INTERNATIONAL MONETARY FUND

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ROMANIA

May 2017

EX-POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2013 STAND-BY ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ROMANIA

The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 22, 2017 consideration of the Evaluation.
- The **Ex-Post Evaluation of Exceptional Access Under the 2013 Stand-By Arrangement** prepared by a staff team of the IMF for the Executive Board's consideration on May 22, 2017, following discussions that ended on March 17, 2017, with the officials of Romania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 4, 2017.
- A **Statement by the Executive Director** for Romania.

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May 25, 2017

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IMF Executive Board Concludes Article IV Consultation with Romania and Ex-Post Evaluation of Exceptional Access Under the 2013 Stand-By Arrangement

On May 22, 2017 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Romania.

Romania saw strong economic growth in 2016, resulting in a closed output gap. Private consumption was boosted by an expansionary and pro-cyclical fiscal policy and wage increases. The cyclically adjusted budget deficit grew by 1½ percent of GDP in 2016, reflecting large tax rate cuts and wage increases. Headline inflation remained subdued due to indirect tax cuts, administrative price adjustments, and low euro area inflation and oil prices. There has been welcome progress in reducing banking sector non-performing loans.

Growth is expected to reach 4.2 percent in 2017—supported by continued stimulus to private consumption from a new round of fiscal relaxation and wage increases—and to moderate to 3½ percent in the medium term. A reorientation of policies—from stimulating consumption to supporting investment—is required to reduce poverty, raise medium term growth, and accelerate the pace of convergence towards the EU's income level.

The main risks to the economic outlook include a perception of weakening fiscal prudence or institutions, which could adversely affect market confidence. This, together with heightened political tensions, could erode consumption and investment, increase the cost of government borrowing and put pressure on the exchange rate which would affect banks' balance sheets through their FX exposures. Maintaining adequate reserve levels, a flexible exchange rate, and fiscal buffers will help against such risks. Prudent economic policies and visible steps to accelerate the pace of structural reforms and improve governance would send a powerful signal about Romania as a good place for doing business.

The Executive Board also discussed an ex post evaluation of the precautionary SBA with Romania approved in September 2013. The ex post evaluation finds that while policy

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

objectives under the program were broadly appropriate, and some progress was achieved, setbacks on key structural reforms and concerns about the quality of fiscal measures prevented program completion. The report also includes recommendations for the design of future Fund programs.

Executive Board Assessment

Executive Directors welcomed Romania's progress in reducing economic imbalances after the global financial crisis. Growth has been robust in recent years and unemployment has declined. Directors noted, however, that the recent deterioration in fiscal policies and a weakened pace of structural reforms could threaten these gains. Against this background, they underscored the need for a reorientation of policies from stimulating consumption towards supporting investment to protect buffers and sustainably raise living standards.

While observing that Romania's public debt is relatively low, Directors highlighted that the recent and projected fiscal expansion is not warranted by the economy's cyclical position. Successive tax cuts have reduced revenues while the share of wages and pensions has grown at the cost of investment. Directors underscored that additional measures would be needed to keep the fiscal deficit below the authorities' target of 3 percent of GDP in 2017.

Directors noted that the unified wage bill and further tax cuts pose risks to the fiscal balance. They called for targeting a medium-term deficit of 1.5 percent of GDP to protect buffers and gradually reduce public debt. Directors emphasized the need to avoid further tax cuts, moderate pension increases, and carefully assess and modify the planned unified wage law in line with available fiscal space and the medium-term fiscal objectives. They encouraged efforts to enhance the effectiveness of the public sector. These include strengthening revenue administration, enhancing expenditure efficiency, and strengthening transparency and commitment controls for local investment programs.

Directors noted that there has been some progress with structural reforms. They emphasized the need to reenergize the reform momentum to secure faster convergence with the EU. Priority should be given to improving the performance of state-owned enterprises, including by restarting the privatization and restructuring program, and fully implementing the corporate governance law. Directors also called for stronger efforts to strengthen public investment management institutions to fully utilize EU funds and improve the quality of domestically-financed public investment. Recognizing progress made in the fight against corruption, Directors encouraged the authorities to maintain the momentum.

Directors encouraged the central bank to remain vigilant to rising inflationary pressures and to consider tightening monetary conditions. They recommended supporting higher market rates by narrowing the interest rate corridor and absorbing excess liquidity. This would lay the groundwork for a subsequent policy rate hike.

Directors commended the significant reduction in nonperforming loans and underscored the need for continued efforts to reduce them further, especially for corporate loans. They welcomed the decisions of the Constitutional Court which have lessened threats to financial stability. Directors called for close monitoring of the growing exposure of banks to households and government debt and taking steps to mitigate emerging risks.

Directors broadly agreed with the conclusions of the ex post evaluation of the precautionary SBA approved in September 2013. They noted that while policy objectives under the program were broadly appropriate and some progress was achieved, setbacks on key structural reforms and concerns about the quality of fiscal measures prevented program completion. Directors considered that the EPE on Romania held some potentially useful lessons for the design of future Fund programs, including the need to pay close attention to political economy and capacity constraints, prioritization and sequencing of reforms, and private sector balance sheets and their role in the financing of the economy.

Romania: Selected Economic Indicators

Population: 19.8 million (2015)
Quota: 1,811 million SDRs (0.4% of total)
Key export markets: European Union (Germany, Italy, France)
Main products and exports: Machinery and transport equipment, manufactured goods

Per capita GDP: US$8,956 (2015)
Literacy rate: 99.3%
People at risk of poverty: 37.3% (2015)

	2015	2016	2017	2018
		Prel.	Proj.	
Output				
Real GDP growth (%)	3.9	4.8	4.2	3.4
Output gap	-1.2	0.3	1.1	0.9
Employment				
Unemployment (%)	6.8	5.9	5.4	5.2
Prices				
CPI inflation (%, period average)	-0.6	-1.6	1.3	3.1
General government finances				
Revenue	32.8	29.0	29.1	29.3
Expenditure	34.3	31.4	32.7	33.1
Fiscal balance	-1.5	-2.4	-3.7	-3.9
Primary balance	-0.2	-1.1	-2.3	-2.5
Structural fiscal balance 1/	-0.5	-2.3	-3.8	-3.9
Public debt (including guarantees)	39.4	39.1	40.5	41.7
Money and credit				
Broad money (% change)	9.7	9.7	8.7	7.9
Credit to the private sector (% change)	3.0	1.2	4.0	4.4
Policy rate (percent) 2/	1.75	1.75	-	-
Balance of payments				
Current account (% GDP)	-1.2	-2.3	-2.7	-2.5
FDI (% GDP)	-1.8	-2.3	-2.2	-2.1
Reserves (months imports)	5.9	5.3	5.1	5.1
External debt (% GDP)	56.5	54.6	52.9	49.8
Exchange rate				
REER (% change)	-0.8	1.4	…	…

Sources: Romanian authorities, World Bank, Eurostat and IMF staff calculations.

1/ Fiscal balance (cash basis) adjusted for the automatic effects of the business cycle and one-off effects.

2/ For 2016, latest available data.

INTERNATIONAL MONETARY FUND

ROMANIA

May 9, 2017

EX-POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2013 STAND-BY ARRANGEMENT

EXECUTIVE SUMMARY

A 24-month precautionary Stand-By Arrangement (SBA) was approved in September 2013. The SBA, in an amount of SDR 1,751 million (170 percent of quota), was supported by the European Union and the World Bank and entailed exceptional access given Romania's cumulative use of Fund resources. It followed on the heels of two previous SBAs, which had considerably reduced external and fiscal imbalances. Since 1991, a total of ten programs have been approved with Romania and, at the time of the 2013 SBA request, Romania was the fourth largest Fund borrower.

The program's broad objectives were to secure the fiscal position, pursue prudent monetary and financial policies, and boost economic growth. Structural reforms—particularly relating to state-owned enterprises (SOEs)—were key to paving the way for higher sustainable growth. With much fiscal consolidation having been achieved prior to 2013, the adjustment envisaged under the program was moderate (about ½ percent of GDP annually). The financial sector leg of the program aimed to strengthen bank balance sheets under still volatile external market conditions, while monetary policy focused on attaining NBR's inflation target, and, at the same time, supporting exchange rate flexibility and seeking to preserve international reserves.

The program could not be completed, on account of setbacks on structural reforms and concerns about fiscal policy. Although the program had strong political support initially, the 2014 elections and improved macroeconomic and financing conditions reduced incentives for undertaking difficult structural reforms. By the time of the third review in June 2014, progress implementing key reforms suffered setbacks and more expansionary fiscal policies threatened to give rise to a large fiscal gap. In the end, the envisaged SOE sector restructuring did not materialize, fiscal objectives were achieved through low-quality measures, and public investment fell short of expectations. As a result, the 2nd program review (March 2014) was the final one completed under the program. The program, which remained precautionary, expired in September 2015.

Despite shortfalls in key areas of the program, there were several successes. Over the program period, growth exceeded expectations, fiscal consolidation was attained, the external position was strengthened, inflation fell, and reserve buffers exceeded projections. Progress was also achieved in reducing SOE arrears, strengthening banks' balance sheets and reducing non-performing loans, reforming healthcare, and deregulating energy prices. Some reforms continued to be implemented after the program expired in 2015.

While policy objectives under the program were broadly appropriate, a combination of factors undermined their achievement. With major imbalances corrected, the program appropriately focused on safeguarding macroeconomic stability and advancing structural reforms. However, expectations regarding progress on structural reforms, including in the fiscal area, proved too ambitious. Attempts to frontload reforms to get ahead of the electoral cycle proved unsuccessful given the proximity of the elections, implementation capacity constraints, and the Fund's limited expertise in some reform areas.

One lesson from Romania's experience is that an assessment of political economy constraints could figure more prominently in program design. While commitment at the highest level of government was provided early on, program ownership proved insufficient as the election drew near. Romania's history of weak structural reform implementation could also have played a greater role in tempering reform expectations. More in-depth analysis of the political economy of reform would help to inform about the timing of the program and realism of its objectives. This is especially important in cases like Romania, where politically difficult to implement structural reforms are a centerpiece of the program and when a country has a history of prolonged use of IMF resources. At the same time, past weaknesses should not prevent staff from proposing ambitious but achievable goals.

Romania's 2013 SBA experience also suggests the need for greater prioritization of reforms and of capacity building in program design. Reform prioritization in areas such as raising high-quality investment, strengthening tax revenues, and ensuring fiscal discipline, as well as more judicious use of conditionality could help deliver on realistic objectives, allow time to build capacity, and maintain ownership. Programs with heavy structural reform agendas like Romania may also benefit from spreading out reforms over the program duration. This is particularly relevant where multiple institutions are involved and when demands on the authorities can overwhelm the capacity to implement reforms. Identifying capacity needs early on, and closely integrating them with program priorities would increase the likelihood of program success.

Other lessons from Romania's 2013 SBA concern the need to enhance coordination between institutions, particularly in areas where the Fund has limited expertise in order to facilitate program implementation; accord higher priority to private sector balance sheets and financing of the economy so as to mitigate associated risks; and ensure the quality of fiscal measures and discipline. More clarity on the operational framework for monetary policy would also have added transparency and helped guide market expectations.

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The European Department, and the Strategy, Policy, and Review Department

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INTRODUCTION

1. In September 2013, Romania requested a successor 24-month SBA (SDR 1,751.34 million, about €2 billion or 170 percent of quota) to continue the economic adjustment initiated under previous programs. The authorities intended to treat the SBA as precautionary as Romania was not expected to face pressing balance of payments financing needs, and had access to the European Union's balance of payments facility (€2 billion) and a World Bank Development Policy Loan (€1 billion).

2. Program implementation was difficult against the backdrop of political transition. Only two of the five reviews envisaged under the 2-year arrangement were completed, with the first review delayed by three months. By the time that the third review was under discussion, in June 2014, Romania had entered an electoral cycle—starting with EU parliamentary elections (summer 2014) and the Presidential election (end-2014). Key structural reforms stalled, and expansionary fiscal measures raised concerns about the emergence of a large fiscal gap. The program expired in September 2015, without another review being completed.

3. This report conducts an Ex-Post Evaluation (EPE) of Romania's 2013 SBA. Because the 2013 SBA entailed exceptional access (given Romania's cumulative use of Fund resources), an EPE is mandatory.[1] As with all EPEs, the purpose of this report is to (i) review performance against program objectives; and (ii) evaluate whether the macroeconomic strategy, program design, and financing were appropriate to address Romania's challenges.[2]

BACKGROUND TO THE 2013 SBA ARRANGEMENT

4. Following a severe downturn in economic activity during the 2008–09 crisis, Romania made substantial progress in restoring macroeconomic stability. Under two previous consecutive Stand-By Arrangements (SBAs), during 2009-2013, the country had succeeded in reducing large external and fiscal imbalances. The European Union and the World Bank provided financial and technical support. The authorities were also able to access markets continuously from 2010 onwards, while maintaining fiscal and external buffers and making repayments to the Fund.

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[1] Under the access limits applicable during Romania's SBA, access to GRA resources was exceptional when it exceeded 200 percent of quota in a year or 600 percent cumulatively, net of scheduled repurchases. See IMF (2010) "Ex Post Evaluations of Exceptional Access Arrangements—Revised Guidance Note", Washington DC.

[2] In accordance with procedures, this report was prepared at headquarters by an interdepartmental staff team, primarily on the basis of available documents and data. The team is grateful for discussions with Romanian officials, staff from the European Commission and World Bank, and with former Fund mission chiefs and staff who were involved in the 2013 SBA. The key findings from the EPE were discussed with the authorities during a staff visit on April 3, 2017 and their overall response is presented in Annex I.

Current Account Balance
(Percent of GDP)

Romania
Hungary
Poland
Czech Republic
Croatia
Bulgaria (rhs)

Source: IMF WEO database.

Fiscal Balance
(Percent of GDP)

Romania
Hungary
Poland
Czech Republic
Bulgaria
Croatia

Source: IMF WEO database.

Gross International Reserves
(Months of Imports)

Romania
Hungary
Poland
Czech Republic
Croatia
Bulgaria

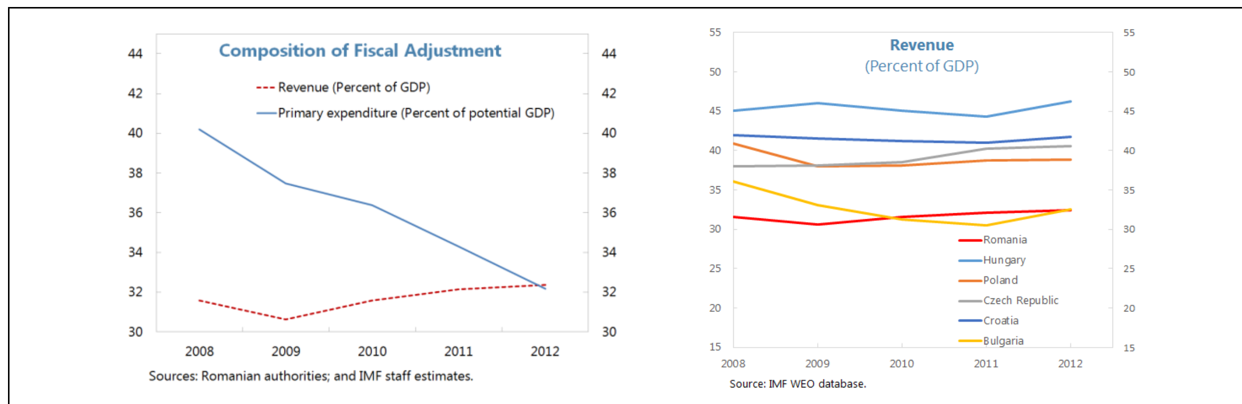
Source: IMF WEO database.

Inflation
(Percent)

Romania
Hungary
Poland
Czech Republic
Croatia
Bulgaria

Source: IMF WEO database.

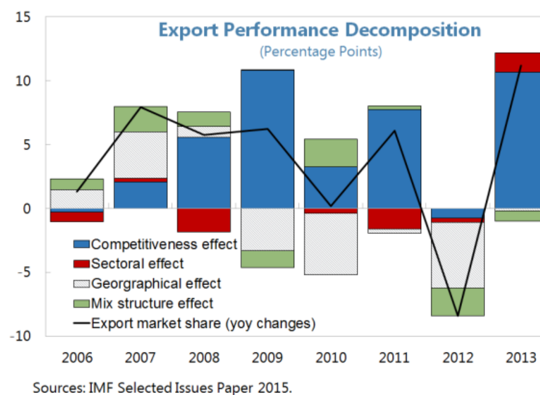
5. **Fiscal adjustment relied primarily on expenditure cuts.** Between 2009 and 2012, the fiscal deficit fell by 4.6 percentage points of GDP, two-thirds of which came from lower public spending, primarily related to lower public employment and capital expenditures. Revenue performance also improved, although revenue remained low by regional standards.



Sources: Romanian authorities; and IMF staff estimates.

