

Romania: Report on the Observance of Standards and Codes—Fiscal Transparency Module

This Report on the Observance of Standards and Codes on Fiscal Transparency for **Romania** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **November 6, 2002**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Romania** or the Executive Board of the IMF.

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ROMANIA

**Report on the Observance of Standards and Codes (ROSC)
Fiscal Transparency Module**

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November 6, 2002

EXECUTIVE SUMMARY

This report provides an assessment of fiscal transparency practices in Romania in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency* based on discussions with the authorities and other organizations, the authorities' response to the IMF fiscal transparency questionnaire, and other sources of information. The IMF *Manual on Fiscal Transparency* (<http://www.imf.org/external/np/fad/trans/manual/>) should be consulted for further explanation of the terms and concepts discussed in this report.

Romania has made progress in improving fiscal transparency. Over the last few years, the pace of reforms in this area and in strengthening the management of public finances has intensified, with the strong commitment to EU accession serving as a catalyst. This has led to a significant amount of relevant legislation that has either been passed recently or is in the final approval stages. However, for these reforms to have a prompt and lasting impact, particular attention will need to be placed on ensuring that such legislative changes are effectively operationalized within the public sector.

Further progress is needed in several areas in order for Romania to fully meet the standards of the code. In this context, the staff recommends for the authorities to: explicitly include reporting on quasi-fiscal activities in the budget proposal and execution reports; further develop the medium-term framework and include it, along with an analysis of contingent liabilities, fiscal risks, and tax expenditures, in the budget documents; expand the program-based approach to expenditure management; introduce a commitment-based accounting system and develop a statement of accounting policies; present a budget policy statement at the outset of the annual budgetary process; and develop the supporting regulations associated with the ongoing work on establishing a Code of Ethics.

Contents	Page
I. Introduction	4
II. Description of Practices	4
A. Clarity of Roles and Responsibilities	4
B. Public Availability of Information.....	10
C. Open Budget Preparation, Execution, and Reporting	12
D. Assurances of Integrity	17
III. IMF Staff Commentary	19

ABBREVIATIONS AND ACRONYMS

APAPS	Authority for Privatization and Management of State Ownership
AVAB	Bank Asset Resolution Authority
ESA	European System of Accounts
EU	European Union
FAD	Fiscal Affairs Department
GDDS	General Data Dissemination Standard
GDP	Gross domestic product
GEO	Government Emergency Ordinance
GFS	Government Finance Statistics
GD	Government Decision
GO	Government Ordinance
MOPF	Ministry of Public Finance
MTEF	Medium-term expenditure framework
NBR	National Bank of Romania
NFPE	Non-financial public enterprises
PEP	Pre-accession Economic Program
QFA	Quasi-fiscal activity
ROSC	Report on the Observance of Standards and Codes
SEC	Social and Economic Council

Romania: Basic Data

Type of government: Parliamentary
Fiscal year: January 1–December 31
Population (2000): 23 million
GDP (2001): US\$38 billion
Debt/GDP (2001): 27.2 percent

I. INTRODUCTION¹

1. This report provides an assessment of fiscal transparency practices in Romania against the requirements of the IMF *Code of Good Practices on Fiscal Transparency*. The assessment has two parts. The first part is a description of practice, prepared by the IMF staff on the basis of discussions with the authorities and their responses to the fiscal transparency questionnaire, and drawing on other available information. The second part is an IMF staff commentary on fiscal transparency in Romania.

II. DESCRIPTION OF PRACTICES

A. Clarity of Roles and Responsibilities

2. **General government is defined according to accepted international standards.** The role and responsibilities of the government for fiscal activity are described in legislation, including in the Constitution of the Republic of Romania.² The definition of general government follows internationally accepted (GFS86) standards and encompasses the central government (state budget), the social security funds (pension fund, health insurance fund and unemployment insurance fund), four extrabudgetary funds,³ and local governments.⁴ The government is working toward revising their statistics to be consistent with the European System of Accounts (ESA95) and is looking into the new Government Finance Statistics (GFS2001).

¹ Discussions on fiscal transparency were held in Bucharest during May 14-24, 2002. The staff team comprised Mr. Tsibouris, Ms. Jacobs (both FAD), and Mr. Webber (FAD panel of fiscal experts). It met with officials from the Ministry of Public Finance, Ministry of Health, Ministry of Public Administration, Ministry of Development and Prognosis, National Bank of Romania, National Institute of Statistics, the Authority for Privatization and Management of State Ownership, Bank Asset Resolution Authority, Court of Accounts, National Health Insurance Fund, Finance Commission of the Chamber of Deputies, Chamber of Commerce of Romania, and Petrom (state-owned oil company).

² The constitution gives broad guidance regarding centralized public administration, particularly Articles 115-118, with more specific definition in the *Law on the Functioning of Government, No. 90/2001* and the *Law on Public Finance, No. 500/2002* (which superceded *Law No. 72/1996*). Local administrations are also guided by the Constitution (Articles 119-122) as well as the *Law on Functioning of Local Administration, No. 215/2001* and the *Law on Local Public Finance, No. 189/1998*.

³ These four funds are the Energy Development Fund, the Road Modernization Fund, the Insurance Guarantee Fund, and the Agricultural Development Fund.

⁴ General government currently consists of the following entities: the Presidency, the Senate, the Chamber of Deputies, the Supreme Court of Justice, the Constitutional Court, the Public Procuracy, 23 ministries, 25 other agencies, the state social security fund, the unemployment insurance fund, the health insurance fund, 4 special funds (see footnote 3), 41 districts (judets) plus the city of Bucharest, and approximately 3,000 local government units.

3. **Some nonfinancial public enterprises (NFPEs) are undertaking noncommercial activities on behalf of the state.**⁵ Government support for such noncommercial operations is provided, in some cases, either directly in the budget by subsidies or through the issuance of government guarantees; in other cases, public enterprises have had to finance such activities from their own resources. These arrangements, in addition to being complex, are non-transparent in terms of assessing the overall impact on fiscal policy. For example, the maintenance of reference prices below cost recovery for heating, electricity, and gas has led to a steady accumulation of losses for the relevant public enterprises. The noncommercial activities of some NFPEs are discussed further in paragraph 21 below. In the past, public financial institutions (the Romanian Commercial Bank, the Romanian Savings Bank, and the Romanian Export-Import Bank) have engaged in noncommercial activities on behalf of the state, a practice that appears to have been discontinued recently. As part of the privatization of state-owned banks, the Bank Asset Resolution Authority (AVAB) has taken on its books bad loans of state banks (in exchange for government debt) and seeks to recover such loans.

