments and SOEs (LOI¶15-16)	SB	June 30, 2010	New conditionality
Financial Sector			
Passage of amendments to the banking law to strengthen NBR's power to request bank shareholders an increase in their share capital and limit profit distribution (¶22 of the April 24, 2009 LOI)	SB	June 30, 2009	Met
Passage of amendments to deposit insurance legislation to broaden grounds for activation of deposit insurance, expedite payouts and provide a line of credit from the government (¶23 of the April 24, 2009 LOI)	SB	August 30, 2009	Met
Passage of amendments to the banking and winding-up laws to enhance the bank resolution framework, in consultation with the IMF (¶22 of the April 24, 2009 LOI)	SB	November 30, 2009	Moved to March 31, 2010
Passage of amendments to the banking and winding-up laws to enhance the bank resolution framework, in consultation with the IMF	SB	March 31, 2010	

1/ SB = structural benchmark.

ROMANIA: TECHNICAL MEMORANDUM OF UNDERSTANDING

September 8, 2009

1. This Technical Memorandum of Understanding (TMU) updates and replaces the TMU dated April 1, 2009. It: (i) defines the variables subject to the quantitative targets specified in the Letter of Intent (LOI); (ii) describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets (Section I); and (iii) provides clarifications for some of the structural conditionality under the program (Section II). As is standard under all Fund arrangements, we will consult with the Fund before modifying measures contained in this letter, or adopting new measures that would deviate from the goals of the program, and provide the Fund with the necessary information for program monitoring.

2. For the purposes of the program, *the exchange rates* of the Romanian Leu (RON) to the euro is set at RON 3.9852 = €1, to the U.S. dollar at RON 2.8342 = $1, to the Japanese yen at RON 3.1419 = ¥100, and to the pound sterling at RON 4.1169 = £1, the rates as shown on the National Bank of Romania's (NBR's) website as of December 31, 2008. The exchange rates to other currencies, where applicable, will also be the ones shown on the NBR's website as of December 31, 2008.

3. For the purposes of the program, the *general government* includes the entities as defined in the 2009 budget. These are: the central government (state budget, treasury, self-financed state entities included in the budget, etc.), local governments, social security funds (pension, health, and unemployment), road fund company, and administration of the property fund. 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 operations of a fiscal nature as defined in the IMF's *Manual on Government Finance Statistics 2001*. The authorities will inform IMF staff of the creation of any such new funds or programs immediately.

I. QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE CEILING, AND CONTINUOUS PERFORMANCE CRITERIA

A. Floor on the Net Foreign Assets

4. **For program purposes, Net Foreign Assets (NFA) are defined as the NFA of the NBR minus Treasury liabilities to the International Monetary Fund.**

5. **NFA** of the National Bank of Romania (NBR) are defined as the euro value of gross foreign assets of the NBR (including reserve requirements of the commercial banking system held at 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.

6. **Gross foreign assets of the NBR** are defined to include the NBR's holdings of SDRs, the country's reserve position at the Fund, holdings of cash, securities and deposits abroad in convertible foreign currencies. Excluded from reserve assets are: (i) gold and other precious metals; (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), and all credit outstanding from the Fund, but excluding (i) banks' foreign currency deposits against reserve requirements; and (ii) government foreign currency deposits at the NBR. This definition is meant to bring the concept of foreign liabilities closer to the balance of payment definition, on which the targets are based.

Floor on cumulative change in NFA from the beginning of the year (in mln. euros) 1/

	2008	2009				2010
	December	March	June	September	December	December
	(stock)	(actual)	(actual)	PC	PC	IT
Cumulative change in NFA	25,532	-3,468	-5,118	-8,720	-9,000	-500
Memorandum Item:						
Gross Foreign Assets	26,220	-1,549	-132	-1,200	0	3,000

1/ PC=performance criterion; IT=indicative target. Data for end-month.

8. NFA targets will be adjusted upward (downward) by the surplus (shortfall) in program disbursements relative to the baseline projection. Program disbursements are defined as external disbursements from official creditors (World Bank and the EC) that are usable for the financing of the overall central government budget. The NFA targets will also be adjusted upward by the increase in commercial bank reserve requirements held with the NBR relative to end-December, 2008 (€13,038 million), measured at program exchange rates. The SDR allocation to Romania in the third quarter of 2009 will not result in higher NFA of the NBR, as it will increase both NBR's gross foreign assets and liabilities as defined in the TMU paragraphs 6 and 7 above.

9External Program Disbursements – Baseline Projections (in mln. euros)

	2009				2010
	March	June	September	December	December
Cumulative flows from end-December 2008	0	0	1,300	2,800	2,350

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

The quarterly consultation bands for the 12-month 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 above, the authorities will complete a consultation with the Fund on their proposed policy response before requesting further purchases under the program. In addition, the NBR will conduct discussions with the Fund 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 above.