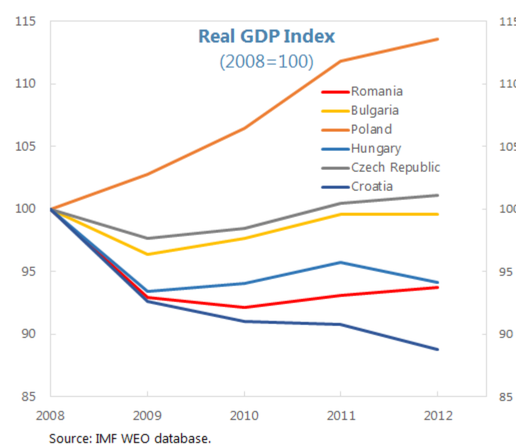
Source: IMF WEO database.

6. Improved competitiveness and weaker domestic demand helped achieve considerable narrowing in the external current account deficit. Prior to the global crisis, Romania consistently ran double digit current account deficits. By 2013 the deficit had been reduced to under 2 percent of GDP, with much of the adjustment in previous years coming from weaker domestic demand and strong export performance, which largely reflected enhanced competitiveness.[3]



Sources: IMF Selected Issues Paper 2015.

7. Despite the progress achieved under previous programs, the economic recovery remained tepid, concerns about external sustainability persisted, and significant progress was still needed in the structural area. Real GDP growth had yet to return to pre-crisis levels, and financial and external vulnerabilities remained a threat given the high level of NPLs and external debt rollover needs. The banking systems' dependence on parent bank funding, and susceptibility to deleveraging taking place in the euro area—as well as rising volatility in capital flows to emerging markets—represented additional risk factors, particularly when viewed against the backdrop of the recent global financial crisis. In the structural area, reforms were still needed to improve SOEs' financial performance, reduce SOE arrears, and raise the quality of public investment through improved absorption of EU funds.



Source: IMF WEO database.

8. Against this background, a request for a Fund program was made.

PROGRAM STRATEGY AND FINANCING

A. Program Strategy

9. Romania embarked on the precautionary SBA in September 2013. The key objectives were to: (i) secure the fiscal position; (ii) continue prudent monetary and financial policies to restore

[3] Romania's Selected Issues Paper (March 2015) suggested that structural factors—including improved infrastructure and specialized training services—helped strengthen Romania's competitiveness.

buffers and shield the economy against external shocks; and, (iii) reduce structural bottlenecks to growth. To achieve these broad objectives, the program was based on four main pillars.

10. The first pillar of the program was to continue fiscal adjustment and strengthen the fiscal institutional framework. The authorities aimed to gradually reach their medium-term budget objective (MTO) of a structural deficit of 1 percent of GDP (in ESA terms)[4] in 2015. This implied fiscal adjustment of around ½ percentage point of GDP annually in 2013–14 to be achieved through a mix of tax measures and expenditure rationalization. To underpin the required adjustment effort and contain fiscal risks, the program placed strong emphasis on fiscal structural reforms to strengthen fiscal institutions, and better control spending at all levels of the public sector to avoid future arrears.

11. The second pillar of the program consisted of structural reforms to pave the way for higher sustainable growth. The authorities planned to pursue a three-pronged approach comprising: (i) strengthened measures to reduce arrears of central-government owned enterprises; (ii) further efforts to enhance SOE governance and transparency; and, (iii) reforms to improve pricing and efficiency in the energy and transportation sectors. Implementation of structural reforms had encountered strong political resistance under the last program and, some structural "heavy-lifting" through a frontloaded agenda was envisaged under this program to complete the reforms initiated previously. The reforms were supported by other multilateral donors (WB, EBRD, EC), and were assessed to be macro-critical on the basis that they could spur economy-wide investment, permanently lift the growth trajectory, and enable the development of underutilized energy resources.

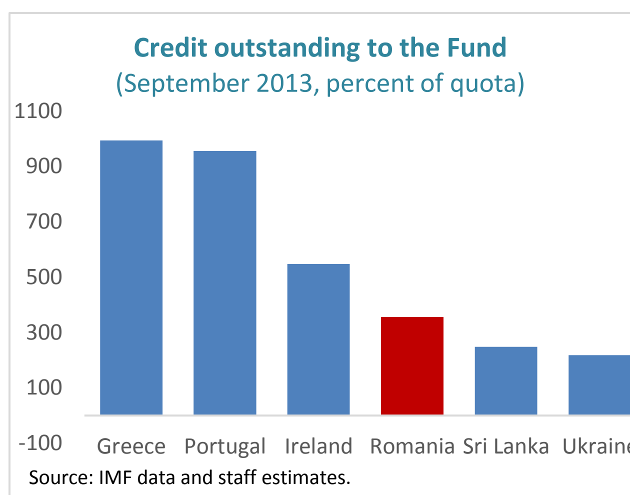
12. The third pillar of the program rested on strengthening the resilience of the financial sector. The program sought to reduce the banks' sizable NPLs, finalize the operational preparedness for bank resolution powers, and further strengthen financial sector supervision. Measures were also envisaged to facilitate access to credit as the economy recovered.

13. The fourth pillar of the program aimed at ensuring prudent monetary and exchange rate policies while maintaining foreign reserves buffers. Key objectives were to maintain prudent monetary policy in line with the NBR's inflation target and support exchange rate flexibility while seeking to preserve international reserve buffers to guard against external shocks. Most standard reserve metrics assessed the level of reserves at program approval as broadly adequate. Over the program period, substantial repayments to the Fund and a first repayment to the EC were expected to weigh on reserves. Within the context of an uncertain external environment, the program thus aimed to preserve external stability.

[4] The European system of accounts (ESA) 2010 is the European legal requirement for the production of national accounts statistics since September 2014.

B. Program Financing

14. Romania has a long history of financial arrangements with the Fund. Romania has had a program with the Fund for 23 of the last 25 years. Since 1991, a total of ten programs have been approved and, at the time of the 2013 SBA request, Romania was the fourth largest Fund borrower (Table 2 and chart). All obligations to the Fund under these programs have been met in a timely manner.



Source: IMF data and staff estimates.

15. Romania's 2013 SBA envisaged exceptional access. Romania's annual access limits under the program were relatively low. Program resources were available at 37.8 percent of quota in 2013, 75.6 percent of quota in 2014, and 56.6 percent of quota in 2015. Disbursements would be in equal installments of 18.9 percent of quota. However, given Romania's long history of Fund arrangements, the cumulative access by Romania to the Fund's general resources (net of scheduled purchases) exceeded normal access, requiring evaluation under the exceptional access framework.[5]

16. Romania was not expected to face immediate balance of payments needs under the 2013 precautionary SBA, yet financing risks remained. Under staff's baseline assumptions, continued portfolio inflows, and renewed private sector capital inflows, including FDI, would fully cover the current account deficit. The government was expected to fully rollover its external obligations. However, Romania, like a number of other emerging markets, remained vulnerable to adverse developments in international financial markets, which could produce a scenario whereby the authorities might need to draw on the proposed SBA. Furthermore, a protracted recession in the euro area and uncertainty about the path of US monetary policy normalization were plausible risks that could exacerbate balance of payment pressures and give rise to systemic stability concerns given the large volume of foreign-currency lending. In staff's view, access of 170 percent of quota (SDR 1,751.34 million) under the SBA, together with precautionary resources under the EU's balance of payments facility (€2 billion) and a World Bank Development Policy Loan (DPL DDO, €1 billion), provided a sufficient financing cushion against such an adverse scenario.

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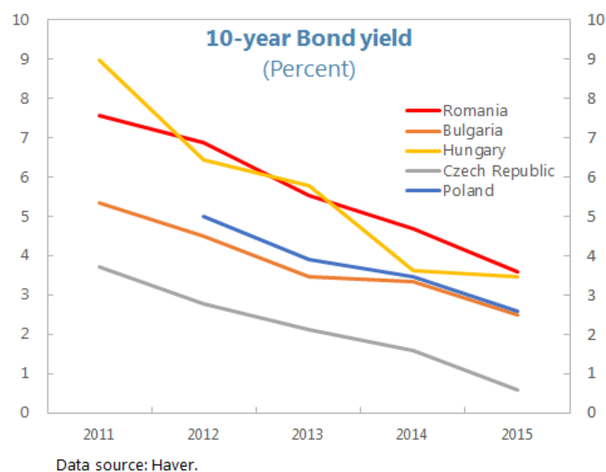
[5] Prior to the completion of the 14th General Review of Quotas, exceptional access in the General Resources Account constituted levels beyond (i) an annual limit of 200 percent of quota; and (ii) a cumulative limit of 600 percent of quota, net of scheduled repurchases. Romania's credit outstanding to the Fund peaked in October 2013 at 625 percent of quota.

17. The authorities did not draw on the SBA and the program expired in September 2015. By the time of the 3rd review, which was expected in mid-2014, the program stalled and was never completed. By that time, Romania had market access at more favorable market conditions and the government had no near-term financing need. External financing for 2014 was completed, and domestic financing largely front-loaded. Subsequent discussions to bring the program back on track were unsuccessful as reforms continued to stall after the 2014 elections.



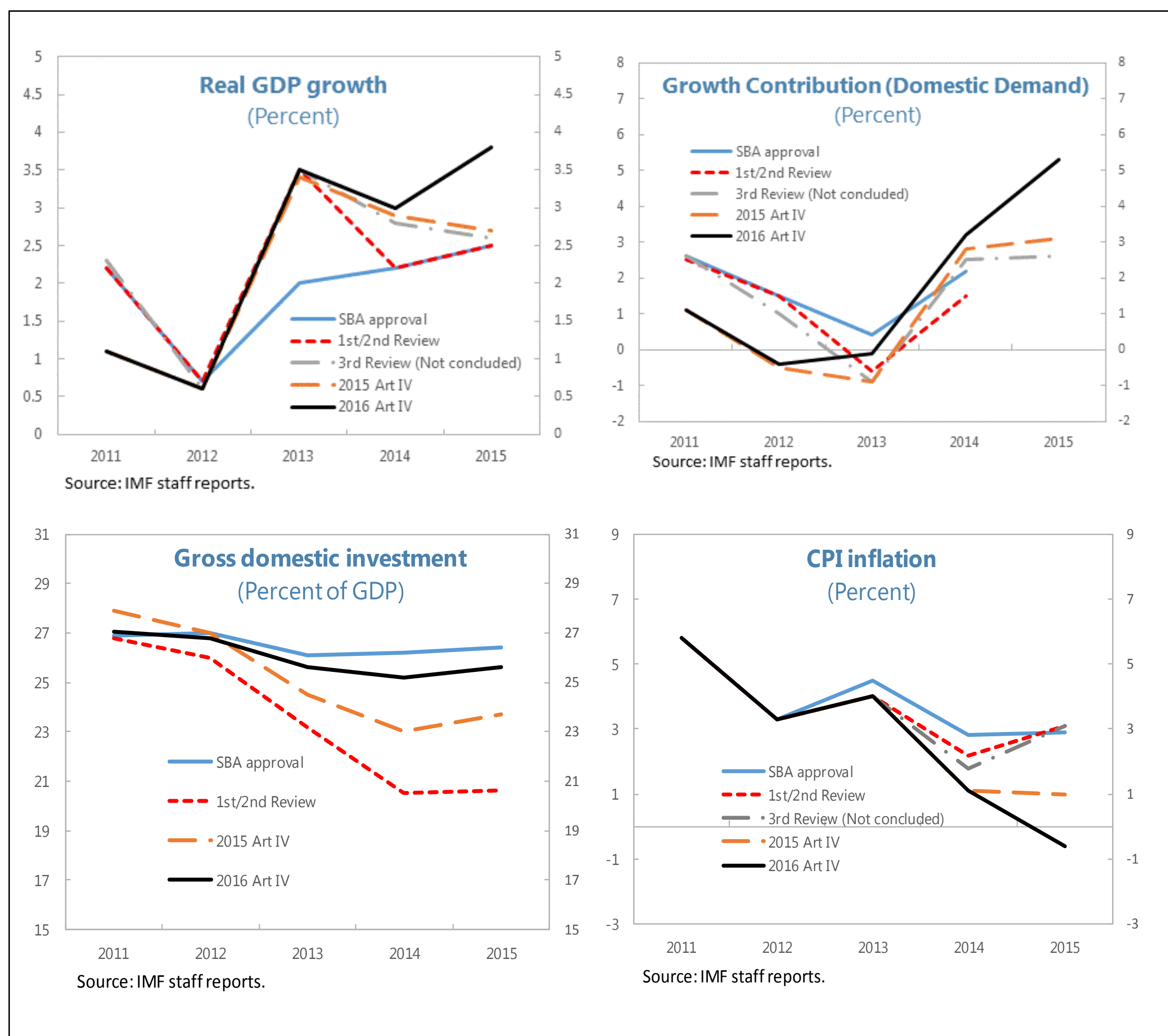
Data source: Haver.

PROGRAM PERFORMANCE

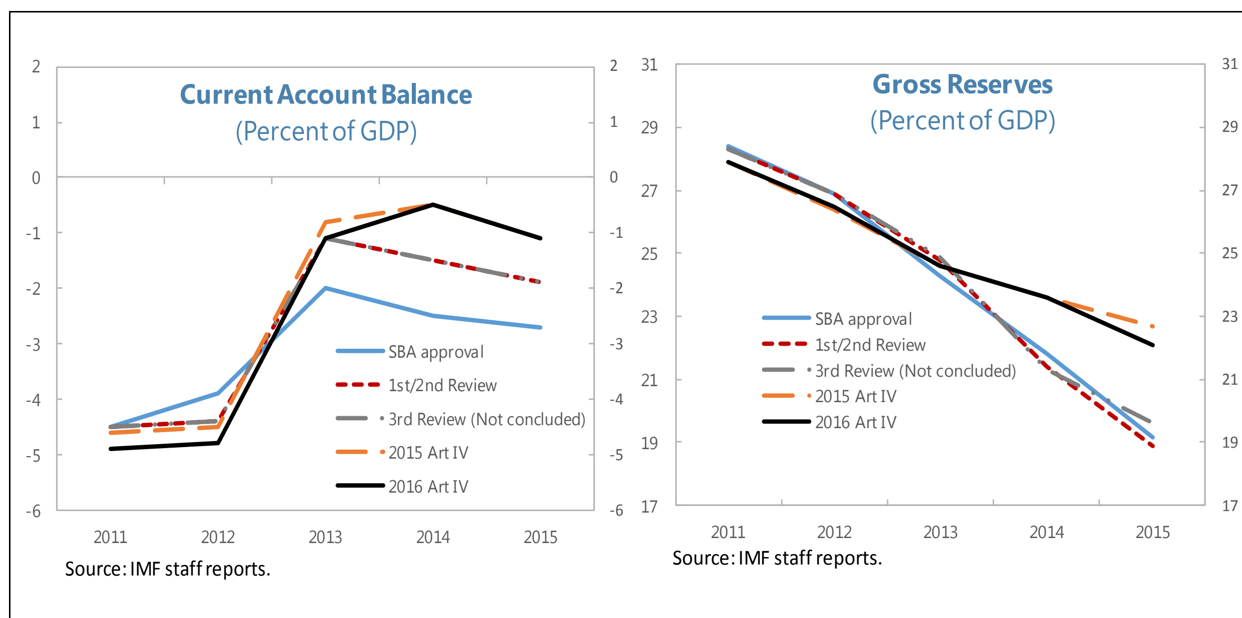
18. Overall economic outcomes exceeded program projections but implementation was insufficient to complete the third review. On the fiscal front, the deficit target was achieved through low-quality measures and fiscal rules were circumvented, while progress on fiscal structural reforms was mixed. Despite some progress on the structural reform front, setbacks in many areas—including deterioration in SOEs' financial performance and missed arrears reduction targets—also prevented the third review from being completed. Overall implementation of program targets was mixed, with about half of envisaged structural benchmarks either not met or met with delay.

A. Macroeconomic Outcomes

19. Economic performance exceeded program projections. Strong export growth in 2013 raised GDP growth to 3.5 percent from 0.6 percent a year earlier. The momentum continued in 2014, when the economy grew by 3.1 percent, supported by stronger consumption, which benefited from lower inflation and more accommodative monetary conditions. Inflation fell faster than expected, on account of lower food prices, lower imported inflation and indirect tax cuts. Fiscal and income policies, including a reduction in VAT rates for food items and higher public and minimum wages, drove GDP growth to a post crisis high of 3.8 percent in 2015. Gross domestic investment, however, underperformed compared to the level projected at the outset of the program.



20. External positions also outperformed. Higher than anticipated exports helped reduce the current account deficit to about 1 percent of GDP, below initial projections. The improved current account balance and stronger income receipts from the capital account, contributed to higher-than-forecasted reserve buffers, amounting to 6 months of next year's imports (from 5 months of imports forecasted at the outset of the program). This positive development occurred despite a persistent reduction in parent bank funding.



Source: IMF staff reports.

Source: IMF staff reports.

