

## **Romania: Ex Post Evaluation of Exceptional Access Under the 2009 Stand-By Arrangement**

This Ex Post Evaluation of Exceptional Access Under the 2009 Stand-By Arrangement on Romania was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on February 29, 2012. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Romania or the Executive Board of the IMF.

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INTERNATIONAL MONETARY FUND

ROMANIA

**Ex Post Evaluation of Exceptional Access Under the 2009 Stand-By Arrangement**

Prepared by an Interdepartmental Staff Team<sup>1</sup>

Authorized for Distribution by the European and  
Strategy, Policy, and Review Departments

February 29, 2012

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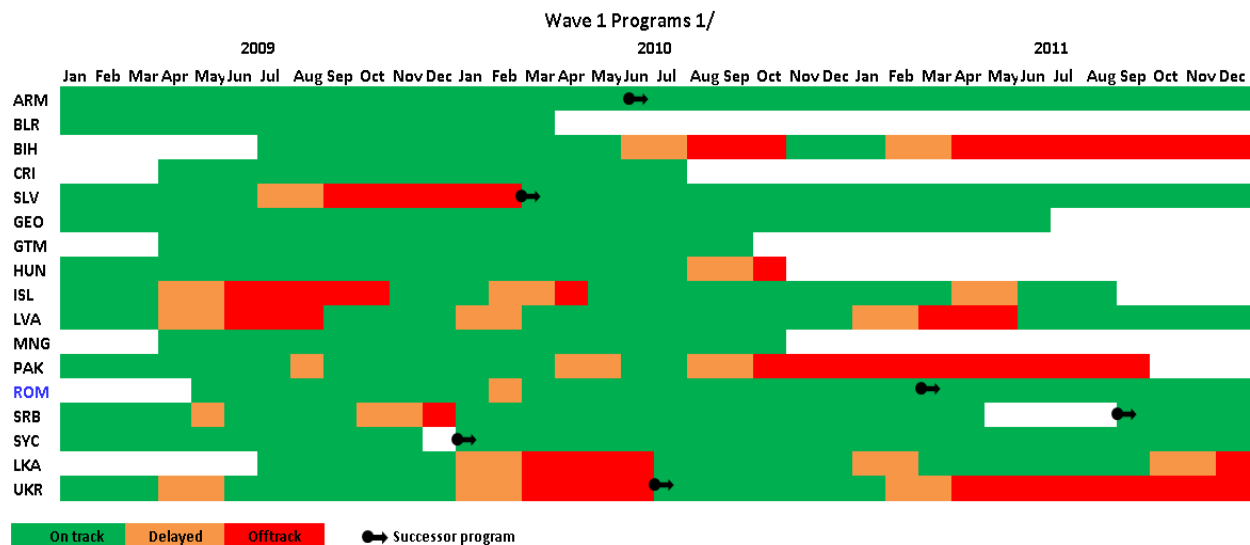
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## I. INTRODUCTION AND SUMMARY

- 1. Romania’s economic boom associated with its EU accession in 2007, alongside loose income and fiscal policies, generated overheating and significant vulnerabilities.** The boom—fueled by external borrowing—created external and domestic imbalances, including a rapid increase in domestic private credit and associated asset bubbles. Over half of the private credit was in foreign currency (FX) to unhedged households and corporate sector, with financing for the bank lending supported by the parents of foreign-owned banks, increasing banks’ vulnerability to liquidity and exchange rate risks. Meanwhile, fiscal imbalances rose rapidly as the policy stance was procyclical with little medium-term orientation, resulting in large structural fiscal deficits.
- 2. With the onset of the 2008 global financial crisis, the domestic economy came under severe stress.** Asset and financial markets were hit hard—the Bucharest stock market lost 65 percent of its value since August 2008 and the leu depreciated over 15 percent. Concerns about Romania’s external and fiscal sustainability triggered significant increase in external borrowing costs as sovereign yields jumped to 9 percent. Banks too came under increasing pressure, with liquidity drying up from the interbank market. Rollover risks also increased as the maturity structure gradually deteriorated, and reserves coverage of shorter term external debt declined.
- 3. Given the severity of the problems, Romania requested a Stand-By Arrangement (SBA) to restore market confidence by addressing the economic imbalances, along with reforms to achieve medium-term fiscal sustainability.** The SBA was approved in May 2009, with an exceptional access of SDR 11.443 billion, equivalent to 1,110.8 percent of quota—one of the largest in Fund history at the time, with co-financing from the EU. The program sought to stabilize the economy by a significant reduction in the fiscal and external imbalances, as well as stabilize and strengthen the financial sector. The strong fiscal structural component aimed to improve long-term fiscal and external sustainability.
- 4. Strong ownership, along with the large financing, flexible program design, and appropriate reform prioritization were central to achieving the program objectives.** The large and front-loaded financing along with upfront fiscal actions helped quickly restore market confidence, with a successful return to private financial markets during the program period. Despite the worse-than-expected economic downturn, which appropriately required some fiscal accommodation, and initial implementation and political hurdles which delayed completion of the second review, the program achieved strong fiscal adjustment and made substantial structural reforms, paving the way for greater medium-term fiscal sustainability anchored by the obligation under the EU’s Stability and Growth Pact. The banking system weathered the crisis well, thanks to the European Bank Coordination Initiative (EBCI) under which foreign parent banks committed to maintain their exposures to their Romanian subsidiaries and capitalize them as needed. On the monetary and external side, the central

bank skillfully balanced between the need for monetary easing and containing exchange rate and capital flight pressures. International reserve buffers were also quickly built, thanks to consistent over-performance on the program targets. For only the second time in Romania's history with the Fund, all reviews under the SBA were successfully completed, with a delay in the completion of only the second review (text chart).<sup>2</sup>



1/ Wave 1 programs refer to SBAs approved between September 2008 and August 2009.

Note: A given program is "On track" if there has been a review within 60 days after the scheduled date. "Delayed" is up to 120 days delay and "Offtrack" is 120 days or more delay.

Source: Fund staff calculations

5. **This report assesses the effectiveness of the 2009 SBA**, given the requirement for an evaluation in exceptional access cases.<sup>3</sup> It addresses the following two questions: (i) were the macroeconomic strategy, program design, and financing appropriate and consistent with Fund policy, including exceptional access policy? and (ii) did outcomes under the program meet program objectives?<sup>4</sup> This evaluation answers both questions in the affirmative, and draws broad lessons from the Romanian experience for future Fund arrangements.

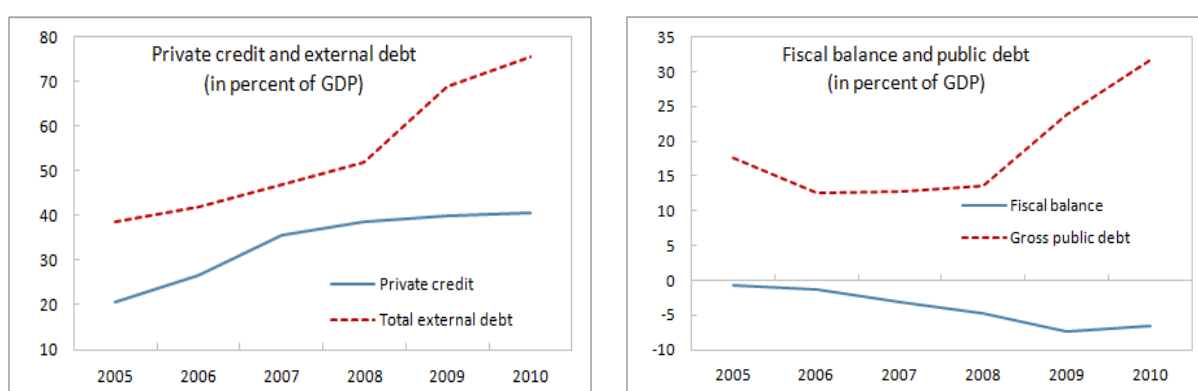
<sup>2</sup> The 2001 SBA was the first time that all reviews under a Fund arrangement with Romania were completed.

<sup>3</sup> See "[Ex Post Evaluations of Exceptional Access Arrangements—Revised Guidance Note](#)".

<sup>4</sup> In accordance with procedure, this report was prepared by an interdepartmental staff team, primarily on the basis of available documents and data. The team is grateful for conversations with the Romanian authorities, and with Fund staff who were involved in the SBA. The EPE findings were discussed with the authorities during a staff visit on February 6, 2012; the Annex presents their general reactions.

## II. WHY DID ROMANIA REQUEST FUND ASSISTANCE?

6. **Romania's loose income and fiscal policies in the run-up to the EU accession in 2007 led to overheating and unsustainable macroeconomic imbalances.** Despite measures by the National Bank of Romania (NBR) to counter the overheating pressures, including reducing inflation and containing credit expansion (especially in FX lending), the procyclical fiscal policy and large capital inflows resulted in missed inflation targets in 2007 and 2008. Meanwhile, the government was subject to high rollover and funding risks as deficits had increased to 8½ percent of GDP by 2008 in structural terms from only about 2 percent of GDP in 2005, and had to rely heavily on short-term financing as borrowing on longer-term maturities had become too costly. The increase in domestic demand led the current account deficit to increase to more than 13 percent of GDP in 2007.



7. **Fund surveillance during the pre-crisis period had highlighted key risks and the high vulnerabilities.** The 2008 Article IV Consultation reported on the growing macroeconomic imbalances, and Romania's high vulnerability to a sudden stop in capital flows arising from the widening fiscal and current account deficits. Specifically:

- Vulnerabilities were high relative to other countries in the region, particularly in the external and fiscal sectors. External debt relative to exports was high (about 130 percent of GDP), and the reserve level was low relative to debt servicing needs and the current account deficit. Also, while public debt was low, the rapid increase in fiscal deficit was financed through short term loans as borrowing on longer maturities had become too costly.

