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Romania: Fourth Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Romania

In the context of the fourth review under the Stand-By Arrangement and request for waiver of performance criteria, the following documents have been released and are included in this package:

- the staff report for the fourth review under the Stand-By Arrangement and request for waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **July 31, 2003**, 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 October 2, 2003**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **October 15, 2003** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its October 15, 2003 discussion** of the staff report that completed the request and/or review.

- a statement by the Executive Director for Romania.

The document(s) listed below have been or will be separately released.

Financial Sector Stability Assessment
Letter of Intent sent to the IMF by the authorities of Romania*
Supplementary Memorandum of Economic and Financial Policies*
Technical Memorandum of Understanding*

*May also be included in the Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

ROMANIA

Fourth Review Under the Stand-By Arrangement and Request for Waivers of Performance Criteria

Prepared by the European I and the Policy Development and Review Departments

(In consultation with other departments)

Approved by Susan Schadler and John Hicklin

October 2, 2003

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I. Introduction

1. The 18-month Stand-By Arrangement (SBA) for Romania in the amount of SDR 300 million, or 29 percent of quota, was approved on October 31, 2001. Romania has purchased SDR 189.777 million upon approval of the program, the completion of the combined first and second reviews on August 28, 2002, and the third review on April 25, 2003, when the program was extended by 5½ months. Discussions on the fourth review were held in Bucharest July 21–August 1, 2003.[1]

2. **In concluding the third review in April 2003, Executive Directors called for strict implementation of sound macroeconomic policies and accelerated structural reforms to sustain favorable macroeconomic developments.** They noted the more uncertain macroeconomic outlook stemming from the large minimum wage hike in January 2003 and the global slowdown. Reaching the 2003 program objectives would thus require rigorous implementation of programmed fiscal and wage policies, and might necessitate tightening later in the year. Directors encouraged the authorities to slash losses of state-owned enterprises (SOEs) by downsizing, accelerating privatization and closing nonviable companies. They regretted the unsuccessful tender for the privatization of the largest bank, BCR, and stressed the importance of selling a minority share to the EBRD and IFC, as a step toward future sale to a strategic investor.

3. **Romania's macroeconomic performance remains broadly in line with the program, but the recent strengthening of domestic demand and non-observance of four performance criteria require corrective measures.** Robust GDP growth and rapid disinflation continued in the first half of 2003. However, reflecting slowing exports and fast credit growth, the current account deficit overshot the program projections by ¼ percent of GDP. The budget was on track, but the reduction in quasi-fiscal losses stalled, due to higher energy import prices. Collections of electricity and gas distributors improved and program targets were met. However, the PC on collections of the main thermo-power producer was missed, mainly on account of heating bills collection. SOEs' wage bill targets were observed, but a mid-year surge in wages put the September and December targets at risk. A temporary reversal in capital inflows prevented the NBR from meeting its end-June NFA and NDA performance criteria. Privatization has picked up in the enterprise sector, but continued to be behind schedule in utilities and the energy sector in general. Technical delays led to the non-observance of the end-July PC on selling a minority share in BCR to the EBRD and IFC.

[1] The mission team included Messrs. Mates (head), Westphal, Gueorguiev, and Carnot (all EU1), Mr. Lall (PDR), and Ms. Shelley (staff assistant EU1). The Fund's resident representative Mr. Justice assisted the mission. Discussions were held with Prime Minister Năstase, Governor of the National Bank of Romania (NBR) Isarescu, Minister of Public Finance Tanasescu, Minister of Labor Dumitru, Minister of Economy Popescu, and the President of the Privatization Agency, Mr. Musetescu.

4. **The authorities are requesting waivers for the nonobservance of the three quantitative and one structural performance criteria mentioned above.** On the basis of measures presented in the Supplementary Memorandum on Economic and Financial Policies (SMEFP-3, Appendix V), which will ensure that the main macroeconomic objectives of the program are achieved, staff considers the requests for waivers and the completion of the review as warranted. Box 1 reviews the overall performance under the arrangement.

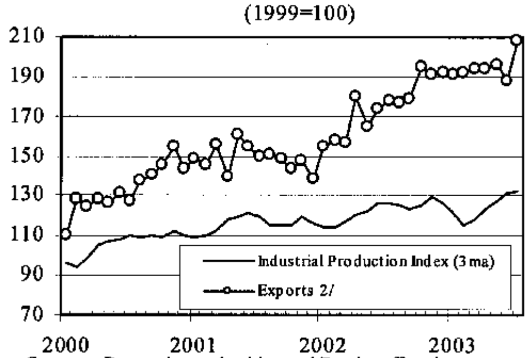
5. **The authorities' highest priority remains progress toward EU accession, with the successful completion of the SBA seen as an important step in this direction.** Public support for the government remains high. However, the prospects of local, parliamentary and presidential elections in late 2004 have started to generate pressures for relaxing the fiscal stance. Moreover, several trade unions staunchly oppose further downsizing of SOEs.

II. Recent Economic Developments and Performance Under the Program

6. **GDP growth moderated in H1, as external demand and exports weakened (Text Table 1); recent indicators point toward strengthening in activity.** After a slowdown in Q1, industrial production and exports have recently gained momentum (Figure 1). Domestic demand also picked up, fueled by rapid growth in net real wages (about 9 percent) and credit to the private sector (about 45 percent in real terms in the 12 months to July). The former reflected the January 2003 minimum wage increase and payroll tax cuts; the latter improved business confidence, declining inflation and lower interest rates.

Figure 1. Industrial Production and Exports, 2000-03 1/

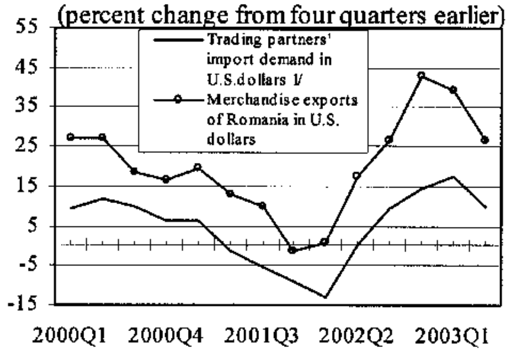
(1999=100)



Sources: Romanian authorities and Fund staff estimates.
1/ Seasonally adjusted data.
2/ Measured against a basket of 60% euros and 40% U.S. dollars.

Figure 2. Trading Partners' Import Demand and Romania's Exports 2000-03

(percent change from four quarters earlier)



Sources: Romanian authorities, Direction of Trade Statistics (DOTS) and Fund staff estimates.
1/ Trade-weighted average for Romania's trading partners. 2003 are estimates.

Box 1: Overview of the Stand-by Arrangement, 2001-2003.

Against a background of high inflation and growing demand pressures, the program, negotiated in February-September 2001, focused on fiscal consolidation, reduction in SOEs' losses, wage moderation, and accelerated structural reforms.

Macroeconomic performance under the program has been favorable, but progress in structural reforms has been limited (Text table 1). Inflation has been curbed sharply, reserves strengthened, and the current account contained at a sustainable level. Robust GDP growth has continued along with rising investment. Fiscal policy has been on track, delivering a budget adjustment of 1¼ percent of GDP in 2001-03. The far-reaching reform of VAT and profit tax legislation eliminated numerous distortions.

Quasi-fiscal adjustment has been sizable. Energy sector losses were reduced by an impressive 2¼ percentage points of GDP in 2002, but will increase by 0.4 percentage points in 2003 owing to delayed adjustment of prices. Progress was achieved through a series of tariff hikes and some improvement in collection rates. Between mid-2001 and September 2003, the natural gas price for residential users was increased from US$46/tcm to US$120/tcm, for other users from US$81/tcm to US$110/tcm, the electricity price for consumers from US$35/MWh to US$72/MWh, and the heating price from US$10/gcal to US$20/gcal. However, severe problems in collections for heating remain.

Wage policy contributed to containing domestic demand in 2002, but government ownership has been consistently weak, leading to repeated breaches of performance criteria. A sharp rise in the minimum wage in January 2003 slowed disinflation.

State involvement in the economy has gradually declined. The Privatization Agency (APAPS), after initially imposing excessive conditions on investors, moved forward in 2003, when it implemented a program of layoffs for about 22,000 employees. Between mid-2001 and mid-2003, it succeeded to sell about half of the large companies in its portfolio. Substantial employment reductions have also been implemented in the railway sector (16,400 or 15 percent), and in the armaments sector (about 14,000 or 33 percent). By contrast, no privatization and only limited restructuring took place in the energy sector.

Banking supervision has been strengthened through enhanced regulations for loan classification and provisioning and is responding to the current rapid growth in credit by increased scrutiny of bank lending, especially by the weaker banks. The once large Banca Agricola was successfully privatized. The sale of the largest bank BCR to a strategic investor failed, but the government reached agreement with the EBRD and IFC on their acquisition of minority participation, to better prepare the bank for successful privatization.

Finally, the business environment has only gradually improved. Weak governance and pervasive corruption prevailed, and enforcement of laws by the judiciary, including in the area of bankruptcy legislation, has remained weak. Employers associations have frequently raised concerns about lack of consultation, particularly on the new labor code, which has imposed large compliance costs.

In summary, following a decade of largely failed attempts at stabilization and reform, the implementation of the current program has shown the benefits of more concerted policy efforts. But gaps in policies remain, especially in wage control, curbing quasi-fiscal activities, and restructuring and privatization, that if not addressed forcefully, will threaten the recently achieved gains.

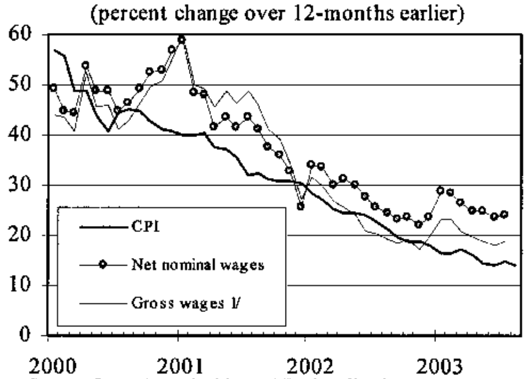
Table 1. Macroeconomic Outcomes, 2000-2003

	2000	2001	2002		2003			
		Actual	Prog.	Actual	Prog.	Proj.	Q1	Q2 prel.
				(In percent)				
CPI inflation (eop)	40.7	30.3	22.0	17.8	15.0	14.0	17.1	14.0
GDP growth	2.1	5.7	5.0	4.9	5.0	4.7	4.4	4.2
Total final consumption growth	1.5	6.0	4.0	3.0	3.8	4.7	3.5	7.0
Gross fixed capital formation growth	5.5	9.1	11.2	8.3	11.0	10.9	6.8	7.9
				(In percent of GDP)				
Current account balance	-3.9	-5.5	-5.6	-3.4	-5.2	-4.8	-0.3	-2.2
General government balance	-4.0	-3.2	-3.0	-2.6	-3.0	-2.7	-0.4	-0.5
Energy sector losses and implicit subsidies	4.7	4.8	3.2	2.5	...	2.9	...	...
				(In US$ billions)				
Gross official reserves of the NBR (eop)	3.5	5.1	5.0	7.0	5.9	7.9	7.0	6.8

7. **Inflation declined faster than projected, from 18 percent at end-2002 to 14 percent in August 2003 (Figure 3).** Nevertheless, it is likely to pick up in the months ahead following energy price hikes. The end-year target of 14 percent remains feasible, assuming domestic demand is contained during the rest of the year.

Figure 3. Consumer Price Index (CPI) and Wages, 2000-03

(percent change over 12-months earlier)

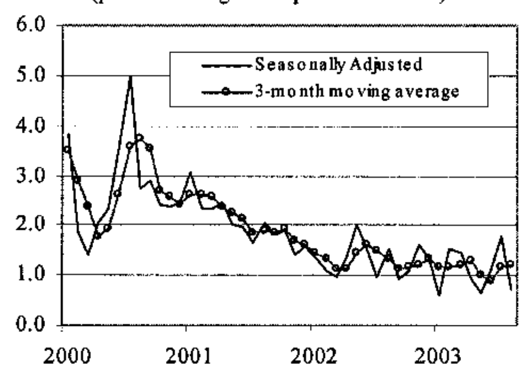


Sources: Romanian authorities; and Fund staff estimates.

1/ Gross wages adjusted for employers' social security taxes.

Figure 4. CPI Excluding Administered Prices, 2000-03

(percent change over previous month)

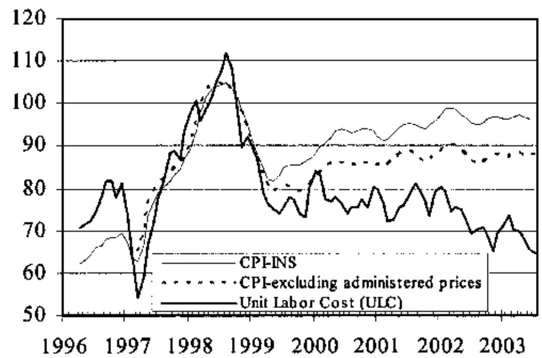


Sources: Romanian authorities, and Fund staff estimates.

8. **External competitiveness has remained adequate.** Rising productivity and the appreciation of the euro have improved the ULC-based indicator of competitiveness, while CPI-based indicators have remained flat (Figure 5). Romania has continued to increase its share in its main export markets (Figure 2). Wage share indicators suggest that profitability was adversely affected by the minimum wage increase in January 2003, but some correction has already occurred (Figure 6).

Figure 5. Real Effective Exchange Rates, 1996-2003

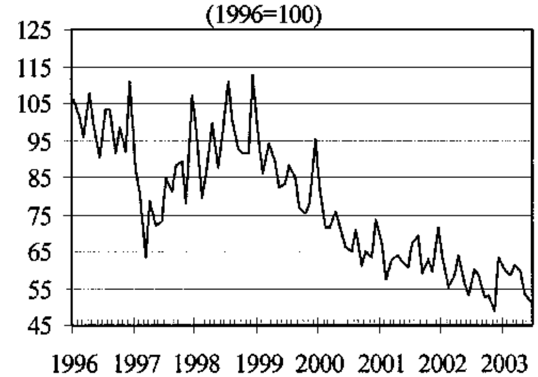
(3-Month Moving Average)



Sources: Romanian authorities, and Fund staff calculations. CPI based measures use INS weights, while ULC-based REER includes advanced economy partners only.

Figure 6. Unit Labor Cost Deflated by Producer Price Index, 1996-2003

(1996=100)



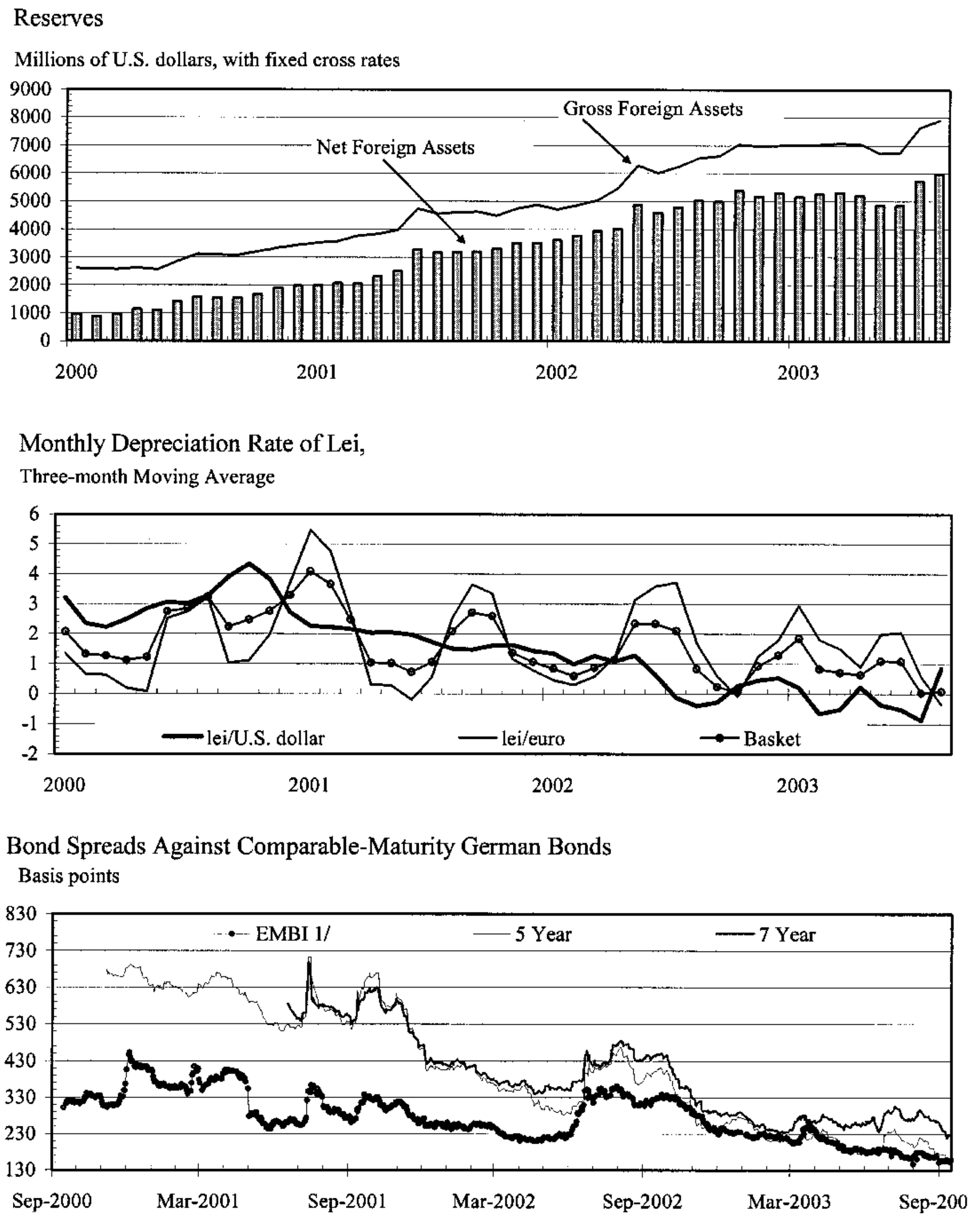
Sources: Romanian Authorities and Fund staff estimates.