B. Fiscal Policy Outcomes

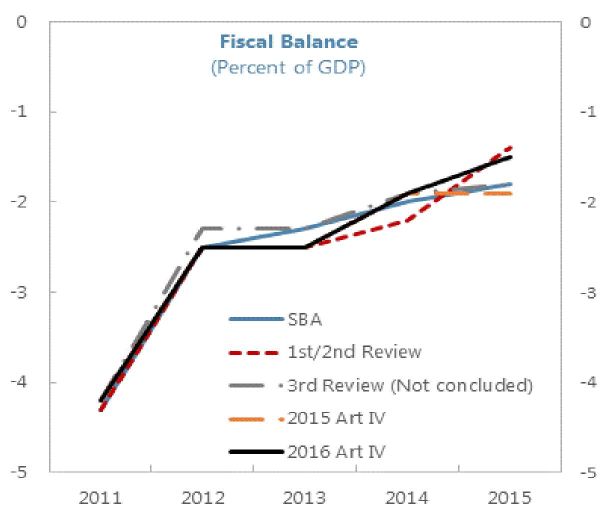
21. Gradual fiscal consolidation was pursued at the outset of the program. The 2013 deficit outturn of 2.5 percent of GDP breached the deficit target set at program approval by a small margin, largely due to underperforming revenues.[6] For 2014, a budget was approved consistent with a deficit target of 2.2 percent of GDP, 0.2 percentage point higher than that set at program approval, to create room for more co-financing of EU funds. In the event, EU-funded investment spending was considerably lower than expected. As a result, lower than programmed expenditures more than offset weak revenue performance and the overall fiscal deficit outturn (1.9 percent of GDP) was lower than budgeted.

22. More expansionary policies threatened to create a large fiscal gap in 2015. By the time of the third review in June 2014, concerns had grown that a potentially large fiscal gap (2 percent of GDP) was developing in 2015, on account of ad-hoc public wage increases and a tax reduction package that included cuts in the VAT rate and social security contributions.[7] Without sufficient specific compensating measures, it was difficult to foresee an achievement of the deficit target.

[6] Factors leading to underperforming revenues included a three-month delay in the excise increase on fuel products, declining VAT from imports, lower nontax revenues, and weaker collections partly due to a restructuring of the tax administration.

[7] Other fiscal policy changes included court-ordered compensation payments to teachers, higher defense spending, and corporate income tax deduction for reinvested profits. The authorities also wanted to implement changes in oil and gas taxes, implement a tax credit for poor borrowers, and broaden the goods covered by the reduced VAT rate, but these were either not implemented or delayed.

23. Despite staff concerns, fiscal outcomes in 2015 turned out better than expected. The overall fiscal deficit outcome of 1.5 percent of GDP was 0.3 percentage points lower than budgeted. Over-performance in tax revenues, driven by administrative measures[8], the impact of fiscal stimulus, as well as conservative projections, outweighed higher than envisaged expenditures related to personnel spending.



24. The deficit target for 2015 was achieved through low-quality measures, while fiscal rules were circumvented. Public investment—a priority under the program—was persistently lower than targeted, particularly in relation to the use of EU funds even if EU funds increased with time. Low absorption of EU funds reflected stricter scrutiny over public procurement contracts and a weak budget formulation process, including those related to planning and prioritization of public investments. Budgetary space created by the under-execution of EU-related investments was used for more investment projects at the local government level (which were generally of lower quality reflecting inefficiencies in investment planning and execution) and last-minute procurements, while expansionary measures took on added importance in the budget. Overall fiscal discipline also suffered. A fiscal council was established in 2010 and fiscal rules based on the EU model were introduced in 2013. However, these rules were circumvented, and the powers of the fiscal council remained weak.[9]

[8] Stepped up collection efforts included the introduction of mandatory cash registers, reforms of the VAT registration process, pilot projects on unreported labor, anti-fraud audits, and verifications of high-net wealth individuals.

[9] The fiscal council was regularly consulted but not given sufficient time to analyze the impact of fiscal measures. As a result, Parliament took decisions on fiscal policy without benefiting from the council's analysis. In addition, fiscal rules were breached through provisions in the budget law.

General Government Operations, 2012–15 (percent of GDP)

	2012	2013			2014			2015		
	Outturn	Prog.	Outturn	Diff.	Budget	Outturn	Diff.	Budget	Outturn	Diff.
Revenue	**32.4**	**33.4**	**31.4**	**-2.0**	**32.9**	**32.0**	**-0.9**	**31.9**	**32.8**	**0.9**
Taxes	27.8	28.2	27.2	-1.0	27.9	27.3	-0.6	26.6	27.5	0.9
Grants 1/	1.4	2.0	1.4	-0.6	2.3	1.7	-0.6	2.6	2.4	-0.2
Other	3.2	3.2	2.7	-0.5	2.7	3.0	0.3	2.7	2.9	0.2
Expenditure	**34.9**	**35.8**	**33.9**	**-1.9**	**35.1**	**33.9**	**-1.2**	**33.7**	**34.2**	**0.5**
Current	31.8	32.9	31.2	-1.7	32.4	31.5	-0.9	31.1	31.8	0.7
Compensation of employees	6.9	7.4	7.3	-0.1	7.3	7.5	0.2	6.8	7.3	0.5
Transfers 1/	16.1	16.4	15.3	-1.1	16.4	15.5	-0.9	16.3	16.5	0.2
Other	8.9	9.1	8.6	-0.5	8.7	8.4	-0.3	8.0	8.0	0.0
Capital and other 2/	3.1	2.9	2.6	-0.3	2.7	2.4	-0.3	2.6	2.4	-0.2
Fiscal balance	**-2.5**	**-2.3**	**-2.5**	**-0.2**	**-2.2**	**-1.9**	**0.3**	**-1.8**	**-1.5**	**0.3**
Structural fiscal deficit 3/	**-1.7**	**-1.2**	**-1.7**	**-0.5**	**...**	**-0.5**	**...**	**...**	**-0.7**	**...**
Memorandum item										
Total capital expenditure	6.4	...	5.6	...	...	5.3	...	...	6.2	...

Source: IMF Staff Reports, Romanian authorities

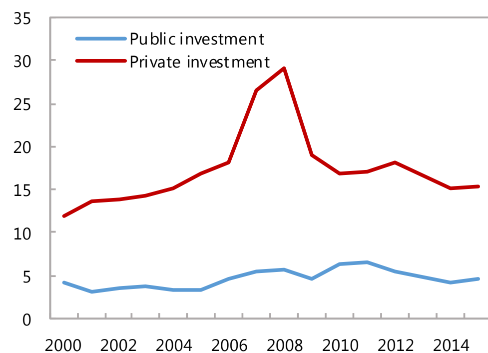
1/ Includes EU funds.

2/ Does not include all capital spending.

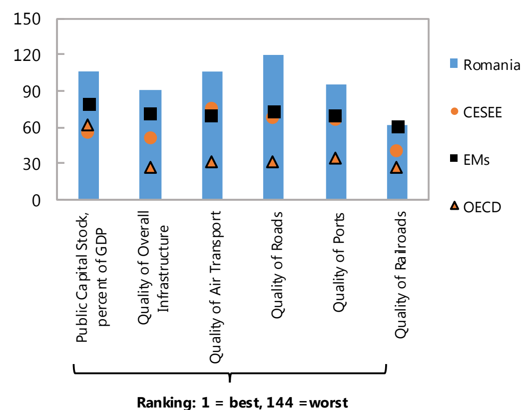
3/ Percent of potential output; IMF staff estimates.

Investment and Infrastructure

Romania -- Evolution of Investment (in percent of GDP)

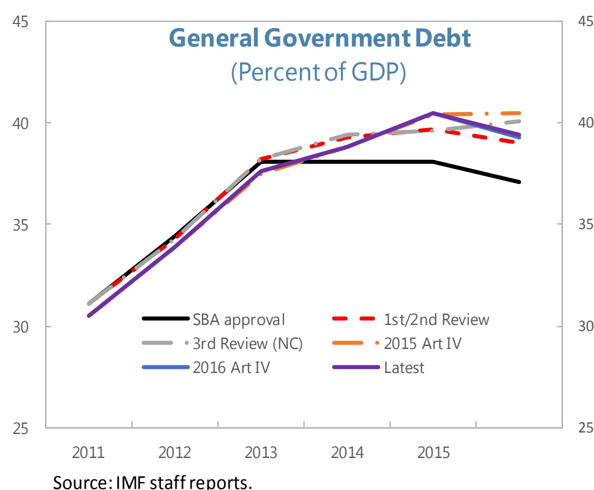


Capital Stock and Infrastructure Quality, 2015



Sources: IMF FAD Expenditure Assessment Tool (EAT), IMF Investment and Capital Stock Dataset, and World Economic Forum.

25. Romania's public debt marginally exceeded program projections but remained sustainable. Romania's public debt sustainability was not a major program concern and remained well below the 60 percent of GDP threshold under the Stability and Growth Pact. At the time of program approval, gross public debt (including guarantees) was low (estimated at 38.1 percent of GDP at end-2013) and projected to fall by a percentage point to 37.1 percent of GDP over the program period. Public debt ended up somewhat higher (39.3 percent of GDP) at end-2015, reflecting increased foreign borrowing from international bond placements and exchange rate valuation effects.

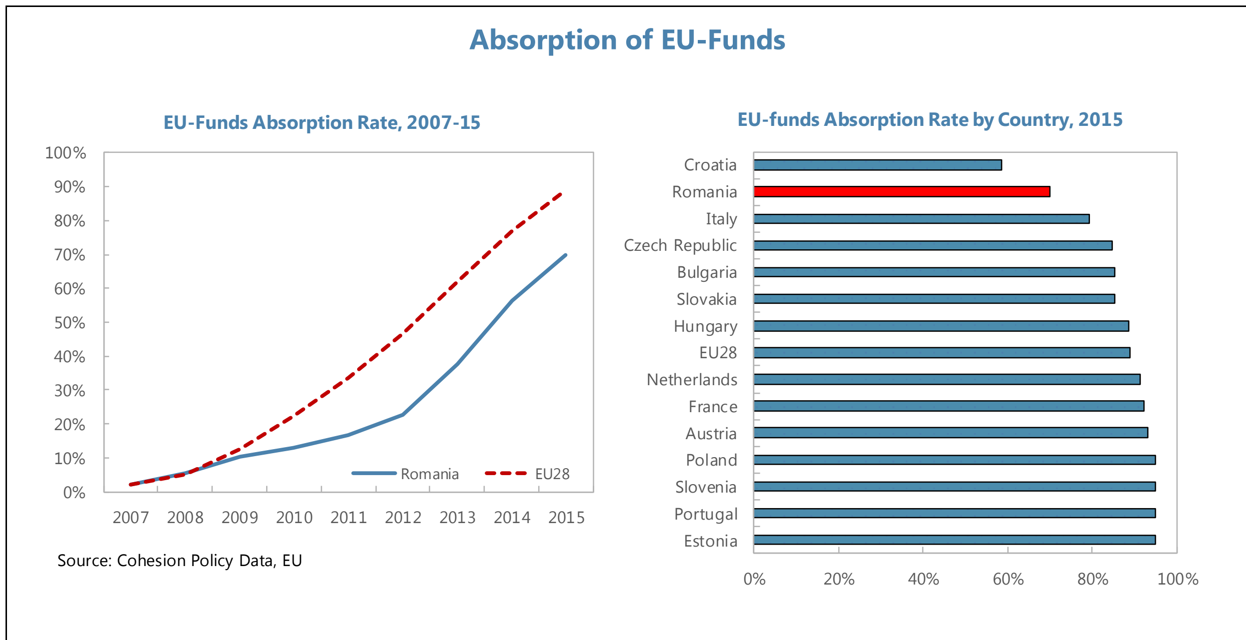


Source: IMF staff reports.

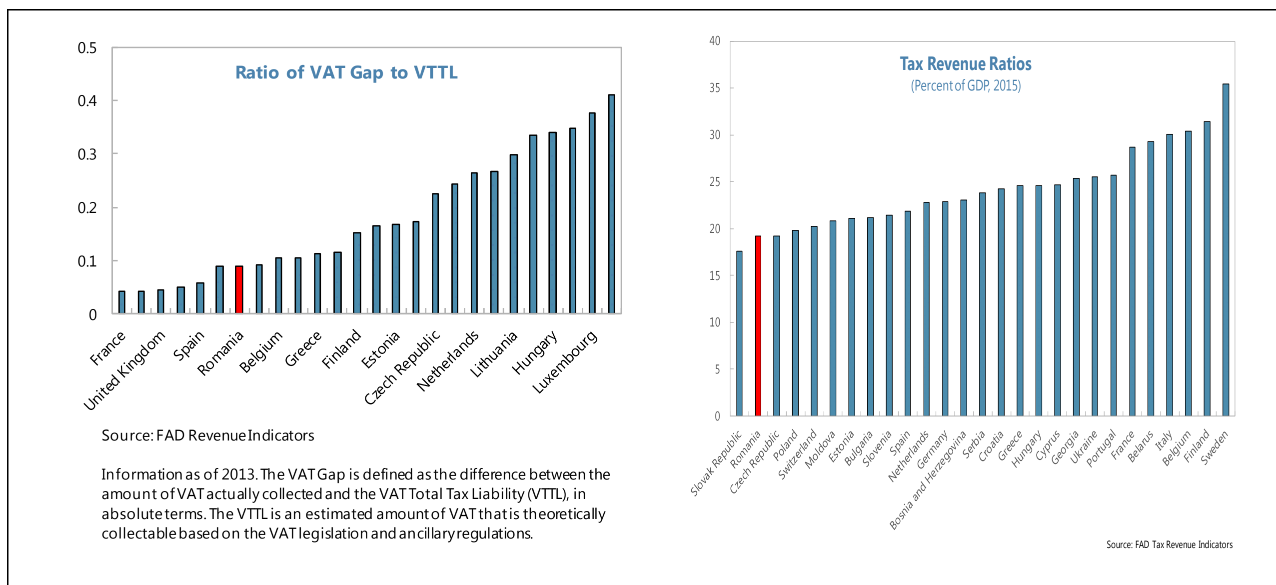
26. Progress on fiscal structural reforms was mixed. Fiscal structural reform was a high priority, with structural benchmarks in this area representing half of the conditionality established under the program. While good progress was made in some areas, capacity constraints, lack of ownership, and political uncertainty eroded some of the reform momentum.

- *Public financial management.* The program aimed to contain arrears, improve fiscal reporting, and better manage fiscal risks. The authorities started to publish detailed information on arrears, and made good progress in implementing the commitment control system. As part of the 2014 draft budget, the authorities also prepared for the first time an analysis of fiscal risks. However, commitment control failed to extend to all public institutions as a safeguard against the re-accumulation of arrears. Fiscal reporting reforms advanced more slowly than anticipated, due to a combination of highly ambitious objectives and capacity constraints.

- *Public investment planning and EU-fund absorption.* A key priority was to prioritize projects and improve budget planning to increase absorption of EU funds. A list of priority investment projects was prepared, a public investment evaluation unit was set up, and the medium-term fiscal implications of EU-funded projects were determined to ensure sufficient resources for co-financing and to mitigate potential financial risks. Despite these positive developments, and an increase in the EU-funds absorption rate, EU-supported projects remained below those targeted under the program. Even now, the absorption rate for Romania remains one of the lowest in the region. This reflects a number of factors, including lengthy procurement processes, insufficient integration of the project prioritization process into budget planning and across government levels, and political interference.



- *Tax administration*. Reform efforts focused on raising revenue collection and enhancing efficiency. The authorities started producing quarterly progress reports from end-2013 showing the number of audits, installment agreements, and collection targets. The tax administration agency (ANAF) began shifting resources towards its anti-fraud unit and moved to risk-based audits. Efforts were also made to strengthen tax collection from high net-worth individuals and to address undeclared labor and tax evasion. Less headway was made in the areas of risk assessment, reorganization of large tax payers' unit, application of commitment control to all ministries, updating the IT system, and capacity building to further strengthen tax collection and close the tax collection gap, which remains high compared to other countries in the region.



- *Healthcare system*. Good progress was made in the healthcare system to help ensure financial sustainability and improved health outcomes. A basic health package was introduced in 2014, which helped gradually shift health services away from hospital-based treatments to more cost-effective ambulatory care, and the reimbursement policy was revised. Centralized procurement was also established, which has helped to reduce arrears in the sector considerably.

- *Public administration.* The program aimed to achieve tighter control over public employment and ensure a more efficient and equitable public sector. However, the pension and civil service reforms of 2010 were phased out in some areas.[10] The one-to-seven hiring policy was terminated in 2013 and replaced with a one-to-one rule.[11] The subsequent reinstatement of prior pension benefits for selected categories of retirees and increases in the minimum wage raised spending pressures.[12] The minimum wage increase also created distortions in the public sector wage system, as the salary of low-skilled public servants at the minimum wage level moved up to that of higher-skilled public servants whose salaries were not revised. The government considered addressing these distortions through a unified wage law which would entail an upward shift of the entire wage system.