	Pre-crisis Vulnerabilities (in percent of GDP, end-2008)				
	Romania	Hungary	Bulgaria	Latvia	Others 1/
Primary Balance	-4.1	0.5	3.7	-3.0	-1.2
Overall Balance	-4.8	-3.6	2.9	-3.4	-1.8
Current Account Balance	-11.6	-7.4	-23.2	-13.1	-13.0
Credit Growth 2/	45.7	11.8	28.7	39.5	37.1
Public Debt	13.6	72.3	15.5	17.1	23.0
External Debt	51.8	108.2	101.3	128.7	52.4

1/ Average of Lithuania, Ukraine, Bosnia and Herzegovina, Serbia, and Belarus.  
2/ Average over 2005-2007, percent

- Banking vulnerabilities were also noted, with the rising dependence on foreign funding and growing non-performing loans (NPLs), for which larger capital cushions were recommended for riskier exposures. The findings of the November 2008 FSAP

update also highlighted the strains on bank capital and recommended measures to bolster crisis management and safety net framework.

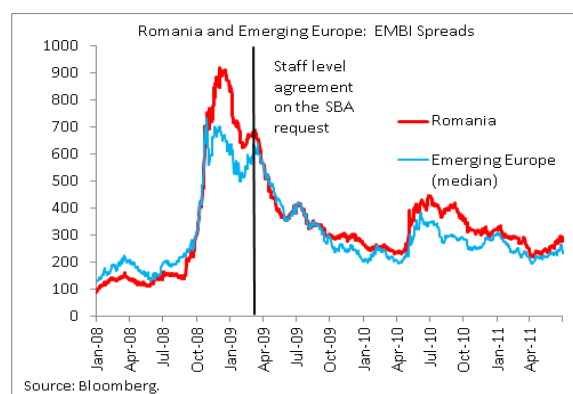
8. **With the onset of the 2008 global financial crisis, domestic financial markets and the banking system came under severe stress.** Interbank liquidity was disrupted on account of market segmentation, counterparty risks, and rising risk aversion. Access to external funding was limited, leading to a spike in interest rates. Romania's credit rating was downgraded by Fitch to below investment grade, further raising the risk premium and borrowing costs. The financial stress was clearly evident in the sharp rise in CDS spreads. The slowdown in capital flows led to large exchange rate depreciation, deteriorating asset quality and further weakening of bank balance sheets. Meanwhile, FX reserves declined by €2.2 billion to €27 billion (about 88 percent cover of short-term debt at end 2008) as the central banks intervened to stabilize the leu. The ensuing drop in domestic demand coupled with the collapse in trade resulted in one of the sharpest economic downturns among emerging economies and a large correction of the current account.

9. **Parliamentary elections in late 2008 also contributed to pre-crisis fiscal vulnerabilities from large pre-electoral spending.** Spending on public wages and pensions increased by 35 and 46 percent, respectively, in 2008 compared to the previous year. Nevertheless, in the aftermath of the crisis, the electoral cycle likely helped with designing a program with a strong fiscal consolidation component through discussions with the new coalition government.

### III. WAS THE PROGRAM DESIGN APPROPRIATE?

#### A. Program Design and Objectives

10. **The SBA aimed to stabilize Romania's economy from the effects of the large capital flow reversals, while addressing external and fiscal imbalances and bolstering the financial sector.** The main objectives were to: (i) substantially lower the fiscal imbalance, accompanied by structural reforms, to restore market confidence and improve long-term fiscal and external sustainability; (ii) strengthen the bank resolution framework to provide an enhanced safety net, including better governance and financing for the Deposit Guarantee Fund (DGF), for banks to weather the economic downturn; (iii) lower and maintain inflation to within the NBR's target range; and (iv) secure sizeable external financing to restore market confidence and cushion the adjustment process to achieve a more orderly outcome than what might result without the support. Discussions and conclusion of the staff level agreement on

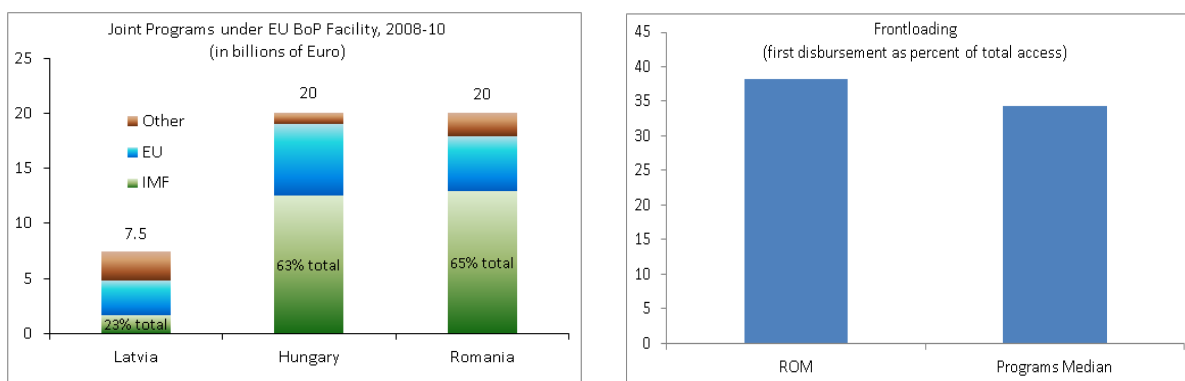


the SBA in the first quarter of 2009 already lowered Romania's spreads rapidly, more so than other regional economies, from the peak spreads in December 2008.

11. **The program also placed emphasis on restoring medium- and long-term sustainability and paved the way for future growth.** Structural reforms were a large component of the program, including tax administration, pensions, public wages and employment, and social benefits, all of which would benefit Romania well beyond the program period in easing fiscal pressures, improving public sector efficiency, as well as enhancing the business environment.

### B. Adequacy of the Financing Package

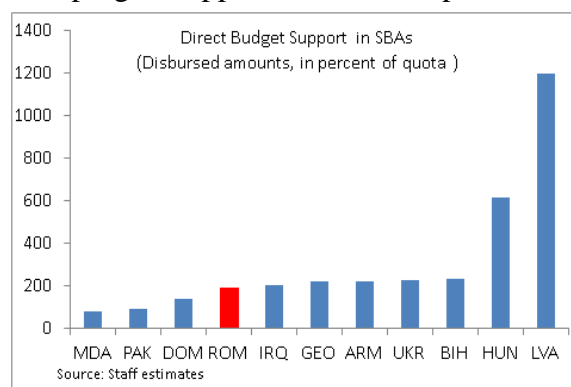
12. **In May 2009, the Fund approved a front-loaded and exceptional access SBA of SDR 11.4 billion (1,111 percent of quota).** Upon approval of the 24-month arrangement, SDR 4.37 billion (424 percent of quota) was available immediately. The total financing package was €20 billion, which, in keeping with other Fund-supported programs in EU countries, included co-financing from the EU of €5 billion (via their balance of payments facility), and the remaining €2 billion from the World Bank, EBRD, and EIB. Potential Fund exposure to Romania, as a percent of quota, was to be one of the highest among SBA-supported programs at that time, with debt service to the Fund peaking at higher levels than those reached in most exceptional access cases. Nevertheless, the low public debt level and Romania's excellent track record in external debt servicing mitigated risks to the Fund.



13. **The access request was justified by the large balance of payments needs over the two-year period.** With contraction in capital flows being the main perceived external risk, the frontloaded financing package sought to create a large external financial buffer to shore up private sector confidence, and avoid destabilizing overshooting of the exchange rate which could significantly affect bank balance sheets and result in a disorderly adjustment. Staff's baseline scenario at program approval perceived a large decline in capital inflows during 2009-11 from lower FDI, but export assumptions were a bit more optimistic (Figure 1). Rollover assumptions on short and medium-term debt were generally conservative.



14. **Although not envisaged when the SBA was approved, a portion of the purchases under the arrangement was used for budget financing.** Romania's domestic economy contracted more sharply than expected at the time of program approval as consumption collapsed, and the weak external environment tempered exports even further, resulting in a deeper economic downturn. Thus, the first review approved a larger fiscal accommodation, which—under tough market financing conditions—had to be funded with a portion of the domestic currency counterpart of the FX purchased from the Fund. A total of SDR 1.9 billion (189 percent of quota) of Fund resources during the first through the third reviews was used for budget financing.<sup>5</sup> This need did not arise after the third review as Romania successfully accessed the Eurobond market in Spring 2010.



### C. Were the Exceptional Access Criteria Met?

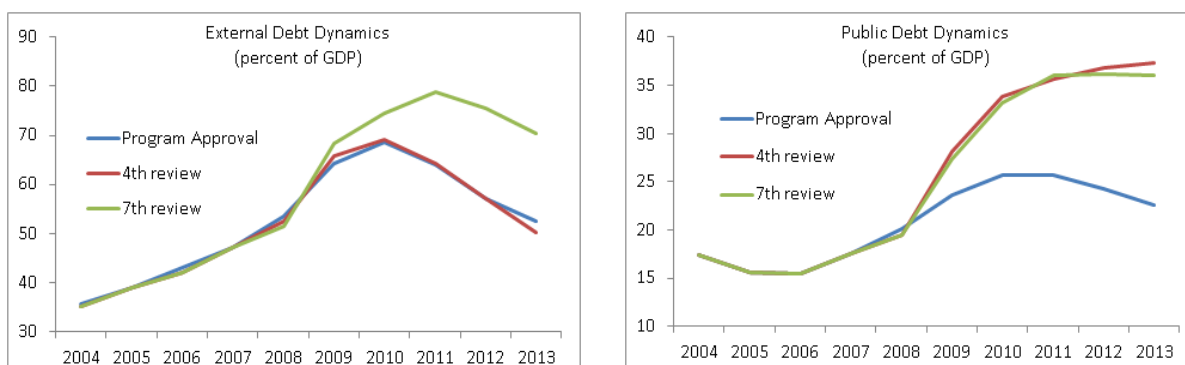
15. **Criterion 1:** *The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account resulting in a need for Fund financing that cannot be met within the normal limits.* Staff appropriately assessed that the severe reduction in capital inflows to Romania, despite a significant contraction in the current account deficit, produced a financing gap beyond what could be financed within normal limits. The exchange rate had depreciated significantly, and central bank reserves had begun to fall. Absent exceptional financing from the Fund, there was a risk of a disorderly balance of payments adjustment.

16. **Criterion 2:** *A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term.*<sup>6</sup> Romania's public debt sustainability was not a major program concern. At approval, public debt was low (estimated at 20 percent of GDP in 2008) and was not expected to pose a risk (projected to rise to 26 percent of GDP in the program period). Also, the financial sector was largely foreign owned, and most of the parent banks had access to liquidity through ECB facilities, and the parents' commitment to rollover and provide capital support as needed for their Romanian subsidiaries in the program period limited risks to the public purse. Eventually, public debt ended higher, but still relatively low, at 32 percent of GDP at end-2010, and

<sup>5</sup> The entire €5 billion financing from the EU went toward budget support.