9. **Pressures on the trade balance emerged in H1, but the balance of payments subsequently improved.** The pick up in domestic demand and lower export growth worsened the trade balance and widened the current account deficit to 2½ percent of GDP in H1, about ¼ percent of GDP above projections. This, and delays in disbursing some public and private loans, led to a decline in official reserves by US$250 million (½ percent of GDP) in January–June. In July and August, however, renewed public and private borrowing allowed the NBR to purchase over US$450 million from the market, in addition to the issuance of a €700 million Eurobond. Following the issue, spreads temporarily slowed their downward trajectory, but then continued to sharply narrow to around 220 bps (Figure 7).

10. **The budget deficit was contained below the end-June target, as cautious spending more than offset revenue underperformance.** The deficit of the general government was only 0.9 percent of GDP in H1, 0.3 percent of GDP below the program target. Social security contributions were lower than expected owing to the postponement of the broadening of the base from October 2002 to March 2003. The revenue shortfall was more than offset by lower interest payments, savings in maternity benefits, and lower-than-expected cofinancing of EU grants.

11. **Notwithstanding some delays, the comprehensive tax administration reform is proceeding.** The tax administration department in the Ministry of Public Finance, established in early 2003, will be transformed into a semi-autonomous agency on January 1, 2004. The ambitious project for unifying the collections of social security contributions, originally envisaged for January 2004, is behind schedule, but will be implemented in several steps during 2004.

Figure 7. Reserves, Exchange Rates, and Bond Spreads, 2000-03



Sources: Romanian authorities; Fund staff calculations and Bloomberg.

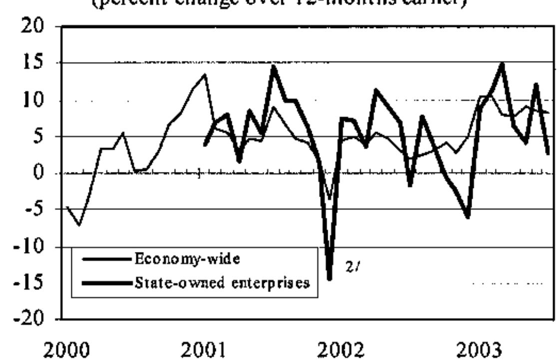
1/ Euro EMBI Global index excluding Latin America.

12. **Losses in the energy sector increased in the first half of 2003, reflecting a sharp increase in imported energy prices.** Indexation of electricity and heating prices to the U.S. dollar proved insufficient to cover costs in the context of rising world fuel prices and a weak dollar. Imported gas prices shot up to US$140/tcm, compared to the projections of US$110. As a result, the gas price adjustment to US$99/tcm at end June, US$6 more than originally agreed, was insufficient to prevent the domestic producer price from declining. (Domestic producers receive a residual after import and distribution costs are covered.)

13. **The collection performance of energy utilities has been positive on balance.** The end-June collection PCs of gas and electricity distributors were observed, with the 12-month cumulative collection rates reaching 97.5 percent and 95.7 percent, respectively, and for electricity further improving in August. Payments by large industrial SOEs have tended to improve, although outright disconnections of bad payers are still not systematically implemented. However, the performance criterion on the collection rate of Termoelectrica (the main thermal energy producer) was missed by 2½ percentage points at end-June, primarily reflecting disappointing collections in heating of 80 percent (see Appendix IV), and weakened by another 2 percentage points by August, this time because of electricity.[2]

14. **The wage bill targets in monitored SOEs were observed in Q1 and Q2, but September and December targets were at risk (Figure 8).** This was achieved by sharply reducing employment via voluntary layoff programs. However, wages in the railway companies grew excessively (15 percent in real terms), as the Ministry of Transportation did not substantially compress wages following the minimum wage increase. Further mid-year wage increases in railways and some other companies put at risk the Q3 and Q4 wage bill targets.

Figure 8. Real Wage Growth, 2000-03 1/ 2/
(percent change over 12-months earlier)



Sources: Romanian Authorities; and Fund staff estimates.
1/ Net of withholding taxes.
2/ The particularly low increase in December 2001 and the spike at the beginning of 2002 are primarily due to a postponement of bonus payments.

15. **As expected, the NBR missed its NFA and NDA targets for June.** A temporary reversal in capital inflows in H1 did not allow the NBR to make the projected purchases in the foreign currency market while following its targeted exchange rate path. Moreover, insufficient sterilization and the reluctance of the NBR to increase interest rates

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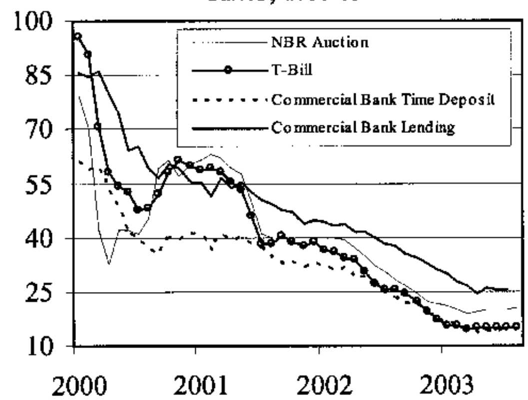
[2] Despite the recent improvement in Electrica's collection rate to respectable 96.7 percent according to preliminary data in August, it has not been able to fully pay Termoelectrica and other producers, as until September its price was not adjusted to accommodate the higher share of more expensive supplies from thermo units, compared to less expensive supplies from hydro and nuclear producers.

led to the non-observance of the NDA target. Since mid-July, the surplus in the foreign exchange market reappeared, and the NBR made sizable foreign exchange purchases.

16. **Bank credit to the nongovernment sector accelerated, reaching an annual growth rate of about 45 percent in real terms in July.** Growth was driven primarily by consumer and mortgage credit, which tripled in real terms since mid-2002 and now constitutes 20 percent of private sector credit. Lending to SOEs remains contained.

Figure 9. Evolution of Nominal Interest Rates, 2000-03



Sources: Romanian authorities; and Fund staff estimates.

17. **The FSAP mission in May concluded that systemic risks to the banking sector appeared low, although growing as a result of the rapid increase in credit to the private sector.** The mission found that banks are well-capitalized and liquid. The new regulation on loan classification and provisioning in January 2003, which requires provisioning on the basis of debtors' financial performance in addition to payment history, has increased the ratio of loans classified as substandard or worse to a still manageable level for transition economies of 11 percent as of June 2003.

18. **Structural benchmarks for the privatization of enterprises outside the energy sector have been met, while progress in the latter has been slow.** Privatization contracts for seven large companies were signed in Q2, compared with the indicative target of six (for some of them, the transfer of shares awaited agreements on the rescheduling of energy arrears). In the energy sector, privatization plans have suffered repeated delays that affected their credibility. Only one bid was submitted for two electricity distribution companies, and ongoing negotiations are clouded by uncertainties about future tariffs. The preparation of the privatization strategy for the gas distributors has again been postponed, implying a 16-month delay compared to original plans. After protracted discussions, the privatization announcement for the oil company Petrom was published in late August, with World Bank approval. The success of the privatization will depend on the governments' decisions on the schedule for future gas price adjustments, the assumption of environmental risks, and to relinquish conditions to preserve employment.

19. **The negotiations on the EBRD's and the IFC's equity participation in the largest bank BCR were successfully concluded in late September.** The two institutions will pay US$222 million for the 25 percent share package and will be appropriately represented in the board and management of the bank.

III. Policy Discussions on the 2003 Program

20. **Discussions on policies for 2003 took place in the context of increasing risks stemming from unfavorable external developments, accelerating domestic demand and a widening of the current account deficit.** The strategy to address these issues was based on three pillars: first, energy price adjustments, in the wake of higher import fuel prices, and measures to improve collections were seen as crucial for improving SOEs' financial performance and containing domestic demand. Second, the same objective would be supported by a strict implementation of the 2003 wage program for SOEs, which would also moderate the effects of the minimum wage increase on labor costs and competitiveness. The agreed corrective measures are expected to improve the S-I balance of the broad public sector by about ¼ percent of GDP in the second half of 2003, while furthering structural reforms. Staff therefore concurred with the authorities that there was no need to lower the budget deficit target. Third, it was agreed that monetary policy needed to be tightened to address rapid credit growth.

A. Macroeconomic Framework for 2003

21. **The macroeconomic framework for 2003 remains broadly appropriate.** Taking account of stronger private sector credit growth and the effects of delays in adjusting energy prices, the current account is expected to widen to about 4¾ percent of GDP, or ¼ percentage point more than originally targeted. This deficit level remains within a sustainable range, as outlined in the 2003 Article IV staff report. The objective to reduce the end-period inflation rate to 14 percent remains within reach. Severe drought has necessitated a modest downward revision of GDP growth, to about 4.7 percent, compared with the original projection of 4.9 percent.

B. Fiscal Policy

22. **Discussions on fiscal policy during the remainder of 2003 focused on the need to cut certain expenditure to compensate for weaker-than-projected revenue and to provide resources for unforeseen but necessary spending.** The supplementary budget, approved in late August, compensated for the estimated annual revenue shortfall of 0.4 percent of GDP and accommodated additional spending equivalent to about 1 percent of GDP to support structural reforms, provide additional drought-related subsidies to agriculture, and clear the health system arrears. (In respect to these arrears, the authorities are currently tightening procurement procedures and reviewing additional disputed claims; SMEFP-3, ¶12). Within the reduced revenue envelope, the additional spending will be compensated by savings on interest expenditure (which was cautiously budgeted), various benefits paid by the pension fund, investment, and co-financing of EU grants.

C. Wage Policy in SOEs

23. **Staff emphasized the crucial importance of guaranteeing the credibility of the 2003 wage program.** While wage discipline in companies under the Ministry of Industry

and the Privatization Agency improved, staff regretted the excessive wage settlements in the railways. The authorities explained that they had had limited leverage in wage negotiations with the particularly strong railway trade unions. Moreover, as a compensating measure, they pointed to their plan to reduce employment in railway companies by 19,300 positions, or 17 percent of the work-force. (While this measure was set as a prior action, the authorities have subsequently reduced this number to about 16,500 positions, having again incurred opposition by labor unions. In the event, they delivered 16,100 layoffs, with additional 300 workers going into early retirement and 100 layoffs being delayed because of sick leave.) To eliminate the risks for the September and December wage bill targets created by the wage dynamics in mid-2003, the authorities agreed to several other measures, including the elimination of Christmas bonuses in seven large companies, and a complete hiring freeze in all monitored SOEs (SMEFP-3, ¶14).

D. Privatization

24. **The privatization of large lossmakers progressed.** The authorities explained that the cancellation of energy arrears and the reduction in employment in large lossmakers—by 22,800 positions, about 4,800 more than originally envisaged—had allowed them to conclude 12 privatization contracts in H1. Staff commended this progress while encouraging the Privatization Agency to swiftly resolve the outstanding issues preventing the transfer of shares to the buyers. (The cabinet approved the corresponding decision on September 25.) In the context of their plans to restructure railways, the authorities sold 12 railway subsidiaries at an auction on September 14 and will offer 11 more on September 29, employing in total about 4,000 workers.

25. **Staff urged the authorities to liquidate several non-viable enterprises.** Staff noted that no action had been taken to liquidate perennial lossmakers, the privatization of which had repeatedly failed. The authorities pointed out that they would initiate liquidation of two companies soon. Regarding the large lossmaking producers of trucks and special vehicles, Roman and ARO, the authorities noted that they wanted to give these two companies another chance for privatization. Should this fail, they decided to start their liquidation by late September (SMEFP-3, ¶21). By the deadline, the Privatization Agency signed contracts for the privatization of both companies. In the case of Roman, the contract is complex, and further efforts will be needed to ensure that some company's parts are not returned to state-ownership.

26. **The contract on the acquisition by the EBRD and IFC of a minority share in BCR was initialed in late September (prior action).** The authorities explained that technical delays in due diligence involving the non-observance of the end-July structural PC were beyond their control. Given that agreement has been reached on the transaction, staff support the authorities' request for a waiver for the non-observance of the PC.

E. Financial Discipline and Energy Sector Reforms

27. **Determination will be needed to further improve collection performance.** In electricity and gas, the authorities reiterated their commitment to disconnect perennial non-payers, while the budget will continue to assume the payment of energy bills of a few selected lossmakers until their early privatization or liquidation. In the heating sector, additional measures will be taken to lift collections, including seizure of assets of delinquent customers, a new legislative mechanism to ensure that local governments' subsidies are paid in full, and the strengthening of assistance to low-income households (SMEFP-3, ¶17).

28. **The authorities agreed to proceed with some important energy price adjustments** (SMEFP-3, ¶16). Staff regretted delays in adjusting energy prices, which increased losses in H1, contrary to the program targets. The authorities agreed to raise Termoelectrica's heating and electricity prices to cost-recovery levels in early September, and significantly increase the margins for gas and electricity distributors, to facilitate their privatization. Moreover, the higher increase in the price for final users of 17½ percent, than for producers (on average 12 percent), will accommodate this year's shift to more expensive supplies, and ensure that the main distributor can pay Termoelectrica in a timely manner.[3] In September, the budget also paid subsidies to clear their arrears for electricity. However, the authorities resisted any increase in the consumer heating price, citing affordability concerns and a negative impact on collections. Staff encouraged the authorities to prepare a comprehensive reform of the district heating sector. On balance, as the tariff increases and measures to improve collections are expected to strengthen the financial performance of the energy sector during the remainder of 2003 and in 2004, staff supports the authorities' request for a waiver of the non-observed end-June PC on Termoelectrica's collections.

29. **On natural gas, staff supported a recent study commissioned by the World Bank, which recommended a hike of the average end-user price to US$122 immediately, and to US$136 in 2004.** The authorities concurred that increases were necessary over the medium term, but argued that an immediate sharp adjustment would render a substantial part of the industrial sector uncompetitive. Therefore, they decided in favor of a gradual approach, raising the price by an average 14 percent as of early September. Subsequently, they decided on another 4 percent increase effective November 1, to offset the effects of the lei depreciation since the previous decision to increase prices. Combined with the electricity price adjustments, this will improve the financial performance of the energy sector by about 0.3 percent of GDP in 2003, compared to the projected outcome without measures; nevertheless, losses relative to GDP will increase by about 0.4 percentage points from 2002 and by 0.9 percent of GDP compared to the original program target. The authorities have also made an important commitment in the SMEFP to announce, by end-2003, a quarterly schedule for gas price adjustments with a view to reaching import parity by 2007, a key measure to facilitate the privatization of the largest state-owned company, Petrom, in 2004.