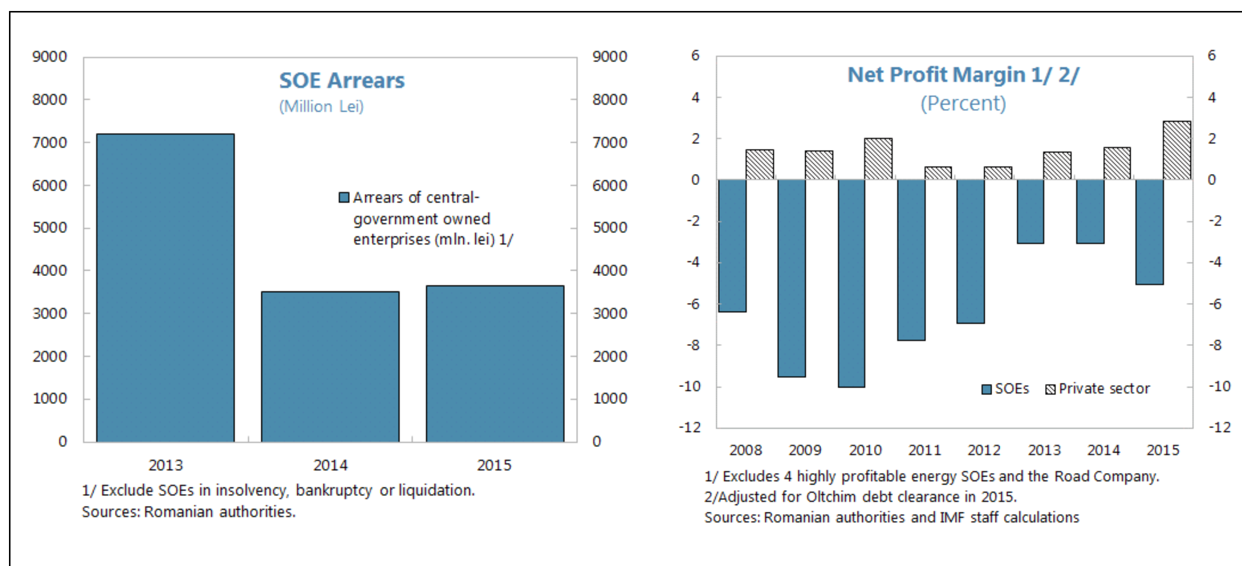
C. Structural Reforms

27. Central government-owned SOE arrears fell substantially under the program, but overall SOE performance remained weak. The new SBA focused on reducing SOE arrears and improving overall SOE financial performance. In 2014, significant progress was made in reducing SOE arrears. However, plans to reduce arrears further over the medium term were not supported by specific measures that would lead to a reduction in arrears, and progress stalled in 2015. Furthermore, the sector's financial performance did not improve during the program. With the exception of a few SOEs that benefited from electricity and gas market deregulation and the road company, most SOEs continued to post losses, in particular those in the transport and energy sectors. The ongoing weakness of the sector reflected resistance to restructuring, and in some cases the need to resolve entities, such as the coal-based energy company Hunedoara.

[10] In 2010, the government introduced forceful measures: parametric reforms to pension system (including the removal of special pension regimes), the introduction of a unified wage system, and a one-to-seven rule (one hiring per seven departure).

[11] The one-to-seven hiring policy provided that a maximum of one person could be hired for every seven persons leaving civil service employment.

[12] The minimum wage was raised from RON 800 in 2013 to RON 1050 by 2015.



28. The privatization agency made initial headway, but progress eventually stalled. Shares were sold in three large energy companies (Nuclearelectrica, Romgaz and Eletrica) as planned. However, the IPO for Hidroelectrica was suspended after an appeals court placed the company back into insolvency proceedings. It exited bankruptcy only in 2016, after the program expired. The IPO for the coal mining company Oltenia was also delayed and subsequent restructuring failed to improve its financial performance. The failed privatization of the rail freight operator, CFR Marfa, was a major setback in the transport sector. Its privatization was a prior action for completing the last review under the previous SBA, and Marfa continued to post losses despite downsizing efforts.

29. Limited progress was made in strengthening the governance and oversight of SOEs during the program period. Initially, professional managers were appointed in a number of SOEs, including Hidroelectrica, to comply with the Corporate Governance Emergency Ordinance (109/2011). However, SOE corporate governance suffered a setback in 2014 due to heavy intervention by line ministries in SOE decision-making and some appointments were reversed, especially in the transport sector. The SOE Corporate Governance law aimed to provide a legal foundation for change, but languished in Parliament as the authorities decided to wait for an independent study on the implementation of Ordinance 109. The SOE corporate governance law finally passed in parliament in 2016.

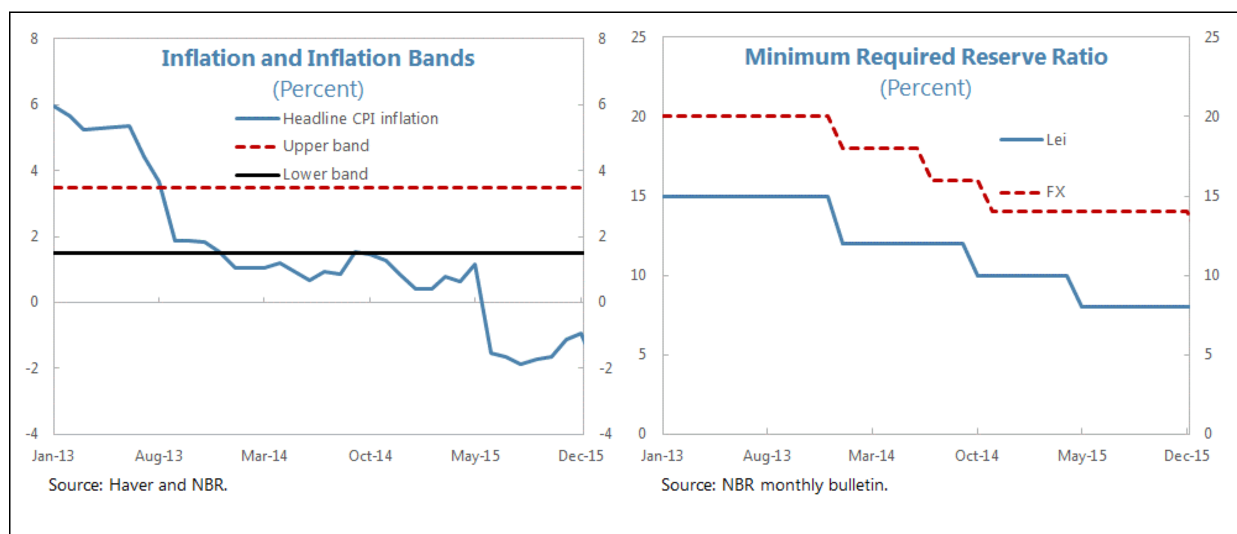
30. The pricing framework for the energy sector improved. The energy regulator (ANRE) fully deregulated the gas and electricity markets for non-residential consumers—a major achievement as the segment accounts for the bulk of energy consumption. However, progress on gas price liberalization for households stalled in mid-2014 and the deadline for completing the deregulation was extended from 2018 to 2021. The authorities considered the original timetable for

price liberalization too aggressive and demanding for households with fragile incomes, even though measures to protect vulnerable consumers were taken.[13]

31. Despite some progress on the structural reform front, setbacks in many areas prevented the third review being concluded. The arrears reduction target was missed and financial performance of several SOEs deteriorated. More aggressive restructuring or liquidation to deal with the long-standing financial problem of some SOEs envisaged under the program proved unrealistic during an election year. Moreover, heavy intervention by line ministries in SOEs' management and decision-making prevented completion of the review. Subsequent efforts to bring the program back on track were not successful, partly because of continued delays, including on the privatization front and on the restructuring and resolution of loss-making SOEs.

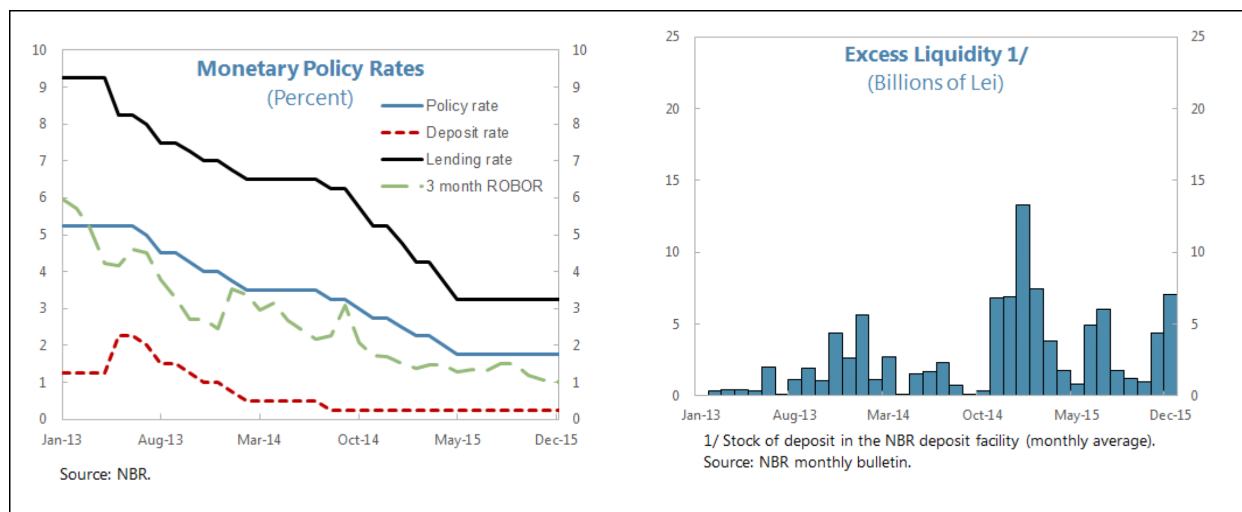
D. Monetary Outcomes

32. Monetary policy was eased throughout the program period. The objective at the outset of the program was to reduce inflation within a target band of 2.5 percent +/- 1 percentage point while allowing for exchange rate flexibility to help preserve foreign exchange reserves and guard against external shocks. Headline inflation decelerated considerably, and was below the lower bound of the central bank's target range for most of 2014, and turned negative early in 2015. The decline in inflation reflected both domestic and external factors, including a sharp reduction in VAT on food items, lower commodity prices, and low inflation in the euro area. Falling inflation and a persistent output gap enabled a reduction in NBR's policy rate, and the authorities progressively reduced the minimum reserve requirements (MRRs) on both lei- and FX-denominated liabilities.



[13] The authorities provided compensatory measures to coincide with the planned energy deregulation to protect the poorest households by raising minimum incomes and family and child allowances.

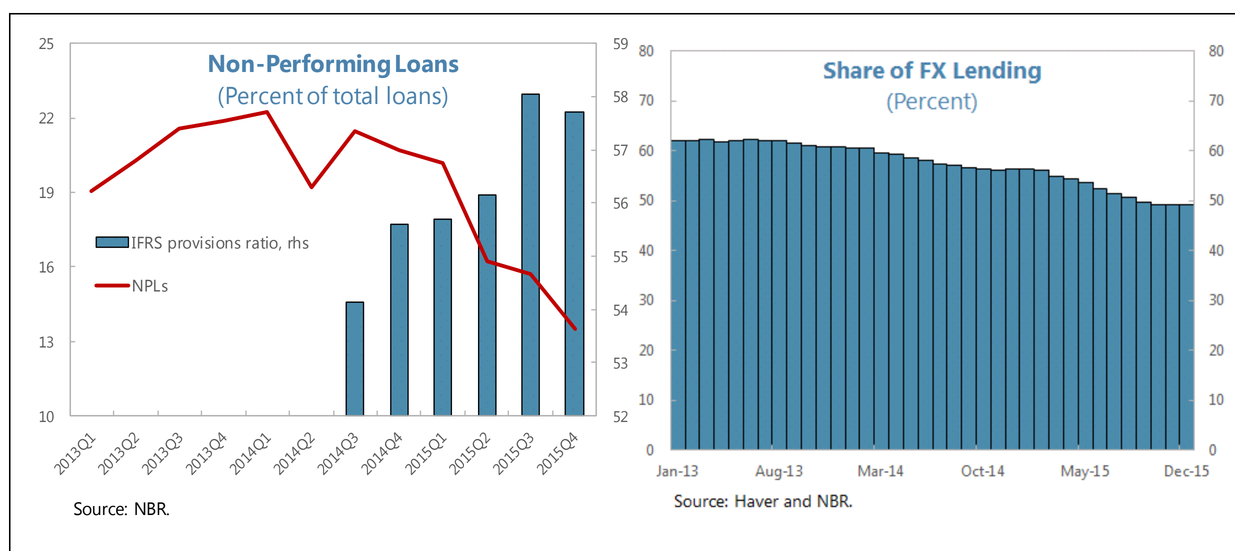
33. Steps were taken to strengthen monetary policy transmission. Considerable divergence between interbank rates and the policy rate weakened monetary policy signals and the transmission channel. At the same time, the interest rate corridor was too wide, not providing sufficient guidance to market rates. The NBR progressively narrowed the interest rate corridor, starting in October 2014, with a view to help strengthen monetary policy transmission. However, the accommodative monetary policy coupled with reductions in MRRs contributed to excess liquidity conditions. Foreign exchange interventions in support of the lei helped mop up some excess liquidity, but excess liquidity and divergence between interbank rates and the policy rate persisted.



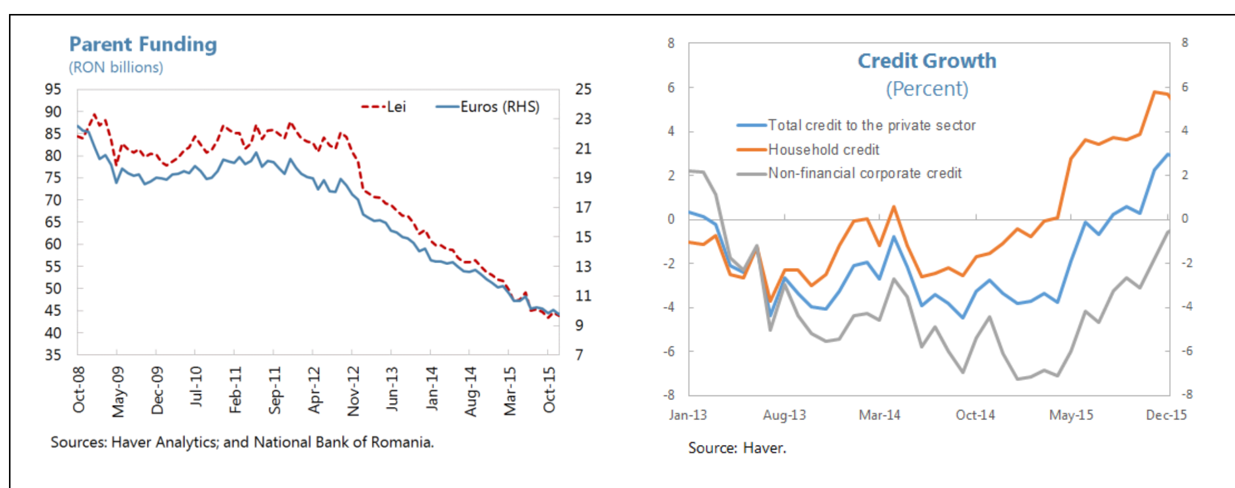
34. Foreign exchange intervention was used to support financial stability, but was not fully consistent with the stated inflation objective. Given the high degree of foreign exchange-denominated lending (around 60 percent), the NBR aimed to limit exchange rate volatility and support financial stability. Staff, on the other hand, called for more exchange rate flexibility to help preserve international reserves and guard against external shocks, while at the same time advocating more orthodox instruments to mop up excess liquidity, such as the issuance of central bank deposit certificates. While NBR's foreign exchange intervention may have helped support financial stability, the primacy accorded to exchange rate stability was not fully consistent with the stated inflation objective under the program.

E. Financial Sector

35. Good progress was made on strengthening bank balance sheets. High NPLs were reduced considerably, falling from nearly 22 percent in 2013 to under 14 percent by the time the program expired in September 2015. The NPL reduction was achieved through NPL sales, as well as direct write-offs, which were facilitated by high provisioning levels that helped preserve bank capital. Reducing foreign exchange risk for banks was another priority—for instance by reducing MRRs on domestic lending relative to FX-loans and limiting the extension to government guarantee schemes on mortgages to RON-denominated loans—with considerable success, as the share of banks' foreign exchange loans fell from over 60 percent in 2013 to under 50 percent in 2015.