<sup>6</sup> Romania's 2009 SBA was approved prior to the change to the exceptional access policy made in 2010 that "in instances where there are significant uncertainties that make it difficult to state categorically that there is a high probability that the debt is sustainable over the medium term, exceptional access would be justified if there is a high risk of international systemic spillovers" ([Decision No. 14064-\(08/18\)](#)).

projected to be 34 percent at end-2011, reflecting poor revenue collection, rising expenditure pressures, and weak growth recovery. External debt also ended higher than envisaged.



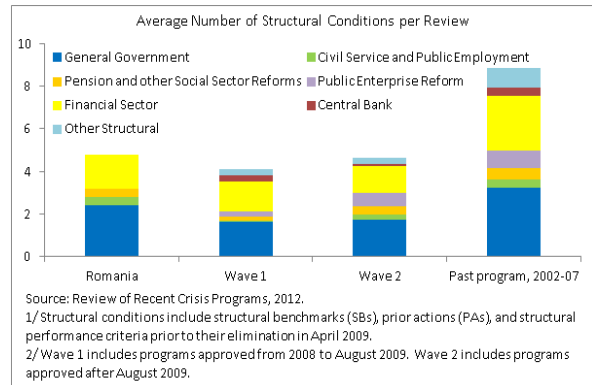
17. **Criterion 3:** *The member has prospects of gaining or regaining access to private capital markets within the timeframe when Fund resources are outstanding.* As an EU member with moderate external debt, strong growth potential, excellent track record in servicing its external debt even in periods of balance of payments stress, and the prospect of eventual euro area accession, staff assessed Romania's access to private financial markets to be restored. Indeed, in March 2010, a €1 billion Eurobond issuance and domestic issuances of euro-denominated instruments totaling €2.4 billion were both successful. Despite the prevailing market volatility, the initiation in 2011 of the medium-term notes program also kicked off with the placement of €1.5 billion in mid-2011, and a further—delayed but oversubscribed—issuance of US\$1.5 billion in January 2012.

18. **Criterion 4:** *The member's policy program provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.* While Romania's past track record of adherence to Fund-supported programs was mixed, staff noted the economic reforms under the 2009 SBA as having support at the highest political level and by both parties in a coalition that had an ample majority in parliament. Risks were recognized from the presidential elections in November 2009, but considered sufficiently ring-fenced by the relatively conservative program scenario. However, the governing coalition in place at the time of program negotiation broke down in September 2009, resulting in several months of a caretaker regime before a different coalition was formed in early 2010. Since then, as the President was re-elected and the Prime Minister reappointed, the high level of program commitment remained.

19. **There was an appropriate level of Board consultation in the lead up to the SBA request.** An informal Board meeting was held on March 13, 2009 to discuss the needs for an SBA involving exceptional access. A report assessing the risks to the Fund and the Fund liquidity position was provided to the Board, consistent with exceptional access procedures.

## D. Was the Conditionality Appropriate?

20. **Program conditionality appropriately aimed to address areas of greatest vulnerability to restore economic stability and investor confidence.** Thus, conditionality focused on: (i) fiscal adjustment to reverse pre-crisis increase in current spending to restore confidence, combined with structural reforms to achieve medium-term fiscal sustainability; and (ii) strengthening the bank resolution framework, bolstering the deposit insurance system, and improving banking supervision. Structural conditionality also focused on these two macro-critical areas, although the number of structural conditions was slightly higher than in other recent crisis programs. Moreover, structural conditionality, especially prior actions—often incomplete structural benchmarks reset as prior actions for review completion—were used effectively to achieve timely completion of significant reforms.



21. **Fiscal adjustment was sizeable and front-loaded, which, combined with key structural reforms, aimed to restore market confidence and achieve medium-term sustainability.** A quantitative performance criterion (PC) on the general government balance on a cash basis was set to monitor fiscal performance. Additional PCs were also established to ensure non-accumulation of new arrears and their elimination during the program period, and limit the issuance of government guarantees to the non-financial private sector and public enterprises. Once a monitoring system for public enterprises was put in place (see ¶32), the financial balance of the largest public enterprises was included as an indicative target. Structural conditionality on public wages, pensions, public enterprises, and the passage of Fiscal Responsibility Law, supported by reforms to improve tax administration and expenditure efficiency were critical to ensure medium-term fiscal sustainability.

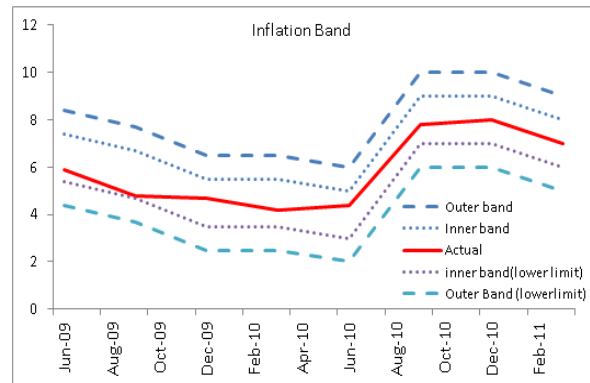
22. **Monetary conditionality safeguarded the central bank's credibility and financial sector conditionality helped preserve stability.** Prudent management of monetary and exchange rate policy via an inflation consultation clause to bring inflation within the NBR's target range and a floor on the change in net foreign assets supported the overall policy package, struck an appropriate balance between a firm stance against inflation and supporting economic recovery. The inflation band was adjusted upward by more than four percentage points at the fifth review to accommodate inflationary effects from the program-induced VAT increase. In the financial sector, with commitments in place from foreign parent banks to support their Romanian subsidiaries, program conditionality focused on ensuring an adequate bank resolution mechanism and restoring system-wide stability, including stress testing banks to assess potential funding needs and amending the deposit insurance system to ensure confidence in the banking system.

## IV. WAS THE POLICY RESPONSE APPROPRIATE?

### A. Macroeconomic Forecasts

23. **The initial growth projection for 2009 substantially underestimated the severity of the recession which led to a swift external adjustment** (Figure 2). Romania was among the first European countries seeking an SBA in early 2009, when the crisis had not yet fully unfolded. The program was quick to adjust its growth forecast in the first review. The 2009 real GDP growth forecast was revised down from -4.1 percent at program approval to -8.5 percent at the first review as domestic demand, especially consumption, dropped sharply. As a result, imports too retracted more than expected, resulting in a quicker external adjustment. Although FDI suffered an even more protracted slowdown than originally envisaged, Romania's external position continued to strengthen and international reserves also accumulated at a faster pace throughout the program, helping restore market confidence and access. Notwithstanding the loss of reserves at the onset of the crisis, Romania built a comfortable reserve buffer during the program—by 2010, FX reserves were almost 30 percent of GDP, and the reserve cover ratio was as high as 98 percent of short-term debt.

24. **Inflation was broadly on a downward trend, thanks to the widening output gap.** However, following inflationary pressures arising from the program-induced VAT increase, the inflation forecast was revised upward by over four percentage points for end 2010 at the time of the fifth review. The inflation band was also consequently adjusted upward to accommodate the inflationary impact, helping avoid triggering the inflation consultation clause.



### B. Fiscal Policy

25. **Romania's fiscal adjustment under the SBA was broadly comparable to the adjustment in other program cases** (Figure 3). The structural deficit narrowed by 6 percentage points of GDP in the program period, from an unsustainably high level (Figure 4).<sup>7</sup> Given financing constraints and concerns about fiscal sustainability, the adjustment program appropriately focused on spending measures, seeking to reverse the pre-crisis

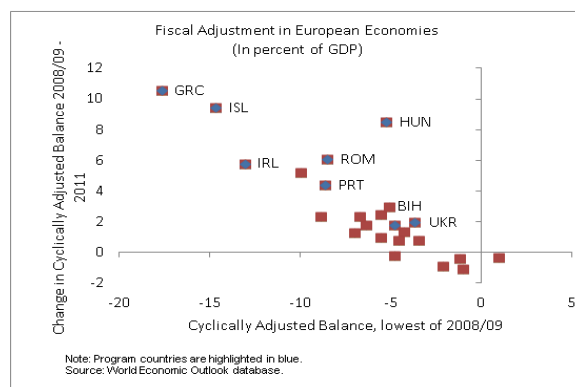
<sup>7</sup> The adjustment reflects the change in structural deficit from 2008 to 2011. Despite completion of the 2009 SBA in March 2011, the adjustment is computed over end 2011 as the budget deficit target for 2011 was discussed during the 2009 arrangement. While some uncertainties remain in the outturn of the fiscal deficit and GDP growth for 2011, headline fiscal deficit is expected to meet or even exceed the targets.

excesses. The program was frontloaded through prior actions to ensure some of the spending cutbacks were implemented quickly. This was needed to anchor market confidence and in line with the large frontloaded disbursement schedule of the program.

**26. With the deeper-than-expected downturn, the program quickly responded by revising the fiscal deficit targets, while not conceding the overall program goals.**

The deficits for 2009 and 2010 were revised up (from 4.6 percent of GDP to 7.3 percent in 2009 and from 3.6 percent to 5.9 percent in 2010) during the first review in response to the sharp economic decline. The 2010 deficit target was again revised up to 6.8 percent of GDP at the fourth review as the recovery continued to lag expectations. Concerns about fiscal accommodation in the short term were offset by a strong and ambitious medium-term program that tackled fiscal sustainability concerns (see discussion under structural fiscal measures).

**27. More specifically, fiscal adjustment in 2009 was roiled by the deeper-than-expected downturn, implementation delays, and political uncertainty.** Initially, the government aimed for a more front-loaded fiscal consolidation with both revenue and spending measures.<sup>8</sup> These measures, however, proved insufficient to meet the 2009 targets given the severity of the downturn and spending overruns in several areas, particularly outside the central government. While offsets through cuts in capital spending, lower interest payments, and some late revenue recovery enabled the government to ultimately meet the revised end-year deficit target, implementation delays in spending measures and budget uncertainties in the run up to Presidential elections delayed completion of the second review. Meanwhile, the authorities also resorted to payment delays, leading to higher domestic arrears, the targets for which were repeatedly missed—albeit by very small amounts (text table and Box 1). Nonetheless, with better commitment control and budget execution procedures, arrears stopped accumulating, and later even declined during the program period.