4. **The government is undertaking measures aimed at accelerating the privatization process and significantly strengthening its transparency.** Several reforms have been undertaken in the context of the introduction of the new privatization law,⁶ as well as an acceleration of the privatization process.⁷ The legal framework for accelerating the privatization process is based on the following principles: (i) to ensure the transparency of the privatization process; (ii) to sell enterprises on the open market; (iii) to ensure the equal treatment of buyers; (iv) to implement pre-privatization restructuring programs focused on shedding certain assets (primarily social assets); (v) to restructure enterprise debts in order to enhance the attractiveness of the privatization offer; and (vi) to appoint special administrators to manage the assets during the “hand-over” process. The treasury receives no less than 80 percent of the privatization proceeds and dividends, while the rest remains with APAPS and other responsible agencies to cover their operational costs.⁸

5. **The National Bank of Romania (NBR) is functionally independent and does not currently carry out quasi-fiscal activities (QFAs).** The primary objective of the NBR, according to *Law No. 101/1998*, is to ensure “the stability of the national currency, in order to contribute to price stability.” In order to harmonize with Chapter 11 of the EU Accession Agreement, price stability will become the fundamental objective of the NBR. Banking services performed by the NBR on behalf of the government would be subject to a fee. The board of the NBR is appointed by Parliament for a six-year term and the NBR presents a

⁵ Such non-commercial activities include energy provision (e.g., household heating), urban passenger transport, and railway passenger transport.

⁶ A new *Law on Privatization, No. 137/2002* was approved by Parliament in April 2002.

⁷ APAPS, a public institution with legal status, was established by *Government Emergency Ordinance No. 296/2000*. Its organizational structure and regulations were established by *Government Decision No. 678/2001*. Prior to the establishment of the Authority for the Privatization and Management of State Ownership (APAPS), the State Ownership Fund was solely responsible for privatization. The responsibility for privatizing state assets is now assigned to both APAPS and relevant sectoral ministries.

⁸ The staff of APAPS is remunerated more in line with the private sector.

report to Parliament on an annual basis. Banking activity is regulated by *Law No. 58/1998* and by NBR regulations.⁹ The NBR may act as an agent for the sale of government bonds.

6. Government regulation of the nonbank private sector has not been implemented with clear simple regulations and an open regulatory process; these problems are being addressed. Until 2001, businesses in Romania had to comply with numerous bureaucratic procedures and were operating in a confusing and unpredictable regulatory and legal environment.¹⁰ The costs of compliance in terms of money and time were burdensome for businesses and had a negative impact on the development of new businesses and economic growth. Several steps aimed at simplifying the registration of new companies have been taken. Among others, *Government Ordinance (GO) No. 76/2001* reduced the number of permits needed from over 100 to only 5. The Chamber of Commerce of Romania and Bucharest now acts as a “one stop” agency for enterprises seeking to obtain these five permits.

7. Government equity holdings remain relatively extensive and could be reported in a more comprehensive manner. APAPS has submitted an annual report on its activities and of government equity holdings under its portfolio to the government. In addition, APAPS maintains a database (available on CD-ROM) that provides prospective buyers with relevant information on state-owned companies.¹¹ No comprehensive statement on the market value of government-held equity holdings and state assets is available.

8. The allocation of responsibilities between different levels of government is, for the most part, clearly defined and inter-governmental fiscal relations are based on stable principles. The Constitution gives broad guidance regarding central and local public administration (Articles 119–122). Clarifications of the revenue and expenditure assignments are given in the relevant legislation: the *Law on the Functioning of Local Administration, No. 215/2001*, the recently approved *Law on Public Finance, No. 500/2002* (which supercedes *Law No. 72/1996*), as well as in the *Law on Local Public Finance, No. 189/1998*.¹² These laws, together with the *Law on the Court of Accounts*, establish the creation, allocation, and utilization of financial resources by the state, local governments and public institutions controlled by the Ministry of Public Finance (MOPF), the Court of Accounts, and other authorized bodies. One of the main reforms introduced by the *Law on Local Public Finance* is the distribution of revenues between the State Budget and local government budgets. This clarification of the vertical division led to the cancellation of

⁹ Details of these laws and regulations are available on the website of the NBR: <http://www.bnr.ro/>.

¹⁰ A useful reference to the regulatory regime can be found in: *Red Tape Analysis: Regulation and Bureaucracy in Romania*, The Center for Institutional Reform and the Informal Sector, 2000 (USAID: Bucharest).

¹¹ The following detailed information is available from APAPS on selected companies under state ownership: (i) contact details and the physical address; (ii) registration number and tax code; (iii) listing of share holders (also expressed in percentage of total); (iv) field of main activity; (v) transport facilities; (vi) share capital; (vii) financial data (annual data from 1997 to the first quarter of 2001) on turnover, profit/losses, debts; and (viii) number of employees.

¹² Articles 8-18 in the *Law on Local Public Finance, No. 189/1998* set out the revenues and expenditures of local budgets.

earmarked transfers applied up to 1998. Several earmarked transfers remain, including in the areas of investment (partially financed from external loans), pre-university education, minimum income guarantee, and subsidies of local heating producers and distributors. The *Law on Local Public Finance* (Article 51) also sets out the limits for local government borrowing.¹³ Local governments have to inform the MOPF of all their domestic borrowing. External borrowing, some of which may be guaranteed by the government, needs approval of a commission, comprising the MOPF, the NBR, the Ministry of Public Administration, and the Ministry of Local Governments.