	2008	2009				2010
	December	March	June	September	December	December
Outer band (upper limit)	…	…	…	7.7	6.5	4.5
Inner band (upper limit)	…	…	…	6.7	5.5	3.5
Center point	*6.3*	*6.7*	*5.9*	*5.7*	*4.5*	*2.5*
Inner band (lower limit)	…	…	…	4.7	3.5	1.5
Outer band (lower limit)	…	…	…	3.7	2.5	0.5

C. Performance Criterion on General Government Balance

10. The budget deficit will be monitored quarterly through the cash balance of the general government. The authorities will consult with IMF staff on corrective measures in the event of shortfalls in government revenue and financing.

Cumulative floor on general government balance

	(In millions of lei)
End-March 2009 (actual)	-8,300
End-June 2009 (actual)	-14,456
End-September 2009 (performance criterion)	-26,900
End-December 2009 (performance criterion)	-36,500

11. The budget deficit will be measured from above the line using the budget execution data. The Ministry of Public Finance (MPF) 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.

12. 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 2009, and to be determined for 2010 during the second review, the Ministry of Public Finance will consult with IMF staff.

13. In the event that non-grant revenues exceed those projected under the program, the deficit target will be adjusted downward by one half of the surplus to allow for additional capital spending while reducing the deficit further. The following table shows the accumulated projected non-grant revenue for 2009, to which the actual non-grant revenue will be compared.

Cumulative projected revenue of general government, net of EU funds	(In millions of lei)
End-March 2009 (actual)	37,204
End-June 2009 (actual)	75,069
End-September 2009 (forecast)	110,050
End-December 2009 (forecast)	149,518

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

14. The issuance of general government guarantees to the non-financial private sector and public enterprises will be limited during the program period.

Ceiling on new general government guarantees issued from end-2008 until:	(In billions of lei)
End-March 2009 (actual)	…
End-June 2009 (actual)	6.0
End-September 2009 (performance criterion)	7.7
End-December 2009 (performance criterion)	7.7

E. Performance Criterion on Non-Accumulation of Domestic Arrears by the General Government

15. The performance criterion established on the change in domestic payments arrears of the general government contemplates no accumulation of new arrears and their elimination 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 due date by 90 days (in line with ESA95 definitions for expenditures).

Cumulative change in general government arrears from the end of previous year	(In billions of lei)
December 31, 2008 (stock, actual)	1.06
End-March 2009 (actual)	0.35
End-June 2009 (actual)	0.49
End-September 2009 (performance criterion)	0.0
End-December 2009 (performance criterion)	-0.15
End-December 2010 (indicative target)	-0.91

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

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

G. Indicative Target on General Government Primary Spending

17. The indicative target on primary expenditure of the general government, i.e., overall spending excluding interest payments, net of disbursements of pre-accession and post-accession EU funds, will be subject to the same adjustor as applied to the deficit target.

Cumulative change in general government primary expenditures, net of EU funds	(In millions of lei)
December 31, 2008 (actual)	182,411
End-March 2009 (actual)	44,120
End-June 2009 (indicative target)	87,505

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, subsidies, transfers to public entities, Reserve Fund, and other expenditure as classified in the monthly reporting tables:

Cumulative change in general government current primary expenditures	(In millions of lei)
End-March 2009 (actual)	22,149
End-June 2009 (actual)	42,849
End-September 2009 (indicative target)	63,725
End-December 2009 (indicative target)	81,015

I. Monitoring of Public Enterprises

19. The Ministry of Public Finance, the Ministry of Labor and Social Protection, and other pertinent institutions will provide information to document that a monitoring system of public enterprises is in place by the time of the first review. During the program period, information will be provided to document that sanctions—decline in remuneration and dismissal of management according to Ordinances 37/2008 and 79/2008—are imposed if the budgets and company targets for restructuring are not observed.

20. Following the first review, monitoring will focus on the following public enterprises: (1) C.N. Cai Ferate CFR; (2) S.N. Transport CFR Calatori; (3) CN a Huilei; (4) SC Termoelectrica; (5) C.N. de Autostrazi si Drumuri Nationale; (6) S.C. Metrorex; (7) S.N. de Transport Feroviar CFR Marfa S.A.; (8) SC Electrocentrale Bucuresti; (9) Societatea Comerciala Electrificare CFR S.A.; and (10) S.C. Administratia Nationala a Imbunatatirilor Funciare.

21. During the second review, after the monitoring system of the Ministry of Public Finance has been refined, quarterly indicative targets for 2010 will be established on the operating balance (earnings before interest and tax), net of subsidies, of the 30 largest enterprises by total expenditures (as of 2009).

J. Reporting Requirements

22. Performance under the program will be monitored from data supplied to the IMF by the NBR and the Ministry of Finance as outlined in Table 1. The authorities will transmit promptly to the IMF staff any data revisions as well as other information necessary to monitor the arrangement with the IMF.