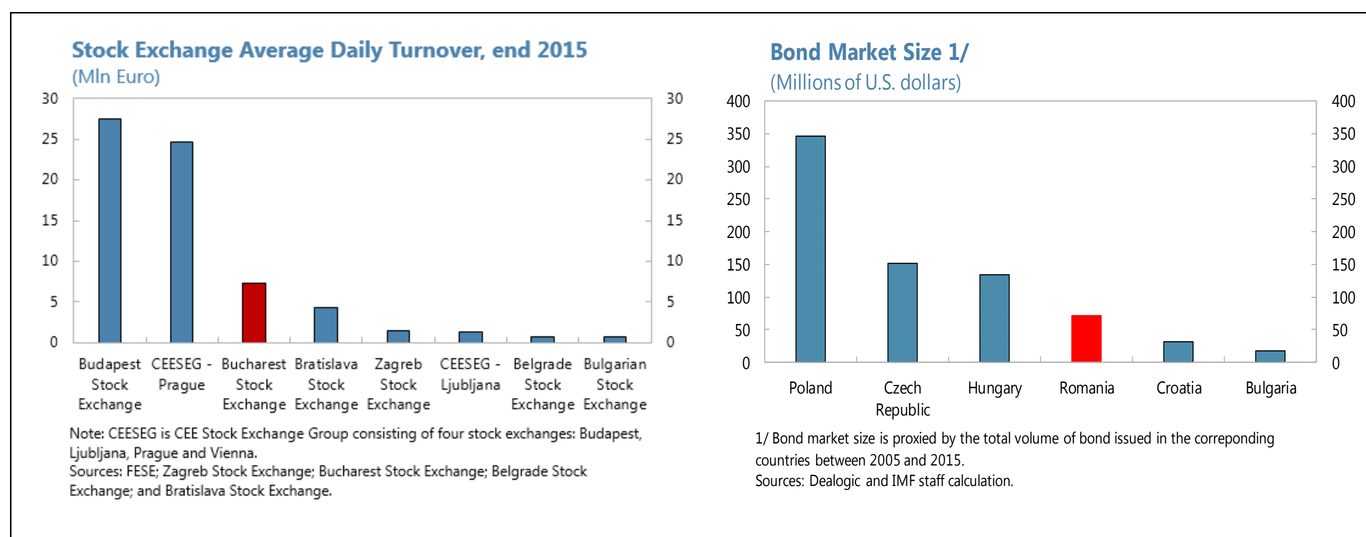
36. Reinvigorating financial intermediation proved more difficult. The mostly foreign-owned banking sector faced a considerable withdrawal of parent funding, which fell by a third between 2013 and 2015, likely reflecting parent bank weaknesses and changes in funding strategies to greater reliance on domestic deposits for subsidiaries. Measures to encourage credit were envisaged under the program—including reducing MRRs, reforming the underutilized SME guarantee fund, and encouraging long term domestic funding through the adoption of covered bond legislation—although some were delayed and credit growth remained negative in 2013–14 before turning positive in 2015.



37. Bank supervision and regulation was fortified to preserve financial stability. The NBR conducted regular solvency and liquidity stress tests based on which precautionary increases in banks' capital were made. System-wide provisioning was reinforced following on-site inspections by the NBR. At the same time, the bank resolution and restructuring framework was strengthened by

giving the NBR more flexibility and powers to protect depositors and stabilize the financial system. Considerable efforts were also made to enhance monitoring of cross-border banking flows and supervision given the high share of foreign-owned banks in the domestic banking sector and parent bank deleveraging.

38. The non-bank financial sector faced important challenges. Efforts were required to bring corporate governance of the new Financial Supervision Authority (FSA) into compliance with international practices, strengthen its intervention and resolution powers for the insurance sector, address capital shortfalls in insurance companies, and develop the still-nascent domestic capital market. Progress was made in each of these areas, with varying speed and degrees of success. By 2015 good headway had been made on restructuring the FSA, and its intervention and resolution tools were strengthened. It also resolved one of the main insurance companies though the insurance sector remained troubled by insolvency issues, which still had to be tackled two years after the initiation of the program. Impediments to capital market development were also removed through the adoption of a revised capital market law, though the equity market remains weakly capitalized (20 percent of GDP), with low levels of liquidity, and the bond market remains small and undiversified.



Note: CEESEG is CEE Stock Exchange Group consisting of four stock exchanges: Budapest, Ljubljana, Prague and Vienna.
Sources: FESE; Zagreb Stock Exchange; Bucharest Stock Exchange; Belgrade Stock Exchange; and Bratislava Stock Exchange.

1/ Bond market size is proxied by the total volume of bond issued in the correponding countries between 2005 and 2015.
Sources: Dealogic and IMF staff calculation.

39. Legal uncertainty represented a source of risk. A civil procedure code enacted in 2013 gave rise to interpretation regarding the validity of some interest charges and a basis for possible class action law suits on loan financial terms, which could undermine financial stability. While the authorities planned to set up a specialized court to handle such cases, its establishment was repeatedly delayed for administrative reasons. Other legislative initiatives intended to introduce retroactive changes to contracts (e.g. related to the conversion of foreign exchange liabilities at historical rates) created further uncertainty.

F. Program Targets

40. Overall implementation of program targets was mixed. Quantitative performance criteria and indicative targets were generally observed during the program (text table). However, as described above, many structural reforms were not implemented according to schedule, including in the areas of SOE reform, the financial sector and on the structural fiscal front (see also Table 4). These delays prevented completion of the third review under the program.

Implementation of conditionality (percent of total)			
	Quantitative performance criteria	Quantitative indicative targets	Structural benchmarks
First and second review	80%	80%	47%
Third review*	80%	67%	46%
*Third review was not completed.			
Source: staff estimates and IMF staff reports			

PROGRAM DESIGN

A. Was the Program Appropriate and Financing Adequate?

41. When the program was agreed, the justification for the program and the key objectives were sound, given the volatile external environment and the authorities' strong commitment. Following the severe downturn during the 2008–09 crisis, the economic recovery in Romania was still fragile. Vulnerability to external shocks remained high, given high external debt rollover needs; the banking system's heavy dependence on foreign parent funding; and the high volatility of capital flows to emerging markets following the May 2013 "taper tantrum".

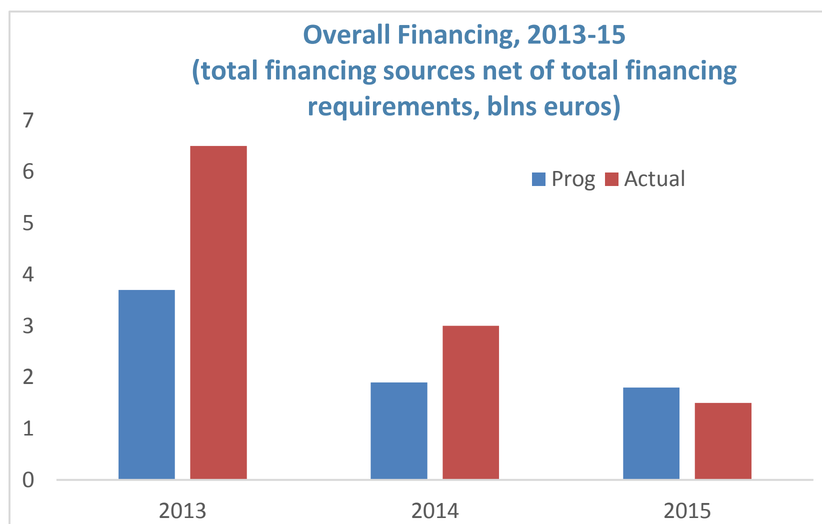
42. Repeat programs for extended periods of time, as in the case for Romania, raises questions about the role of Fund engagement. While the authorities were keen to have Fund support to help advance, in particular, the structural reform agenda, the experience of prolonged use of IMF resources suggests that these programs are typically less effective than expected in achieving their objectives, can hinder incentives to undertake reforms, and can weaken domestic policy formulation processes over time.[14]

[14] See *Evaluation of the Prolonged Use of IMF Resources* (Washington: International Monetary Fund, 2002).

43. Mindful of these concerns, staff sought to strengthen the program by focusing policy priorities on key areas. It also aimed to frontload some difficult reforms to help achieve program success and progress towards exiting from Fund support. Progress on structural reforms, particularly in the energy and transportation sector, was seen as crucial to remove bottlenecks in the economy and reduce fiscal pressures that could otherwise crowd out much needed spending for other priority areas. However, this required that the majority of the program's structural conditionality was either shared with other institutions, and/or was outside the core area of Fund expertise—which presented a significant risk that outcomes would be poor.[15]

44. The appropriateness of the Stand-By Arrangement as a tool for implementing deep structural reforms is an open question. Specifically, the deeper structural reforms envisaged under the program may have been overly ambitious within the SBA's 24-month duration particularly since weak implementation capacity had been a factor in prior programs. Other recent EPEs (Greece, Sri Lanka) have also pointed to difficulties in delivering on ambitious reform goals within the time frames envisaged within those programs. While longer duration programs face challenges of their own—including reform fatigue—programs with heavy structural reform agendas could spread reforms out over the duration of the program, with key reforms tackled at the outset.

45. The exceptional access request was justified even though the program's financing assumptions appear conservative ex-post. Romania's credit outstanding to the Fund only exceeded cumulative access limits temporarily and its obligations to the Fund have always been met in a timely manner. The risks envisaged under staff's downside scenario that may have required financial support from the Fund did not materialize and there were no purchases under the SBA. Moreover, better than expected macroeconomic performance, coupled with more benign financing conditions for Romania—in part supported by having a Fund program in place—ensured that financing needs were comfortably met even though the program could not be completed.



[15] See *Crisis Program Review* (International Monetary Fund, 2015) and *Structural Conditionality in IMF-Supported Programs* (International Monetary Fund, 2007).

B. Was Fiscal Adjustment Appropriate and Were Reforms Sufficiently Focused?

46. The fiscal deficit reduction target under the program was moderate and appropriate. The fiscal adjustment of around ½ percentage point of GDP annually in 2013–14 was consistent with attaining a structural deficit of 1 percent of GDP (in ESA terms) in 2015. The MTO aimed to solidify the gains of adjustment achieved in previous years and avoid a reversal in the policy stance. A quantitative performance criterion (PC) on the general government's overall balance helped monitor fiscal performance (Table 3). An additional PC was set on arrears of the central government and social security system, and indicative targets were set to contain the stock of local government arrears and reduce to more manageable levels the outstanding payments past due of all central government owned enterprises.

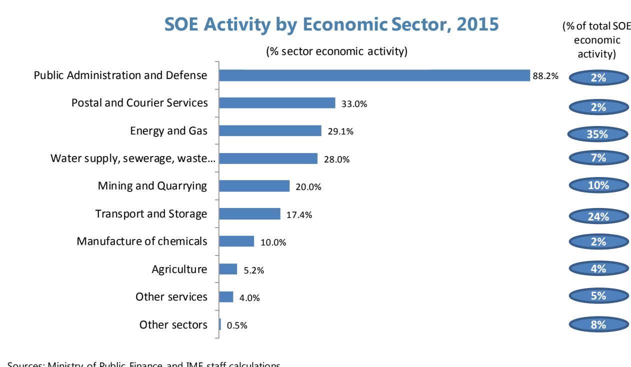
47. Fiscal structural reforms aimed to underpin the required fiscal adjustment and anchor medium-term fiscal sustainability. The program's objectives of strengthening fiscal institutions, improving control on spending at all levels of the public sector to avoid future arrears, and reforming the health care system to make it more efficient were well conceived. Structural benchmarks to support these reforms included measures to improve fiscal reporting system, better manage fiscal risks, improve budgetary planning and project prioritization of public investment, strengthen tax administration, and prepare a basic health reform package. At the first and second reviews in March 2014, two additional structural benchmarks were proposed to raise the efficiency of the large taxpayer unit and the high net wealth individuals' unit as well as to reduce tax evasion.

48. The number of fiscal structural conditions per review was quite high relative to other programs and could have been more focused (Box 1). With the benefit of hindsight, and given the importance of raising investment, relatively low tax yields, and difficulties in achieving fiscal discipline, more efforts could have been devoted in these areas relative to other reforms. For example, although some progress was made in terms of prioritizing investments, the program could have placed greater emphasis on capacity building to enhance EU-funds absorption. Revenue administration could have centered on establishing modern compliance risk management and a more effective administration of large taxpayers. The program could also have explicitly requested that the existing fiscal council be part of the budget formulation process. In addition, automatic corrections mechanisms or sanctions could have been considered in the organic budget law, for instances of non-compliance with existing fiscal rules.[16]

[16] Many countries, including Germany and Switzerland, use automatic correction mechanisms that specify in advance in legislation when and how to correct deviations from fiscal rules. Some countries, such as Brazil and Spain, also apply financial sanctions when fiscal rules are breached.

C. Were Structural Reforms Well Targeted, Phased and Executed?

49. Structural reform efforts centered on macro-critical areas. Building on structural measures initiated under the previous program, the new SBA sought to improve the efficiency of the SOE sector by reducing arrears, strengthening corporate governance, and pursuing privatization in the energy and transportation sectors. With many SOEs operating at a loss, improved performance was important to help lift potential growth, given their important role in economic activities. Price deregulation in the energy and transportation sectors was also essential to enhance the role of price signals in the economy, improve resource allocation and provide incentives for investment in these sectors.



Program Measures and Implementations in the Structural Reform Sector

Area	Key Goals	Prior Action/Structural Benchmark/Indicative Measures/Other Measures	
		Program Design	Subsequent Measures/ Other measures
SOE arrears	Reduce SOE arrears and improve overall SOE efficiency	• **Quarterly indicative target** of arrears in central government owned SOEs (mostly missed by small margins) • **Quarterly indicative target** of operating performance in the three railway companies and their subsidiaries (met)	• A **structural benchmark** on a medium-term plan to reduce arrears (not met)
SOE corporate governance	Implement the SOE corporate governance emergency ordinance and adopt the SOE corporate governance law	• A **structural benchmark** on appointing a professional board in Hidroelectrica (met)	
SOE privatization	Increase the share of private capital in the energy and transportation sectors	• A **prior action** to clarify the tax treatment in Romania for securities issued in a foreign jurisdiction (met) • Four **structural benchmark** on IPOs of Romgaz, Eletrica, Oltenia and Hidroelectrica (met only for Romgaz and Eletrica)	• **Quarterly indicative target** on the arrears in CFR Marfa following the failure in insolvency (missed) • Advised to put Honedoara into insolvency (not taken)
Pricing framework	Deregulate prices and markets in the energy and transportation sector		• Monitored the implementation of the price liberalization road map (not fully implemented)

50. Discussions with the authorities and other parties suggests that the structural reform agenda was ambitious but tackled the right issues to help bolster the economies' growth potential. The focus on reducing inefficiencies in the transport and energy sectors was warranted as they generated the highest operating losses and arrears. Compared with the much wider and detailed coverage of the SOE sector in the previous SBA, the 2013 program also streamlined SOE monitoring by targeting aggregate arrears of central government-owned SOEs, rather than arrears of individual companies.

51. However, frontloading the reform agenda to help ensure program success proved unsuccessful. While the 2013 SBA request report considered the period preceding the 2014 EU parliamentary and presidential elections as a window of opportunity for reforms, it acknowledged that vested interests could delay SOE reforms, an area where progress in previous programs had been limited. In the end the program frontloaded many reform measures. While this may have been a sound strategy during the formulation of the program, it did not yield the intended results for a number of reasons. First, shortly after the approval of the SBA, Romania was already entering the electoral cycle. Second, there was high turnover in key ministry positions, implementation capacity was limited, and vested interests opposed key reforms, in particular those related to privatization and corporate governance. And third, the Fund has limited expertise in some areas included in the program, such as corporate governance reform, investment prioritization, and pricing deregulation, where it had to rely on the World Bank's and European Commission's expertise. The lack of first-hand knowledge may have contributed to overestimating the authorities' ability to implement these reforms. Taken together, these factors prevented more substantive progress from being made.

52. It would be difficult to argue that more detailed structural conditionality would have reestablished reform momentum. While there may have been scope for taking intermediate steps to help advance reforms in some areas[17], the ex-post evaluation of the 2011 SBA found that greater reliance on detailed structural conditionality was not effective in reestablishing reform momentum and meeting the program's broad objectives. In addition, the evolution of the economic and political landscape in 2014 made further conditionality superfluous.

D. Did Monetary and Exchange Rate Policies Achieve Their Objectives?

53. The accommodative monetary policy stance was appropriate. The decline in inflation below the lower bound of the central bank's target range and persistent negative output gap supported the NBR's policy stance. At the same time, the inflation consultation mechanism established under the program helped ensure a prudent monetary policy stance aimed at firmly anchoring inflation expectations.[18]

54. The operational framework for monetary and exchange rate policy could have been clarified. The NBR primarily aimed to minimize exchange rate volatility to support financial stability, despite announcing the inflation target as a nominal anchor for monetary policy. While foreign exchange intervention helped ensure financial stability, the framework was not fully consistent with the inflation objective and the program's stated support of exchange rate flexibility. Moreover, favorable external developments over the program period helped preserve reserve buffers and net

[17] For instance, some of the proposed IPOs (CE Oltenia and Hydroelectrica) could have benefited from further due diligence and audits prior to launching the IPOs.

[18] Under the program progress achieved towards achieving the inflation target was monitored through an inflation consultation with consultation bands drawn symmetrically around the projected path of headline inflation. Any inflation outcomes outside these bands required further discussion with staff to address deviations, thereby helping to anchor expectations.

international reserves targets under the program were met, but tensions between the NBR's stated inflation target objective and its pursuit of exchange rate stability would have grown had this not been the case. Non-recourse to conventional liquidity management instruments to mop up excess liquidity also contributed to maintaining a wedge between interbank rates and the policy rate, weakening the effectiveness of the NBR's policy rate. More clarity on the operational framework for monetary and exchange rate policy up front in the design of the program would have added transparency to help guide market expectations and could have strengthened the interest rate transmission mechanism.

E. Was Financial Sector Resilience Strengthened?

55. The emphasis placed on strengthening banks' balance sheets was essential to preserve financial stability. The buildup of NPLs was unsustainable, and the upfront remedial action by the NBR to forcefully address the situation was key to preserve the health of the banking system. Similarly, progress on reducing foreign exchange loans and associated risk to the banking system were commendable. Although banks' direct foreign exchange exposure was limited, given the relatively small net open FX positions in relation to capital, the high FX-denominated lending presented a considerable risk to corporate and household balance sheets, which positions were likely not well hedged.