9. **The roles of the executive, legislative and judicial branches are clearly defined in the Constitution and in law.** The Constitution and the *Law on the Functioning of Government, No. 90/2001* give a clear description of the executive, legislative, and judicial functions. The Constitution (Chapter IV) sets out the relations between Parliament and the Government. The Parliament approves the budgets of each ministry and government agency. Each institution is responsible for the execution of budgetary allocations (under the limits approved by the MOPF) and for the preparation of the annual budget execution accounts to be approved by Parliament, after taking into account the advice of the Court of Accounts. According to the *Law on Public Finance*, if the budget law is not approved by the start of the fiscal year, monthly provisions, equal to $\frac{1}{12}$ of the authorized budget of the previous year, are allocated. The drafts of the annual budget laws, before being discussed by Parliament, are analyzed and debated by the Social and Economic Council (SEC)—a tripartite organization that ensures regular dialogue between government, trade unions, and employer associations.

10. **Fiscal management is defined by a clear legal and administrative framework. The legal framework for expenditures is mostly comprehensive.** The core legal framework of the public finance system is set out in the recently approved *Law on Public Finance, No. 500/2002* which contains several improvements relative to previous legislation.¹⁴ In conjunction with the *Law on Local Public Finance, No. 189/1998*, they stipulate the general principles regarding the approval, formation, use, and control of the public financial resources. The annual budgetary laws detail some of these provisions. The *Law on Public Finance* includes a number of restrictions designed to reduce the discretionary use of public funds. The *Law on Internal Public Audit and Preventive (ex-ante) Financial Control, No. 119/1999* obliges the persons administering public funds to perform good financial management. Also, the law establishes internal public audit and preventive financial control functions within budget institutions.

11. **Mechanisms for the coordination and management of budgetary and extrabudgetary activities are generally well defined.** The *Government Emergency*

¹³ Local government borrowing is allowed only to the extent that debt service will not exceed 20 percent of total current revenue of the local budget.

¹⁴ These improvements include, among others, increased requirements for public debate of the budget proposals and budget execution accounts; the incorporation of certain special funds into the state budget; and the introduction of financial impact assessments to accompany the initiation of new normative acts. Special funds would be phased out over the course of three years.

*Ordinance*¹⁵ (*GEO*) No. 32/2001 (published in the government gazette, Official Journal No. 110/2001) and subsequently approved by *Law No. 374/2001* on the regulation of certain financial matters merges seven special funds into the State Budget.¹⁶ The *Law on the State Budget* (2002) introduced for the first time a presentation of budget funds allocated to ministries and agencies from all financing sources (state budget revenues, extrabudgetary revenues, external credits, and grants).

Box 1. The Structure of Legislative Decisions

Executive authority in Romania, including many of the actions and decisions through which fiscal policy is approved and implemented, is exercised through a tiered structure of laws, government ordinances (GO), government emergency ordinances (GEO) and government decisions (GD).

Legislation proposed by the Government and other members of Parliament and confirmed by the Parliament enters the legal framework as a "Law" and is given a title, sequential numbering for the year, and year of approval. For example, much of the current legal authority for budget management is provided by the *Law on Public Finance No. 500/2002* (which superceded *Law No. 72/1996*).

Some laws include a specification of the subordinate legislation that the Government may promulgate during any period in which the Parliament is not in session. These are called *Government Ordinances*. However, they cannot modify the superior law and must be approved subsequently by the Parliament. Once approved, they have the same legal force as a Law.

Government Emergency Ordinances are government ordinances which were not given authority by a superior Law. They also require the confirmation of Parliament.

Government Decisions are a lower level of regulation or instruction made within the authority of a law or government ordinance. As with each of the above, these must be notified in the Official Gazette within a specified period.

12. Mechanisms for the coordination of the budget and the NBR and public financial institutions are fairly well defined. The *NBR Law*, Art. 29(3) and (4), stipulates that the NBR can only provide treasury financing up to 180 days and that the total amount of NBR financing may not exceed 7 percent of the past year's budget revenue or twice the sum of capital and reserves of the NBR. This facility was used twice in 2000 for brief periods and

¹⁵ See Box 1 for a discussion of Government Ordinances (GO) and Government Emergency Ordinances (GEO).

¹⁶ These funds include: the special fund for public health, the special fund for social solidarity with handicapped persons, the special fund for development and modernization of the customs, the special fund for tourism promotion and development, the special fund for civil aviation, the national fund for solidarity, and the special fund for state education sustenance. The latter has subsequently been eliminated by *GEO No. 163/2001*. This ordinance eliminated the economic agents' contribution for the state education sustenance. The same ordinance abolished a special fund for capital risk insurance on machinery, equipment, and industrial installations.

was not used in 2001. In preparation for negotiations relating to Chapter 11 of the EU Accession Agreement, the NBR envisages the elimination of such short-term credit facilities. The NBR pays 80 percent of its gross profits to the treasury. In the past, the NBR provided lending to public financial institutions, for example, the Agricultural Bank. A well-defined policy, available on the NBR's website, now exists regarding the restructuring of state-owned banks.

13. **The legislative basis for the administration of taxes is complex and difficult to observe in practice.** According to the provisions of the Constitution, taxes, charges, and other revenues of the State Budget and of the state social security budget are established by law. However, the number and frequency of changes to tax laws and regulations, including through the use of GEOs, in recent years have led to confusion of interpretation by both taxpayers and tax administrators. In addition to the MOPF, sectoral ministries can initiate legislation on revenue issues through the Cabinet, which further complicates the process. A codification of the profit tax and the VAT was recently implemented. Local taxes, fees, and charges are established by the local and district councils, within the limits and conditions provided by law.¹⁷ Furthermore, the absence of a unified revenue collection agency has presented some problems with tax administration. At present, the responsibility for revenue collection is spread across the MOPF and various institutions responsible for managing the social funds and the special funds. The authority for the collection of taxes, contributions, and other budgetary claims is contained in *GO No. 11/1996*. The recently enacted laws on VAT, profit tax, and income tax should improve tax administration and voluntary compliance, by removing ambiguities that existed in prior legislative acts. The Ministry of Public Finance is in the process of preparing a Code of Fiscal Procedures and a Fiscal Code in order to improve tax administration and taxpayer compliance.