Fiscal Quantitative Program (in billions, RON)													
		GG Balance		GG Arrears		GG Guarantees		GG Primary Spending		GG Current Primary Spending		Operating Balance of SOEs	
		PC	Actual	PC	Actual	PC	Actual	Ind. Target	Actual	Ind. Target	Actual	Ind. Target	Actual
Program	end March 2009	...	...	...	...	...	...	...	43.9	...	22.1	...	...
1st review	end June 2009	-14.5	-14.5	0.4	1.6	6	0.0	87.5	87.3	...	43.2	...	...
2nd and 3rd review	end-Sept 2009	-26.9	-25.6	1.1	1.4	7.7	0.8	132.4	...	63.7	63.9	...	...
	end Dec 2009	-36.5	-36.1	0.9	1.5	7.7	2.2	...	...	81.0	85.6	...	...
4th review	end March 2010	-8.3	-8.4	1.3	1.8	12	4.6	...	...	32.9	32.7	-1.4	-1.1
5th review	end June 2010	-18.2	-18.0	1.1	1.8	12	5.5	...	...	66.2	66.1	-2.0	-2.3
6th review	end Sept 2010	-27.5	-23.7	0.8	1.6	12	6.5	...	...	100.0	98.7	-3.0	-3.8
7th review	end-Dec 2010	-34.1	-33.6	0.5	1.1	12	7.6	...	...	131.5	131.9	-4.0	-5.5

Note. Shaded area indicates targets that were missed.

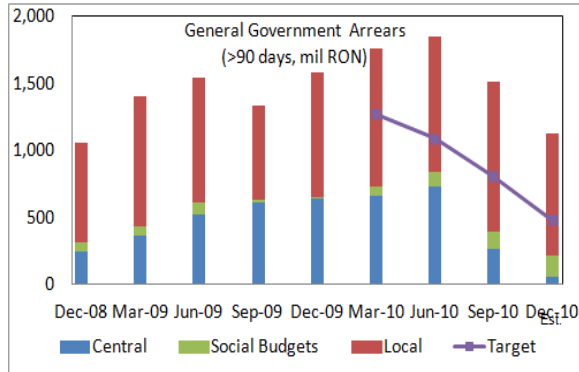
<sup>8</sup> These initial measures included higher social contributions, hikes in excise taxes, higher property taxes, public wage bill cuts, and reductions in goods and services spending and subsidies.

### Box 1. How did the Program Deal with General Government Arrears?

**Domestic arrears were mostly concentrated in the local governments and the health sector.** The stock of arrears increased considerably in 2009 as the crisis unfolded and revenue shortfalls necessitated sizable fiscal consolidation measures. The stock of unpaid bills also increased, partly reflecting the extended payment deadline for bills. In the health sector, some bills were not registered owing to poor funding.

**The program appropriately introduced measures to remove existing arrears and prevent new ones by balancing the release of additional budgetary allocations with needed reforms.**

Measures included repayment of 2.5 billion lei, most in the health sector, part of which was a prior action, and developing a commitment control system (structural benchmark). The public finance law was amended to ensure new commitments were not undertaken by local governments until previous obligations were met and that balanced budget rules applied on spending, including arrears. Health care reforms were also implemented to limit costs and increase revenues. The authorities also committed to allocate necessary funds to keep central and social security arrears near zero.



**The impact of these measures was mixed.** In general, they were insufficient to tackle the deeper structural problems. The local government finance reform prevented recurrence of new arrears, but failed to significantly reduce the stock of outstanding arrears as burden-sharing of past commitments remained unresolved and projects remained incomplete. In the health sector, progress was slower than anticipated and was insufficient to cover the health care costs. In the absence of adequate cost control mechanisms, the tight ceiling on goods and services spending led to underfunding and accumulation of large unpaid bills. Given low spending on health care, more focused revenue reforms for health care financing could have helped place the health care system on a more sustainable footing. The program began a stocktaking exercise of all arrears and unpaid bills as of end-2010 for the entire general government and the SOEs and required an action plan to be prepared by end-April 2011, after which payments would not be authorized for unregistered bills. While program targets were consistently breached, these measures helped lower arrears by end-2010, with central government arrears reaching near zero.

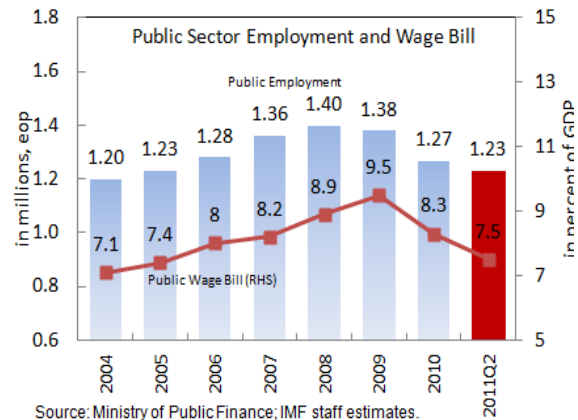
28. **For 2010, the government introduced radical fiscal measures to offset the effects of the deeper downturn, which may have contributed to greater output loss.** The measures—mostly on spending, aiming to restore the wage bill back to 2007 levels— included a 25 percent cut in public wages, 15 percent cut in social transfers and other reductions in goods and services spending, and over 8 percent reduction in public employment.<sup>9</sup> A VAT increase of 5 percentage points to 24 percent was also introduced in July 2010.<sup>10</sup> These measures ensured the achievement of the program targets, and the

<sup>9</sup> To lower the wage bill to below 7 percent of GDP over the medium term, from its peak of over 9 percent of GDP in 2009, the authorities incorporated strict provisions on the wage bill on the Fiscal Responsibility Law, continued to enforce public employment reductions by replacing only 1 staff for every 7 departures at every public institutions, simplified and limited bonus system, and undertook functional reviews of line ministries.

<sup>10</sup> The VAT increase was introduced after a proposed 15 percent cut in pensions was overruled by the Constitutional Court.



authorities' firm commitment to undertake such tough measures sent a strong signal to markets on the credibility of the reform agenda. The measures, however, led to a sharply procyclical stance, effectively delaying the economic recovery. With the benefit of hindsight, one might argue that the adjustment could have been more gradual, particularly in light of Romania's low public debt level. At the time, however, the program fiscal targets were already substantially relaxed to accommodate the deeper-than-expected downturn, and monetary policy was also supportive of recovery (see Section C).



29. **The authorities were also fully committed to meeting their commitments under the EU's excessive deficit procedure, which served as the anchor for the adjustment path.** In July 2009, the excessive deficit procedure for Romania was opened, on the basis of a government deficit above 3 percent of GDP in 2008, and recommended the correction below 3 percent take place by 2011. However, in light of the severe and larger-than-expected downturn, and considering the efforts made by Romania to reduce public expenditure, including cut the public wage bill, the EC proposed extension of the deadline for the correction of the deficit below 3 percent of GDP by one year to 2012. While the 3 percent target timeline was still ambitious in light of the depth of the downturn and volatile external environment, the authorities were committed to meet their obligation under the EU's Stability and Growth Pact to sustainably lower the deficit below 3 percent of GDP.

30. **The program sought to explicitly limit the impact on the most vulnerable and build public support for the program.** In addition to earmarking funds for the Guaranteed Minimum Income scheme, the lowest wage employees and poorest pensioners were protected from the cuts in public wage and pension. The minimum pension and minimum public wage thresholds also were unchanged. While implementing reforms to social transfers, better targeted programs were protected in response to concerns about the distributional impact of cuts in social transfers. In this regard, efforts to engage with various key external stakeholders throughout the program period helped foster support for the program and its implementation.

### Structural fiscal measures

31. **Structural fiscal reform was a key component of the reform agenda to achieve medium-term fiscal sustainability and improve fiscal institutions.** The reform measures—phased over three years—included overhauling the pension system, tax administration, and the public wage framework, and significantly benefited from the wide-ranging Fund technical assistance. The Pension Law raised retirement ages, re-indexed pensions, and improved the second pillar regime. A Fiscal Responsibility Law was enacted to streamline

budgeting and enhance budget planning discipline. A public financial management structure was introduced for multiyear budgeting while limiting intra-year budget revisions. Fiscal rules were introduced on spending, public debt and primary deficit, and a framework for managing guarantees and other contingent liabilities was approved. Local public finance law was amended to bolster fiscal discipline and limit risks from local governments. All these reforms helped improve local investors' confidence, evidenced by their higher participation in government domestic debt auctions and subscription of T-Bills.

**32. Improved oversight of state-owned enterprises was another key component of the program.** Given the primary goal of lowering fiscal imbalances, the program agenda did not include privatization of public enterprises, instead focusing on governance reform to ensure stronger government control over SOE finances and performance. Moreover, including a privatization agenda would have likely stretched the implementation capacity too thin under circumstances where the authorities were already grappling with a very deep economic crisis, and deep fiscal structural reforms were already being pushed forward. Also, and importantly, information on SOE performance was scarce as there was no formal monitoring system. The program, thus, included monitoring SOE arrears and fiscal balances as part of program conditionality. Government control on budgeting and wage-setting process was strengthened—public enterprises with losses were not allowed to raise wages while others could do so only in line with inflation and productivity growth.

**33. Strong efforts were made to strengthen the public compensation system and health care sector, although these initiatives fell somewhat short of program objectives.** The public wage bill was significantly reduced under the program and the use of bonuses, which constituted a large share of total compensation, were limited under the Unified Public Wage Law (UWL) framework approved in September 2009. The UWL also laid out, inter alia, the principles for a simplified and unified wage grid across the general government. In practice, however, application of the revised grid under this law is unlikely to be realized any time soon as restrictions on nominal wage reduction, the court decision to restore pre-crisis wages, and the relatively high level of the new wage grid imply that its transition would require a gradual increase in public wage,<sup>11</sup> which, despite the large reduction in public employment, creates uncertainties regarding whether lasting savings from the wage reform can be realized. More generally, multiple legal setbacks such as the partial reversal of the wage cut in 2011 and the overruling by the Constitutional Court of a proposed pension cut in 2010, made implementation of reforms particularly challenging. Such legal problems also contributed to a delay in the completion of the second review. In health care, slow reforms (e.g., delays in the enactment of the copayment law), and implementation difficulties in areas

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<sup>11</sup> A 15 percent wage increase was already provided in early 2011.