56. More attention could have been paid to strengthening financial intermediation and funding. While staff identified the risks associated with banks' funding model and put in place measures to help mitigate those risks (e.g. covered bond legislation and reforming the SME guarantee fund), those reforms were protracted, and the structural benchmark related to the covered bonds legislation was reset and modified, with the law only passing after the program had expired. More generally, little attention was focused on understanding private non-financial sector balance sheet risks or the overall financing of the economy in the context of a credit-less recovery. More analysis of non-financial sector balance sheets, especially SMEs (representing over 50 percent of GDP), and interlinkages with the financial sector and funding would have been helpful to understand associated risks and could have informed policies to strengthen financial intermediation and funding.

57. With hindsight, the insurance sector would have benefitted from more decisive intervention. The program appropriately focused its conditionality on strengthening the oversight framework, specifically the establishment of an operational FSA and strengthening the regulatory and supervisory framework. The EC's program also provided expertise in this area.[19] However, the health of the insurance sector continued to deteriorate, resulting in the need to raise capital and resolve some insurance companies. While the insurance sector is relatively small (under 5 percent of

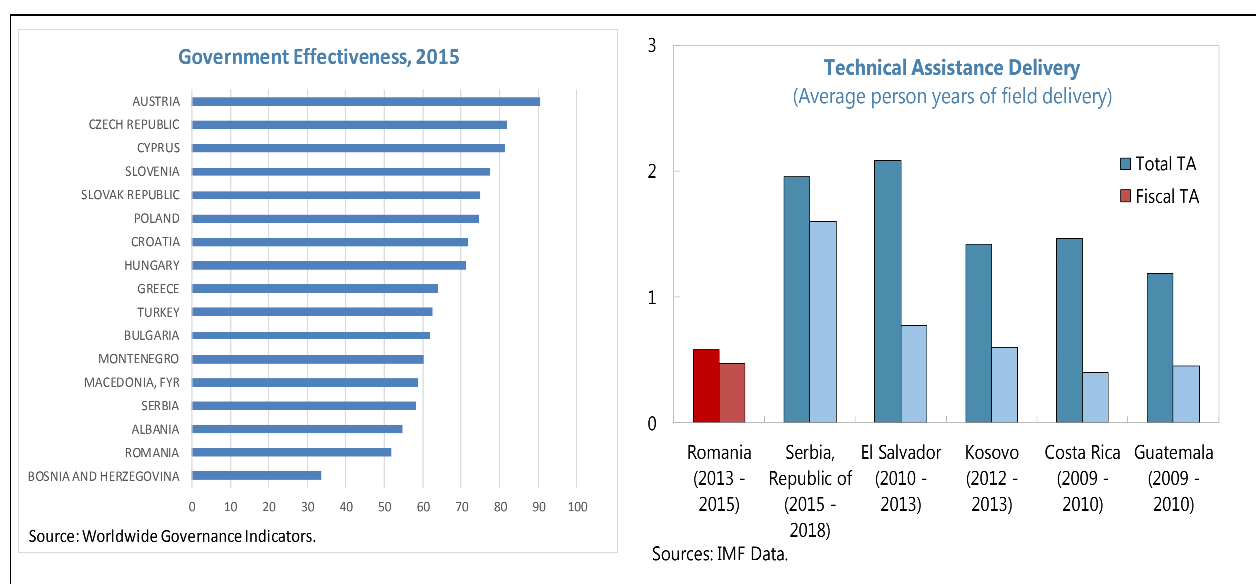
[19] The EC had insurance sector expertise on their team, and were able to provide technical support on insurance sector issues that provided assurance to the Fund-supported program.

financial sector assets), tackling the underlying weaknesses more forcefully would have helped put the sector on a sounder footing.

F. Was Ownership and Capacity for Reforms Sufficient?

58. Ownership of the program was insufficient. While staff recognized the risks to ownership and program implementation, they were encouraged by the authorities' commitment at the outset of the program. As it turned out, the program could not be completed. Some reforms established under the program continued to make progress even after the elections, but the drive for implementing key macro-critical yet politically-sensitive SOE reforms had waned. With the benefit of hindsight, a more in-depth analysis of the political economy of reform may have been useful, particularly when difficult to implement structural reforms are a central feature of the program. For instance, such analysis could have informed whether starting the program ahead of the elections was appropriate and whether objectives could be realistically achieved. At the same time, past weaknesses should not prevent staff from proposing ambitious but achievable goals.

59. Implementation of the ambitious reform agenda was undermined by capacity constraints. Considerable Fund conditionality, combined with program elements of other official institutions, increased the strain on the authorities' implementation capacity. Some key areas of reform, such as EU funds absorption and associated investment projects, were delayed or not of sufficient quality. This, in part, reflected capacity constraints as the government's effectiveness in prioritizing and implementing public investment remains low even by regional standards despite technical assistance and training provided by the EU. While technical assistance was provided by the Fund as well, particularly in the fiscal area, it was below that of other precautionary SBA programs. More could probably have been done on this front, recognizing that capacity building takes time, especially given high personnel turnover in the government. Reform progress was also impeded by insufficient governance reforms, which were needed to prevent the misuse of public resources.



G. Was Exceptional Access Justified?

60. This report is supportive of the decision to grant Romania exceptional access, although it sees staff as optimistic on the fourth criterion.

- ***Criterion 1 was met***—*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.*

  Romania did not face immediate balance of payments pressures. However, it was exposed to risks of economic and financial disruption, particularly in Europe, and from greater global volatility in capital flows. The realization of staff's stress scenario could have given rise to a need for Fund financing that could not have been met within the normal access limits, given outstanding GRA credit.

- ***Criterion 2 was met***—*A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term. However, 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 this period, exceptional access would be justified if there is a high risk of international systemic spillovers.*

  Public debt at the time of program approval was below 40 percent of GDP and was not expected to pose a risk under the program or over the medium term. The overall assessment that continued fiscal adjustment would ensure medium-term debt sustainability with high probability was reasonable and justified.

- ***Criterion 3 was met***—*The member has prospects of gaining or regaining access to private capital markets within the timeframe when Fund resources are outstanding.*

  Romania maintained access to private capital markets throughout the program duration. Even under an adverse scenario, staff expected Romania to continue having market access, but with lower rollover rates. As it turns out, the authorities continued successfully tapping international capital markets, issuing 10- to 20-year dollar and euro-denominated bonds, with yields ranging from 3.3–5.6 percent.

- ***Staff were optimistic on Criterion 4***—*The policy program of the member 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.*

  Romania's adherence to the prior, recent Fund-supported programs had been reasonably good. However, there were delays in completing the second and third reviews in the 2009 SBA and the seventh and eighth reviews of the 2011 SBA due to political reasons. Given the initial strong commitment at the outset of the program at the highest level of government, assessing the criterion as having been met could be justified. However, with the benefit of hindsight, it now

seems optimistic to have assumed that the authorities could overcome opposition to reforms from vested interests, given also the past track record and the upcoming start of the electoral cycle. The criterion could no longer be considered as met as the program suffered setbacks and could not be completed.

H. How Well Did Coordination with Other Institutions Work?

61. Coordination across institutions worked, but could have worked better. The authorities viewed cooperation with the IMF, European Commission and World Bank as key to catalyze economic reforms, and working relations between the institutions was good overall. The institutions' close engagement with the authorities also helped avoid some policy initiatives that would have conflicted with program objectives. While staff considered that coordination generally worked, the Fund had to rely on the expertise of the World Bank and the European Commission for key reform elements of the program (including in the energy, transport, and investment areas), and the three institutions had different views on the program priorities.[20] At the same time, respective institutions have different procedures on taking policy decisions and did not always feel properly consulted, making reaching agreements protracted at times, while information was not consistently shared in a timely fashion. This suggests there may be scope for enhancing coordination, particularly in areas such as public investment planning, where the Fund does not have a comparative advantage and where it had to rely on other institutions' expertise. As time elapsed and the reviews were not completed, the institutions increasingly proceeded with their own agendas on separate tracks.

CONCLUSION AND POSSIBLE LESSONS

62. The 2013 SBA, including exceptional access, was justified. The program had strong political backing at the outset, and the authorities' commitment at the highest level of government provided reasonable prospects of success. Romania's capacity to repay the Fund was expected to remain strong. While Romania's access would exceed the cumulative access limit temporarily, the breach was small compared to other exceptional access cases, and debt servicing risks were mitigated by the relatively low level of public debt. Moreover, Romania's strong track record in servicing external obligations provided reassurances that it would fulfill its financial obligations to the Fund in a timely manner.

63. The thrust of the policies under the program was appropriate. With major macroeconomic imbalances corrected under previous programs, the 2013 SBA appropriately focused on measures to safeguard macroeconomic stability and strengthen growth prospects by advancing the structural reform agenda.

[20] For instance, the European Commission had 49 Specific Economic Policy Criteria, with more detailed conditionality and covering a broader range of issues, including for strengthening the business environment and public debt management. None of the EU reviews were completed.

64. Although key structural reforms were not implemented and the program could not be completed, there were several successes. Over the program period, growth exceeded expectations, fiscal consolidation was attained, external positions were strengthened, inflation fell, and reserve buffers ended up better than expected. The over-performance was due in part to better than expected external developments and financing conditions, as well as some reforms undertaken under the program. Progress was also achieved in reducing SOE arrears initially, strengthening banks' balance sheets, reducing NPLs, reforming the healthcare system, and deregulating energy prices. Some reforms continued to be implemented even after the program expired in 2015.

65. Some lessons can be learned from the experience of the 2013 Romania SBA. Romania is an interesting case in the sense that macroeconomic outcomes in many areas exceeded expectations under the program, yet the program reviews could not be completed. Romania's experience carries some potential lessons for future Fund program design:

- **More careful assessment of the political economy of reform.** Ownership is critical to the success of any program. In the case of Romania, the authorities' initial commitment and frontloading the program were seen as mitigating implementation risks. This strategy was not successful, however, given, in particular, that the electoral cycle started soon after the start of the program. Reforming the SOE sector proved particularly difficult, given entrenched interests, declining political support, and insufficient governance reforms. In the end, greater ownership was needed to successfully reform the Romanian economy. More in-depth analysis of the political economy of reform may be useful to help inform whether the timing of the program is appropriate and objectives realistic. This is particularly relevant when difficult to implement structural reforms are a central feature of the program and in cases of prolonged use of Fund resources. At the same time, past weaknesses should not prevent staff from proposing ambitious but achievable goals.

- **Greater prioritization of reforms and judicious use of structural benchmarks.** The extent to which reforms are pursued and monitored in Fund programs remains a matter of judgement and depends on the relative importance for attaining programs objectives. That said, the frontloaded reform agenda in Romania coupled with the high number of structural benchmarks, particularly in the fiscal structural area, may have proved overly ambitious even in the absence of political change. This is particularly relevant in a program when multiple institutions are involved—where demands on the authorities can proliferate—and in the context of the need to further build capacity. The evidence also shows that compliance and effectiveness of structural benchmarks tend to be lower in areas outside of the Fund's core competency. All of this argues for a more parsimonious approach, designed around well-targeted, high-priority benchmarks, that are demonstrably critical to the success of the program. In the case of Romania, and with the benefit of hindsight, efforts could have focused on raising high-quality investment, strengthening tax revenues, and ensuring fiscal discipline. Strong performance in delivering realistic targets is also more likely to maintain ownership.

- **More focus in capacity-building efforts.** Romania faced capacity constraints in key areas of the program, such as EU funds absorption, increasing public investment, and public financial

management. More focus on capacity development needs in these areas would have contributed to program success. The key goal is not to encourage short-term incremental gains in meeting program targets, but to promote the internal capacity and consensus needed to implement and sustain difficult reforms over the longer term.

- **Provide adequate time to implement programs with heavy structural reform agendas.** While the decline in ownership prevented implementation of key reforms, the reforms envisaged under the program were very ambitious within the SBA's 24-month period. Programs with heavy structural reform agendas may benefit from spreading out reforms over the program period, also taking into consideration the need to build up capacity. At the same time, Romania has had an extensive financial relation with the Fund, and it is important to remain mindful of the adverse consequences of prolonged use of Fund program engagement, including the potential to reduce credibility of IMF programs more generally.

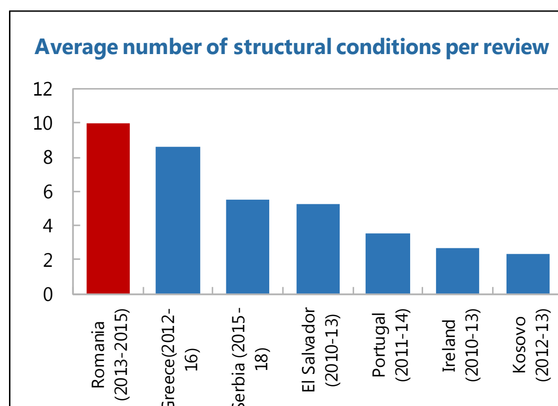
- **Ensure quality and discipline of fiscal measures.** Strengthening the institutional framework was an overarching objective under the program and some progress was achieved. Still, fiscal targets were met through low-quality measures and fiscal discipline suffered. Capacity development can help in this area, although ensuring transparency and appropriate checks and balances is equally important. Having adequate and appropriately-enforced rules about the role of the fiscal council can go a long way to help ensure higher-quality fiscal outcomes.

- **Accord higher priority to private sector balance sheets and financing of the economy.** The program was successful in achieving its main objective of strengthening the resilience of the financial sector. In addition, risks associated with parent bank funding were reduced and closely monitored. At the same time, addressing risks in the non-bank financial sector were more protracted and little attention was devoted to understanding the credit-less recovery or non-financial private sector balance sheet risks. Given the improved external and domestic conjuncture, potential risks emanating from private sector balance sheets did not materialize, but more emphasis on understanding and mitigating these types of risks should be factored more explicitly into program design.

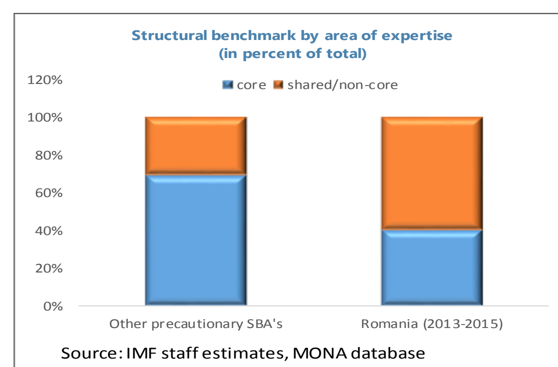
- **Ensure effective coordination on macro-critical structural reforms in which the Fund has limited (or no) expertise.** With macro-imbalances largely addressed, the program focused heavily on structural reforms, where the Fund may have limited (or no) expertise. In such cases, the Fund often has to rely on other institutions' expertise, like the World Bank and the European Commission in the case of Romania. In areas that are outside the core expertise of the Fund and that are critical to program success, it is essential to ensure strong coordination with other institutions that have the requisite expertise, and to align institutional priorities and timelines. For this to be successful it is key for all involved institutions to appreciate the benefits of greater coordination. More reliance and interaction with outside consultants could also be considered when institutional priorities differ or expertise is insufficient.

Box 1. Structural Benchmarks: Design and Implementation

The number of Structural Benchmarks (SBs) in Romania was relatively large, many in the fiscal area. The average number of SBs per review in Romania was 10, half of which were in the fiscal structural area. By contrast, the average number of SBs per review in comparator countries and in previous Romanian programs was lower.[1] The extensive reform agenda reflected the emphasis on structural reforms in the program and was motivated by the need to maintain momentum on difficult reforms—necessary to boost investments, competitiveness and long-term growth—in the face of political headwinds.

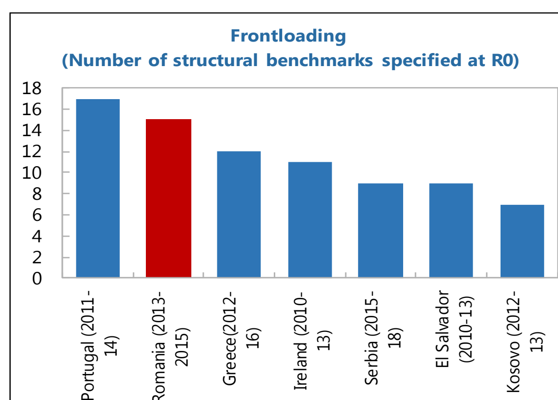


Structural conditionality focused on areas that was either shared with other institutions or outside the Fund's core expertise. Fiscal-structural reforms were mainly in the core areas of the Fund's responsibility or shared with other institutions, but other conditionality, such as that related to public enterprise reform (including four proposed IPOs) were outside the Fund's traditional areas of expertise, even when assessed as macro critical.[2] In comparator countries, structural benchmarks were mainly core to the Fund's expertise with a few exceptions (Serbia).



Source: IMF staff estimates, MONA database

The decision to frontload reforms likely overwhelmed capacity. There were a total of 15 SBs at the time of the program request, higher than in most comparator countries, and also in relation to previous Romanian programs, and countries with similar program duration. In conjunction with reforms from the World bank and EC, the frontloaded reform agenda under the program increased the strain on the authorities' implementation capacity.