[3] This measure will start to affect Termoelectrica's collections in October.

30. **Staff urged the authorities to complete the privatization projects in the energy sector.** Staff noted the long delay in preparing the privatization strategy for the largest company, Petrom, and encouraged the authorities to make every effort to complete the privatization of this company by March 2004. The deadline to privatize the gas companies has also been postponed by 6 months, to June 2004. The authorities still hoped to conclude the deal for the two electricity distributors by end-2003. Staff strongly encouraged the authorities to continue close coordination with the World Bank on energy sector reforms (Appendix II, ¶11).

F. Monetary Policy and Banking Supervision

31. **Staff argued that monetary policy needed to be tightened.** To slow credit growth, which had already affected the current account deficit and was likely to affect disinflation, staff advised the authorities to increase the policy interest rate, and keep the door open for further monetary tightening. Staff also warned that, given the recent developments in the current account and lower-than-targeted accumulation of reserves, the NBR should not try to overperform in reducing inflation by slowing the targeted depreciation. The NBR agreed with the need to tighten monetary policy and raised the interest rate by 100 basis points in early August. Based on this measure, as well as on the resumption of reserve accumulation, staff supports the authorities' request for waivers for the non-observed June NFA and NDA PCs.

32. **Staff reiterated concerns about accelerating credit to the private sector also on prudential grounds.** Staff urged the authorities to keep close watch on banks' exposure to private borrowers, intensify inspections, use moral suasion, and, if necessary, increase prudential ratios. In the NBR's view, the high credit growth was inevitable and desirable in the context of the low degree of financial intermediation. The NBR noted that it had strongly advised the few banks with a weak credit portfolio to be more selective in choosing clients and to increase their capital. It also indicated that it will continue with the program of selective on-site inspections and bank-by-bank stress assessments, as recommended by the FSAP mission. The representatives of the largest foreign banks, which are heavily increasing their exposure to Romania, indicated that they did not consider the rapid credit growth as creating excessive risks, pointing out that Romania's economy was under-banked.

IV. Outlook for 2004

33. **The mission held preliminary discussions on policies for 2004, following a request by the authorities to start discussions on a successor arrangement.** Agreement was reached on the objectives: to lower inflation to 9 percent by end-2004, to contain the current account deficit to 4¾ percent of GDP, and to strengthen official reserves. However, staff was concerned whether these objectives could be realized in the context of the proposed relaxation in the budget stance (see below) and insufficiently ambitious plans for SOEs' restructuring. Staff also urged the authorities to strengthen competitiveness through appropriate wage policies and labor code reform.

34. **The authorities are envisaging a relaxation of the 2004 budget deficit target, combined with measures to reduce losses in SOEs.** At the time of the mission, they intended to increase the general government deficit target to 3.0–3.3 percent of GDP, from 2.7 percent in 2003, to allow for increased infrastructure investment, including for motorway construction. (The 3.0 percent scenario envisaged off-budget guarantees to finance infrastructure investment, including under various public-private partnership (PPP) schemes, equivalent to about ½ percent of GDP.[4]) The government also envisaged increasing social transfers and already approved doubling farmers' pensions on January 1, 2004. To compensate for the expansionary effects of the relaxation in the budgetary stance, they had started to prepare a loss-reduction program for selected state-owned companies.[5]

35. **Staff raised concerns that the envisaged policies were not sufficient to deliver the desired outcomes.** In the staff's view, a reduction of the overall public sector deficit by ¾ percent of GDP would be required to achieve the current account target and single-digit inflation. This could be compatible with a moderate increase in the budget deficit target only if strong up-front measures could be implemented that would improve the savings-investment balance of SOEs by about 1 percentage point of GDP. Such measures would need to include: (i) further increases in energy prices (especially the natural gas price, by about US$10/tcm, in line with the recent World Bank study); (ii) accelerated restructuring of large lossmaking SOEs, including in the mining and transportation sectors; (iii) an ambitious wage program limiting nominal wage bill growth in SOEs below targeted inflation; and (iv) an increase in the minimum wage of at most 9 percent in January 2004. On tax policy, staff supported a further reduction in social security contribution rates by 2–3 percentage points, but cautioned against the introduction of a reduced VAT rate.

36. **The authorities were not ready to commit to such a package, or an alternative that would deliver similar results.** They were reluctant to discuss details of energy price increases in 2004 while clearly indicating their determination to keep the heating price unchanged in nominal terms until after a more comprehensive reform is implemented in 2005. Staff welcomed the proposed restructuring in the railway sector, which in addition to lay offs in 2003 envisaged retiring about 10 percent of railway lines in 2004, but in its view the proposals for other sectors lacked ambition. At that time, the authorities appeared to have accepted limiting the minimum wage increase in January 2004 to 9 percent in nominal terms.

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[4] Staff indicated that such spending would count toward the general government deficit target, as concessions were not a viable option, tolls were neither envisaged nor would they produce a sufficient income stream, and the PPP schemes would effectively be financed by the government.

[5] The authorities have started to compile a database that could facilitate monitoring the balance of the broad public sector, but the quality of data, particularly on arrears, is not yet sufficient for program monitoring.

However, the *Pre-Accession Economic Programme*, subsequently submitted to the EU Commission, refers to an increase of about 20 percent.

37. **Staff also sought the authorities' view on amending the new Labor Code.** Staff suggested liberalizing regulations on fixed-term contracts, dismissals, and overtime, as well as provisions imposing mandatory application of branch agreements to non-participating employers. The authorities explained that, in light of the numerous criticisms from the business community, they would undertake a review of the Labor Code in cooperation with both employers and labor unions.

38. **In a letter to the Managing Director of September 4, the Prime Minister requested that discussions on a successor arrangement continue**. He expressed commitment to reduce the overall public sector deficit by implementing a prudent wage policy, increasing energy prices to cover costs, and continuing structural reforms, while increasing the general government deficit to 3.0 percent of GDP in 2004 to mitigate the social impact of reforms.

V. Medium-Term Outlook, External Vulnerability, and Capacity to Repay the Fund

39. **The medium-term outlook is clouded by the slowdown in the EU and uncertainty regarding the authorities' plans to continue with structural reforms.** Negative or sluggish GDP growth in main trading partners may put Romania's strong export expansion at risk. Romania's growth performance will therefore depend crucially on strengthened competitiveness, an improved business climate, and the ability to attract FDI. Any deterioration in macroeconomic stability would adversely affect such prospects. Also, if structural reforms stall, the burden of unreformed SOEs would become a drag on growth and hinder stabilization.

40. **Nevertheless, Romania's near-term external vulnerability remains low.** Official reserves are comfortable in terms of import coverage and short-term debt (Table 8). The widening in the current account deficit in 2003, while potentially worrisome, is not expected to push the deficit beyond the sustainable level of 5 percent of GDP. Low short-term debt should reduce sensitivity to sharp reversals in capital flows.

41. **Romania's capacity to repay the Fund remains good.** Over the medium term, debt service to the Fund, including that on prospective purchases, would be modest, averaging 0.6 percent of exports of goods and nonfactor services (Table 9). The medium-term public debt-service profile is fairly smooth.

VI. Staff Appraisal

42. **Romania's broadly satisfactory performance under the program has shown the benefits of concerted stabilization policies.** Since the last review, further progress has been

achieved in disinflation and growth has remained robust. The current account deficit has widened, reflecting rapid expansion in private sector credit and the effects of the minimum wage increase, but it has remained within acceptable limits. The budget deficit has been on track and discipline in payments to the main utilities has improved. However, delays were experienced in adjusting energy prices for higher costs and collections of heating bills have remained weak. Wage policy in state-owned enterprises has also continued to lack consistency. Progress in privatization has been mixed, with reasonable results achieved by the Privatization Agency and delays in the energy sector.

43. **The problem confronting the authorities now is how to sustain macroeconomic stabilization and further structural reforms in the run-up to the elections in late 2004.** Reining in domestic demand and arresting any further current account deterioration while resuming the trend toward single-digit inflation are of utmost importance. Just as important is to ensure that progress toward imposing strict financial discipline, a crucial element for establishing a functioning market economy, does not falter. Given the uncertainties emanating from the global economic environment and Romania's unfinished structural reform agenda, there is no room for slippages.

44. **The authorities need to clarify their intentions for 2004.** If markets assess that the coming elections will trigger pressures—similar to those that resulted in the large minimum wage increase in 2003, weak wage discipline in SOEs, reluctance to implement necessary energy price adjustments, and delays in privatization—the business climate could substantially deteriorate, with consequences for growth and, while not necessarily immediately, Romania's external position.

45. **A relaxation of the budget stance in 2004 without credible measures to reduce SOEs losses and improve the saving-investment balance of the broad public sector should be avoided.** The current account deficit is already at the upper bound of sustainability and further disinflation is by no means assured. To avoid unraveling of the achieved stabilization, the authorities would be well advised to maintain the prudent fiscal policy of recent years.

46. **The benefits of the comprehensive VAT and profit tax reform should not be eroded.** A reduced VAT rate for a number of goods and services contemplated by the authorities would undermine the effectiveness of tax administration with little benefit in terms of social fairness. The revenue loss would also undermine the prospects for further reducing the high payroll taxes. The tax administration reform needs to be sustained. The authorities' commitment to transform the tax administration department under the Ministry of Public Finance into a semi-autonomous agency by January 2004 is commendable. It is, however, equally important to ensure that this administration gradually integrates the collection of social security contributions.

47. **Prudent wage policy will continue to be crucial for reducing SOE losses and containing domestic demand within sustainable limits.** Given the SOEs' proclivity to pay high wages regardless of their financial condition, the authorities would be well advised to tighten control procedures established during the SBA. Moreover, another large increase in the minimum wage would disrupt macroeconomic stabilization, as it has already slowed disinflation this year.

48. **Further efforts to reduce energy sector losses and enforce hard budget constraints are required.** After the significant success in reducing losses in 2002, losses increased somewhat in 2003, in an admittedly adverse external environment of rising import prices. As further price increases are necessary to ensure an appropriate level of investment in the gas sector, staff welcomes the authorities decision to announce by end-2003 a timetable for gas price adjustments with a view to reaching import parity by 2007. The timetable should be ambitious, as keeping obsolete industries afloat by providing gas at below market prices is unsustainable and inconsistent with the objective of establishing a fully functional market economy. To alleviate the effects of the energy sector reforms on the most vulnerable households, further improvements in targeted social assistance should be considered. However, vigorous enforcement of payment discipline is crucial. Rapid progress in the privatization of gas and electricity distribution companies will be very important in this respect, given weak corporate governance in Romania's state-owned sector.

49. **The authorities have achieved notable progress in downsizing large lossmaking SOEs as a prerequisite for privatization; they should continue on this course.** Largely reflecting the practice of imposing conditions on investors to preserve employment and commit to investment, progress in privatization was slow in 2001 and 2002. The recent reduction of employment in 22 large lossmaking SOEs facilitated the completion of a number of privatization projects. However, in the energy sector the continuing practice of imposing conditions adversely affects privatization. A more vigorous approach to liquidating unviable companies is also needed, both by strengthening the legislative and institutional framework for bankruptcy procedures and by actually liquidating perennial lossmakers.

50. **The monetary policy framework remains adequate, but the rapid expansion of credit is a concern.** The current policy of guiding the exchange rate consistent with the inflation objective has been successful, and remains appropriate for the near future, until conditions for introducing inflation targeting are firmly in place. However, the rapid growth of credit to the non-government sector contributes to the strong expansion of domestic demand and exposes banks to higher risks. Although this trait is shared with many other EU accession candidates, prudence dictates that credit growth be moderated. Moral suasion and supervisory measures should be applied for that purpose as well as further monetary tightening, particularly should the inflation objective come under risk.

51. **The staff considers that the authorities' request for the completion of the review deserves support.** The authorities have reconfirmed their commitment to the objectives of the program through the implementation of corrective measures as specified in the SMEFP-3. The staff therefore recommends the approval of the waivers and the completion of the fourth and final review.

Table 1. Romania: Main Economic Indicators, 1999-2004

	1999	2000	2001	2002	2003 Prog. / Proj.	2004 Proj.
Real economy (change in percent) 1/						
Real GDP	-1.2	2.1	5.7	4.9	4.7	5.0
Final domestic demand	-2.9	2.1	6.6	3.9	6.1	5.3
CPI (end of period)	54.8	40.7	30.3	17.8	14.0	9.0
CPI (period average)	45.8	45.7	34.5	22.5	15.1	12.0
Unemployment rate (end of period; percent)	11.8	10.5	8.6	8.1	8.0	8.0
Gross national saving (percent of GDP)	11.9	15.6	17.0	19.7	18.8	19.0
Gross domestic investment (percent of GDP)	16.1	19.5	22.6	23.1	23.6	23.9
Public finance (general government, percent of GDP)						
Overall balance	-3.6	-4.0	-3.3	-2.6	-2.7	-3.0
Primary balance	2.4	0.9	0.6	0.4	-0.3	...
Total public debt (in percent of GDP) 2/	30.5	29.9	27.4	26.8	26.3	25.5
Money and credit (end of year, percent change)						
Real domestic credit 3/	-7.6	9.9	25.6	33.1	33.5	...
Broad money	46.4	39.2	47.8	38.1	26.6	...
Interest rates (percent)						
NBR interest rates (end of period) 4/	88.7	60.1	39.9	21.5	...	...
Treasury bill rate (end of period)	104.8	59.4	38.4	17.4	...	...
Balance of payments (percent of GDP)						
Trade balance	-3.5	-4.5	-7.4	-5.7	-6.8	-6.6
Current account balance	-4.0	-3.9	-5.5	-3.4	-4.8	-4.8
External debt	24.6	27.7	29.7	33.3	31.3	31.3
Official reserves (end-year, US$ million)	2,472	3,466	5,090	6,975	7,883	8,710
Reserve cover (months of prospective imports)	2.1	2.5	3.2	3.5	3.7	3.8
Exchange rate						
Lei per US$ (end of period)	18,250	25,926	31,597	33,500	34,140 5/	...
NEER appreciation (+) (annual average in percent)	-39.8	-22.8	-22.3	-14.4	-12.5 5/	...
REER appreciation (+) (CPI-based, annual average in percent)	-15.0	9.3	1.5	2.7	-0.9 5/	...
REER appreciation (+) (CPI excl. admin. prices , annual average in percent)	...	5.9	1.8	1.0	-1.2 5/	...
REER appreciation (+) (ULC-based, annual average in percent)	-21.8	-0.2	-0.8	-6.6	-6.7 5/	...

Sources: Romanian authorities; and Fund staff estimates.

1/ In 2002, national accounts data starting 1998 have been revised due to methodological change (adoption of ESA95 guidelines).

2/ Including domestic public debt and external public debt (public and publicly guaranteed).

3/ Credit to nongovernment sector. From 1999 onwards, weighted average of real lei credit growth and U.S. dollar-measured foreign currency credit growth.

4/ NBR deposit auction interest rate.

5/ Nominal exchange rate as of August 29, 2003. 2003H1 on 2002 H1 for effective exchange rates.