14. **Work is underway to develop a code of behavior for public servants.** Currently, *Law No. 188/1999*, as amended by *GO No. 82/2000*, provides the legislative framework for the employment of civil servants. This legislation provides standards regarding the positions, rights, duties, and requirements for hiring of civil servants. In addition, there are five applicable government regulations dealing with: (i) evaluation; (ii) disciplinary commissions; (iii) bilateral commissions (management and employees); (iv) rules regarding appointments; and (v) training. Special employment regulations apply to the unit of delegated controllers within line ministries. A project is now underway to draft an ethics code for civil servants (along the lines of those found in some EU countries).¹⁸

¹⁷ The main tax laws in Romania are: the *Law on Profit Tax (No. 414/2002)*; the *Law of the Tax on Income of Individuals (No. 493/2002)*; the *Law on VAT (No. 345/2002)*; custom duties (*Law No. 141/1997* regarding Romania's customs code and *GD No. 1114/2001*); excises (*GO No. 158/2001*, *GD No. 163/2002* for the approval of the implementing norms of the *GD No. 158/2001*), and several local taxes, fees and charges.

¹⁸ The EU is providing technical assistance for this project.

B. Public Availability of Information

15. **A notable feature of the Romanian Constitution is the right of citizens to access public information.**¹⁹ The right to public information is reinforced by the *Law on Free Access to the Information of Public Interest, No. 544/2001*. The definition of items of public interest is relatively broad based and is defined as: “any information regarding or resulting from a public authority’s or public institution’s activities, irrespective of the support, or the form, or the mode of expressing the information.”²⁰

16. **The budget documents cover most central government fiscal activities and provide some information on general government fiscal activity.** According to the *Law on Public Finance* “public financial resources are created and administrated through a unitary system of budgets.” Furthermore, “the Government shall examine the reports and shall present the annual general execution account of the state budget and state social security budget and the other annual execution accounts to the Parliament for approval, by July 1 of the year following the execution.” The data of the central government budget execution are compiled by the MOPF and are published on a monthly basis, in addition to being placed on the MOPF website.²¹ Monthly expenditure data are available according to administrative, economic, and functional classifications. Aggregate information on the execution of local budgets is available to the MOPF on a monthly basis and is included in the consolidated general government budget. On a quarterly and annual basis, local public authorities are required to submit detailed information on their budget execution (according to the *Law of Local Public Finance*). They are also required to provide judet and local councils, as the case may be, with such information for approval.

17. **According to current legislation, the Ministry of Defense is treated like any other line ministry and must comply with all the relevant laws and regulations regarding fiscal reporting.**

18. **The budget document provides ministerial expenditure estimates in a multi-year framework but only presents the main fiscal aggregates for one year prior to the budget year and one year beyond the budget year.** Debt projections are made over a longer time period. Starting with the 2002 budget, all ministries have included at least one example of program-based expenditure for which they also developed medium-term estimates (covering a three-year period). It is expected that this exercise will be expanded in anticipation of creating a full MTEF in the near future. The government’s Pre-accession Economic Program (PEP) document contains medium-term projections of the main fiscal aggregates.²² The 2003

¹⁹ A person’s right to public information cannot be restricted; correct information should be provided and public radio and television services shall be autonomous.

²⁰ The new *Law for the Protection of Classified Information, No. 182/2002* has been criticized in the press for its lack of clarity on what should be regarded as classified information.

²¹ The MOPF’s website is located at <http://www.mfinante.ro>.

²² A more detailed exposition of current policies and medium-term prospects is provided in the Government’s Pre-Accession Economic Program (PEP) document.

budget document will include information on the main fiscal aggregates for the period 2001-2006.

19. **No comprehensive statements on contingent liabilities are included in the budget documentation.**²³ **Provisions for government guarantees that have a high probability of falling due are provided for in the budget.** Both the stock of public debt and debt service (including government guaranteed) are mentioned in the report that accompanies the State Budget law. Provision for expenditure on external loans contracted directly or guaranteed by the government can be found in the State Budget provides under the heading “Interest and other expenditures due to public debt.”

20. **No separate information on tax expenditures is included in the budget documents presented to parliament or made available to the public.** The MOPF has some information on tax expenditures, which is available to Parliament on request.

21. **Quasi-fiscal activities are extensive and their estimated cost is not included in the budget documents.** In the past, the limited progress in reducing quasi-fiscal activities has jeopardized macroeconomic stability. Reporting and transparency thereof have improved somewhat in recent years due to the fact that quasi-fiscal activities have come under increased scrutiny. However, there is still no accounting framework in place for quasi-fiscal activities. In addition, large-scale cancellation of tax obligations of state-owned enterprises remains a problem area as evidenced, for example, by the cancellation of tax arrears (amounting to about 1 percent of GDP) of the energy production company Termoelectrica and some of its suppliers in December 2001. A limited amount of information on QFAs has been generated through ongoing discussions with international financial institutions (IFIs).

22. **While detailed information on gross public debt is published, it is not comprehensive; some information on financial assets is publicly available.** Information on domestic debt and external debt is available on a monthly basis and can be found on the MOPF’s website. Information on local government domestic debt is being collected and will be included in future annual budget execution reports. Information regarding domestic public debt is also provided on the purpose of issuance, types of holders and instruments, and maturity. As required by the *Law on Public Debt, No. 81/1999*, the Ministry of Public Finance issues an annual report on the stock of public debt (including local borrowing, on-lending, and government guarantees), which is an annex to the annual budget execution report. A semi-annual report is also presented to the Government, while data are updated monthly on the MOPF website.

23. **The periodicity and frequency of the publication of fiscal data has improved and advance release date calendars are announced.** The fiscal information is published on MOPF’s website monthly and is referred to in monthly press releases. Romania’s adherence

²³ Contingent liabilities are potential expenditure demands, for which the probability and precise amount of payment cannot be accurately known at the time of budget preparation. These (foreseeable) contingent liabilities should not be confused with the debt servicing costs associated with government “guarantees” relating to line ministry external credits. Provision for the latter is made in the Budget. The budget also includes a reserve fund, from which unforeseen outlays can be financed.

to GDDS has provided a catalyst for some improvements relating to public finance statistics. The Romanian authorities have published the data transparency module of the ROSC (<http://www.imf.org/external/pubs/ft/scr/2001/cr01206.pdf>); it identifies several areas where government finance statistics could be strengthened.