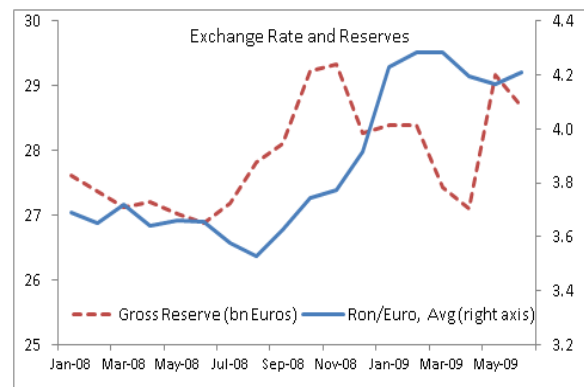


such as the clawback tax to reduce financing pressures, resulted in frequent overruns in health care costs and accumulation of arrears.<sup>12</sup>

34. **Absorption of the EU structural funds was limited by bureaucratic barriers.** Romania has about €20 billion (17 percent of 2009 GDP) in project funds from the EU for use by 2013. Better absorption of these funds in much needed infrastructure projects—with a 15 percent contribution from Romania—could have accelerated the path to economic recovery. However, significant inefficiencies created by bureaucratic hurdles (in both Romania and the EU) and capacity constraints delayed absorption. With an already substantial reform agenda to restore Romania’s medium-term fiscal sustainability, and given the difficulties in the implementation of some laws, (e.g., procurement laws), the SBA could not directly address the constraints to improve the absorption of these funds.

### C. Monetary and Exchange Rate Policy

35. **Moderating inflation and exchange rate pressures allowed gradual easing of monetary policy from the onset of the program.** The NBR reduced its key policy rate by 4 percentage points since 2009, while keeping inflation well within the inflation consultation band (see ¶24). It also cut reserve requirement significantly during the program period, especially on FX liabilities. Pressure in the FX market was limited during the program, and the authorities allowed full exchange rate flexibility with very limited FX market intervention. Following the 2008 depreciation, staff assessed the real exchange rate to be broadly in line with fundamentals.



36. **The program set net foreign assets target floors based on the NBR’s reserves and commercial banks’ FX reserve requirements held at the NBR, which, on balance, worked well.** Including FX reserve requirements (FXRR) in the floor was designed to constrain the NBR’s ability to lower the FXRR, effectively yielding a tighter monetary stance to deflect capital outflows. On the other hand, however, this approach increased the risk of missing the NFA target as a result of deposit outflows, if the NIR accumulation was insufficient, or if the NBR was unable to raise the RR ratio, to offset the decline in the FXRR holdings arising from such outflows. Overall, the NFA target was suitable for Romania, and it was consistently met by large margins, even with a drop in FX reserve requirement from 40 percent at program approval to 25 percent at the seventh review. Separately, inclusion of

<sup>12</sup> The copayment law sought to establish copayment by beneficiaries for most healthcare services, and the clawback tax introduced a tax on medical suppliers for drug overconsumption.

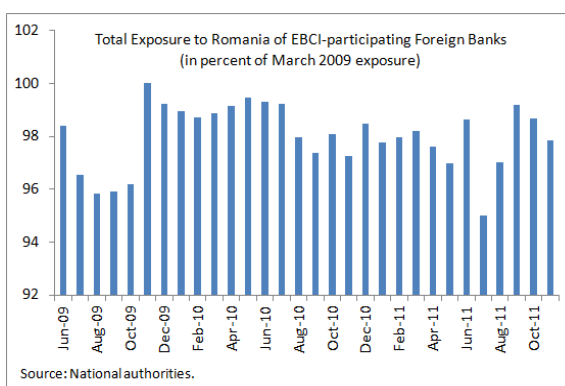
the FXRR may potentially create scope for “window dressing” to meet the NFA target around program test dates in the form of excess reserves, but this risk was mitigated in Romania with a largely foreign-owned banking system, and there is no evidence of such occurrence during the program period.

#### D. Financial Sector

##### 37. **Banking sector confidence was restored through liquidity injections by the NBR, and parent bank commitments to maintain exposures in their Romanian subsidiaries.**

The NBR injected ample leu liquidity into the banking system to ease pressures early in the program, including by reintroducing repo operations to provide short-term liquidity, and broadening the range of acceptable collateral for refinancing operations at the central bank.

Foreign parent bank commitments to maintain their exposure and meet their Romanian subsidiaries’ recapitalization needs, as part of the EBCI initiative, also provided confidence in the banking sector (Box 2). The prospective IMF-EU financing program also played an important role as a policy anchor and ensured the participation of the nine largest foreign banks in this initiative. As a group, these nine banks



maintained their overall exposure throughout 2009-10 near their end-March 2009 level, despite delays in completing the second review and the associated disbursements, and agreement at the EBCI meeting in July 2010 to allow a reduction in the commitment to 95 percent of the banks’ end-March 2009 exposure.

38. **The authorities made major reforms to improve the safety net to deal with financial sector distress and enhance bank supervision and regulation.** Bank stress tests were conducted covering over 90 percent of system assets, based on which capital increases were proactively sought in several banks to ensure that the capital adequacy ratio (CAR) was above 10 percent. System-wide CAR rose to 14.7 percent at end-2010 (13.8 percent at end-2008). The banking resolution framework was also significantly enhanced to deal with weak banks, and legal amendments were enacted to broaden the grounds for the activation of deposit insurance and accelerate payouts. The authorities also strengthened the funding regime and governance of the DGF. Legislative initiatives that infringed on the independence of the central bank and non-bank financial regulators were reversed, and provisions inconsistent with the monetary financing prohibitions under EU law were removed.

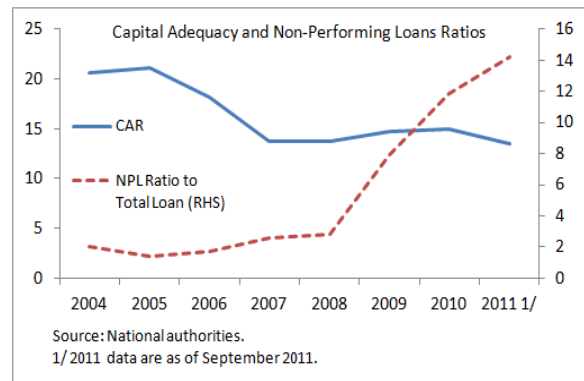
## Box 2. The European Bank Coordination Initiative

**The European Bank Coordination Initiative (EBCI), or Vienna Initiative, was launched at the height of the 2008 financial crisis to coordinate large cross-border banks with systemic importance in emerging Europe.** Created on January 23, 2009 in Vienna, Austria, the initiative brought together key western parent bank groups, home and host country regulatory and fiscal authorities, and IFIs (the IMF, EBRD, EC, EIB and the World Bank; the ECB participated as an observer). On February 27, 2009, the Joint IFI Initiative was launched as the financial assistance arm of the Vienna Initiative. By the conclusion of the Joint IFI Action Plan at end-2010, the EBRD, the World Bank, and EIB made available about €33 billion to support the financial sectors in the CEE region.

**The meetings on Romania—the first to seek a coordinated approach on financial sector issues for a country affected in the 2008 crisis—were held in Vienna on March 26, 2009.** Support from commercial banks in Romania was vital to avert a serious financial sector meltdown, and given the large foreign ownership of Romanian banks (90 percent of the banking system), involvement of the foreign parent banks was crucial for the stabilization efforts. Thus, the meetings included the nine largest foreign-owned banks incorporated in Romania, their parent banks, the EC, the World Bank, EBRD, the EIB, the NBR, representatives of the home country authorities (Austria, France, Greece and Italy), and an observer from the ECB. Following the meetings, all nine parent banks signed a statement that:

- Expressed their support for Romania’s program and awareness that its success would depend on the continued involvement of the foreign-owned banks.
- Confirmed their long-term approach to Romania as strategic investors, while acknowledging the potential need for additional capital for some of their subsidiaries in Romania.
- Expressed their support to the stress tests of the banks conducted by the NBR.
- Confirmed their willingness to commit, within the framework of the multilateral support programs, on a bilateral basis with the NBR to maintain exposure to Romania at the March 2009 level and recapitalize their subsidiaries as needed.

39. **The banking sector’s loan quality, however, deteriorated during the program period.** The NPLs more than doubled during 2009 and continued to increase in 2010 and 2011, driven by the sharp economic downturn, as well as the difficulty to write off NPLs.<sup>13</sup> Risks to the banking sector, however, were mitigated by the very high (98 percent) loan-loss provisioning requirement. The high provisions, on the other hand, compressed banks’ profits, preventing a decline in lending rates in line with the monetary easing. The IMF and World Bank worked continuously with the authorities to tackle the NPL



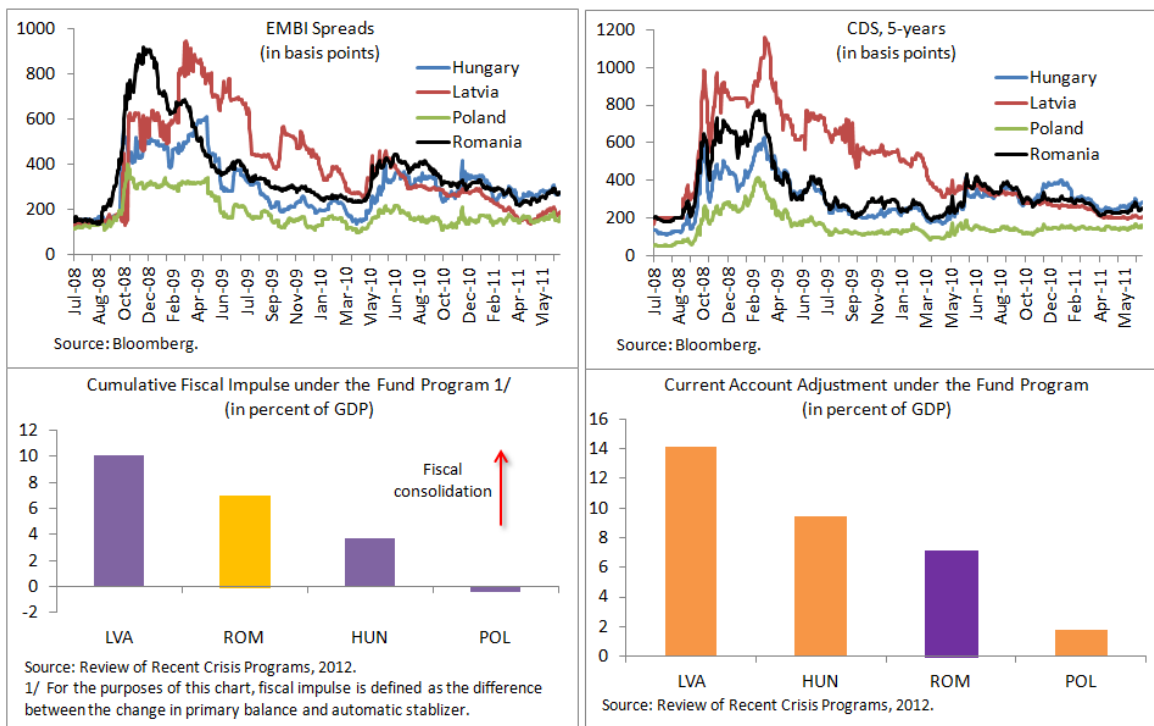
problem, though the program did not include any explicit conditionality in light of the high provisioning. An earlier staff proposal to set up an asset management company was not