Table 2. Romania: Balance of Payments, 2002-03

(In millions of U.S. dollars)

	2002						2003				
	Q1	Q2	Q3	Q4			Q1	Q2	Q3	Q4	
	Act.	Act.	Act.	Act.	Act.	Prog.	Act	Prelim.	Proj.	Proj.	Proj.
Current account	-277	-627	-21	-647	-1,572	-2,294	-170	-1,202	-520	-700	-2,593
Ratio to annual GDP	-0.6	-1.4	0.0	-1.4	-3.4	-5.6	-0.3	-2.2	-1.0	-1.3	-4.8
Trade balance	-473	-667	-591	-881	-2,612	-3,039	-446	-1,290	-950	-1,000	-3,686
Exports	2,900	3,319	3,764	3,887	13,870	12,699	4,045	4,210	4,540	4,575	17,370
Imports	-3,373	-3,986	-4,355	-4,768	-16,482	-15,738	-4,490	-5,500	-5,490	-5,575	-21,055
Services account, net	-103	-255	31	-169	-496	-433	-72	-284	4	-223	-577
Receipts	497	648	792	762	2,699	2,587	717	757	866	833	3,173
Of which: Interest	39	44	77	60	220	400	61	52	100	78	291
Payments	-600	-903	-761	-931	-3,195	-3,020	-789	-1,041	-862	-1,057	-3,749
Of which: Interest	-93	-212	-127	-201	-633	-860	-120	-302	-156	-247	-825
Unrequited transfers (net)	299	295	539	403	1,536	1,178	348	373	426	523	1,670
o/w c official	34	19	157	71	281	120	64	-1	98	100	261
private	265	276	382	332	1,255	1,058	284	373	328	423	1,408
Capital account	434	724	572	1,613	3,342	2,580	561	77	1,305	688	2,630
Direct investment and capital transfers	253	247	328	350	1,178	1,457	416	264	386	419	1,484
Portfolio investment	5	-8	-1	133	129	50	12	-27	10	15	10
Borrowing by public sector 1/	68	362	65	437	931	673	60	82	965	102	1,209
Loans (net)	103	36	80	450	668	530	86	95	157	275	613
Disbursements	339	341	400	847	1,926	1,670	383	386	466	583	1,817
Of which: Direct debt	114	110	193	315	732	840	105	124	285	467	981
Of which: Government guaranteed	225	232	206	532	1,194	830	278	262	181	116	837
Amortization	-236	-305	-320	-397	-1,259	-1,140	-297	-291	-309	-308	-1,205
Bonds (net)	-35	326	-15	-13	263	143	-26	-13	808	-173	596
Disbursements	30	661	15	17	723	440	0	0	808	0	808
Amortization	-65	-335	-30	-30	-460	-297	-26	-13	0	-173	-212
Borrowing by private sector (net)	11	-35	99	549	624	399	58	-90	-56	152	64
Medium- and long-term loans (net)	11	-35	99	549	624	399	58	-90	-56	152	64
Disbursements	80	176	315	762	1,333	1,075	164	238	457	573	1,432
Amortization	-70	-211	-216	-213	-710	-676	-106	-328	-513	-421	-1,368
Trade credit (net)	98	158	81	144	481	0	15	-152	0	0	-137
o/w short-term (net)	89	145	77	147	458	0	23	-148	0	0	-125
Gap financing amortization											
Net errors and omissions	-170	376	-120	-660	-574	300	-615	815	0	0	200
Overall balance	-13	473	430	306	1,196	587	-224	-310	785	-12	238
Financing	13	-473	-430	-306	-1,196	-587	224	310	-785	12	-238
Net foreign assets NBR (increase, -)	-214	-756	-506	-499	-1,975	-507	-79	280	-905	-88	-791
Assets (increase, -)	-193	-717	-604	-371	-1,885	-621	-70	236	-881	-193	-908
Liabilities	-21	-39	98	-128	-90	114	-9	44	-24	105	117
IMF, net	-21	-39	98	-28	10	114	-9	44	-24	105	117
Purchases	0	0	107	0	107	211	0	75	0	150	226
Repurchases	-21	-39	-10	-28	-98	-97	-9	-31	-24	-45	-109
Others, net	0	0	0	-100	-100	0	0	0	0	0	0
Short-term	0	0	0	-100	-100	0	0	0	0	0	0
Medium and long-term, net	0	0	0	0	0	0	0	0	0	0	0
Disbursements	0	0	0	0	0	0	0	0	0	0	0
Repayments	0	0	0	0	0	0	0	0	0	0	0
Net foreign assets DMBs (increase, -)	227	283	76	193	779	-80	303	30	120	100	553
Assets (increase, -)	167	114	6	146	433	-80	120	-168	0	0	-48
Liabilities	60	169	70	47	346	0	183	198	120	100	601
Short-term	63	78	60	-81	120	0	104	107	0	0	0
Medium- and long-term, net	-3	91	10	128	226	0	79	91	0	0	0
Portfolio (net)	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:											
Current account balance plus FDI	...	...	...	...	-394	-836	...	...	...	...	-1,108
Ratio to GDP	...	...	...	...	-0.9	-2.0	...	...	...	...	-2.0
Export growth (percent)	0.9	17.6	26.9	42.8	21.8	7.4	39.5	26.8	20.6	17.7	25.2
Of which: Volume growth (percent)	...	...	...	...	17.00	7.4	...	...	...	...	8.2
o/w unit value growth (percent)	...	...	...	...	4.13	0.0	...	...	...	...	15.8
Import growth (percent)	-1.1	6.7	31.8	22.0	14.82	7.8	33.1	38.0	26.1	16.9	27.7
Of which: Volume growth (percent)	...	...	...	...	12.00	7.1	...	...	...	...	7.5
o/w unit value growth (percent)	...	...	...	...	2.52	0.7	...	...	...	...	18.9
GDP growth	...	...	...	...	7.2	7.2	...	...	...	...	7.2
GDP (in billions of US$)	...	...	...	...	45.7	40.8	...	...	...	...	54.6
Terms of trade (percentage change)	...	...	...	...	1.6	-0.6	...	...	...	...	-2.6
External debt (US$)	...	...	...	...	15,251	12,407	...	...	...	...	17,105
Of which: Public and publicly guaranteed	...	...	...	...	9,551	8,661	...	...	...	...	10,877
External debt/GDP (percent)	...	...	...	...	33.3	30.4	...	...	...	...	31.3
Net External Indebtness/GDP (percent)	...	...	...	...	15.5	14.5	...	...	...	...	14.7
Debt service (US$)	...	...	...	...	3,259	3,070	...	...	...	...	3,718
Debt service ratio	...	...	...	...	20.1	20.1	...	...	...	...	18.5
Gross official reserves of the NBR 2/	5,283	6,000	6,604	6,975	6,975	5,038	7,045	6,809	7,690	7,883	7,883
(in months of imports of goods and services)	...	...	...	...	3.5	3.2	...	...	...	...	3.7
(as percent of short-term debt)	...	...	...	...	176.7	183.4	...	...	...	...	160.3
Net external financing of the budget (US$ mln)	...	...	...	...	684	711	...	...	...	...	736
Nominal GDP (US$ bln)	...	...	...	...	45.7	40.8	...	...	...	...	54.6

Sources: Romanian authorities; and Fund staff estimates.

1/ Including public enterprises.

2/ Includes gold.

Table 3. Romania: Summary of Consolidated General Government, 1999-2003

(in billions lei)

	1999 Actual	2000 Actual	2001 Actual	2002 Supplem. budget 31-Oct-02	2002 Actual 7/	2002 Actual 6/	2003 Budget 7/ 13-Nov-02	2003 Supplem. Budget 7/ 28-Aug-03
Total revenue and grants	173,838	251,095	351,741	451,202	447,521	449,012	562,457	554,724
Current	173,337	249,945	351,108	450,499	446,655	447,645	561,202	553,755
Tax	164,026	235,048	326,699	423,654	418,166	418,166	523,968	517,586
Profits	17,037	20,334	22,206	28,093	30,190	30,190	39,596	39,695
Wages and salaries 1/	17,834	26,998	37,203	42,600	41,661	41,661	59,434	55,198
Social security 1/	57,667	86,557	125,106	169,628	161,867	161,867	195,760	182,150
Other direct taxes	8,276	8,081	13,025	13,020	14,637	14,637	19,151	18,254
VAT	32,471	50,439	73,604	103,366	104,495	104,495	124,572	134,632
Customs	7,847	8,702	9,038	9,000	9,362	9,362	8,163	12,350
Excise	16,958	20,636	27,293	33,792	32,434	32,434	57,808	55,071
Other indirect taxes	5,937	13,301	19,224	24,155	23,521	23,521	19,484	20,236
Nontax	9,311	14,897	24,409	26,845	28,490	29,479	37,234	36,169
Capital	297	826	387	498	682	682	849	855
Grants	204	325	246	205	184	685	405	114
Total expenditure	193,567	283,351	389,321	494,402	485,604	488,523	611,977	603,644
Current	177,835	255,275	351,794	445,310	435,574	438,494	541,467	533,431
Wages and salaries	26,259	43,894	58,174	74,299	72,902	73,555	90,996	91,894
Materials and operating expenditures	57,504	56,503	81,119	104,672	105,221	107,295	125,811	129,441
o/w: health insurance fund	22,597	24,997	36,779	47,924	47,687	47,687	55,184	59,184
Interest	28,796	38,973	44,610	48,076	45,157	45,351	54,317	42,895
Subsidies and transfers	80,239	115,905	167,891	218,136	212,293	212,293	269,166	267,768
Subsidies	9,303	17,581	24,294	30,795	29,900	29,900	33,616	40,221
Transfers	70,936	98,324	143,597	187,341	182,393	182,393	235,550	227,548
o/w: Pensions	37,854	53,579	79,578	103,926	102,185	102,185	124,964	119,370
Capital	15,015	24,482	36,549	47,884	48,864	48,864	68,923	67,766
Lending minus repayments	717	3,594	978	1,208	1,165	1,165	1,586	2,448
Overall balance (cash, including grants)	-19,729	-32,256	-37,580	-43,200	-38,083	-39,512	-49,520	-48,920
Financing	18,080	28,322	36,948	43,200	34,818	34,818	49,520	48,920
Domestic	8,614	-1,913	10,730	13,603	4,383	4,383	18,590	7,740
External	2,360	22,575	20,104	23,497	22,826	22,826	25,030	34,280
Privatization proceeds	6,859	5,062	3,460	4,000	5,532	5,532	4,000	5,000
Bank asset recoveries	247	2,597	2,654	2,100	2,077	2,077	1,900	1,900
Discrepancy 2/	-1,649	-3,934	-632	0	-3,265	-4,694	0	0
Memorandum items:								
Primary expenditure 4/	160,956	244,167	344,711	446,326	440,447	443,172	557,660	560,750
Primary current expenditure 4/	149,039	216,302	307,184	397,234	390,417	393,143	487,150	490,536
Primary balance (cash, including grants) 3/	12,883	6,928	7,030	4,876	7,075	5,839	4,797	-6,026
Nominal GDP (billions lei)	545,730	803,773	1,167,243	1,512,257	1,512,257	1,512,257	1,822,059	1,822,059

(in percent of GDP)

	1999 Actual	2000 Actual	2001 Actual	2002 Supplem. budget 31-Oct-02	2002 Actual 7/	2002 Actual 6/	2003 Budget 7/ 13-Nov-02	2003 Supplem. Budget 7/ 28-Aug-03
Total revenue and grants	31.9	31.2	30.1	29.8	29.6	29.7	30.9	30.4
Current	31.8	31.1	30.1	29.8	29.5	29.6	30.8	30.4
Tax	30.1	29.2	28.0	28.0	27.7	27.7	28.8	28.4
Profits	3.1	2.5	1.9	1.9	2.0	2.0	2.2	2.2
Wages and salaries 1/	3.3	3.4	3.2	2.8	2.8	2.8	3.3	3.0
Social security 1/	10.6	10.8	10.7	11.2	10.7	10.7	10.7	10.0
Other direct taxes	1.5	1.0	1.1	0.9	1.0	1.0	1.1	1.0
VAT	6.0	6.3	6.3	6.8	6.9	6.9	6.8	7.4
Customs	1.4	1.1	0.8	0.6	0.6	0.6	0.4	0.7
Excise	3.1	2.6	2.3	2.2	2.1	2.1	3.2	3.0
Other indirect taxes	1.1	1.7	1.6	1.6	1.6	1.6	1.1	1.1
Nontax	1.7	1.9	2.1	1.8	1.9	1.9	2.0	2.0
Capital	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	35.5	35.3	33.4	32.7	32.1	32.3	33.6	33.1
Current	32.6	31.8	30.1	29.4	28.8	29.0	29.7	29.3
Wages and salaries	4.8	5.5	5.0	4.9	4.8	4.9	5.0	5.0
Materials and operating expenditures	10.5	7.0	6.9	6.9	7.0	7.1	6.9	7.1
o/w: health insurance fund	4.1	3.1	3.2	3.2	3.2	3.2	3.0	3.2
Interest	5.3	4.8	3.8	3.2	3.0	3.0	3.0	2.4
Subsidies and transfers	14.7	14.4	14.4	14.4	14.0	14.0	14.8	14.7
Subsidies	1.7	2.2	2.1	2.0	2.0	2.0	1.8	2.2
Transfers	13.0	12.2	12.3	12.4	12.1	12.1	12.9	12.5
o/w: Pensions	6.9	6.7	6.8	6.9	6.8	6.8	6.9	6.6
Capital	2.8	3.0	3.1	3.2	3.2	3.2	3.8	3.7
Lending minus repayments	0.1	0.4	0.1	0.1	0.1	0.1	0.1	0.1
Overall balance (cash, including grants)	-3.6	-4.0	-3.2	-2.9	-2.5	-2.6	-2.7	-2.7
Financing	3.3	3.5	3.2	2.9	2.3	2.3	2.7	2.7
Domestic	1.6	-0.2	0.9	0.9	0.3	0.3	1.0	0.4
External	0.4	2.8	1.7	1.6	1.5	1.5	1.4	1.9
Privatization proceeds	1.3	0.6	0.3	0.3	0.4	0.4	0.2	0.3
Bank asset recoveries	0.0	0.3	0.2	0.1	0.1	0.1	0.1	0.1
Discrepancy 2/	-0.3	-0.5	-0.1	0.0	-0.2	-0.3	0.0	0.0
Memorandum items:								
Primary expenditure 4/	29.5	30.4	29.5	29.5	29.1	29.3	30.6	30.8
Primary current expenditure 4/	27.3	26.9	26.3	26.3	25.8	26.0	26.7	26.9
Primary balance (cash, including grants) 3/	2.4	0.9	0.6	0.3	0.5	0.4	0.3	-0.3
Nominal GDP (billions lei)	545,730	803,773	1,167,243	1,512,257	1,512,257	1,512,257	1,822,059	1,822,059

Sources: Ministry of Public Finance; and Fund staff estimates.

1/ 1999 actual values adjusted for the collections of health contributions (3,484. 5 and 10,483.2 billion lei, respectively) which were previosuly classified as wage taxes under the program.

2/ Overall balance (cash, including grants) plus financing.

3/ Authorities and staff estimates. EU grants (except for RICOP) are neither included under grants nor under expenditures.

4/ Excluding EU grants and cash expenditure for bank restructuring.

5/ As the 2003 budget incorporated various extrabudgetary revenues and expenditures, the budgets for 2002 and 2003 are not fully comparable. On a comparable basis, revenues and expenditure in the 2002 budget are higher by about 0.3 percent of GDP, leaving the overall balance unchanged.

6/ Including National Administration of Roads.

7/ Excluding National Administration of Roads.