C. Open Budget Preparation, Execution, and Reporting

24. **The annual budget presentation focuses on financial compliance, and the budget classification is moving towards meeting international standards.** The formulation, presentation, and approval of the State Budget are an open and transparent process. A feature of this process is the submission of the draft budget for debate to the tripartite Social and Economic Council (SEC), prior to its presentation to Parliament. Parliament has the legal power to require changes to the draft budget submitted by the Government, though such changes are normally at the margin. For 2002, the budget formulation process adhered to a well-structured calendar that is now specified in the new law on public finances.²⁴ This was the first occasion for many years in which the Budget was approved prior to the commencement of the budget year. The new preparation process is based on detailed guidelines issued by the MOPF to budget institutions and local governments. The MOPF issues a budget circular to line ministries, but this falls short of what would constitute a budget policy statement, according to the Code. The documentation accompanying the State Budget comprises a budget policy framework, financial tables, departmental estimates, and estimated revenues and expenditures of special funds. This documentation is available on request from the MOPF and is also found on the MOPF website. This website contains the previous budget, current draft budget as submitted to Parliament, and the current budget as approved. All Government documents are in Romanian, though an unofficial summary of the 2002 budget text is available in English. In addition to a presentation according to economic and functional classifications, detailed information on revenues and expenditures is provided on an administrative basis at three levels of budget institution: primary, secondary, and tertiary. The policy framework presented in the Budget text provides a clear but generalized short- to medium-term fiscal outlook with key policy objectives. Presentation of some expenditure in programmatic form commenced in 2002 (see paragraph 30).

25. **The overall balance of general government provides the main fiscal indicator for budget policy; it is monitored systematically together with the State and Social Security budget outturns during the year.** The general government fiscal balance is derived from the fiscal operations of each of the State Budget, Social Fund, aggregated local budgets, and special funds. Expenditure undertaken by special funds account for about 35 percent of total consolidated general government expenditures in 2002.²⁵ The State Budget includes

²⁴ A new *Law for Public Finance* was approved by Parliament in August 2002. The new law includes specific provisions for increasing the degree of public debate on budget issues. The new law specifies that the key macroeconomic and social parameters for budget formulation are to be presented to the Government by the end of March and that the draft Budget is to be submitted to the Parliament by October 15.

²⁵ See footnote 16.

subventions to local authorities.²⁶ However, local budgets can only be finalized after the State Budget has been approved. In 2002, local government expenditures accounted for approximately 17 percent of the estimated consolidated general government expenditure. The quasi-fiscal operations of state-owned enterprises, including their borrowing requirements, are not presented in the budget, though the Government is attempting to reduce the number and volume of these expenditures. The Budget document does not include a borrowing requirement for the broader public sector—that is, including state-owned enterprises. This would be useful in view of the scale of these activities and of the extent of associated government liabilities and guarantees.

26. Budgetary forecasts are presented in the budget documents, and some macroeconomic assumptions are disclosed to the public. However, the range of information is not complete. Macroeconomic forecasts are made by the Ministry for Development and Prognosis and submitted to the MOPF. Fiscal projections (for major aggregates and sectors) are made for three years following the budget year and are included in the budget documentation submitted to the Social and Economic Council and Parliament.²⁷ The key macroeconomic indicators and assumptions are discussed in the budget text and further information and discussion may be found in the PEP.²⁸ The Government prepared a medium-term expenditure framework (MTEF) for the first time as part of the 2002 budget process, drawing on the PEP. This involved the identification of broad expenditure envelopes, by sectors and broad economic classification, based on estimated aggregate revenues and expenditures. These indicative targets are derived from the Government's current economic strategy and associated forecasts of macroeconomic parameters; are for information purposes only; and are not explicitly approved by the Parliament as part of the budget process. The MTEF will be developed more fully over the next few years in order to become an effective mechanism for forward planning of expenditure priorities.

27. A statement on medium-term fiscal policy objectives is included in the budget documents. Fiscal policy objectives are set annually and are formulated in view of the fiscal aspects of the convergence requirements for EU accession. At present, the key fiscal target comprises a deficit of 3 percent of GDP on the consolidated general government budget balance²⁹ through to 2005. The Government has also set a goal of non-inflationary financing of the deficit within a broad context of maintaining debt sustainability.³⁰ Other budget targets are expressed more as medium-term policy objectives—for example, reducing the quasi-fiscal operations of state-owned companies and raising revenues and reducing tax exemptions in order to harmonize with EU policies. Medium-term (3-year) estimates for

²⁶ Includes districts, municipalities, towns, and communes.

²⁷ This process has become a legal requirement on the Government under the new law on public finances.

²⁸ Published in September 2001 and to be updated annually.

²⁹ Calculated based on the cash-based balance of the state budget, special fund, and local government budget balances.

³⁰ Debt servicing forecasts for 2002 include a ceiling of 2 percent of GDP on interest payments on domestic public debt and a "projection" of 1 percent of GDP for interest payments on external debt.

revenue and expenditure are presented in the Budget and are monitored internally by MOPF. Forecasts of revenues and expenditures are provided, including on a sectoral basis, though the deficit figure is the only one that may be considered a formal (aggregate) target of fiscal policy.

28. **Estimates of new initiatives and ongoing costs of government policies are not clearly distinguished in the budget documents.** New revenue measures are announced in the budget documentation together with their expected fiscal impacts. Major adjustments to expenditure policies are identified in the budget text, mainly at the level of broad economic category and by specific sectors. A particular shortcoming in budget coverage and clarity concerns the significant volume of capital expenditures that are financed by line ministries through external credits. These credits are guaranteed by the Government and have direct budgetary implications. The associated debt servicing obligations should be incorporated as part of the Government's budget estimates for debt servicing, and not budgeted as line ministry expenditures.