Table 1. Romania: Data Provision to the IMF

Item	Periodicity
To be provided by the Ministry of Finance	
Preliminary monthly data on general government accounts	Monthly, on the 25th day of the following month
Quarterly final data on general government accounts	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	Quarterly, no later than 45 days past the test date
Total accounts payable and arrears of the general government	Quarterly, within 55 days
Total accounts payable and arrears of the central government and social security funds	Monthly, within the next 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 will be reported to the IMF staff within 25 days
Final quarterly data on general government primary spending, net of EU disbursements	Quarterly, within 35 days from the test date
From 2010, the operating balance, profits, arrears, and personnel expenditures of 30 largest public enterprises by total expenditures	Quarterly, within three months of the test date
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

To be provided by the National Bank of Romania	
NFA 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 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 corporates	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

II. Structural Conditionality: Specifications

A. Bank Resolution

23. The legal amendments enacted by Parliament to the banking and winding-up laws will be drafted in consultation with the IMF and will include the following elements:

a. The law will specify a clear trigger for the early and mandatory appointment of a special administrator based on a regulatory threshold.

b. Supplementing its existing authority, the special administrator will be granted new authority to implement promptly a broad range of restructuring measures, which shall include purchase and assumptions, sales of assets, transfer of deposits, and write downs of capital to absorb losses.

c. The law will provide authority for the appointment of the special administrator with the powers of all of the banks' decision-making bodies, including the bank's general assembly of shareholders

d. The law will carve out the application of burdensome provisions, including under the general companies law, to the extent that they are inconsistent with the prompt implementation of restructuring measures (i.e., in particular, the prompt implementation of the transfer of substantial assets and of the reduction of capital to absorb all existing losses)

e. The law will provide legal protection for the special administrator's good faith actions in the performance of his duties.

f. The law will provide greater legal certainty for bank resolution measures during special administration so that these measures may not be suspended or reversed by litigation (i.e., such as by means of avoidance powers under the winding-up or insolvency proceedings). It will also clarify that restructuring measures are not subject to creditors' consent.

g. Initiation of winding up proceedings under the winding-up law and of liquidation proceedings under the companies law will require the NBR's prior approval.

h. The law will provide seniority in insolvency to depositors' claims and the same priority ranking to the Deposit Guarantee Fund.

B. Public Wage Legislation

24. The organic public wage law ("the law") to be approved by end-October 2009 will include the following provisions and requirements for subsequent implementing legislation:

a. The law will specify annual limits to expenditure on public service pay for the period from 2010 – 2015 such that the wage bill is reduced progressively to 7 per cent of GDP by the end of this period. It will specify that implementation of the new pay scheme is subject to this wage bill limit and that no pay measures may be introduced that breach these annual limits. Any increases in wages will therefore be tied to employment reductions.

b. The law will not link the public pay scale to the minimum wage.

c. The law will freeze general government wages for 2010 (except for those that earn less than RON705 per month), with increases in the reference value (to which the public pay scale is indexed) after 2010 conditioned on personnel cuts needed to reach the wage bill targets as a share of GDP.

d. The law will include the following reforms of the system of bonuses: (i) it will include a limit on bonuses as a share of the total wage bill (up to 30 percent) and an individual limit per worker consistent with the overall limit; and (ii) it will specifically prohibit the creation of new bonuses and ratify the elimination and capping (or rolling into the base wage) of old bonuses.

e. The law will require unified control of public service pay by the Cabinet. No minister or any public service official may create any new salary, allowance or bonus payment without specific authorization by Law.

f. The law will provide for the new pay system to be benchmarked on private sector wages to ensure that public pay is broadly competitive with other pay, within affordability constraints.

g. The principles underlying the new pay and grading system will include the following:

- The new grade structure will be based primarily on occupation and job responsibilities, so as to promote equal pay for equal work. This grade structure will consist of a limited number of grades based on occupation (e.g. administration; teaching; police officers), with each grade comprising distinct job families (e.g. senior managers; professionals; qualified teachers). All public service jobs shall be classified for pay purposes in accordance with this new grade structure.

- For each grade, a Grade Pay Scale shall be established, designed to provide higher rewards for jobs with greater responsibility, and to provide incentives for suitably qualified and experienced staff to take on greater responsibility. The range of each Grade Pay Scale (i.e. the difference between the maximum and minimum pay) shall be relatively narrow (except for occupations where there are few career development opportunities, such as teachers, nurses, policemen) and movement through the Grade Pay Scale shall be based significantly less on seniority than the existing coefficient system.

h. The law will include clear provisions on how it would apply outside the central government (local governments, self-financed entities).

i. The law will require that the subsequent implementing legislation: (i) be fully costed (and judged consistent with the overall wage bill limits) before submission to parliament; (ii) be approved by end-September 2010; (iii) be implemented starting January 1st, 2011.

j. A centralized system (database of all employees, grades, and pay) will be established to administer the unified pay system, with all public sector institutions required to supply such data on request.