Table 4. Romania: Monetary Survey, 2000-2003

(In billions of lei, actual/program exchange rates)

	2001	2002				2003							
	December actual	March actual	June actual	September actual	December actual	March program	March actual	June program	June actual	September program	September rev. program	December program	December rev. program
Monetary Survey													
Net foreign assets (including valuation changes)	171,866	178,368	197,564	209,139	222,271	235,077	212,784	263,662	201,431	281,741	229,974	284,507	237,573
In millions of U.S. dollars	5,439	5,424	5,901	6,327	6,635	7,038	6,411	7,524	6,101	7,804	6,810	7,685	6,838
Of which: Commercial banks	866	639	356	280	87	196	-216	116	-246	36	-366	-33	-466
NBR	4,573	4,785	5,545	6,047	6,548	6,842	6,627	7,408	6,347	7,768	7,176	7,718	7,304
Net domestic assets	98,646	96,958	103,347	108,193	151,440	150,629	156,666	151,848	187,068	166,250	184,260	221,690	235,369
Domestic credit	143,245	155,234	164,421	170,243	200,358	216,314	215,324	222,298	246,397	237,766	250,638	268,180	289,185
Government	24,990	24,997	17,154	13,241	20,732	25,004	17,339	14,622	21,926	17,358	7,981	28,150	21,897
Of which: T-bills for bank restructuring 1/	16,310	16,632	16,392	12,153	7,563	6,977	5,922	2,762	2,036	1,615	1,652	685	787
Non-government	118,254	130,237	147,267	157,003	179,626	191,310	197,985	207,676	224,470	220,408	242,656	240,030	267,288
In foreign currency	70,721	78,627	94,486	98,923	112,898	117,717	120,876	132,290	129,352	139,177	138,850	148,273	151,537
(in millions of U.S. dollars)	2,238	2,391	2,822	2,993	3,370	3,525	3,642	3,775	3,918	3,855	4,111	4,005	4,361
In lei	47,533	51,610	52,781	58,079	66,729	73,593	77,109	75,386	95,118	81,231	103,806	91,757	115,751
								28,050	44,844	0.60	16,794		
Other items net	-44,598	-58,276	-61,074	-62,050	-48,918	-65,685	-58,658	-70,450	-59,328	-71,516	-66,378	-46,490	-53,816
Broad money	270,512	275,326	300,912	317,332	373,711	385,706	369,451	415,510	388,499	447,991	414,234	506,196	472,943
Of which: Lei denominated (M2)	154,728	157,746	176,348	189,458	226,900	235,396	223,134	256,049	235,809	280,100	252,936	326,627	301,438
Currency in circulation	35,635	33,416	39,615	42,334	45,577	45,530	45,867	51,500	52,535	56,060	57,953	60,042	62,623
Lei deposits	119,092	124,330	136,733	147,124	181,322	189,866	177,267	204,549	183,274	224,040	194,983	266,586	238,815
Foreign currency deposits	115,784	117,580	124,564	127,874	146,812	150,310	146,317	159,461	152,691	167,892	161,298	179,569	171,504
In millions of U.S. dollars	3,664	3,575	3,721	3,869	4,382	4,500	4,409	4,550	4,625	4,650	4,776	4,850	4,936
Memorandum items: 3/			9.7		11.9				12.3				14.7
Broad money (M2X) growth	46.2	43.7	44.3	35.0	38.1	40.1	34.2	38.1	29.1	41.2	30.5	35.5	26.6
NFA contribution	55.9	36.7	29.5	22.6	18.6	20.6	12.5	22.0	1.3	22.9	6.6	16.7	4.1
NDA contribution	-9.8	7.0	14.8	12.3	19.5	19.5	21.7	16.1	27.8	18.3	24.0	18.8	22.5
Lei-denominated money growth (M2)	40.4	45.7	48.7	47.6	46.6	49.2	41.5	45.2	33.7	47.8	33.5	44.0	32.9
Growth of currency in circulation	38.4	40.6	33.6	29.7	27.9	36.3	37.3	30.0	32.6	32.4	36.9	31.7	37.4
Real broad money growth	12.2	14.9	16.4	12.7	17.2	19.5	14.6	19.0	13.2	21.1	12.6	18.8	11.0
Real lei-denominated money growth (M2)	7.8	16.4	19.9	23.3	24.4	27.3	20.8	25.2	17.3	26.8	15.2	26.3	16.5
Real growth of currency in circulation	6.3	12.3	7.7	8.3	8.5	16.2	17.2	12.1	16.3	13.6	18.1	15.6	20.5
Growth of lei credit to nongovernment, adjusted 2/	56.3	54.5	41.7	38.6	40.4	42.6	49.4	42.8	76.5	39.9	75.3	37.5	70.4
Growth of lei credit to nongovernment, adjusted, real 2/	20.0	23.5	14.3	15.7	19.1	21.6	27.6	23.1	54.8	20.0	51.2	20.6	49.5
Growth of foreign currency credit, adjusted, in US$ 2/	33.2	31.0	40.4	45.2	41.5	39.9	39.1	33.2	30.0	27.7	25.8	20.8	21.5
Growth of credit to nongovernment, composite 2/ 4/	28.0	28.1	31.1	34.4	33.1	32.8	34.5	29.6	40.4	24.9	36.6	20.7	33.5
CPI inflation	30.3	25.1	24.0	19.8	17.8	17.2	17.1	16.0	14.0	16.6	15.9	14.0	14.0
M2X (Broad Money) velocity	4.8	5.2	5.0	4.8	4.3	4.5	4.8	4.4	4.6	4.2	4.5	3.8	4.1
M2 (Domestic Broad Money) velocity	8.4	9.0	8.5	8.1	7.1	7.4	7.9	7.1	7.7	6.6	7.3	5.9	6.5
M2X+Tbill velocity	4.3	4.5	4.4	4.2	3.9	4.1	4.3	4.0	4.2	3.8	4.1	3.5	3.8
M2X+Tbill growth	49.3	43.9	43.5	35.3	37.3	36.4	31.6	33.7	25.9	36.4	26.8	32.6	24.7

Sources: Romanian authorities; and Fund staff estimates.

1/ Bonds issued to restructure Bancorex and Banca Agricola.

2/ Adjusted for write-offs in the last 12 months and changes in the US$/EUR exchange rate. Owing to large-scale write-offs and reclassifications, credit growth rates are estimated.

3/ All changes are 12-month rates of change, unless otherwise indicated.

4/ Real lei credit growth and foreign currency credit growth, weighted by their respective shares.

Table 4. (continued) Romania: Balance Sheet of the National Bank, 2000-2003 1/

	2001	2002				2003							
	December actual	March actual	June actual	September actual	December actual	March program	March actual	June program	June actual	September program	September rev. program	December program	December rev. program
National Bank of Romania													
Net foreign assets (including valuation) 2/	114,890	127,410	157,476	166,157	175,723	181,896	174,404	210,180	158,913	228,988	190,288	231,536	199,159
In millions of U.S. dollars	3,641	3,889	4,716	5,017	5,221	5,486	5,264	6,039	4,872	6,374	5,663	6,274	5,751
Net domestic assets	-48,929	-59,972	-82,467	-84,518	-83,337	-85,740	-76,640	-106,780	-55,941	-113,972	-79,659	-106,675	-75,603
Total credit	-21,036	-28,853	-52,651	-56,429	-55,273	-49,419	-54,545	-72,426	-38,046	-81,450	-61,548	-75,126	-57,933
Credit to banks	-20,993	-31,246	-34,908	-46,836	-47,844	-44,765	-45,406	-54,562	-34,057	-65,411	-48,382	-62,736	-53,938
NBR refinancing (including to DGF and Law 101)	4,900	4,684	4,626	3,751	3,114	3,114	3,095	2,781	2,757	2,781	2,757	2,148	2,124
NBR refinancing to litigous debtor	284	284	284	284	284	284	284	284	284	284	284	284	284
NBR credit line to Deposit Guarantee Fund	3,510	3,503	3,481	3,467	2,830	2,830	2,810	2,497	2,473	2,497	2,473	1,864	1,840
Law 101 (Bancorex) & Special credit to BA	1,105	898	861	0	0	0	0	0	0	0	0	0	0
Deposit taking operations	-24,835	-33,956	-38,744	-49,659	-50,910	-47,879	-48,501	-57,343	-36,815	-68,192	-51,140	-64,884	-56,062
Reverse repo	-1,058	-1,974	-790	-928	-48	0	0	0	0	0	0	0	0
Credit to government	-43	2,393	-17,743	-9,593	-7,429	-4,654	-9,139	-17,864	-3,989	-16,039	-13,165	-12,390	-3,995
Treasury balance (+deficit, -surplus)	-7,762	-4,746	-24,776	-14,973	-9,916	-6,916	-11,401	-17,864	-3,995	-16,039	-13,165	-12,390	-3,995
Treasury overdraft	-3,158	-3,511	-3,168	-9,054	-3,693	-3,693	-9,760	-3,693	-1,897	-3,693	-1,897	-3,693	-1,897
Treasury deposits	4,605	1,235	21,608	5,919	6,223	3,223	1,641	14,170	2,098	12,346	11,268	8,696	2,098
Treasury bills	7,719	7,139	7,033	5,380	2,487	2,262	2,262	0	6	0	0	0	0
Other items net	-27,893	-31,119	-29,816	-28,089	-28,064	-36,321	-22,095	-34,354	-17,895	-32,522	-18,112	-31,549	-17,670
Lei reserve money 3/ 6/	65,961	67,438	75,009	81,639	92,385	96,157	97,764	103,401	102,972	115,016	110,628	124,861	123,556
Currency	37,747	35,407	39,495	44,727	50,592	48,571	50,215	52,114	55,780	58,807	61,709	63,416	68,512
Bank deposits 6/	28,213	32,031	35,514	36,912	41,793	47,586	47,549	51,287	47,192	56,209	48,919	61,445	55,045
Memorandum items: 4/													
Lei reserve money growth	28.6	42.3	41.3	39.5	40.1	42.6	45.0	37.9	37.3	40.9	35.5	35.2	33.7
NFA contribution	131.9	148.6	147.6	113.3	92.2	80.8	69.7	70.3	1.9	77.0	29.6	60.4	25.4
NDA contribution	-103.2	-106.3	-106.3	-73.8	-52.2	-38.2	-24.7	-32.4	35.4	-36.1	6.0	-25.3	8.4
Real reserve money growth (adjusted) 5/	6.9	14.2	24.6	20.9	19.2	21.5	23.7	18.8	20.4	20.8	16.9	18.6	17.3
Adjusted lei reserve money growth 5/ 6/	39.3	42.9	54.5	44.8	40.5	42.5	44.8	37.9	37.3	40.9	35.5	35.2	33.7
NDA contribution	-89.7	-93.3	-92.9	-63.1	-44.3	-43.6	-24.7	-38.3	23.7	-41.4	-2.8	-31.5	-0.6
NFA contribution	128.9	136.2	147.4	107.9	84.9	73.7	69.6	64.2	1.8	70.6	27.1	55.4	23.3
CPI inflation	30.3	25.1	24.0	19.8	17.8	17.2	17.1	16.0	14.0	16.6	15.9	14.0	14.0

Sources: Romanian authorities; and Fund staff estimates.

1/ For program purposes, all values are defined on a monthly average basis.

2/ Program definition excludes deposits of commercial banks to meet required reserves against foreign currency deposits. This, and the fact that the figures here are monthly averages, explain the differences from the monetary survey.

3/ Indicative targets based on which the NDA PC is set.

4/ All changes are 12-month rates of change, unless otherwise indicated.

5/ Adjusted for both (i) shortfalls in reported reserve money and (ii) changes in minimum reserve requirements.

(i) Shortfalls in reported reserve money occured in 1999 and early 2000 owing to failure of some banks to observe the reserve requirements and the time lag given to BCR to absorb certain transfered deposits from the former Bancorex in the first part of 2000. Small deficiencies persisted throughout 2000 and 2001 and disappeared since mid-2002.

(ii) Minimum reserve requirement for lei deposits was decreased in 2001 from 30 percent to 27 percent on July 1 and further to 25 percent on October 1. In 2002, further cuts were made (to 22 percent in April and to 18 percent in December).

6/ Adjusted to correspond to a 25 percent reserve requirement.

Table 5. Implicit Subsidies and Losses in the Energy Sector, 2000-04

	2000	2001 (w/o adjustments) 2/	2001 Program	2001 Actual	2002 Program	2002 Actual	2003 Prog.	2003 Proj.	2003 Rev. Prog.	2004 Proj.	2004 With measures agreed	2004 With additional measures
					Losses at Termoelectrica and the externalized units							
HEATING												
Cost recovery price ($/Gcal) 1/	19.2	20.0	20.0	20.2	20.0	20.2	20.6	22.9	22.9	24.3	24.3	24.3
Current prices ($/Gcal, year-average)	11.2	10.4	12.0	12.3	17.0	16.6	20.0	20.1	21.0	18.7	21.2	22.5
Termoelectrica's heating output sold (million Gcal)	22	26	26	23	26	23	21	23	23	23	23	23
Termoelectrica's losses from heating ($m)	181	249	198	180	77	84	12	66	45	130	71	41
ELECTRICITY												
Cost recovery price ($/Mwh) 1/	35.4	40.0	40.0	38.1	40.0	38.4	39.1	44.1	44.1	46.8	46.8	46.8
Actual prices ($/Mwh, year-average)	34.2	28.5	32.0	32.2	38.0	36.3	39.0	38.9	40.9	36.3	41.9	46.9
Termoelectrica's electricity output sold (million Mwh)	26	29	29	28	29	28	28	28	28	28	28	28
Termoelectrica's losses from electricity ($m)	30	329	234	165	47	58	3	145	90	292	136	-4
Total losses from operations ($m)	210	578	432	346	124	142	15	211	135	422	207	37
In percent of GDP	0.6	1.5	1.1	0.9	0.3	0.3	0.0	0.4	0.2	0.7	0.3	0.1
Collection rate (%)	82	75	95	86	98	91	95	89	91	90	92	94
Losses from non-collection ($m)	208	270	61	172	38	130	75	171	155	145	133	110
Total losses including non-collection ($m)	418	848	493	517	162	272	90	383	290	567	340	147
In percent of GDP	1.1	2.1	1.2	1.3	0.4	0.6	0.2	0.7	0.5	0.9	0.6	0.2
					Implicit Subsidies from Natural Gas							
NATURAL GAS PRODUCTION												
Import price (average, $/tcm)	124	130	130	130	120	110	125	136	136	134	134	134
Domestic wellhead price (average, incl. excise tax, $/tcm)	35	26	35	35	46	40	45	31	38	27	42	62
Domestic output (million tcm)	14.0	14.0	14.0	13.0	14.0	12.1	11.9	12.7	12.7	12.5	12.5	12.5
Loss from low prices ($m)	1246	1456	1327	1230	1025	842	956	1327	1233	1340	1156	900
Total supply to end-users, incl. transp. & dist. ($m)	566	1103	1103	974	1155	981	1074	1184	1239	1125	1288	1463
Collection rate (%)	87	76	95	81	98	99	99	96	97	96	98	99
Losses from non-collection ($m)	74	270	55	185	29	12	11	47	37	45	32	15
Total losses and implicit subsidy ($m)	1320	1726	1382	1415	1054	854	967	1374	1270	1385	1188	915
In percent of GDP	3.6	4.3	3.5	3.5	2.3	1.9	1.8	2.5	2.3	2.3	2.0	1.5
TOTAL IMPLICIT SUBSIDIES AND LOSSES	1738	2574	1875	1933	1216	1126	1057	1757	1560	1952	1529	1062
In percent of GDP	4.7	6.5	4.7	4.8	2.7	2.5	2.0	3.2	2.9	3.3	2.5	1.8
Change in losses relative to the previous year	...	1.8	0.0	0.1	-2.1	-2.4	-0.5	0.8	0.4	0.0	-0.3	-1.1
Estimated change in saving - investment balance of public enterprises	...	-0.6	0.0	0.0	0.7	0.8	0.2	-0.4	-0.2	0.0	0.2	0.5
Memorandum item:												
GDP (in USD Mill.)	37060.3	39,721	39,721	40172.4	45,135	45749.4	52705.3	54568.1	54568.1	60004.9	60004.9	60004.9

Sources: ANRE (electricity regulatory agency), Termoelectrica and Distrigaz Nord and Sud; World Bank; Fund staff estimates.

1/ Cost recovery price estimates are based on WEO fuel price projections.
2/ Estimates, as of September 2001, based on the assumption that the adjustments as envisaged under the program were not implemented.
3/ The reduction in losses only partially translates into an improvement in the saving-investment balance, owing to three offsetting factors: (i) increase in losses in other public enterprises; (ii) higher tax payments of the energy sector; (iii) higher investment in the energy sector. For 2003 and 2004, this effect is estimated at 1/2.