29. **A sensitivity analysis of the budget estimates to changes in economic variables is published, though major fiscal risks are not systematically presented in the budget document.** Detailed presentation of the Government's current economic framework is contained in the PEP. This includes an alternative, less optimistic, scenario which analyses the aggregate fiscal and other impacts of a lower annual growth rate—in the most recent PEP, an annual rate of 4 percent to 2005 compared to the baseline scenario of 5.1 percent per year. Contingent liabilities are not specifically identified, *ex ante*, in the budget documents. To the extent that unexpected expenditure obligations occur, these may be met from the Reserve Fund and/or the Intervention Fund in the State Budget. The *Law on Public Debt, No. 81/1999* provides authority for the Government to underwrite loans by budget institutions, local governments, and commercial companies. The guarantees granted to commercial companies have resulted in unbudgeted expenditure obligations in recent years. Presently, there is no systematic discussion of the uncertainties associated with the future costs of some programs. The authorities acknowledge that in the current transition environment there are considerable uncertainties in program costs, but that it is not always helpful or possible to quantify these future costs. Progress has been made in bringing a range of risks more explicitly into the budget framework.³¹

30. **Romania is moving toward a budget presentation in which objectives of most major programs are announced and where actual progress is reported against these objectives.** At present, public policy objectives for fiscal operations are mainly expressed at the sectoral level. The identification of sub-sectoral program objectives and the development of associated performance indicators are in their initial stages of development. The authorities expect to improve and extend this capability over the next 3–5 years in order to meet international standards of program management specification, quality, and transparency.

³¹ In the PEP, key identified risks include: (i) higher than expected quasi-fiscal and current account deficits; (ii) banking sector restructuring; and (iii) pension system financing requirements.

31. **Improved structures and procedures for internal financial control have been put in place and the accounting system can generate reports on arrears on a quarterly basis.** Internal systems for ex-ante and ex-post audit have recently been strengthened under *GO No. 119/1999*. In effect, the ex-ante audit system consists of the placement in line ministries of trained and specially remunerated “delegated controllers” under the auspices of MOPF. These controllers now attempt to ensure that expenditure limits and correct procedures are observed for major budget expenditures. Success will take time, as there are many practical difficulties in establishing effective internal audit. Ex-post audits are selective and aimed at problem areas or institutions. Local governments have their own systems for internal audit, many of which are not yet adequately developed. State Budget arrears are a problem due to a combination of perceived inadequacies in some budget allocations and to poor fiscal discipline in agencies simply committing expenditures in excess of monthly approved limits.³² Manually compiled accounting reports are generated quarterly to determine the extent of outstanding payments arrears. However, limitations in the accounting system, especially the absence of commitments reporting and lack of computerization, mean that there are difficulties in gathering these data on a timely basis. Regulations for issuing contracts, for procurement, and for recruiting and paying civil servants have all been improved in recent years, following serious financial management and control problems in these areas.³³ There is a commitment by the Government to eliminate these problems. The legislative requirements for supporting these objectives are now largely in place.

32. The accounting system is capable of producing complete and reasonably accurate in-year reports on the central and general government budget outturns. Fiscal targets are carefully monitored and in-year adjustments are made to budget execution in line with these targets. The fact that the financial data generated by the current accounting system is mainly cash-based, only semi-automated, and not comprehensive with regard to quasi-fiscal activities means that it is less than totally complete or valid. Nonetheless, financial reporting is maintained on a daily, monthly, quarterly, and annual basis and reflects the budget classifications. Efforts are being made to improve the quality of these reports, especially in terms of their inclusion of outstanding obligations and their contribution to managerial decision making, and to harmonize with EU fiscal reporting standards. (See Box 2 for an outline of the Government accounting process.)

³² The MOPF estimated the stock of State Budget arrears to be equal to 0.4 percent of GDP at end-December 2001.

³³ The new regulations governing public procurement are contained in *GO No. 60/2001* and *GD No. 461/2001*. The government is also initiating an Internet-based bidding system for government procurement contracts.

Box 2. The Current Budget Execution Process in Romania and Next Steps Towards Full Transparency

Budget execution in Romania is based largely on cash accounting practices, involving a system of budget disbursements by budgetary institutions through regional and local treasury (MOPF) offices. A small number of budget agencies report on a commitment, as opposed to a cash, basis. The key steps and procedures for executing budget operations are summarized as follows:

1. The budget execution process in Romania commences with MOPF notifying the primary budget institutions of their appropriation amounts. MOPF requests these primary institutions to prepare and submit within 20 days quarterly breakdowns of these appropriations, including the amounts required by each secondary and tertiary level institution under their budget authority.
2. Based on revenue projections, the MOPF further breaks these quarterly estimates into monthly limits. This information is communicated to the respective regional (judet) and local treasuries and copied to the institutions concerned. (Each institution has a local or regional treasury that holds the account from which its budget expenditures can be made.)
3. On the basis of this instruction, a budget account (credit line) is opened for each institution, containing details of chapter and category of expenditure. At this point, the various institutions are authorized and able to commence budget operations. Subject to any ex ante (preventative) audit procedures that may apply to them, commitments may be undertaken within the specific budget appropriation and monthly credit limits.
4. On receipt of goods and services, the institution checks the invoice and sends this, together with a payment order to its designated local treasury. The treasury performs a further control function by checking that the documentation is in order, contains the appropriate expenditure code and is within the (remaining) available cash limit for that institution. If all is in order, the treasury debits the institution account accordingly.
5. Payments are made by local treasuries predominantly in cash for salaries and wages and by payable order for goods and services. These payable orders are transmitted through the judet treasuries to a branch of the National Bank which, provided there are funds available, debits the judet treasury and credits the payee (supplier) account. This transfer of funds by payable order may take 1 to 2 days to complete, depending on the location of the local and judet treasuries.
6. Primary budget institutions are responsible for collecting budget execution (revenue and expenditure) data from the secondary and tertiary level institutions under their authority. They report this execution data monthly, or more regularly if required, to MOPF manually, either on paper or on diskette. At the same time, judet treasuries consolidate budget execution data from the local treasuries under their authority and report this, predominantly on-line, to the central treasury in MOPF. The Ministry then reconciles the accounting data from these two sources with the relevant bank account information received from the National Bank of Romania.