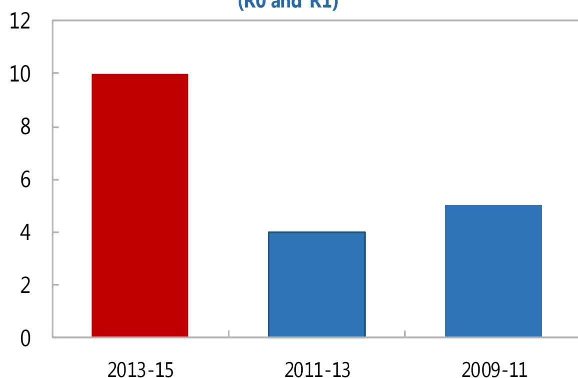
While progress was achieved, essential structural benchmarks were not addressed. Conditionality related primarily to fiscal structural, SOE, and financial sector reforms. While initial progress was achieved, conditionality related to SOE reform, arrears reduction, and the fiscal structural area was not met or met with considerable delay (Table 4). About 60 percent of structural benchmarks outside the Fund's core area of expertise were either not met, or met with considerable delays.

[1] A sample of countries with precautionary SBA's since 2008. Other SBAs with similar duration, such as Ukraine 2014 (24-month) and Latvia 2008 (27-month), also had less conditionality per review on average (8 and 6 structural benchmarks, respectively). Combined reviews are considered as one review. R0 is also counted as a review.

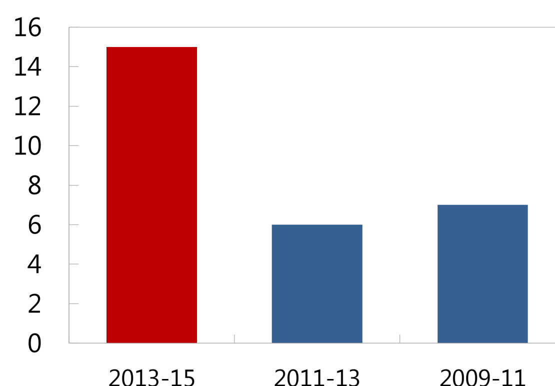
[2] The institutional classification of structural conditionality is based on the 2011 Review of Conditionality Background Paper 1, Appendix 1: Institutional Classification of Structural Conditionality. A similar approach was used in the 2015 Crisis Program Review.

Box 1. Structural Benchmarks: Design and Implementation (concluded)

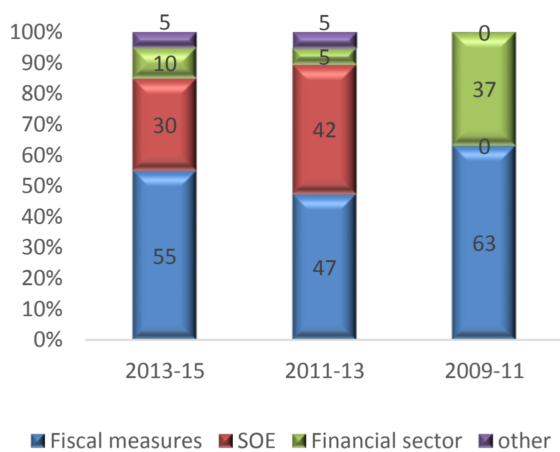
Structural conditionality in the 2013 SBA was more than in prior programs…



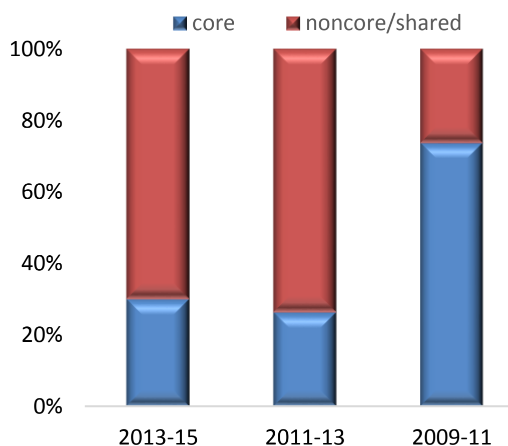
…and also more frontloaded.



Structural benchmarks were mostly fiscal…



…and in areas outside the Fund's care area of expertise.



Source: IMF estimates; MONA database

Table 1. Romania: Selected Economic and Social Indicators, 2010–15

	2010	2011	2012	2013		2014		2015	
				Prog.	Actual	Prog.	Actual	Prog.	Actual
Output and prices	(Annual percentage change)								
Real GDP	-0.8	1.1	0.6	2.0	3.5	2.2	3.1	2.5	3.9
Contributions to GDP growth									
Domestic demand	-0.7	1.1	-0.4	0.4	-0.1	2.2	3.4	2.8	5.5
Net exports	-0.1	-0.1	1.1	1.6	3.6	0.0	-0.3	-0.2	-1.6
Consumer price index (CPI, average)	6.1	5.8	3.3	4.5	4.0	2.8	1.1	2.9	-0.6
Consumer price index (CPI, end of period)	8.0	3.1	5.0	3.3	1.6	3.0	0.8	2.9	-0.9
Core price index (CPI, end of period)	4.1	2.4	3.3	2.0	-0.1	2.0	1.2	…	-3.1
Producer price index (average)	4.4	7.1	5.4	…	2.1	…	-0.1	…	-2.2
Unemployment rate (average)	7.0	7.1	6.8	7.1	7.1	7.1	6.8	6.9	6.8
Nominal wages	2.5	4.9	5.0	5.3	5.0	4.0	5.3	5.0	8.5
Saving and Investment	(In percent of GDP)								
Gross domestic investment	26.8	27.9	26.8	26.1	25.6	26.2	24.7	26.4	25.0
Gross national savings	21.8	22.9	22.1	24.1	24.5	23.7	24.0	23.7	23.7
General government finances 1/									
Revenue	31.6	32.1	32.4	33.4	31.4	33.1	32.0	33.1	32.8
Expenditure	37.9	36.3	34.9	35.8	33.9	35.1	33.9	34.8	34.3
Fiscal balance	-6.3	-4.2	-2.5	-2.3	-2.5	-2.0	-1.9	-1.8	-1.5
External financing	2.8	2.7	3.2	1.1	2.1	0.9	1.9	0.2	-0.5
Domestic financing	3.5	1.5	-0.8	1.3	1.4	1.1	1.2	1.0	1.1
Primary balance	-5.0	-2.8	-0.7	-0.5	-0.8	-0.2	-0.4	0.0	-0.2
Structural fiscal balance 2/	-6.1	-3.4	-1.7	-1.3	-1.7	-0.9	-0.5	-1.2	-0.6
Gross public debt (including guarantees)	30.5	33.9	37.6	38.1	38.8	38.1	40.5	37.1	39.4
Money and credit	(Annual percentage change)								
Broad money (M3)	6.9	6.6	2.7	6.6	8.8	5.5	8.1	5.8	9.7
Credit to private sector	4.7	6.6	1.3	-1.1	-3.3	2.7	-3.4	5.8	3.0
Interest rates, eop	(In percent)								
NBR policy rate	6.25	6.0	5.25	…	4.0	…	2.50	…	1.75
NBR lending rate (Lombard)	10.25	10.0	9.25	…	7.0	…	4.75	…	4.25
Interbank offer rate (1 week)	3.6	6.0	5.9	…	1.8	…	0.7	…	0.6
Balance of payments	(In percent of GDP)								
Current account balance	-5.1	-4.9	-4.8	-2.0	-1.1	-2.5	-0.7	-2.7	-1.2
Merchandise trade balance	-7.6	-7.0	-6.9	-3.9	-4.0	-4.2	-4.3	-4.2	-4.9
Capital account balance	0.2	0.5	1.4	…	2.1	…	2.6	…	2.4
Financial account balance	-2.0	-2.0	-2.6	…	-3.0	…	0.1	…	0.4
Foreign direct investment balance	-1.8	-1.3	-1.9	1.0	-2.0	1.5	-1.8	1.6	-1.8
International investment position	-62.3	-64.2	-67.8	-65.1	-61.7	-67.3	-56.9	-66.1	-51.1
Gross official reserves	28.3	27.9	26.5	24.3	24.6	21.8	23.6	19.9	22.2
Gross external debt	72.9	74.0	74.6	71.3	68.0	70.4	63.0	67.6	56.5
Exchange rates									
Lei per euro (end of period)	4.3	4.3	4.4	…	4.5	…	4.5	…	4.5
Lei per euro (average)	4.2	4.2	4.5	…	4.4	…	4.4	…	4.4
Real effective exchange rate									
CPI based (percentage change)	2.0	2.9	-6.0	…	4.7	…	0.2	…	-3.7
GDP deflator based (percentage change)	1.3	1.8	-4.8	…	4.1	…	0.8	…	-0.3
Memorandum Items:									
Nominal GDP (in bn RON)	533.9	565.1	595.4	626.2	637.5	661.3	668.1	700.7	711.1
Potential output growth	2.0	1.9	2.1	1.3	2.3	1.6	3.0	2.0	3.0
Potential output gap	-0.4	-1.3	-2.6	-2.3	-1.5	-1.8	-1.4	-1.3	-1.1

Social and Other Indicators

GDP per capita: US$ 8,956 (2015); **GDP per capita, PPP:** current international $21,403 (2015)

People at risk of poverty or social exclusion: 37.3% (2015)

Sources: Romanian authorities; IMF staff estimates and projections; World Development Indicators database, Eurostat.

1/ General government finances refer to cash data.

2/ Fiscal balance (cash basis) adjusted for the automatic effects of the business cycle and one-off effects.

Table 2. Romania: IMF Financial Arrangements, 1991–2020 1/

(In millions of SDRs)

Year	Date of Approval	Date of Expiration / Cancellation	Amount Agreed in SDR millions	Amount Agreed As a Percent of Quota	Amount Drawn	Purchases	Repurchases	Fund Exposure 2/
1991	11-Apr-91	10-Apr-92	380.5	72.7	318.1	565.8		565.8
1992	29-May-92	28-Mar-93	314.0	41.6	261.7	338.5	153.4	750.9
1993								750.9
1994	11-May-94	22-Apr-97	320.5	42.5	94.3	245.1	89.6	906.4
1995						37.7	245.8	698.3
1996							245.4	453.0
1997	22-Apr-97	21-May-98	301.5	40.0	120.6	120.6	98.4	475.2
1998							92.3	382.8
1999	05-Aug-99	28-Feb-01	400.0	38.8	139.8	53.0	102.0	333.8
2000						86.8	72.9	347.7
2001	31-Oct-01	15-Oct-03	300.0	29.1	300.0	52.0	91.7	308.0
2002						82.7	75.7	314.9
2003						165.3	79.6	400.6
2004	07-Jul-04	06-Jul-06	250.0	24.3	0.0		115.3	285.4
2005							102.8	182.6
2006							113.7	68.9
2007							68.9	
2008								
2009	04-May-09	03-May-11	11,443.0	1,110.8	10,569.0	6,088.0		6,088.0
2010						3,712.0		9,800.0
2011	25-Mar-11	15-Mar-13	3,090.6	300.0	0.0	769.0		10,569.0
2012							1,307.3	9,261.8
2013 3/	*25-Sep-13*	*24-Sep-2015*	*1,751.3*	*170.0*		*389.4*	*4,051.8*	*5,599.4*
2014 3/						*778.8*	*3,881.1*	*2,497.1*
2015 3/						*583.1*	*1,232.8*	*1,847.4*
2016 3/							*120.5*	*1,727.0*
2017 3/							*340.7*	*1,386.2*
2018 3/							*705.7*	*680.6*
2019 3/							*534.9*	*145.7*
2020 3/							*145.7*	*0.0*

Source: Finance Department.

1/ All Stand-By Arrangements.

2/ As of end-December.

3/ Figures under the proposed Stand-By Arrangement are in italics. Assumes repurchases on an obligations basis.

Table 3. Romania: Quantitative Program Targets

	2012	2013					2014				
	Dec	June	Sept	Sept	Dec		March		June	Sept	Dec
	Actual	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Indicative	Indicative
I. Quantitative Performance Criteria											
1. Floor on the change in net international reserves (mln euros) 1/ 2/	16,344	3,922	3,922	6,326	4,622	7,343	-500	1,025	0	200	500
2. Floor on the general government overall balance (mln lei) 3/	-17,430	-6,629	-9,340	-8,143	-15,300	-15,771	-4,539	-930	-8,230	-7,209	-14,712
3. Ceiling on the stock of central government and social security arrears (bn lei)	0.027	0.04	0.020	0.018	0.02	0.01995	0.02	0.0358	0.02	0.0175	0.015
4. Ceiling on general government guarantees issued since end-2008 (face value, bn lei)	9.8	10.9	16.0	11.45	16.0	12.1	18.0	12.6	18.0	18.0	18.0
II. Continuous Performance Criterion											
5. Nonaccumulation of external debt arrears	0	0	0	0	0	0	0	0	0	0	0
III. Inflation Consultation											
6. 12-month rate of inflation in consumer prices											
Outer band (upper limit)	...	...	5.1	...	5.3	...	3.0	...	3.6	5.0	5.5
Inner band (upper limit)	...	...	4.1	...	4.3	...	2.0	...	2.6	4.0	4.5
Actual/Center point	5.0	5.4	3.1	1.9	3.3	1.6	1.0	1.0	1.6	3.0	3.5
Inner band (lower limit)	...	...	2.1	...	2.3	...	0.0	...	0.6	2.0	2.5
Outer band (lower limit)	...	...	1.1	...	1.3	...	-1.0	...	-0.4	1.0	1.5
IV. Indicative Target											
7. Ceiling on general government current primary spending (excl. EU funds and social assistance, mln lei) 3/	134,330	70,412	106,300	105,570	147,509	144,560	36,500	35,733	73,000	109,000	150,500
8. Floor on operating balance (earnings before interest and tax, net of subsidies and one-off adjustments to income due to financial or accounting operations) of key SOEs (as defined in paragraph 22 of the TMU (bn. lei)) 3/	-3.1	-1.0	-1.6	-1.3	-2.3	-2.2	-0.7	...	-0.9	-1.2	-2.1
9. Ceiling on outstanding payments past due of all central-government owned enterprises (as defined in TMU, bn lei) 4/	12.7	8.3	7.5	7.0	5.6	7.2	5.4	[5.421]	4.6	3.9	3.4
10. Ceiling on stock of local government arrears (bn lei)	0.84	0.14	0.30	0.24	0.30	0.20	0.30	0.25	0.25	0.20	0.20
11. Ceiling on stock of net Treasury loans for EU-funded projects (mln lei) 3/	...	1,546	3,000	2,004	3,000	1,852	4,000	1,644	4,000	4,000	4,000
12. Ceiling on outstanding payments past due of CFR Marfa (as defined in TMU, mln lei)	...	...	...	...	...		99.2	121.1	99.2	99.2	99.2
Memorandum items:											
Central government hospital arrears (bn lei)	...	...	...	0.011	...	0.014	...	0.032	...	...	...
Local government hospital arrears (bn lei)	...	...	...	0.045	...	0.053	...	0.063	...	...	...

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

2/ The December 2013 target is adjusted upward by EUR 700 million to reflect the higher than projected program financing due to the drawings under the World Bank DPL-DDO.

3/ Cumulative figure during calendar year (e.g. September 2013 figure is cumulative from January 1, 2013). The September 2013 target is adjusted downward by RON 159 million for higher than programmed spending on national cofinancing of EU funded projects. The December 2013 target is adjusted downward by RON 600 million for higher than programmed spending on national cofinancing of EU funded projects.

4/ Starting end-March 2014, outstanding payments past due accumulated and reported by companies while they are under insolvency procedures are excluded from the target. These past due payments amounted to RON 438 million for end-December 2013.