Table 6. Romania: Medium-Term Balance of Payments Outlook, 2000-08

(In millions of U.S. dollars)

	2000 Act.	2001 Act.	2002 Act.	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.
Current account	-1,435	-2,223	-1,572	-2,593	-2,873	-3,135	-3,410	-3,691	-3,965
Ratio to GDP	-3.9	-5.5	-3.4	-4.8	-4.8	-4.8	-4.7	-4.7	-4.6
Trade balance	-1,684	-2,969	-2,612	-3,686	-3,941	-4,166	-4,416	-4,618	-4,838
Exports	10,366	11,385	13,870	17,370	18,970	20,571	22,317	24,177	26,176
Imports	-12,050	-14,354	-16,482	-21,055	-22,911	-24,737	-26,733	-28,795	-31,015
Services account, net	-254	-397	-496	-577	-680	-819	-979	-1,179	-1,352
Of which: interest, net	-382	-288	-413	-535	-563	-632	-710	-828	-911
Unrequited transfers	860	1,143	1,536	1,670	1,749	1,850	1,985	2,106	2,226
Capital account	2,738	3,140	3,342	2,630	3,427	3,450	3,939	4,673	5,368
Direct investment and capital transfers	1,087	1,270	1,178	1,484	2,009	2,087	2,201	2,460	2,636
Portfolio Investment	50	71	129	10	50	50	50	50	50
Borrowing by public sector 1/	882	1,087	931	1,209	671	512	664	864	1,207
Loans (net)	805	314	668	613	-9	-72	-336	323	407
Disbursements	1,544	1,337	1,926	1,817	1,641	1,524	1,456	1,581	1,721
Of which: direct debt	959	465	732	981	1,030	1,081	1,281	1,481	1,681
Of which: government guaranteed	584	873	1,194	837	611	443	175	100	40
Amortization	-739	-1,023	-1,259	-1,205	-1,649	-1,596	-1,792	-1,258	-1,315
Bonds (net)	77	773	263	596	680	584	1,000	541	800
Disbursements	259	922	723	808	839	900	1,000	800	800
Amortization	-182	-149	-460	-212	-159	-316	0	-259	0
Borrowing by private sector	748	565	624	64	496	600	823	1,100	1,275
Medium- and long-term loans (net)	748	565	624	64	496	600	823	1,100	1,275
Disbursements	1,059	1,090	1,333	1,432	1,969	2,117	2,275	2,423	2,581
Amortization	-311	-525	-710	-1,368	-1,473	-1,516	-1,452	-1,324	-1,306
Short-term (net)	5	193	458	-125	200	200	200	200	200
Credit extended	-34	-45	23	-12	0	0	0	0	0
Net errors and ommisions	340	992	-574	200	0	0	0	0	0
Overall balance	1,643	1,909	1,196	238	554	315	528	983	1,403
Financing	-1,643	-1,909	-1,196	-238	-554	-315	-528	-983	-1,403
Net foreign assets NBR (increase, -)	-1,170	-1,949	-1,975	-791	-934	-695	-908	-1,363	-1,783
Assets (increase, -)	-1,004	-1,624	-1,885	-908	-827	-617	-799	-1,210	-1,690
Liabilities	-166	-325	-90	117	-107	-79	-110	-153	-92
IMF, net	20	-50	10	117	-107	-79	-110	-153	-92
Purchases	115	67	107	226	0	0	0	0	0
Repurchases	-95	-117	-98	-109	-107	-79	-110	-153	-92
Other, net	-186	-275	-100	0	0	0	0	0	0
Short-term	-14	0	-100	0	0	0	0	0	0
Medium- and long-term, net	-172	-275	0	0	0	0	0	0	0
Net foreign assets DMBs (increase, -)	-473	40	779	553	380	380	380	380	380
Assets (increase, -)	-336	-99	433	-48	-20	-20	-20	-20	-20
Liabilities	-137	139	346	601	400	400	400	400	400
Short-term	115	67	107	226	0	0	0	0	0
Medium- and long-term, net	-95	-117	-98	-109	-107	-79	-110	-153	-92
Financing gap	0	0	0	0	0	0	0	0	0
Export growth (percent)	21.9	9.8	21.8	25.2	9.2	8.4	8.5	8.3	8.3
Import growth (percent)	23.7	19.1	14.8	27.7	8.8	8.0	8.1	7.7	7.7
Net Resource Balance/GDP (percent)	-2.9	-4.8	-2.4	-3.5	-3.6	-3.5	-3.5	-3.4	-3.3
External debt/GDP (percent)	27.7	29.7	33.3	31.3	31.3	31.0	31.1	31.5	32.3
Public and publicly guaranteed debt/GDP (percent)	18.8	19.4	21.1	20.3	19.1	18.0	17.3	16.7	16.6
Net External Indebtedness/GDP (%)	14.3	13.0	15.5	14.7	14.7	14.9	15.3	15.5	15.6
Debt service ratio	16.9	20.2	20.1	18.5	19.6	19.1	17.5	15.5	13.8
Gross reserves of NBR (in US$ mns.) 2/	3,466	5,090	6,975	7,883	8,710	9,326	10,125	11,335	13,025
(over short-term debt by remaining maturity)	164.5	171.0	176.7	160.3	154.5	153.3	160.1	170.6	..
(in months of imports of following year)	2.5	3.2	3.5	3.7	3.8	3.7	3.8	3.9	..

Sources: Romanian authorities; and Fund staff estimates.

1/ Including public enterprises.

2/ Includes gold.

Table 7. Romania: External Financing Requirements and Sources, 1999-2003

(In millions of U.S. dollarsl)

	1999	2000	2001	2002	2003 Proj.
Gross financing requirements	3,742	4,388	6,135	5,650	6,442
External current account deficit	1,446	1,435	2,223	1,572	2,593
Debt amortization	2,244	1,518	2,072	2,528	2,784
Public sector	1,610	1,207	1,547	1,819	1,416
of which: Bonds and notes	747	354	424	460	212
Private sector	634	311	525	710	1,368
Repayment of arrears	0	0	0	0	0
Gross reserves accumulation	-87	1,340	1,723	1,452	956
IMF repurchases and repayments	139	95	117	98	109
Available financing	3,203	3,828	5,968	5,375	5,990
FDI and capital transfers (net)	1,070	1,087	1,270	1,178	1,484
Public sector borrowing	815	1,458	2,259	2,481	2,399
Loans	815	1,199	1,337	1,758	1,591
Bonds	0	259	922	723	808
Private sector borrowing	780	922	1,229	1,679	2,033
Other flows 1/	538	361	1,210	36	74
Financing gap	539	560	167	275	452
Balance of payments financing	539	560	167	275	452
IMF	73	115	67	107	226
Other 2/	466	445	100	168	226
Accumulation of arrears (exceptional)	0	0	0	0	0
Residual financing gap	0	0	0	0	0

Sources: Romanian authorities; and Fund staff estimates.

1/ Includes all other net financial flows, and errors and omissions.

2/ Includes World Bank PSAL2 and EU loans.

Table 8. Romania: Indicators of External Vulnerability, 1997–2003 1/

(In percent of GDP unless othewise specified)

	1997	1998	1999	2000	2001	2002	2003 proj.
Financial Indicators							
Public sector debt	28.1	27.6	30.5	29.9	27.4	26.8	27.3
Broad money (percent change, 12-month basis)	104.8	48.9	44.9	38.0	46.2	38.1	26.6
Credit to non-government (percent change, 12-month basis) 2/	33.7	64.7	45.8	50.5	59.9	46.3	47.7
Real credit to non-government (percent change, 12-month basis) 2/	-46.9	17.0	-9.2	7.4	26.0	29.6	33.5
Monthly weighted average T-bill rate	133.5	82.4	105.2	62.4	38.4	17.4	15.2 4/
Monthly weighted average real T-bill rate 3/	-7.1	29.7	32.6	15.4	6.3	-0.3	0.9 4/
External Indicators							
Exports (percent change, 12-month basis in US$)	4.6	-1.6	2.4	21.9	9.8	21.8	25.2
Imports (percent change, 12-month basis in US$)	-1.4	4.8	-12.1	23.7	19.1	14.8	27.7
Terms of Trade (percent change, 12-month basis)	9.0	-4.0	0.2	2.7	2.3	1.6	-2.6
Current account balance	-5.4	-6.9	-4.0	-3.9	-5.5	-3.4	-4.8
Current account balance after FDI	-1.9	-2.0	-1.2	-0.9	-2.4	-0.9	-2.0
Errors and omissions	3.2	0.8	2.3	0.9	2.5	-1.3	0.4
Gross official reserves (in US$ millions)	3,075	2,278	2,462	3,466	5,090	6,975	7,883
(in months of imports GNFS of the following year)	2.9	2.4	2.1	2.5	3.2	3.5	3.7
Central Bank short-term foreign liabilities (in US$ millions)	100	0	170	100	100	0	0
Gross reserves of the banking system (in US$ millions)	4,763	3,768	3,623	4,963	6,686	8,138	9,094
(in months of imports GNFS of the following year)	4.5	3.9	3.1	3.6	4.3	4.1	4.2
Short term foreign liabilities of the commercial banks (in US$)	267	188	221	225	371	491	664 5/
Open foreign currency position of the commercial banks (in US$)	1,400	1,933	724	318	355	380	482 5/ 10/
Official reserves/Broad money (M2)	40.3	27.0	33.5	48.6	59.5	62.5	57.9
Official reserves/Narrow money (M0) 6/	242.6	106.1	143.6	187.5	241.7	302.3	221.8
Total short term external debt by remaining maturity 7/	8.0	6.5	4.7	5.7	7.4	8.6	9.0
In percent of reserves	91.8	119.8	68.1	60.8	58.5	56.6	62.4
In percent of total debt	30.7	31.8	24.2	20.5	25.0	25.9	28.8
Total external debt (in US$ millions)	8,584	9,323	8,771	10,273	11,925	15,251	17,105
Of which: Public and Publicly guaranteed debt	6,854	6,967	6,220	6,957	7,720	9,551	10,877
Total external debt (in percent of exports of G&S)	86.2	97.9	88.9	84.7	88.9	94.1	85.1
Total external debt/ GDP	24.4	22.1	24.5	27.7	29.7	33.3	31.3
External interest payments (in percent of exports of G&S)	5.0	5.7	5.1	4.4	4.6	3.9	4.1
External amortization payments (in percent of exports of G&S)	15.9	18.0	23.9	12.5	15.6	16.2	14.4
Exchange rate (per US$, period average)	7,195	8,881	15,274	21,688	29,056	33,055	...
REER appreciation (+) (12-month basis)	16.5	30.0	-14.8	9.5	1.6	5.7	...
Financial Market Indicators							
Foreign currency debt ratings							
Moody's	Ba3	B3	B3	B3	B2	B1	B1 8/
Standard and Poor's	BB-	B-	B-	B-	B	B+	BB 8/
Spread of benchmark bonds (basis points, end of period)	350	1,300	780	406	421	282	226 9/

Sources: Romanian authorities; and Fund staff estimates.

1/ All stocks are measured end-of-period.

2/ Adjusted for bad loans written off. Real credit growth is weighted average of real lei credit growth, and U.S. dollar-measured foreign currency growth.

3/ The real rate is based on the ex-post 12-month CPI inflation.

4/ Actual as of August 2003.

5/ Actual as of July 2003.

6/ Narrow money is defined as currency plus lei-denominated sight deposits.

7/ Defined as short-term debt by original maturity basis plus amortization falling due on medium-term loans and bonds.

8/ Actual on September 17, 2003.

9/ Since 2001 the benchmark bond is the '05, while for earlier years it is the '02. Actual on September 17, 2003.

10/ On-balance-sheet only. The overall open currency position, including off-balance-sheet items and capital paid in foreign exchange, was US$93 million as of end-August, 2003.

Table 9. Romania: Indicators of Fund Credit, 2000–07

(In percent, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006	2007
Outstanding Fund Credit (end of period)								
In millions of SDRs	347.9	308.0	314.9	400.4	321.4	263.4	182.3	68.6
In millions of U.S. dollars	458.8	392.1	407.8	546.9	436.9	357.0	246.4	92.4
In percent of quota	33.8	29.9	30.6	38.9	31.2	25.6	17.7	6.7
In percent of GDP	1.2	1.0	0.9	1.0	0.7	0.5	0.3	0.1
In percent of exports of goods and services	3.8	2.9	2.5	2.7	2.0	1.5	1.0	0.3
In percent of official reserves	13.2	7.7	5.8	6.9	5.0	3.8	2.4	0.8
Debt service due to the Fund (in millions of U.S. dollars)	120.3	117.0	111.3	123.4	121.2	90.1	119.0	159.1
In percent of quota	11.7	11.4	10.8	12.0	11.8	8.7	11.6	15.4
In percent of GDP	0.3	0.3	0.2	0.2	0.2	0.1	0.2	0.2
In percent of exports of goods and services	1.0	0.9	0.7	0.6	0.6	0.4	0.5	0.6
In percent of official reserves	3.5	2.3	1.6	1.6	1.4	1.0	1.2	1.4

Sources: Finance Department; Romanian authorities; and Fund staff calculations.

Table 10. Romania: Medium-Term Projections, 2000–08

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Income and prices									
Nominal GDP (in trillions of lei)	803.773	1,167.243	1,512.257	1,822.059	2,142.410	2,414.370	2,673.153	2,931.622	3,201.332
Nominal GDP (in billions of US dollars)	37.060	40.172	45.749	54.568	60.004	66.103	72.210	78.882	86.172
Real GDP	2.1	5.7	4.9	4.7	5.0	5.0	5.0	5.0	5.0
Domestic Demand	4.3	8.2	3.9	5.8	5.2	5.0	5.0	5.0	5.0
Household consumption	-0.8	6.3	3.2	4.8	4.2	4.0	4.0	4.0	4.0
Government consumption	12.3	4.7	2.1	3.9	1.4	3.1	2.9	2.6	2.3
Gross fixed investment	5.5	9.1	8.3	10.9	13.1	9.8	10.2	10.0	9.2
of which: non government	7.7	9.8	8.4	9.5	10.5	10.5	10.3	9.9	9.7
of which: government	-11.2	3.6	7.6	24.7	35.1	5.3	9.5	10.9	6.0
Increase in stocks (contribution) 1/	2.2	1.8	0.0	0.1	-0.2	0.1	-0.1	-0.1	0.1
External Demand (contribution)	-2.3	-3.0	0.7	-1.6	-0.7	-0.5	-0.5	-0.5	-0.5
Exports of goods and services	23.4	11.1	16.9	16.4	8.3	6.6	6.3	6.3	6.3
Imports of goods and services	27.1	17.2	12.1	16.6	8.0	6.3	6.0	6.0	6.0
GDP deflator, p.a.	44.2	37.3	23.6	15.1	12.0	7.3	5.4	4.4	4.0
CPI, e.o.p.	40.7	30.3	17.8	14.0	9.0	6.0	5.0	4.0	4.0
CPI, p.a.	45.7	34.5	22.5	15.1	12.0	7.3	5.4	4.4	4.0
Saving and investment balances									
Total domestic saving	14.2	14.9	17.3	16.9	17.8	18.4	19.0	19.7	20.5
Net factor receipts and transfers from abroad	1.4	2.1	2.3	1.9	1.9	1.7	1.7	1.5	1.4
Total national saving	15.6	17.0	19.7	18.8	19.7	20.1	20.6	21.2	21.9
Non-government	16.6	17.1	19.1	17.7	17.8	17.7	17.9	18.1	18.7
Government	-1.0	-0.1	0.6	1.1	1.9	2.4	2.7	3.1	3.2
Total investment	19.5	22.6	23.1	23.6	24.5	24.9	25.4	25.9	26.5
Non-government	16.4	19.4	19.9	19.9	19.7	20.1	20.4	20.7	21.3
Government	3.0	3.1	3.2	3.8	4.8	4.8	5.0	5.2	5.2
Savings - investment balance	-3.9	-5.5	-3.4	-4.8	-4.8	-4.8	-4.8	-4.7	-4.7
Non-government	0.1	-2.3	-0.8	-2.1	-1.9	-2.5	-2.5	-2.6	-2.6
Government	-4.0	-3.2	-2.6	-2.7	-3.0	-2.4	-2.3	-2.1	-2.0
Change in the saving-investment balance of public enterprises due to the energy sector adjustment	...	0.0	0.8	-0.2	0.5	0.2	0.1	0.1	0.0

Sources: Romanian authorities; and Fund staff estimates and projections.

1/ Includes statistical discrepancy.

ROMANIA—RELATIONS WITH THE FUND
(As of July 31, 2003)

I. Membership Status: Joined 12/15/72; Article VIII

II. General Resources Account:	SDR million	% Quota
Quota	1,030.20	100.00
Fund holdings of currency	1,371.28	133.11

III. SDR Department:	SDR million	% Allocation
Net cumulative allocation	75.95	100.00
Holdings	4.73	6.22

IV. Outstanding Purchases and Loans:	SDR million	% Quota
Stand-By Arrangements	309.65	30.06
Systemic Transformation	31.42	3.05

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-By	10/31/01	10/15/03	300.00	189.78
Stand-By	08/05/99	02/28/01	400.00	139.75
Stand-By	04/22/97	05/21/98	301.50	120.60
Stand-By	05/11/94	04/22/97	320.50	94.27
Stand-By	05/29/92	03/28/93	314.04	261.70
Stand-By	04/11/91	04/10/92	380.50	318.10

VI. Projected Payments to Fund (Expectations Basis)[1]
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	50.65	115.29	102.80	58.56	13.78
Charges/interest	4.16	6.35	4.01	2.11	1.19
Total	54.81	121.64	106.81	60.67	14.96

[1] This schedule presents all currently scheduled payments to the IMF, including repayment expectations where applicable and repayment obligations otherwise. The IMF Executive Board can extend repayment expectations (within predetermined limits) upon request by the debtor country if its external payments position is not strong enough to meet the expectations without undue hardship or risk.