Despite its acknowledged limitations, the system appears moderately efficient and transparent. There are procedures and mechanisms in place that support accurate account reconciliation and regular reporting. However, further integration of the accounting system—through the introduction of commitments reporting, registering expenditures at the accrual stage, and expanded computerization—would strengthen the system considerably. These improvements, in coordination with a gradual shift towards much greater use of the expanding commercial banking system for handling payments transactions, are the key steps required to bring Romania closer to full transparency and accepted best practice in treasury operations.

33. **Tax administration is currently being performed by several agencies.** There is no single statutory agency responsible for national tax administration in Romania. Taxes are collected by the MOPF's territorial entities coordinated by a General Directorate at MOPF headquarters and by other responsible agencies. Legal authority for the collection of taxes is provided by the *Law on Public Finance, No. 500/2002* which supercedes *Law No. 72/1996*. Regulations relating to specific taxes are defined in a range of ordinances. Some confusion in the application of profit tax regulations has been removed by a new fiscal code for profit tax targeted, effective from July 2002. Particular attention is being paid to the proper payment and collection of taxes by the MOPF directorate responsible for ex-post internal audit in an effort to stamp out previous irregularities.

34. **The legislature does not undertake a formal mid-year review.** Budget execution data are reported monthly to the Government and to the public via the MOPF website. In-year budget revisions, with an associated requirement for supplementary estimates, are enacted by the issuance of a Government Ordinance in most years, sometimes more than once.

35. **The Final Accounts must be compiled within six months of the end of the fiscal year.** The Final Accounts are reviewed by the government and subsequently presented to Parliament. The Parliament refers these to the Court of Accounts for external audit and comment. This whole process takes time and Parliamentary discussion of the Final Accounts—together with the Report of the Court of Accounts—may take place up to two years after the end of the fiscal period. This delay can limit the effectiveness of parliamentary scrutiny. Both the Final Accounts and the Court of Accounts Report are available to the public.

D. Assurances of Integrity

36. **Budget data are generally reliable, and the variance between budgeted and actual outturn of main fiscal aggregates is disclosed to the public and to the legislature and is explained.** In both 2000 and 2001, actual outturns of aggregate revenues and cash expenditures for the state budget were reasonably in line with initial budget estimates. However, in both years, operational expenditures significantly exceeded the initial approved budget and these needed to be offset by savings in other categories. More substantive deviations have occurred with respect to the collection of social security contributions.

37. **Comprehensive statements of accounting policy are not included in the budget and in final accounts documents.** The accounting of public finances is mainly on a cash basis, but the precise methodologies are not clearly explained in a comprehensive accounting policy. Regulations and instructions relating to accounting practices are published in the Official Gazette. The Government recognizes the deficiencies in the current accounting methodologies and aims to introduce some improvements in 2003, specifically a register of outstanding tax claims and a system of commitment (expenditure claims) reporting. Introduction of these methodologies will need to be coordinated with the computerization of most line agency and local government financial management operations. Noticeable improvements may take several years.

38. **The processes of accounts reconciliation and fiscal reporting are reasonably effective.** Accounting reports generated on a monthly, quarterly, and annual basis are reconciled with budget appropriations on a timely basis. There continue to be some discrepancies in the internal reconciliation with bank account statements from the NBR.

39. **External audit is independent of the executive branch.** The external audit authority, the Court of Accounts, was established by *Law No. 94/1992* as a statutory entity reporting directly to the Parliament. The role and independence of the Court was recently clarified and strengthened by *Law No. 77/2002*. The eighteen members on the Board of the Court of Accounts are appointed by Parliament for a period of six years each. Legally, the Court has full access to information from public institutions and publishes and presents an annual report to Parliament on its findings.³⁴ These reports are compliance oriented and focus on the execution of accounts under the Court's supervision, on investigations requested by the Chamber of Deputies or the Senate, on any resulting legal infractions, and on audits of agencies involved in the privatization process. A recent restructuring in the audit services of Government has been aimed at expanding the capability of the Court to undertake more analytical and performance-focused audit investigations.

40. **External audit capacity could be strengthened.** The Court of Accounts undertakes an annual audit of the Government's financial accounts plus selective investigations of financial management issues or problems. It reports only to Parliament on these issues, and these reports are available to the public. Strengthening of the external audit function is required to enable the Court of Accounts to play a fully effective role in the scrutiny of public financial management.

41. **The legislature follows up on external audit reports to a limited degree.** The concept of external and fully independent scrutiny of government financial operations is relatively new to Romania. At present, there are no formal mechanisms to ensure that the legislature, or a specific committee within either chamber of Parliament, follows up on the findings and recommendations of the Court of Accounts. However, the new law on public finances contains provisions for increasing the degree of public debate of budget execution accounts.

42. **External scrutiny of macroeconomic models and assumptions is emerging.** External input is made to the macroeconomic models and assumptions underpinning Government's financial operations, mainly by local academic institutions, however, the details of this modeling process are not disseminated. The domestic private sector is still finding its way in terms of monitoring, analyzing, or providing a critique of the Government's fiscal policies and forecasts. Nonetheless, Government aspirations with regard to international borrowing and EU accession are having a significant impact on the degree of external (international) focus on the quality of Romania's economic and financial analysis, strategy and reporting. This oversight is helping to provide greater capability and

³⁴ The law does not provide guidance relating to the timing of Parliamentary debates of the Court of Accounts' annual report.

professionalism in preparing forecasts and budgets while also demanding increasing levels of fiscal accuracy and transparency.

43. **The National Institute of Statistics is given legislative assurance of independence.**³⁵ In the economic area, this institution publishes annual reports on GDP and other national accounts data, generally with a lag of about 2 years. Some economic data is collected and published on a monthly basis. The Institute does not have major independent responsibilities for the collection, analysis, or publication of fiscal data. It accepts information on public finances supplied by MOPF as an input to its national accounts data series.³⁶

III. IMF STAFF COMMENTARY

44. **Romania has made notable progress in improving fiscal transparency.** Over the last few years, the pace of reforms in this area and in strengthening the management of public finances has intensified, with the strong commitment to EU accession serving as a catalyst. At the political level, there is a clear commitment for enhancing fiscal transparency. This has led to a significant amount of relevant legislation that has either been passed recently or is in the final approval stages at present. This is commendable. However, for these reforms to have a prompt and lasting impact, particular attention will need to be placed on ensuring that such legislative reforms are effectively operationalized within the public sector. The successful implementation of such planned improvements and the undertaking of a range of additional reforms would move Romania much closer toward full compliance with the Code.