<sup>13</sup> For example, NPLs can only be written off after all channels for recovering the loans have been exhausted by the banks, which could take many years in Romania.

pursued as the authorities did not consider it an efficient approach and were hesitant to commit—in a volatile financing environment—government resources to purchase distressed assets. Early and pro-active restructuring programs were, thus, encouraged on a bank-by-bank basis, and the World Bank assisted to improve the corporate insolvency framework. The program also ensured that in the transition to the International Financial Reporting Standards (IFRS), the high level of provisions would be maintained since the Romanian Accounting Standards on provisions are stricter than under the IFRS.

## V. DID THE PROGRAM ACHIEVE ITS OBJECTIVES?

40. **The program was successful in achieving its key goals and restoring market confidence.** While the recession during the program period was larger and more prolonged than originally projected, the substantial fiscal and external adjustments lowered Romania's macroeconomic imbalances, restoring market confidence and forestalling massive capital outflows. Country risk (measured by CDS spreads) dropped, and the current account adjusted in an orderly way without undue exchange rate volatility or FX market intervention.



41. **On the fiscal front, despite initial implementation delays, the program achieved a sizable consolidation consistent with the program objectives, and did major reforms toward a sustainable fiscal path.** The program was flexible in adapting to the worse than expected economic downturn, complemented by support to address short term financing difficulties alongside major reforms with a medium term fiscal impact to anchor investor confidence. The authorities' strong ownership of the program enabled large and politically

difficult spending adjustments to be undertaken, directly redressing the pre-crisis excesses and enhancing reform credibility. Tax rates were also raised to boost revenues, and substantial progress was made in reforming the public wage and pension systems. While a lot was achieved under the program, tax administration efforts could have been further boosted by some added revenue measures (e.g., widening the tax base, closing of tax loopholes and exemptions, and simplifying the tax system). Also, more emphasis on assessing the quality of capital spending, and better absorption of EU funded projects, may also have helped with faster economic recovery.

42. **Appropriate and timely monetary and financial sector policies helped Romania weather the crisis, but rising NPLs remain a concern.** The NBR skillfully balanced between achieving external stability and the need to stimulate the economy to achieve stronger growth. On the financial side, the EBCI, combined with NBR liquidity support, played a critical role in sustaining Romania's banking sector stability. The NBR's contingency planning, including measures to improve the safety net, maintain adequate bank capital and strengthen the DGF, further boosted market confidence, lowering the risks of a bank run. However, the rising NPLs, following a sharp economic contraction and the burst of pre-crisis credit bubbles, are still a concern. Further efforts to facilitate timely write-offs of the NPLs are necessary to tackle this problem.

43. **Most program performance criteria (PC) and structural benchmarks were met, except the PC on general government arrears.** The PCs on government guarantees, external arrears, and NFA were consistently met throughout the program. The PC on fiscal deficit was observed for all but the fourth program review, including by a significant margin for end-December 2010. In contrast, the general government arrears PC was not observed in any review and remains an ongoing concern. This said, maintaining these targets was still justified as they helped improve transparency and control underlying spending commitments, as well as reconcile the program's cash deficits with the EU's accrual-based deficits. Moreover, the targets were missed by very small margins. Inflation remained within the inner band of the inflation consultation mechanism, although the band was adjusted to accommodate the program-induced VAT increase. Structural benchmarks were generally met. The indicative target on the operating balances of selected SOEs was missed in several reviews, calling for more profound SOE reforms under the successor arrangement.

## VI. CONCLUSIONS

44. **The authorities made significant strides toward restoring macroeconomic stability and achieving an orderly adjustment of pre-crisis imbalances, despite initial hurdles in program implementation.** Notwithstanding one of the largest economic downturns in Europe, the authorities' strong adjustment effort was the appropriate response to the sharp fiscal imbalance. Balancing the fiscal adjustment, which included unpopular measures to tackle the large public wage bill and pension reforms, while cushioning the social impact, was a mark of strong ownership and successful program implementation. The

authorities also made commendable progress in banking sector reforms under the SBA, reducing Romania's banking system vulnerabilities.

45. **Several broad lessons could be drawn from the Romanian program experience:**

- *Strong program ownership by the authorities*, including taking difficult, sizeable, and sometimes unpopular measures, to restore medium-term sustainability, was indispensable to the program success. Notwithstanding the sharper than expected downturn, difficult measures were completed, instilling market confidence. The authorities also proactively sought to increase capital buffers in the banking system, and also strengthened bank resolution and safety net mechanisms, boosting confidence in the stability of the system.
- *Early engagement with the private sector and international lenders* helped design a strong program with room to build international reserve buffers. Recognizing the importance of maintaining banking sector stability, commitments received from the foreign private banks under the EBCI were essential to restore market confidence.
- *Flexibility in program design to quickly adapt to the worsening outlook, without compromising the overall program goals*, was critical. Program reviews were effectively used to revisit the macroeconomic framework and modify the required adjustment based on evolving risks. The steadfast focus on medium-term fiscal structural issues, together with front-loaded financing and strong prior actions for the SBA approval, helped signal commitment to set fiscal consolidation on the right trajectory and mitigated concerns about fiscal sustainability, enabling greater flexibility while maintaining program credibility.
- *In undertaking structural reforms such as the public wage reforms, lasting changes are likely to be delayed by implementation lags stemming from legal holdups*. Better coordination with other IFIs to overcome some of the legal obstacles could have helped move these reforms forward faster.
- *The program embodied successful cooperation between the EU and the Fund*.<sup>14</sup> Support from the EU contributed effectively to the financing package and allowed burden sharing. The authorities' commitment to adhere to EU targets under the convergence program and the EDP framework played a key role in ensuring that Romania's medium-term goals under the EU's Growth and Stability Pact remained on track, which also helped anchor the fiscal consolidation.

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<sup>14</sup> The details of EU cooperation under Romania's SBA are similar to those discussed in Appendix I of [Hungary—Ex Post Evaluation of Exceptional Access Under the 2008 Stand-By Arrangement](#) (IMF Country Report No. 11/145).

46. **Post-program engagement with the Fund appropriately continues with a successor precautionary SBA.** The successor SBA was approved upon completion of the seventh review in March 25, 2011, with projected capital flows in 2011 and 2012 expected to cover the financing needs. The authorities viewed the new precautionary SBA as an effective insurance against possible future shocks and maintain policy discipline to achieve their fiscal consolidation objectives while undertaking deeper structural reforms. The total financing cushion is €5.4 billion, with €3.6 billion in precautionary support from the Fund (300 percent of quota), €1.4 billion in precautionary support from the EU, and the remainder from the World Bank. The authorities are pressing ahead with further fiscal consolidation and structural reforms in key areas, including achieving efficiency gains in the public sector, and reforming health care and capital expenditure, general government arrears, tax administration, and SOEs. These reforms should help put Romania in a better medium-term fiscal position and boost potential growth.

**Table 1. Romania: Structural Conditionality and Prior Actions Under 2009 SBA**

<b>Structural Benchmarks</b>	<b>Time of Proposal</b>	<b>Status</b>
<b>Fiscal policy</b>		
Ratification by parliament of fiscal measures approved by the government	Initial SBA	Reset as PA
Passage of revised public compensation legislation	Initial SBA	Met, partially
Presentation of fiscal responsibility legislation and implementation plan to parliament	Initial SBA	Met
Passage of revised pension legislation	Initial SBA	Reset as PA
Approval of agreed 2010 budget	1st Review	Met
Approval of legislation and internal regulations necessary to implement tax administration reforms	1st Review	Met
Approval of institutional reforms measures to mitigate fiscal risks from local govts.	1st Review	Met
Legislative changes to improve monitoring the control of SOEs	1st Review	Met
Passage of Fiscal Responsibility Law	2nd & 3rd Review	Met
Passage of implementing legislation for the organic wage law	2nd & 3rd Review	Reset as PA
Reform tax administration methodology for high net wealth individuals	4th review	Met
Integrate the accounting reporting system with the Treasury payment system	4th review	Met
Parliamentary approval of agreed 2011 budget	5th review	Reset as PA
<b>Financial sector</b>		
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	Initial SBA	Met
Passage of amendments to deposit insurance legislation to broaden grounds for its activation, expedite payouts and provide a line of credit from the government	Initial SBA	Met
Passage of amendments to the banking and winding-up laws to enhance the bank resolution framework, in consultation with the IMF	Initial SBA	Met
Reform of the DGF's funding regime through increase in bank's contribution rates and elimination of stand-by credit lines, and review of DGF governance arrangement	4th review	Met, partially
Parliamentary ratification of amendments to the bank resolution framework	5th review	Met, partially
Amend deposit insurance legislation to ensure that neither members of the board nor employees of credit institutions participate in the DGF board	5th review	Met
Amend legislation to allow the use of the deposit guarantee fund resources to facilitate bank restructuring, including purchase and assumption transactions	6th review	Missed, reset to the next program
<b>Prior Actions</b>		
<b>Fiscal Policy</b>		
Passage of 1.1 percent of GDP in fiscal measures to ensure achievement of fiscal targets	Initial SBA	
Enactment of agreed fiscal measures	4th review	
Repayment of RON 1.95 billion in arrears and unpaid bills, most in the health sector	5th review	
Ensuring central government and social security arrears at near zero at end-Nov. 2010	6th review	
Enactment of pension reform	6th review	
<b>Financial sector</b>		
Conducting stress-tests on banks with > 1% of system assets and certain smaller banks to assess the need for additional capital	Initial SBA	
Amending ordinance on credit contracts so that it improves transparency and protects consumer rights while safeguarding the stability of the financial system	6th review	