VII. Exchange Rate Arrangements

From August 1994, a decentralized direct dealing interbank market has been in operation. The official reference rate published by the NBR is an average of rates reported for interbank and client transactions. Romania has accepted the obligations of Article VIII, Sections 2, 3, and 4, with effect from March 25, 1998. Romania's exchange system is free of restrictions on the making of payments and transfers for current international transactions. Romania maintains de jure a managed floating exchange rate regime with no preannounced exchange rate path, while the de facto regime is an unannounced crawling band.

VIII. Article IV Consultation

Romania is on the 24-month consultation cycle subject to the provisions of the decision on consultation cycles approved by the Board on July 15, 2002. The last consultation was concluded on January 8, 2003.

IX. Technical Assistance

The transition in Romania has been supported by substantial technical assistance from multilateral agencies and bilateral donors. The Fund has provided support in a number of areas with more than 40 technical assistance missions since 1990, although the authorities have had a mixed record with regard to implementation. Expert Fund assistance has focused on a number of key areas, including: fiscal reforms; modernization of the central bank and the banking system; creating a market-oriented legal structure; training; and improving the collection and reporting of statistics. The implementation of a comprehensive tax administration reform designed in line with the recommendations of several technical assistance missions of the Fund's Fiscal Affairs Department has started in January 2003. A report on the observance of standards and codes (ROSC) on fiscal transparency was completed on November 6, 2002 (IMF Country Report No. 02/254).

X. Safeguards Assessment

Under the Fund's safeguards assessment policy, National Bank of Romania (NBR) is subject to an assessment with respect to the Stand-By- Arrangement, which was approved on October 31, 2001. A full safeguards assessment of the National Bank of Romania (NBR) was completed on May 13, 2002. The assessment identified certain weaknesses and made appropriate recommendations, as reported in EBS/02/150, which the authorities have begun to implement. The two high-priority recommendations - a quarterly reconcillation between the NBR's accounting records and economic data, submitted to the Fund, and implementing the bank's internal regulation regarding controls over foreign reserve management - have already been implemented.

XI. Resident Representative

The Fund has had a resident representative in Bucharest since 1991. Mr. Graeme Justice assumed the post in January 2003.

Romania: Relations with the World Bank

Partnership in Romania's Development Strategy

1. The Romanian authorities are pursuing a strategy designed to maintain macroeconomic stability and establish sustainable economic growth and poverty reduction, moving towards the eventual goal of accession to the European Union. Key elements of this policy include tightening payments discipline throughout the economy, especially in the energy sector, hardening budget constraints for state-owned enterprises, actively pursuing enterprise and banking privatization and restructuring, and strengthening the social safety net. Over the medium term, continuation of the current economic recovery will depend critically on the maintenance of reform momentum and moving steadily ahead with governance and private sector development reforms. Such reforms would stress transparency and accountability in government, improvements in the business environment, and actions to strengthen the regulation and oversight of financial and capital markets.

2. In broad terms, the IMF has taken the lead in assisting Romania in maintaining macroeconomic stability. As such its program focus is on the fiscal framework, monetary policy and those elements of the structural reform program that have a direct bearing on the macroeconomic situation. The main vehicle for its dialogue with the authorities is a Stand-By Arrangement (SBA) covering the period October 31, 2001 to October 15, 2003. The combined First and Second Review under the SBA was completed on August 28, 2002, and the Third Review was completed on April 25, 2003.

3. The World Bank has taken the lead in policy dialogue on structural issues, including poverty reduction measures, private sector development, institution building and governance. It has a range of instruments through which it conducts dialogue, including adjustment lending operations such as PSAL 1 and PSAL 2, a planned series of Programmatic Adjustment Loans, several sector investment operations and economic work such as the recently completed Public Expenditure and Institutions Review (PEIR), and a planned Country Economic Memorandum (CEM).

4. In some areas where the Bank takes the lead in the dialogue, its analysis is shared with the IMF and is used as input for the fiscal framework, but there are no directly corresponding structural benchmarks or policy conditions in the IMF SBA. In other areas where the Bank takes the lead, the SBA does reflect certain elements in its conditionality. These are generally structural reform measures which have important fiscal implications, such as energy sector reform and restructuring. There are further areas of formal joint responsibility such as the Financial Sector Assessment Program (FSAP).

5. Overall the IMF and World Bank staff maintain a close collaborative relationship in supporting the Government's reform program and are coordinating their policy advice to the Romanian authorities.

IMF-WORLD BANK COLLABORATION IN SPECIFIC AREAS

Areas in which the World Bank leads and there is no direct IMF involvement

6. The policy areas in which the Bank leads and which are not directly incorporated into the IMF program or country dialogue include strengthening the social safety net, revitalizing the economy in rural areas, institution building and governance, and improving the business environment. Bank policy dialogue for strengthening the social safety net includes poverty monitoring, social assistance, pension reform, child welfare reform, health sector reforms, and labor retraining and redeployment. These have been supported by the Bank's Employment and Social Protection Loan, the Social Sector Development Loan, the Social Development Fund and the Mine Closure Loan. They are further supported by economic work such as the recently completed Poverty Profile and the Local Services Delivery Study, and by planned economic studies on poverty and vulnerability, pension reform and gender assessment.

7. The Bank has a range of programs to revitalize the economy in rural areas. These include the Rural Finance Loan which supports income generation activities and will be complemented by a Rural/Urban Linkage Growth Study to set the stage for a Rural Development Loan supporting infrastructure development and improved governance at the community level. The Irrigation Rehabilitation loan supports infrastructure rehabilitation and institutional reform. Other supporting economic work includes the Community Networks Study and the Jiu Valley Development Study.

8. The Bank has a strong institution building and governance program. This builds on recent reforms in local public finance and taxation and decentralization. Policy dialogue has been facilitated the recently completed Public Expenditure and Institutions Review (PEIR) which included analysis and recommendations relating to 1) improved resource allocation in the health sector; 2) delivery of social assistance at the local level; 3) pension reform; 4) institutions for budget management 5) fiscal decentralization; and 6) reforms to the budget process in the judiciary. The policy dialogue will continue through a Country Financial Accountability Assessment (CFAA) to be launched shortly. The Bank completed a Diagnostic Survey of Corruption in Romania prior to the Government's preparing of its National Program for Prevention of Corruption. Work is now beginning on a series of Programmatic Adjustment Loans (PAL) the first of which will focus on institutional and governance reforms in the public service and the judiciary as well as public expenditure management. This will be supported by a $18.6 million Private and Public Sector Institution Building Loan (PPIBL) which will provide technical assistance for these activities and others relating to privatization. Other institution-building support includes financing of a cadastral and land titling project, a project on the environmental aspects of mine closures, a hazards mitigation project cofinanced by a GEF grant which focuses on damage from earthquakes, floods toxic wastes and other hazards in high risk areas, and by a regional project on Trade and Transportation Facilitation in South East Europe.

9. Policy advice and support for reforms in the business environment have been offered by the Bank in several areas. Through PSAL1 and PSAL2 the Bank has focused on reducing barriers to entry for firms and joint ventures, implementing internationally recognized

accounting standards and introducing improved bankruptcy and liquidation procedures. The PALs will also address business environment issues, and all these initiatives will be supported by technical assistance provided under the PPIBL.

Areas in which the World Bank leads and its analysis serves as input into the IMF program

10. The Bank supports the GOR's privatization program through PSAL 2 which includes targets and timelines for privatization of commercial SOEs and financial institutions. The program builds on the progress established under PSAL 1 and identifies pools of SOEs from which set minimum numbers of enterprises are selected for case-by-case privatization and workout. Specific enterprises including Alro, Alprom, and Petrom, were also identified. Key to the success of this program is agreement with the Bank on strategies for the privatization of theses entities and the subsequent adoption of a clear, open and transparent tender process using the services of qualified investment advisors in a manner consistent with Bank policies.

11. The Bank has led the dialogue on restructuring, reform and eventual privatization of enterprises in the electricity, district heating and gas industries and on the adoption of regulatory legislation in preparation for privatization to strategic investors. As part of this process the Bank is supporting, inter alia, energy tariff reforms and the elimination of arrears in the electricity, district heat and gas sectors, and these objectives are woven into the policy conditions of PSAL 2, along with conditions related to the privatization of electricity distribution enterprises. These conditions have been closely coordinated with the IMF since the SBA also includes provisions for structural reforms in the energy sector including tariff setting, arrears clearance and collection rates. The Bank is leading the IFI dialogue with the Government on such critical long-term issues as power generation sector restructuring and the integration of the Romanian power sector with the South East European Regional Electricity Market and with the EU's electricity market, and provides assistance on the associated regulatory and market operation issues. The Bank has also provided technical assistance to the Ministry of Industry to establish a system of pricing and taxation of gas consistent with attracting further investment into the industry. Policy dialogue in these and other areas, notably including the district heating sector, will be further facilitated by ongoing dialogue with the Government on the recently completed Energy and Infrastructure Strategy paper and its operational recommendations. Again, the series of PALs will be used as vehicles for incorporating policy advice in these areas into Bank lending operations.

12. The Bank has taken the lead in dialogue and policy advice regarding regulation, restructuring, privatization and liquidation of banks. Under PSAL 1 the Law on Bank Privatization was modified and transparent privatization procedures established. Liquidity and solvency requirements of the NBR were tightened and provisions introduced for improved compliance with prudential regulations and external audits conducted according to International Accounting Standards. Legal and institutional reforms were introduced for orderly disposition of non-performing assets. These policy changes underpinned liquidation of the most troubled bank (Bancorex) while Bank Agricola was restructured and eventually privatized as were two smaller state owned banks. This policy agenda is continued under PSAL 2 with steps to complete the sale of Banca Comerciala Romana (BCR) and to restructure the Savings Bank (CEC). These initiatives have been supported by the IMF which

has included Stand-By performance criteria relating to privatization of BCR and prior actions related to NBR provisioning requirements. The Bank is continuing dialogue with the government on the need to move forward with further improvements of the legal and regulatory framework for the securities and insurance sectors as well as the banking sector. The PPIBL will provide funding for these activities.

Areas of shared responsibility

13. While the Bank has taken the lead in privatization and in structural reforms in the energy sector as described above, the IMF has a strong interest from a macroeconomic perspective since privatization revenues are used to retire public debt, and quasi-fiscal deficits of the SOEs present a threat to macroeconomic stability. Accordingly, there is high degree of consultation and coordination between the two institutions on these matters. The IMF has introduced into its SBA conditions relating to electricity tariff rates, arrears in gas and electricity collections as well as the privatization of a subset of the enterprises covered under the Bank's program. While the terms of the respective programs are mutually consistent and supportive, the focus and motivation for the Bank's program are on the efficiency of the resulting market structures, improved enterprise operation, service delivery and financial performance, and the transparency of the process and improvement in overall sector governance, and that of the IMF are on immediate revenue generation and expenditure control, and containment of ongoing fiscal burdens.

14. The Bank and the IMF jointly conducted a Financial Sector Assessment Program which was completed in June 2003.

Areas in which the IMF leads and its analysis serves as input into the World Bank program

15. While the Bank has focused on simplifications to the taxation system as a means of improving the business environment the Fund leads the dialogue on fiscal matters. In addition to the achievement of overall fiscal targets the Fund's Stand-By program includes structural benchmarks and performance criteria relating to introduction of new VAT and profits tax laws, increases in specific excises, and elimination of tax preferences under the customs duty and profit tax systems. The IMF is also providing technical assistance in support of unification of the payroll tax systems.

16. The IMF leads the dialogue on certain polices to contain certain expenditures in the public sector. These include policies regarding wage-setting in both the public service and SOEs. The IMF requires monitoring reports of the budgets of a set list of SOEs and has conditions in its Stand-By program relating to the containment of the wage bill in these enterprises and to the achievement of agreed layoff targets. In addition the IMF leads the discussions relating to requirements for disconnections of non-payers in the gas and electricity sectors.

17. In these areas the Bank takes into account the policy recommendations of the IMF and ensures that its own policy advice is consistent.

Areas in which the IMF leads and there is no direct World Bank involvement

18. The IMF is fully responsible for the dialogue on monetary policy, interest rates, the exchange rate regime, the balance of payments and all the related statistical and measurement issues.

World Bank Group Strategy and Lending Operations

19. A Country Assistance Strategy (CAS) for Romania was presented to the World Bank's Board on June 19, 2001. The CAS defines the Bank's lending and advisory services based on the Government's priorities of poverty reduction and EU accession, and builds on the work initiated under the Comprehensive Development Framework, for which Romania was one of the pilot countries. About one half of the FY02-04 lending program is adjustment lending. Two distinct lending scenarios were outlined. A low case in which Romania pursued a hesitant pace of reforms would result in significant reductions in Bank Group support to a level of $60 million during FY02-04 with actions centered on a few poverty focused interventions. However, Romania has successfully remained in the high-case lending scenario under which Bank commitments of up to $995 million during FY02-04 were envisaged, compared with $600 million in FY98-00. This reflects the fulfillment of the high-case triggers, which included progress in establishing a macroeconomic environment conducive to lower inflation and sustainable growth as well as progress on structural issues including privatization as initiated under PSAL 1, initiation of the privatization and work-out process for a number of remaining large state-owned enterprises, agreement on a plan and schedule for reducing energy arrears, agreement on a method and timetable for privatization of Romanian Commercial Bank and the Savings Bank, improvements in the financial sector legal and supervisory framework, an agreement on an anti-corruption strategy, and approval of social assistance legislation.

20. The high-case scenario embodies a program of accelerated structural and sectoral reforms that will pave the way for Romania's eventual accession to the EU. The first stage of this program has now been launched with the approval of PSAL 2 by the Bank Board in September 2002, and the delivery of the Public Expenditure and Institutions Review (PEIR) in July 2002. In the second stage to follow PSAL 2, the Bank would offer support through a series of Programmatic Adjustment Loans (PALs) focusing on institutional and governance reforms, completion of the privatization agenda, implementation of the recommendations of the Energy and Infrastructure Strategy Paper and improvements to the business environment, as well as a Country Financial and Accountability Assessment.

21. The World Bank has been active in Romania since 1991 and has built up a portfolio of 39 Bank-financed operations with total commitments of US$3.9 billion. Romania's portfolio is the second largest in ECA in terms of number of projects and the third largest in terms of commitments. The active portfolio as of September 8, 2003 consists of 23 projects with aggregate net commitments totaling $1,434.1 million and a total undisbursed balance of $837.5 million. Sector composition in terms of net commitments is dominated by energy and infrastructure (30 percent, seven projects) and the social sectors (26 percent, also six projects).

22. The quality of the Bank's Romania portfolio has been improving over the past several years. While the overall performance indicators are positive, several cross-cutting implementation issues persist. These include: (i) the need for special attention to monitoring and evaluation capacity building; (ii) the need to align financial reporting requirements with international best practice; and (iii) the need to strengthen the Government's budget priority-setting process, to ensure adequate IBRD loan disbursements and counterpart funding, in order to yield maximum development impact from the Bank's portfolio.

23. IFC has dedicated substantial resources to implementing a strategy intended to advance structural reform, assist the development of capital markets and infrastructure (utilities and telecommunication), and provide support for small and medium enterprises (SMEs). To date, IFC has approved over US$200 million, in 25 projects amounting to over US$950 million (including regional projects investing in Romania). In addition to investments, IFC has undertaken a number of advisory assignments aimed at supporting the privatization and restructuring of large state-owned enterprises, public utilities and the health sector. The degree of IFC's future success will be dependent to an extent on the Government's willingness to demonstrate a sustained commitment to accelerated reform, particularly with regard to transparency in enterprise privatization, reform of the banking and financial sector, restructuring and deregulation of the energy sector, fiscal decentralization, land privatization and continued reform of the agricultural sector, access to quality education in rural areas, and reform of the pension system to ensure sustainability in the context of an aging population. The ultimate success will also be dependent upon the ability of Romania to attract foreign direct investment.