45. **Romania meets the requirements of the fiscal transparency code in several areas.** In particular, the following specific characteristics are worth highlighting:

- **The roles of the executive, legislative, and judiciary branches are clearly distinguished** in the Constitution. The **responsibilities of different levels of government are clearly defined** in the laws on state and local public finances (some of which have been strengthened recently). **Relevant laws clearly establish the statutory independence of the NBR, Court of Accounts, and Institute of National Statistics.** The **regulatory environment for the private sector has been significantly streamlined** with the application of clear rules and procedures.
- With a few notable exceptions, **the public is provided with adequate information on the fiscal activity of the general government.** Fiscal information on the central government, local governments, and on the extrabudgetary funds is generally reliable and is provided to the legislature and the public on a timely basis.

³⁵ The National Institute of Statistics organizes and coordinates the compilation and reporting of official statistics in Romania, in accordance with the provisions of *GO No. 9/1992*, as amended by *GEO No. 75/2001* and *Law No. 311/2002*. The organization and functioning of the National Institute of Statistics is governed by *GD No. 488/2001*.

³⁶ The web site address for the statistics agency is <http://www.insse.ro>.

- The existing cash-based accounting system falls short of international best practice and the provisions of the Code. However, within that constraint, the present system delivers **reasonably effective accounts reconciliation and fiscal reporting**, though the reconciliation of financing data could be strengthened further. A strengthening of the system of internal audit has bolstered overall expenditure management, though spending arrears have yet to be eliminated.
- The **introduction of the new *Law on Public Finance*** is a major step in bringing Romania closer to the provisions of the Code, particularly with regard to the establishment of the budget calendar, the much-needed reduction of extrabudgetary funds (eliminating all but the social security funds and the privatization agency), and the introduction of a mid-year report of budget execution. This report should be submitted to Parliament.

46. **Romania has the capacity to introduce significant improvements in fiscal transparency in the short term. In the view of the staff, the main areas where further improvements are required include:**

Coverage of fiscal activity

- Given the continued extensive reliance on quasi-fiscal activities in Romania, it will be important to **establish an accounting framework and explicitly include reporting on planned and undertaken quasi-fiscal activities in the budget proposal and annual budget report**, respectively. This will ensure that Parliament would be able to make more informed deliberations on fiscal policy, as well as making such information more readily available to the public. This would also enable full reporting of the public sector borrowing requirement.

Preparation and presentation of the budget

- The **medium-term analysis initiated in the PEP should be expanded and incorporated in the budget documents**. This would enable a fuller multi-year presentation of the budget aggregates, in conjunction with a strengthening of forecasting capacity. Once the MTEF framework has been adequately developed, it should be included in the information sent to budget institutions at the commencement of the formulation process.
- A useful addition to the budget process would be the presentation by Government of a **“budget policy statement”** which identifies the main fiscal objectives and new policies and expenditures. Ideally, such statements should be issued shortly before the line agencies begin preparing their initial estimates, to guide them and the MOPF in the development of line budgets.
- The **program-based approach to expenditure management** should be steadily expanded to include all ministries and expenditures. This will need to be accompanied by the development of a set of performance measures, as indicators of policy effectiveness.

- **Improvements in budget planning and costing of spending initiatives** will help minimize the emergence of expenditure arrears.
- Transparency would be enhanced by **identifying the major sources of deficit financing** in the Budget—that is, more than just by internal and external sources.
- It will be important to **consolidate all debt servicing costs**, currently distributed among line ministries, into the appropriations of the MOPF. At the same time, international best practice requires that principal repayments on government debt not be shown as expenditure, but rather as a negative financing item.
- An analysis and aggregation of **contingent liabilities** and **tax expenditures** should be included in the annual State and social security fund budget documents. The analysis of contingent liabilities should include government guarantees for domestic and external loans and contingencies related to the privatization process.
- The discussion of **fiscal risks** in the PEP should be included in the annual State Budget documentation and expanded to include discussion of the potential budgetary implications.
- Any **revisions to the Budget**, if needed, should be subject to discussion and approval by Parliament.

Budget execution and reporting

- Budget execution reports should include **information on sources of deficit financing**.
- The **introduction of a commitment-based accounting system** will facilitate the generation of comprehensive reports on expenditure execution, including arrears.
- A **statement of accounting policies** should be developed and included with all budget documentation and final accounts.
- The authorities should consider developing a **central government balance sheet** (in line with the legal authority provided by GO No. 61/2001), starting with the financial assets and liabilities and moving towards more comprehensive coverage.

Other legislative initiatives

- The ongoing work in the development of a **Code of Ethics** should lead to the introduction and implementation of supporting regulations and practices aimed at enhancing the performance of the civil service.

47. Other **important reforms could be undertaken over the medium term** and would yield continued improvements in fiscal transparency. These reforms include:

- The ongoing **codification of taxes** (currently the profit tax and VAT laws) could be expanded. A comprehensive consolidation of the existing chain of multiple amendments to laws and regulations will greatly simplify issues of tax compliance for both taxpayers and tax administrators, thus enhancing fiscal transparency. Moreover, consideration should be given to a significant reduction in the use of Government Emergency Ordinances, which have undermined transparency in the area of tax legislation.
- Following on the planned unification of the tax collection, audit, and enforcement of all social contributions, the authorities should aim at **the integration of all tax administration responsibilities into one functionally independent agency** in order to alleviate the administrative burden of taxpayers, in addition to reducing government costs.
- The introduction of a **more comprehensive accounting base** (that records all stages of the expenditure process) and the development of a **fully integrated and computerized financial accounting system** will play an important role in strengthening fiscal reporting and financial control.
- The budget documentation should include further information on the **costing of new expenditure policies**.
- More emphasis needs to be given to the observance of the terms and the authority of **reports of the Court of Accounts** and to making these more readily available to the general public, for example through a web site. The Court needs to enhance its reputation for providing strong, independent, and competent oversight of the Government on matters of public financial management.