**Table 2. Romania: Quantitative Program Target and Actual Values Under the 2009 SBA <sup>1/</sup>**

	Program		1st Review		2nd & 3rd Review		2nd & 3rd Review		4th Review		5th Review		6th Review		7th Review	
	Mar-09		Jun-09		Sep-09		Dec-09		Mar-10		Jun-10		Sep-10		Dec-10	
	PC Target	Actual	PC Target	Actual	PC Target	Actual	PC Target	Actual	PC Target	Actual	PC Target	Actual	PC Target	Actual	PC Target	Actual
Cumulative change in net foreign assets (mln euros) <sup>2/</sup>	...	-3500	-7600	-5119	-8720	-4566	-10000	-4874	-2000	779	-4040	-509	-2000	-318	-2000	-750
Cumulative floor on general government overall balance (bn lei)	...	-8300	-14508	14456	-26900	-25563	-36500	-36101	-8250	-8422	-18200	-18015	-27505	-23732	-34054	-33621
Cumulative change in general government Arrears (bn lei)	...	...	0	0.49	1.1	1.4	0.91	1.5	1.27	1.76	1.09	1.8	0.81	1.57	0.48	1.13
Ceiling on general government guarantees issued during the year (face value, bn lei)	...	...	6	0.02	7.7	0.7	7.7	2.5	12	4.6	12	5.6	12	6.5	12	7.6

1/ Nonaccumulation of external arrears was a continuous PC, and was met.

2/ Relative to December 2008 stock

**Table 3. Romania: Selected Economic Indicators, 2008–11**

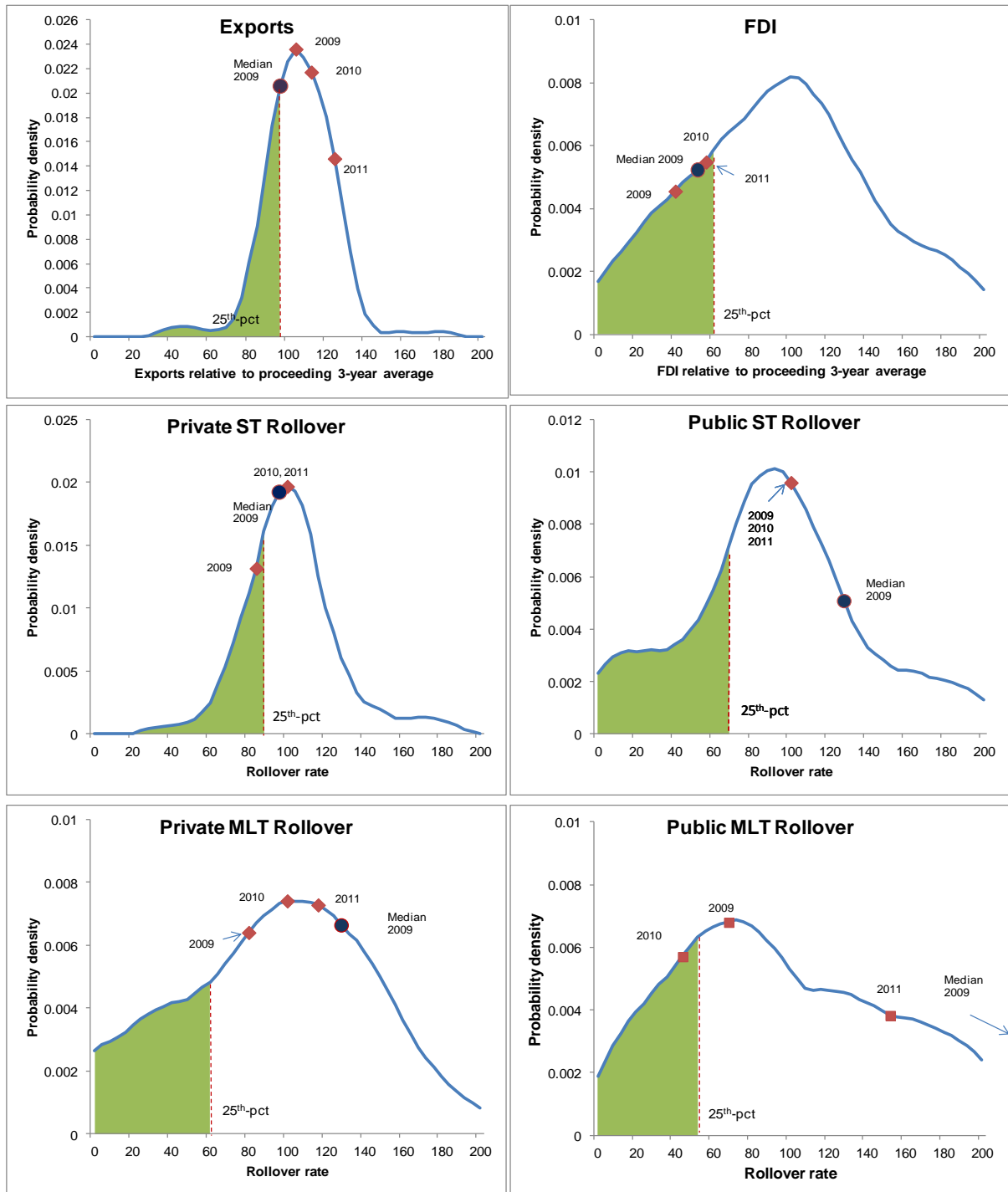
	2008	2009		2010		2011	
		Program	Actual	Program	Actual	Program	Proj.
<b>Output and prices</b>							
				(Annual percentage change)			
Real GDP	7.3	-4.1	-7.1	0.0	-1.3	5.0	2.0
Domestic demand	8.3	-8.2	-14.6	-2.7	-1.0	5.7	1.9
Net exports	-1.0	7.8	7.5	3.9	-0.2	-2.6	0.0
Consumer price index (CPI, average)	7.8	5.9	5.6	3.9	6.1	3.5	5.9
Consumer price index (CPI, end of period)	6.4	4.5	4.8	3.5	8.0	3.5	3.6
Unemployment rate (registered, average)	4.0	8.9	6.3	9.7	7.6	7.7	5.3
Nominal wages	23.7	5.9	8.5	3.8	2.4	5.2	5.3
<b>Saving and Investment</b>							
				(In percent of GDP)			
Gross domestic investment	31.3	30.8	25.3	29.9	26.5	31.9	27.3
Gross national savings	19.7	23.2	21.1	23.4	22.4	25.7	23.3
<b>General government finances</b>							
Revenue	32.2	33.0	31.4	33.4	32.8	33.1	33.0
Expenditure	37.0	37.5	38.7	37.0	39.4	35.8	37.3
Fiscal balance	-4.8	-4.6	-7.3	-3.6	-6.5	-2.7	-4.3
Privatization proceeds 1/	0.1	0.0	0.1	0.0	0.1	0.0	0.1
External financing	0.4	2.8	2.6	1.1	2.9	0.2	3.1
Domestic financing	2.9	1.8	5.8	2.4	4.1	2.5	1.9
Structural fiscal balance 2/	-8.5	-3.8	-7.0	-1.7	-5.1	-1.2	-2.8
Gross public debt (direct debt only)	11.8	23.6	21.8	25.7	28.7	25.7	31.6
<b>Money and credit</b>							
				(Annual percentage change)			
Broad money (M3)	17.5	6.6	9.0	6.5	6.9	11.5	8.3
Credit to private sector	33.7	16.4	0.9	4.8	4.7	3.3	4.8
<b>Balance of payments</b>							
				(In percent of GDP)			
Current account balance	-11.6	-7.5	-4.2	-6.5	-4.1	-6.2	-4.0
Merchandise trade balance	-13.7	-7.5	-5.8	-6.6	-4.9	-6.8	-3.5
Capital and financial account balance	12.7	-2.4	-2.5	3.3	1.2	7.8	2.3
Foreign direct investment balance	6.7	3.1	3.0	3.7	1.8	3.7	1.5
International investment position	-49.4	-56.8	-62.7	-55.8	-63.9	-54.1	-75.5
Gross official reserves	20.2	23.4	26.2	26.1	29.5	25.6	28.9
Gross external debt	51.8	64.2	69.0	68.5	75.7	64.0	77.5
<b>Memorandum Items:</b>							
Nominal GDP (in bn RON)	514.7	531.3	498.0	568.5	513.6	634.1	552.7

Sources: Romanian authorities; Fund staff estimates and projections; and World Development Indicators database.

1/ Excludes receipts from planned privatizations under the program.