Table 4. Romania: Structural Benchmarks

	Measure	Target Date	Comments
Structural fiscal issues			
1	Start publishing monthly arrears reports and corrective measures being taken by the central and local governments, by unit, on a quarterly basis.	End-September 2013	Met
2	Prepare the basic health package within the existing spending envelope which will also define the scope of the private sector in the health care system in the future.	End-September 2013	Met with delay
3	Prepare medium-term financial projections that properly identify the fiscal implications of EU-funded projects, including co-financing needs, financial corrections and non-eligible spending.	Mid-October 2013	Met
4	Approve, by government memorandum, a list of significant priority projects, based on the prioritization criteria, to help prepare for the 2014 budget.	Mid-October 2013	Met
5	Provide quarterly progress reports on the number of completed audits in the large taxpayers unit and high net wealth individuals unit, and number of installment agreements signed for large taxpayers and medium-size taxpayers to clear tax arrears as well as collection targets based on these actions (see TMU, paragraph 28).	End-March 2014	Met
6	Fully operationalize the commitment control system, supported by necessary legal and procedural changes and cover expenditures of the MoPF and at least one additional unit at both the central and local government levels.	End-April 2014	Met
7	Issue a press release announcing the pilot structural compliance project targeted at undocumented labor and tax evasion.	End-May 2014	Met
8	Make the commitment control system available for operation in all general government entities as a pilot.	End-June 2014	Not Met
9	Roll out the consolidated fiscal reporting system to all government entities.	End-June 2014	Not Met 1/
10	Prepare and publish consolidated general government accrual based financial statements and ESA95 based reports from the system (the first sets of reports will be for the year ending 2014), and reconcile with each other and with cash-based budget execution reports.	End-June 2015	Not Met 2/
Financial sector			
11	Resolve possible discrepancies in the fiscal code and IFRS accounting rules on the treatment of NPLs sold to domestic debt management companies in line with the outcome of the pending EC infringement case.	End-December 2014	Met
12	Approve Covered Bond legislation.	End-March 2014	Met with delay
13	Submit to parliament an insolvency code aimed at better supporting early rescue of viable firms and speedy exit of non-viable firms, prepared in consultation with IMF staff, at a minimum on: pre-insolvency procedures, creditor voting, priority financing, automatic stay, ranking of claims, and notice requirements.	End-April 2014	Met with delay
14	Prepare a strategy for the reduction of fully provisioned uncollectible NPLs on commercial banks' balance sheets	End-May 2014	Met
State-owned enterprises			
15	Launch an initial public offering of 15 percent of the government's shares in Romgaz.	Mid-November 2013	Met
16	Appoint a professional board in Hidroelectrica in accordance with the provisions of Ordinance 109/2011.	End-November 2013	Met
17	Prepare a plan that clearly identifies the companies and the actions that will be taken to adhere to the overall path of arrears reduction established under the program.	End-April 2014	Not Met 3/
18	Launch an initial public offering of a majority of the government's shares in Electrica, after the planned capital increase.	End-May 2014	Met with delay
19	Launch an initial public offering of 15 percent of the government's shares in Oltenia, prior to the planned capital increase.	End-June 2014	Not Met 4/
20	Launch an initial public offering of 15 percent of shares in Hidroelectrica, after the planned capital increase.	End-June 2014	Not Met 5/

1. A new system needs to be designed in line with the forthcoming new EU requirements.
2. An FAD-TA mission in January 2015 assessed the status of this project, and determined that a realistic timeline goes beyond the program horizon.
3. The submitted plan fell short on details of concrete actions.
4. The IPO for Oltenia was delayed due to longer than envisaged time needed for the audit of coal reserves.
5. The IPO for Hidroelectrica was suspended after an Appeals Court placed the company back into insolvency.

Table 5. Romania: Prior Actions

	Measure	comments
Structural fiscal issues		
1	Approve a government ordinance to broaden the social contributions base by applying a mandatory tax (health contribution) on rental income of individuals, to be implemented from January 1, 2014.	met
2	Clarify the tax treatment of securities bought in Romgaz traded on the foreign stock exchange and adopt, if needed, the necessary legal basis.	met
3	Approve a government ordinance defining the prioritization criteria for public investment projects.	met
4	Approve a government ordinance to provide standard definitions of commitments for the commitment control system.	met
Public enterprise reform		
5	Authorize, through a General Shareholder's Meeting of Hidroelectrica, the current interim board to take decisions in accordance with law 31/1990, while it seeks to appoint a professional board in accordance with the SOE Corporate Governance ordinance.	met
6	Provide a report to the IMF on the completion of the actions specified in Section L of the TMU to significantly reduce SOE arrears.	met

Appendix I. Views of the Authorities

The Romanian authorities generally agreed with the conclusions of the ex post evaluation report of exceptional access under the precautionary 2013 stand-by arrangement. They concurred with the resulting lessons and hoped they would be taken into account by IMF's Management to improve the products offered to its members. The authorities acknowledged the importance of structural reforms for the program, as well as the partnership with the European Commission and the World Bank, and appreciated the collaboration, even if, at that time, views on priorities and the optimal fiscal policy measures differed.

At the same time, the authorities wished to emphasize the following aspects related to the evaluation:

1. While the assessment of the macroeconomic performance in the report was accurate, more details could have been presented explaining the results. Further explaining the difference between projections and outcomes, and the contribution of the authorities' policies to those outcomes would also have been welcome. For instance, the positive effect of the reduction in the VAT rate and wage increases on growth could have been more explicitly recognized.

Real GDP growth

	IMF forecast	Realizations
2013	2.5	3.5
2014	2.2	3.1
2015	2.5	3.9

Nominal GDP evolution

	Fall forecast (budget)	Actual, NIS	Difference
2012	579.6	595.4	15.8
2013	623.3	637.5	14.2
2014	658.6	668.1	9.5
2015	709.7	711.1	1.4
2016	746.6	759.2	12.6

2. Another accomplishment worth emphasizing was the better-than-expected evolution of the external position and, in particular, the performance of foreign exchange reserves, which increased to 6 months of imports (compared to a projection of 5 months of imports under the program) in spite of the continuous decline in financing from parent banks.

Evolution of the main indicators regarding the external sector

	2012	2013	2014	2015
Annual variation of the export of goods and services (%)	1.0	19.7	8.0	5.4
Contribution of the net export to the GDP (%)	1.1	3.6	-0.3	-1.6
Current account deficit (% of the GDP)	-4.8	-1.1	-0.7	-1.2
Net foreign investments - billion EUR	2.1	2.7	2.4	3.5

3. Fiscal performance also over-performed. In 2013, Romania exited the excessive deficit procedure, and the budget deficit calculated in accordance with the ESA 2010 methodology reached 0.9 percent in 2014 and 0.7 percent of GDP in 2015. Moreover, important progress was achieved on the structural balance, so that in 2014-15 Romania was below the target of 1 percent of GDP.

The authorities also considered that while the report viewed the fiscal adjustment as having been achieved through low quality measures, progress was achieved with regard to collection efficiency. Specifically:

- VAT: while the collection efficiency index initially decreased to 0.61 in 2014 compared to 0.63 in 2013, it increased to 0.72 in 2015. In addition, VAT collection in relation to GDP in Romania was above the EU average in 2013 and in 2014 (8.3% and 7.8%, respectively in Romania, compared to 6.9% and 7% for the EU average, respectively).
- Corporate income tax: the taxation efficiency index increased from 0.19 in 2013 to 0.21 in 2014 and 0.22 in 2015.
- Personal income tax and salaries tax: the taxation efficiency index increased from 0.84 in 2013 and 2014 to 0.86 in 2015.
- Social insurance contributions: the collection efficiency index, which was 0.75 in 2013 and 0.74 in 2014, increased slightly to 0.75 in 2015.

The program also did not anticipate the creation of fiscal space, and could have outlined a strategy for its use.

4. Although the initial targets for state-owned enterprises were not completely reached (with regard to arrears and privatizations), the commitment to implement structural reforms continued and part of the measures agreed upon were adopted, even if with delays. For instance, the corporate governance legislation was amended. The partial privatization through IPOs through the Bucharest Stock Exchange (BSE) are also of significant importance:

- Electrica - The biggest primary initial public offering in Romania, with a value of 1.96 billion RON (444 million EUR), and a free float of 51.2%, was listed on the BSE on July 4, 2014.
- Romgaz – with a value of 1.7 billion RON (383 million EUR), and a free float of 19.99%, was listed on the BSE on November 12, 2013.
- Nuclearelectrica – with a value of 281.8 billion RON (63 million EUR), and a free float of 10%, was listed on the BSE on November 4, 2013.

5. The authorities were also of the view that the opinions of the Fiscal Council were insufficiently substantiated with regard to macroeconomic data.

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Statement by Anthony De Lannoy, Executive Director for Romania and Cezar Botel, Advisor to the Executive Director
May 22, 2017

The macroeconomic fundamentals of Romania grew significantly stronger after the global crisis. Economic growth consolidated and has lately accelerated while unemployment dropped significantly. Inflation has eventually returned to positive values and is slowly but steadily advancing towards the central bank's target. Fiscal and current account deficits bottomed out in 2014-2015 and remain at relatively moderate levels after the ongoing fiscal relaxation which started in 2015. The current account deficit and external debt remain sustainable. The banking system is sound, NPL ratios decreased significantly, adequate buffers are in place and no public funds have been used to support the banking sector during or after the global financial crisis. While some vulnerabilities persist, high risks to financial stability from legal initiatives have abated. Maintaining the fiscal deficit on target appears to be somewhat challenging, but authorities are fully committed to act proactively and take the necessary steps to contain the risks. Fiscal stimulus complemented by improved EU funds absorption and deep structural reforms could unlock more sustainable and inclusive growth.

The Ex-Post Evaluation of Exceptional Access Under the precautionary 2013 SBA provides a useful assessment of the program including valuable lessons that can be used to improve the Fund's products. The Romanian authorities appreciate the support received from the Fund in partnership with the European Commission and the World Bank. They broadly agree with the conclusions of the report.

Growth accelerates under stimulus measures while external position remains sustainable.

After three years of growth rates above 3 percent, the economic activity in Romania continued to gain momentum in 2016. The annual growth accelerated to 4.8 percent, the country's highest after the crisis and one of the fastest in EU, while the average annual unemployment rate dropped to 5.9 percent, the lowest level in eight years. The expansion was primarily driven by private consumption, pushed to a nine-year high of 7.3 percent by stimulus from fiscal and income policies. Additional envisaged stimulus measures, the manifest recovery of the consumer confidence to the pre-crisis level, and the upward trend in consumer credit are expected to support further expansion of consumption, albeit at a slowing pace over the medium term. The dynamics of investment underwent a temporary setback in 2016, when the contribution of gross fixed capital formation to GDP growth turned negative. Nevertheless, investment growth is expected to resume in 2017 and gradually accelerate over the medium term, driven by credit expansion gaining momentum, accruing effects of growth-friendly tax cuts, and steady improvement of the EU funds absorption. Factoring in significant second-round effects of multiple fiscal stimuli on both domestic demand and potential output, the government projects faster growth than staff's baseline: one percentage point higher in 2017 and a moderately accelerating (rather than Fund's decelerating) path over the medium term.

At the beginning of 2017 the annual CPI inflation rate raised above zero after successive VAT cuts and other disinflationary supply shocks held it at negative values since June 2015.

Dwindling influence of these factors along with a positive output gap will drive inflation upwards, allowing it to reenter the ±1 percentage point variation band of the 2.5 percent flat target by end-2017. Thereafter, in the absence of unanticipated shocks, the inflation rate is expected to remain within the target band.

The current account deficit widened in 2016 by 1.1 percent of GDP on the back of imports boosted by buoyant consumption and a higher deficit in the primary income balance. However, the current account deficit was fully matched by the net FDI inflows which recorded a significant increase in 2016, driven mainly by reinvested earnings and intra-company loans. The deficit is anticipated to remain at sustainable levels over the medium term, with exports growth fueled by the gradual recovery of the external demand from EU main trading partners. Since the external deficit financing is expected to come mainly from non-debt-generating flows - FDI and EU funds -, the downward trend of the external debt-to-GDP ratio is projected to continue in the medium term. Both staff and the authorities agree that the external position in 2016 has been broadly in line with the fundamentals; recent developments continue to warrant this assessment. The share of short-term debt in total external debt is relatively low (around 25 percent), and the international reserves coverage is adequate according to all reserve adequacy metrics. Notwithstanding good fundamentals, the external position may be vulnerable to a sharp depreciation of the domestic currency triggered by a sudden worsening of the market sentiment. The authorities carefully monitor these risks.

While fiscal relaxation will be maintained in the short run, budget deficits will be kept within the limits allowed by EU fiscal rules.
In line with the government strategy of promoting economic growth, the fiscal relaxation initiated in previous years has continued at the beginning of 2017, through measures aimed at both increasing the real disposable income of households and improving business environment and supply incentives. The medium term strategy foresees the ESA budget deficit being held constant at slightly below the limit of 3 percent of GDP in 2017-2018, followed by a fiscal consolidation to 2 percent by 2020. While acknowledging the challenge of meeting the 2017-2018 targets, the authorities are strongly committed to comply with the EU fiscal rules, by closely monitoring the budget execution and taking compensatory measures if necessary. To mitigate the risks associated with the fiscal impact of the unified wage law, the authorities will adopt a gradual and flexible implementation which will take fiscal space constraints into consideration.

Concrete measures and reforms to increase budget revenues and reduce public spending, already taken or planned for 2017-2018, are identified in the April 2017 Convergence Report of Romania to the European Commission. An important measure designed to increase the VAT collection is the implementation as of July 1, 2017 of an anti-fraud system of split VAT payments which requires public institutions and enterprises to pay any VAT due for goods or services directly to the State budget account rather than to the supplier. Among the programmed reforms aimed at enhancing expenditure efficiency are included: reducing the number of agencies and institutions subordinated to the government, rationalizing public spending based on principles of auditing, digitization, prioritization and performance

assessment, improving corporate governance of SOEs, centralizing public procurement, creating a national database for records of public administration employment.

Monetary policy is focused on bringing inflation to target in the medium term. Throughout 2016 and the beginning of 2017 the central bank kept unchanged both the monetary policy rate, at the historical low of 1.75 percent, and the amplitude of the symmetrical corridor of interest rates on standing facilities around the policy rate, at ±1.50 percentage points. The status-quo approach was warranted by the persistent divergence between short-term developments in inflation and its longer-term outlook, as reflected by the central bank's successive forecast updates over a period marked by high uncertainty and risks generated by both external and internal factors.

With persistent excess liquidity in the banking system, the central bank pursued an adequate management of money market liquidity and maintained the required reserve ratio on leu-denominated liabilities of credit institutions at 8 percent. However, given the ongoing contraction in foreign currency credit and consolidation of forex reserves, the NBR cut the required reserve ratio on forex-denominated liabilities twice (most recently on May 5, 2017) down to 8 percent, thus continuing the harmonisation of the reserve requirements mechanism with ECB standards and practices.

To increase transparency and the effectiveness of conveying to the markets the rationale behind the adopted decisions, the central bank started in September 2016 to publish the minutes of the NBR Board monetary policy meetings.

The central bank will continue to gear monetary policy towards bringing, and maintaining in the medium run, the annual inflation rate into line with the flat target, in a manner supportive of sustainable economic growth. However, the NBR Board emphasizes that a balanced macroeconomic policy mix and progress in structural reforms are crucial for macroeconomic stability and for the resilience of the Romanian economy to adverse global developments.

Financial stability continues to be robust and immediate risks from legal initiatives have been alleviated.
Romania is among the 5 EU members which haven't used public funds to support the financial sector since the onset of the global crisis. The capital ratio of the Romanian banking sector is adequate and provides, together with the IFRS provisions, a consistent buffer to absorb potential losses and to support the lending activity. The average total capital ratio (18.3% as at December 2016) situates the Romanian banking sector in the lowest European Banking Authority's risk bucket. Contagion risks continue to decline with banks increasingly substituting domestic deposits for foreign sources of funding and the total share of domestic currency loans on the rise for five years.

NPLs have fallen significantly due to the NBR's efforts to encourage banks to clean-up their balance sheets. The overall NPL ratio dropped from 21.5 percent in September 2014 to less than 10 percent presently. Further efforts are needed, since NPL ratios for corporates and SMEs are still high. However, the NPLs are well provisioned, the EBA Risk Dashboard lists Romania's coverage ratio the highest in EU as of Q4 2016.

Liquidity is abundant and banks' profitability improved in 2016, ROA (1.1 percent) and ROE (10.7 percent) standing at year end above EU averages. Credit to households advanced rapidly in 2016. Credit to non-financial corporations (NFCs) remained subdued throughout 2016, but has recently shown signs of recovery, amid stronger economic growth, improved confidence, and historically low interest rates.

The high risks for financial stability generated by two laws passed last year by the Parliament have abated following recent rulings by the Constitutional Court. One of the laws allows debtors to walk away from mortgages ("give-in-payment"); the Court's ruling that the law should be applied on a case-by-case basis and within the provisions dealing with distressed borrowers in the civil code, has greatly limited the potential negative impact of this law on the banking sector. The second law, allowing debtors to convert Swiss Franc denominated loans into domestic currency loans at historical exchange rates, has been declared unconstitutional. However, authorities recognize that important risks to financial stability remain and need to be closely monitored. Highly significant is the risk of abrupt worsening of investor sentiment towards emerging economies, generated by uncertainties surrounding global economic growth, geopolitical tensions and Brexit implications for the future of the EU. Medium-term risks from rising banks' exposure to households and government debt are also relevant. To help prevent and manage risks to financial stability, the authorities have set up a formal macroprudential authority, the National Committee for Macroprudential Supervision (NCMS). NCMS brings together representatives from the NBR, the financial supervisory authority and the government to formulate and coordinate macroprudential policies, issue warnings and recommendations ("soft laws") for NBR and the financial supervisory authority. The authorities also welcome the forthcoming FSAP programmed for 2017-2018.

Improved EU absorption will support structural reforms critical for sustainable growth.

Significantly improving the EU funds absorption as a critical source of financing investment is a top priority for the authorities. While the absorption during the first years of the 2014-2020 financial framework has been weak, progress has been made with respect to designating the managing authorities, compliance with ex-ante conditionality, and limiting domestic financing of projects eligible for EU funding. The authorities are confident that further building on this base will allow a significant acceleration of the absorption in the coming years.

Steps have been taken to restructure major energy producers and prepare IPOs for some of them. SOEs reform is expected to gain momentum after the establishment of the Sovereign Fund for Development and Investment, envisaged to be launched in July 2017.

To stimulate labor mobility across the country and thus increase employment, the government instituted a system of grants for hiring, settlement and relocation. Measures have been taken to increase the quality of education -including through significant salary increases for educators- and to promote vocational training.

The authorities thank staff for the thorough and constructive discussions during and after the Article IV mission, and for their valuable advice on macroeconomic policies.