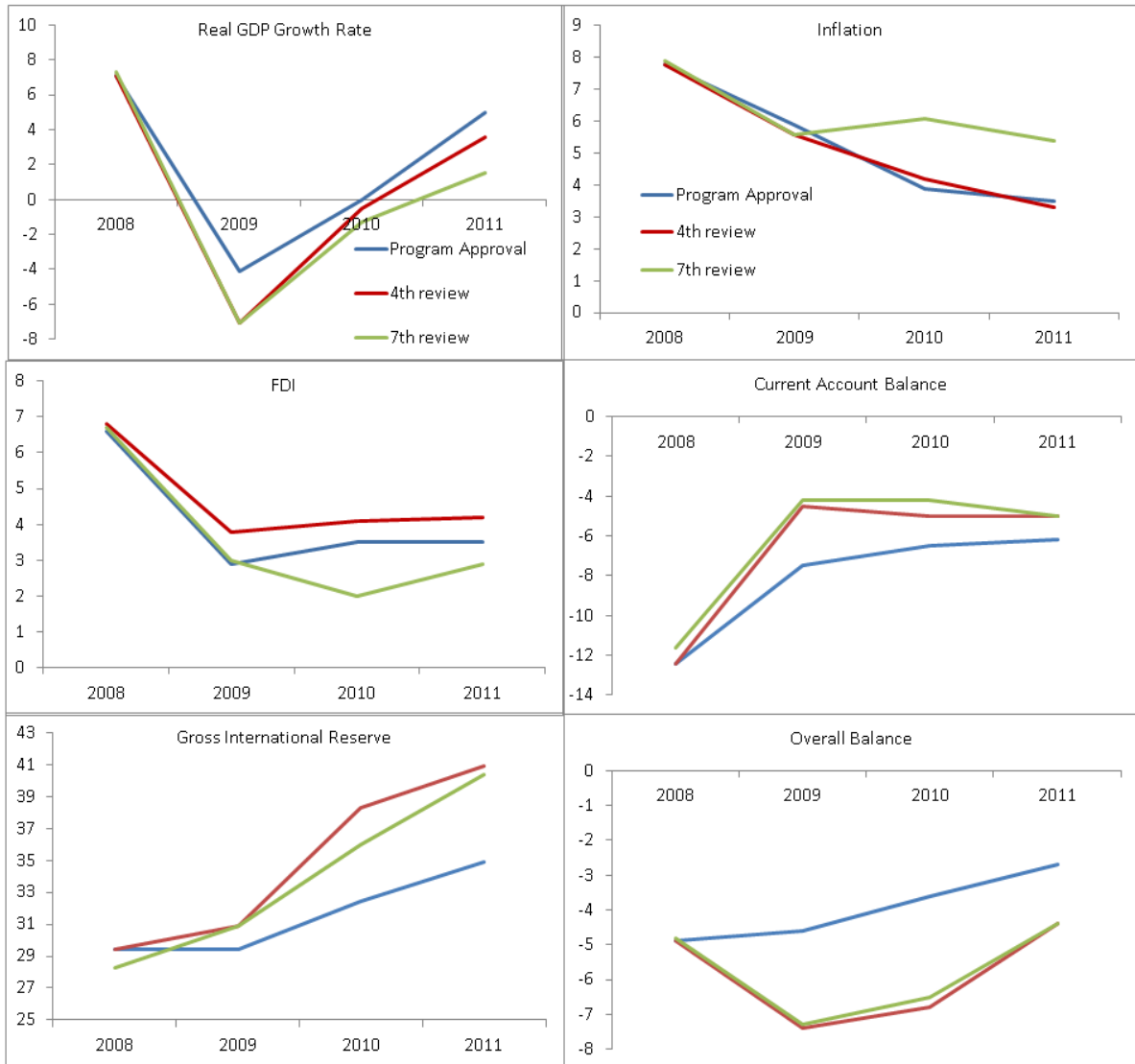
2/ Actual fiscal balance adjusted for the automatic effects of the business cycle.

Figure 1. Program Baseline Scenario 1/

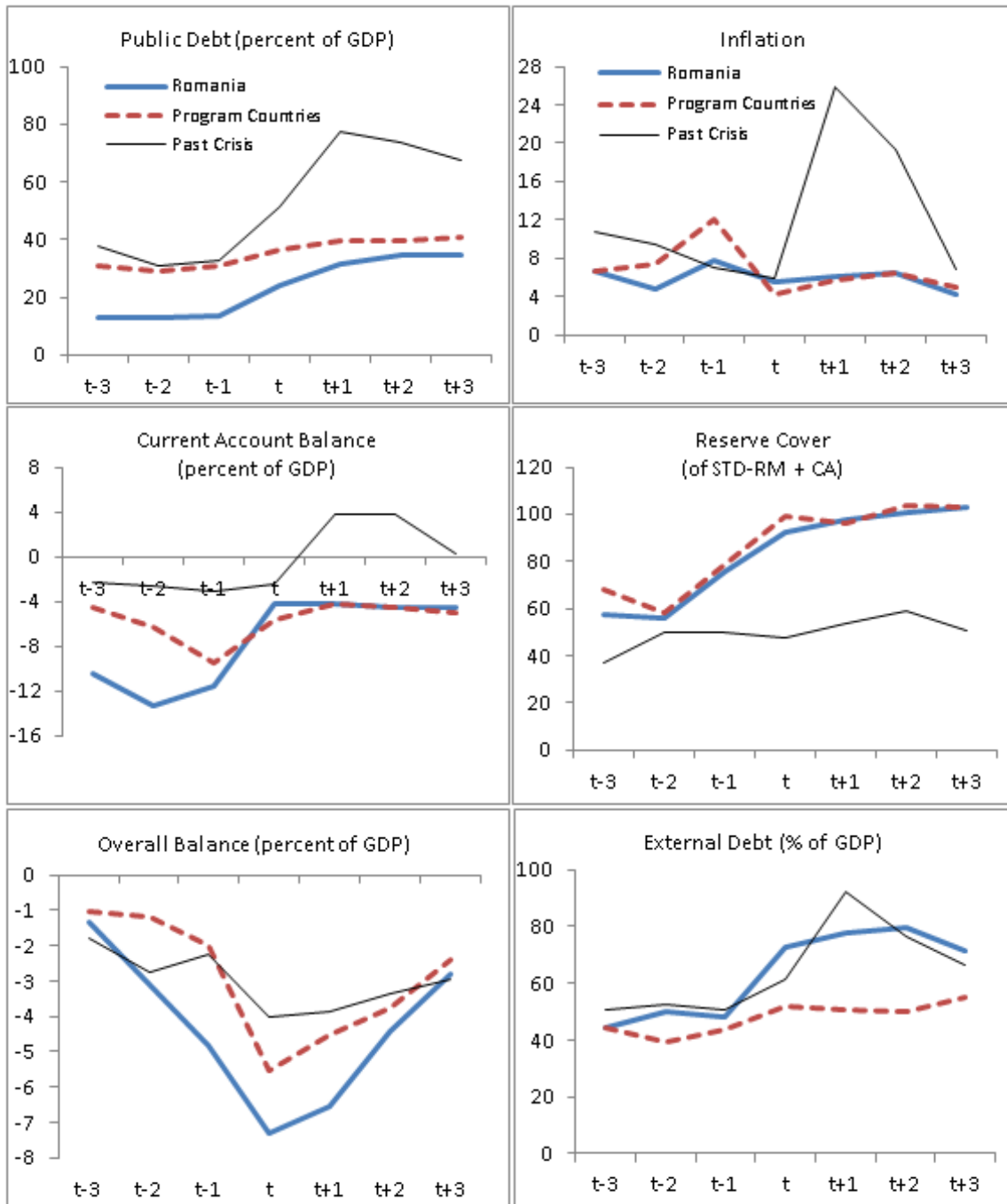


1/ The figure shows the density distributions of external variables across EMs arising from a decline in domestic demand and high financial stress in advanced economies, comparing the program baseline assumptions with past behavior of the variables during crises. For FDI and exports, baseline is the average in the three years prior to the crisis. Red dots are Romania's 2009 SBA assumptions; blue dots are the median of all SBAs approved in 2009. For more on this methodology, see [Review of the Flexible Credit Line and Precautionary Credit Line](#).

**Figure 2. Romania: 2009 SBA Program Projections**



**Figure 3. Macroeconomic Indicators: Cross Country Comparison 1/**



1/ t is the crisis year for past crises, aligning with 2008 for Romania and program countries.



## **Annex I. Romanian Authorities' Views on the Ex-Post Evaluation**

### **1. The authorities were in broad agreement with the findings of the evaluation.**

They agreed that 2009 SBA was well-conceived and beneficial to restore macroeconomic stability. The authorities noted their full commitment to achieving the program objectives and implementing the necessary measures. They recognized the program's positive role in restoring market confidence—as shown by the ability to tap the markets during the program period and not fully drawing on available funds under the SBA, paving the way for a follow-up precautionary arrangement. In conjunction with the Vienna Initiative—for which Romania served as the pilot case—the program helped to ensure banking system stability. They agreed that the program's flexibility in adjusting to evolving conditions, without compromising the program goals, enhanced its credibility.

### **2. On specific program measures, the authorities noted the following:**

- *Public compensation reforms:* The authorities were aware that it would take time to fully implement the new Unified Wage Law. They noted that the law had already achieved a lot, especially in unifying the legal basis for wages across the general government and limiting bonus payments, and expect its full implementation by 2016 if there is economic growth.
- *Absorption of the EU structural funds:* The authorities agreed that the funds could have been absorbed better in the absence of bureaucratic barriers. They noted that a lot of time was wasted during 2007-08 in the absence of clear procedures for the approval of EU funded projects. They also faced difficulties in meeting European standards for regulations such as procurement procedures. Consequently, a new Ministry of European Affairs has been created and guidelines are now in place to help improve absorption, although a few challenges in meeting EU requirements still remain. They noted that the current program has clear targets for absorption (€6 billion in 2012).
- *Arrears:* The authorities considered the program targets for arrears may have been too ambitious given how entrenched the problem was, particularly in local governments. Getting rid of the stock of arrears at the local government level remains a challenge. They emphasized that important progress was achieved in resolving health care arrears, but noted that they continue to search for permanent solutions to prevent arrears even under the current program. They are seeking greater help from the World Bank to help resolve issues in the health care sector.
- *Rising non-performing loans (NPLs):* The authorities noted that the more decentralized approach to lower NPLs worked well for Romania, particularly considering the growth outlook at the time. Specifically, rather than establish an asset management company for a centralized approach to restructure bad loans, they

preferred a disaggregated and bank-driven approach, in part to avoid committing public funds. They also thought that creating a bad bank may impart worse negative signals than actually warranted by the underlying problem. Overall, they considered the high loan loss provisioning and regular offsite supervision of banks as policy choices that mitigated the risks from the high NPLs. They feel confident that as the economy recovers, the size of NPLs is likely to follow a firm downward trend.

- *NFA target*: The inclusion of reserve requirement for FX deposits as part of the NFA target was aimed at maintaining a high and stable FX reserve requirement rate. This was needed to ensure that banks held higher levels of FX liquidity given the prevailing mismatch between FX lending and deposits, and because of the sizeable share of non-residents holdings of deposits. In the event, however, the FX reserve requirement was lowered during the program period as the NFA targets were consistently exceeded, and as the financial sector stabilized. The risk of “window-dressing” was also not a concern given the over-performance of the NFA target.