Questions may be referred to Ron Hood (473-0115) or Myla Williams (473-6997)

ROMANIA: STATISTICAL ISSUES

1. Romania's data collection and reporting is adequate for surveillance and program monitoring. The authorities have made some progress in improving their statistical base with the help of Fund TA missions, although more needs to be done, in particular in the areas of balance of payments and fiscal statistics, and the consistency between monetary and fiscal data. Romania has participated in the GDDS since February 2001. The November 2000 STA mission assisted the authorities in preparing GDDS metadata. The mission also prepared a data module for the ROSC, which is posted on the IMF website. A STA monetary and financial statistics mission visited Bucharest during May 11–23, 2003 to review the status of the GDDS *Plans for Improvement* for the National Bank of Romania (NBR) and assist in adopting the recommendations of the IMF's *Monetary and Financial Statistics Manual (MFSM)*.

Real Sector

2. The national accounts statistics produced by the National Institute for Statistics (INS) for quarterly and annual series on Gross Domestic Product (GDP) are methodologically sound and are reported timely for the *IFS* publication. However, harmonization of quarterly and annual national accounts is not done on a regular basis and late revisions can sometimes be significant The INS has moved to update the framework from the European System of Accounts 1979 (ESA79) to ESA95, and data based on ESA95 were released at the end of 2000. Constant price estimates are in the process of being converted to annual chain-linked indices, as recommended by the "1995 ESA". The INS staff has been downsized significantly over the past two years, which might affect the quality and timeliness of the data.

3. The Consumer Price Index (CPI) is subject to the standard annual re-weighting, and it is considered to be reliable. On the advice of technical assistance under the PHARE Program of the EU,, the INS reduced the coverage of the Producer Price Index (PPI) from the value of all shipments of the covered industries to shipments for domestic uses only beginning with 1998 data.

Public Finance

4. Consolidated data on central government operations are reported yearly for the *GFS Yearbook* and reported quarterly for *IFS*, while the EU1 department receives monthly budget data. A multi-sector statistics mission visited Romania in December 1999 and recommended that all major fiscal categories be reported on a quarterly and monthly basis. The mission also called for the documentation and reporting of all government transactions related to the Agency for Bank Asset Recovery (AVAB)which has received large amounts of nonperforming bank claims in exchange for the bank receipts of government securities. The multi-sector mission also recommended the introduction of detailed financing and debt classifications in the Treasury's chart of accounts and budget classifications. These recommendations have not yet been implemented Work continues on the establishment of a new aid coordination unit to monitor data on grants.

Monetary and Financial

5. The NBR reports monetary and financial statistics for *IFS* on a regular and timely basis. The overall assessment of the May 2003 monetary and financial statistics mission is that the NBR has implemented important recommendations of previous STA missions in the area of monetary statistics. The monetary statistics compiled and disseminated by the NBR meet, and in some instances exceed, the recommendations of the GDDS with respect to coverage, periodicity, and timeliness of dissemination. As regards coverage and periodicity, the data categories in the financial sector also meet the SDDS prescriptions. In terms of timeliness, the current dissemination lag of eight weeks for both data on central bank positions and the banking system do not meet the relevant SDDS specifications of two weeks and four weeks, respectively.

6. Monetary statistics needs to be reconciled with government finance statistics. In line with *1993 SNA* and *MFSM*, accrued interest on deposits loans, and securities other that shares should be incorporated in the outstanding amount of financial asset or liquidity.

7. With the gradual harmonization of Romania's monetary and financial statistics with the *1995 ESA* and ECB statistical reporting requirements, important deviations from the IMF's statistical methodology are expected to diminish over time as a result of the strong concordance among the *1995 ESA*, *1993 SNA*, and *MFSM*.

Balance of Payments

8. The NBR routinely reports balance of payments statistics in a timely fashion. Data collection and compilation have improved following technical assistance. The ROSC data module of November 2001 noted particular concerns with the coverage of the direct investment data (stocks and flows) and related income flows, and with the quality of data on *current transfers*, in particular with the *general government* sector. The NBR has decided to adopt a new balance of payments compilation system in consultation with Eurostat. In July 2003, a BoP Statistics mission has concluded that the new proposed system is broadly appropriate. Among other recommendations, the mission suggested to target implementation of the new system in 2004, including the conduct of the new FDI survey. A switch from annual to quarterly frequency in the outward portfolio survey could also be considered for implementation in 2004 as also the collection of stock data on equity liabilities via the National Commission of Securities..

Table 1: Romania: Core Statistical Indicators
as of September 5, 2003

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	Sept. 5, 2003	Sept. 5, 2003	Jul. 2003	Sept. 5, 2003	Jul. 2003	Jun. 2003	Jul. 2003	Jul. 2003	Jun. 2003	Jul. 2003	2003 Q2	May 2002
Date Received	Sept. 5, 2003	Sept. 5, 2003	Aug. 2003	Sept. 8, 2003	Aug. 2003	Aug. 2003	Aug. 9, 2003	Aug. 2003	Aug. 2003	Aug. 2003	Sep. 2003	Jul. 2003
Frequency of Data	Daily	Daily	Monthly	Daily	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly
Frequency of Reporting	Daily	Daily	Monthly	Bi-Weekly	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly
Source of Update	National Bank of Romania/ Bloomberg	National Bank of Romania	National Bank of Romania	National Bank of Romania	National Bank of Romania	National Bank of Romania	National Institute of Statistics	National Institute of Statistics	National Bank of Romania	MoF	National Institute of Statistics	National Bank of Romania/ MoF
Mode of Reporting	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic
Confidentiality	Published	Published	Published	Published	Published	Published	Published	Published	Published	Published	Published	Published
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Monthly	Quarterly	Quarterly

The Conundrum of Romania's District Heating System

In Romania, district heating is the most common form of delivering heat in urban areas. Heat is generated in either coal, gas or oil-fired plants and distributed through pipes to apartment blocks. Prices are regulated by the government, which provides producer subsidies and means-tested transfers to low-income households, equivalent to 2/3 percent of GDP in 2003. In addition, public sector loses another ¼ percentage point of GDP as a result of weak collections (see below).

A recent study commissioned by the World Bank has underscored that the system is highly inefficient and expensive, owing to large technical losses and weak market incentives. As a result of high costs and low incomes, about ¾ of households using district heating spend over 10 percent of their annual net income on heating bills. Without consumer subsidies, they would be in heating poverty, according to the World Health Organization criterion.

Households do not have the possibility of regulating the quantity of heat they receive, as there is a lack of regulatory devices and meters. Heat distribution between apartments is uneven, implying substantial waste and low incentives to save on energy. Meanwhile, producer subsidies discourage cost-cutting measures and efficiency-enhancing investments.

The system suffers from widespread payment indiscipline at all levels. The aggregate collection rate of the main heating producers has remained disappointingly low, at below 80 percent. As a result, losses reached about ¼ percent of GDP in 2002.

The government lacks a clear strategy. Efforts are now focused on several sizable projects to upgrade generation and reduce losses, but their cost-efficiency remains to be assessed. The government is also considering the split of heating generation from distribution systems, and to possibly privatize parts of these activities. It also agrees that some units will need to be closed and households offered assistance in installing alternative sources of heating. However, concrete plans remain to be spelled out.

Stronger actions to improve financial discipline across the sector are needed. These include an acceleration of metering (both individual and for apartment blocks) and firmer measures against bad-payers. Finally, a case can be made for switching completely from producer subsidies to means-tested support to households, which would strengthen incentives to cut costs and improve efficiency. However, anecdotal evidence suggest that greater efforts are needed to simplify application procedures for household subsidies, as in the current situation many households simply opt for non-payment.

October 3, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

The attached Supplementary Memorandum on Economic and Financial Policies (SMEFP-3) specifies understandings reached with staff in discussions on the completion of the fourth and final review of our program supported by a Stand-By Arrangement (SBA). Since the start of the program in October 2001, macroeconomic imbalances in our economy have been sharply reduced and structural reforms have advanced as well. All this was achieved in an environment of high growth and rising real incomes.

Macroeconomic developments in the first half of 2003 were generally favorable. We brought inflation down to 14.2 percent in August 2003, overperforming relative to projections. After a sharp reduction in 2002, the current account deficit somewhat exceeded the program target in January–June 2003, but we believe that the implemented policy adjustments will keep it contained within prudent limits. While the increase in foreign reserves lagged behind the program target, the recent improvement in market conditions makes us confident that the annual target for reserve accumulation will be achieved.

The SMEFP-3 specifies corrective measures, most of which are already implemented, to address the nonobservance of three quantitative and one structural performance criteria, for which we request waivers. Based on this, and the observance of other performance criteria under the program, we are requesting the completion of the fourth review under the arrangement.

We believe that the policies and measures described in the attached memorandum are sufficient to achieve the objectives of this program, but we will take any further measures that may become appropriate for this purpose. We will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the original MEFP, the SMEFP-1, SMEFP-2, and SMEFP-3, in accordance with the Fund's policies on such consultation. Moreover, we will continue discussions on a successor arrangement with a view to ensure sustainable macroeconomic developments in 2004.

Yours sincerely,

/s/	/s/
Mihai Tanasescu	Mugur Isarescu
Minister of Public Finance	Governor
Ministry of Public Finance	National Bank of Romania

Supplementary Memorandum on Economic and Financial Policies

I. Introduction

1. **Since the conclusion of the third review on April 25, 2003, we have made progress toward achieving the main macroeconomic objectives of our program.** However, higher imported energy prices have increased energy sector losses, and the weaker external environment and stronger domestic demand have put pressure on our current account and international reserve targets. These developments have prompted us to implement the corrective measures specified in this memorandum, which supplements the original memorandum as well as the previous two Supplementary Memoranda.

II. Background and Request for Waivers for Non-Observance of Performance Criteria

2. **While strong macroeconomic performance has continued in 2003, domestic demand pressures have recently emerged.** GDP growth slowed to 4.3 percent in the first half of 2003, reflecting slightly weaker export growth, following a period of exceptionally strong performance. At 14.2 percent in August, CPI inflation fell faster than expected, while rapid economy-wide wage growth and buoyant private sector credit led to a surge in imports, both for capital investment and household spending. As a result, the current account deficit reached 2½ percent of annual GDP in the first semester, exceeding projections by some ¼ percent of GDP. Delayed public and private sector borrowing slowed reserve accumulation in H1, but since then we have restarted purchases in the market and have maintained a comfortable import cover, equivalent to 3.7 months of prospective imports as of end-August.

3. **Fiscal policy has been on track.** The deficit target for the general government in the first half of the year was met with a considerable margin. Restrained spending and interest savings more than offset weaker social security collections.

4. **A temporary reversal in capital flows created difficulties for monetary policy.** Facing lower-than-expected public and private sector borrowing in January-June, the NBR accepted some US$250 million loss in reserves, while keeping its interest rate steady and managing the exchange rate in line with the program. In our view, the net outflows and the concomitant excess demand in the foreign exchange market were temporary and at that time did not appear to warrant policy tightening. However, compounded by the widening trade deficit, the end-June NFA of the NBR fell short of the program target by US$625 million, and the NDA target was exceeded by over 20 percent. Gross reserves have recently been replenished with the successful placement of a €700 million sovereign bond and the resumption of the NBR's market purchases in July-September. On the basis of the policy adjustments specified in paragraph 23, we request waivers for the non-observance of these performance criteria.

5. **Credit to the non-government sector accelerated further.** While the new regulation on loan classification and provisioning introduced in January brought Romanian bank standards in this area in line with international practice, it did not moderate banks'

appetite for higher loan exposure as expected. The differentiation of reserve requirements in favor of lei assets, effective as of November 24, led to an increase in lei lending, but foreign currency credit has slowed only slightly since February, resulting in an overall credit expansion of 40 percent in real terms as of June 2003. Nevertheless, the major banks remain well-capitalized and liquid, and provisioning against credit risk is now adequate.

6. **Progress in reducing energy sector losses has slowed in 2003.** We have kept electricity and heating tariffs indexed to the dollar, as envisaged under the program, but owing to rising fuel prices and the depreciation of the dollar, these tariffs have fallen below cost-recovery levels. Similarly, while we raised the end-user price of natural gas beyond our original plans on July 1, the price of imported gas has increased further, sharply reducing wellhead prices paid to domestic producers. Collection rates of gas and electricity distributors have been in line with the program and are now above 95 percent. Collection in the heating sector has remained weak, however, reflecting non-payment of subsidies by local governments and disruptions in heating sector policy. As a result, the performance criterion on the collection rate of Termoelectrica was missed by 2½ percentage points. Given the corrective actions taken to reduce losses in the energy sector (paragraphs 16–17), we request a waiver for the non-observance of this performance criterion.

7. **The January minimum wage increase and cuts in social security contribution rates have resulted in rapid real net wage growth.** Net average wages in both the economy and the monitored SOEs increased by about 9 percent in real terms in the first half of 2003. While large-scale employment reduction in SOEs slated for privatization allowed us to meet our June target on the SOE wage bill, recent wage acceleration, and attempts by some companies to divert savings from outsourcing a large number of employees to increasing wages has put at risk the September and December targets. Measures to slow down SOE wage growth, which could endanger our 2003 macroeconomic objectives, are described in paragraphs 14–15.

8. **We have made notable progress in privatizing companies under the Authority for Privatization.** We implemented over 22,000 layoffs in these companies, thus meeting the end-June structural PC. Moreover, we signed contracts for the sale of seven large companies in Q2, compared with the structural benchmark of six. However, some of these contracts remain to be executed after agreement has been reached on rescheduling their arrears to energy suppliers. We currently have three large companies in the final negotiation phase and expect to sell them by end-September.

9. **Privatization in the energy sector is taking more time than initially thought.** We received only one non-binding offer for two electricity distribution companies, and are currently in negotiations with the bidder. Delays in approving the privatization strategy for Petrom, the largest company in the country, have resulted in missing our deadline for issuing the tender (June 30). The privatization schedule for the two gas distributors has been pushed backward by six months as the consultant's contract was finalized with a long delay.

10. **The negotiations on the EBRD's and the IFC's equity participation in the largest bank BCR commenced in late July.** Although technical work has proceeded well, more time than envisaged was needed to finalize the due diligence and hold additional discussions on the bank's institution-building plan, resulting in the non-observance of the end-July structural performance criterion.

III. Policy Measures Agreed in the Context of the Fourth Review

11. **Our main macroeconomic objective for 2003 is to consolidate macroeconomic stabilization, which requires moderation of domestic demand and decisive progress in reducing re-emerging energy sector losses.** Despite recent overperformance in disinflation, we maintain our original inflation target of 14 percent for end-2003, as soon-to-be-implemented energy price increases are likely to result in temporary inflation pressures. The current account deficit in 2003 is now projected somewhat higher, at 4¾ percent of GDP, reflecting higher-than-projected wage growth and rapid credit expansion, as well as slowing export demand. Reaching this target requires reducing the broader public sector deficit by about ¼ percent of GDP in the second half of the year, coming from reducing SOE losses. The lower reserve import cover of 3.7 months reflects higher projections for prospective imports, as a result of the import expansion in 2003. We expect that GDP growth will be about 4¾ percent in 2003. Performance in meeting the quantitative performance criteria and indicative targets under the program is presented in Table 1. Table 2 contains the list of prior actions for completing the review and Table 3 outlines our energy price intentions.

A. Fiscal Policy

12. **Despite weaker-than-projected revenue and substantial additional expenditure, the supplementary 2003 budget approved in late-August reduced our deficit target to lei 48,920 billion (2.7 percent of GDP):**

- Owing to a shortfall of revenues compared to the original budget of lei 7,733 billion, primarily reflecting weaker-than-expected pension fund collections, and the reduction in the deficit target, we cut expenditures of the general government in the supplementary budget by lei 8,333 billion. Separately, we will cancel arrears of the transport and mining sectors to the general consolidated budget in an amount of lei 1,700 billion and lei 2,500 billion, respectively, while respecting EU state-aid procedures.

- Moreover, the supplementary budget accommodated additional expenditure equivalent to about 1 percent of GDP, most notably the severance payments under the labor retrenchment program, the doubling in heating-related transfers to low-income households, the payments for utility bills of SOEs that would otherwise have to be disconnected, and additional agricultural subsidies to mitigate the impact of the drought. We have also provided resources in an amount of lei 4,000 billion for the repayment of health institution arrears accumulated in 2002. Should it turn out that the arrears of the health system exceed this amount, we will approve by October 10, 2003 a second supplementary budget providing for the necessary resources. To ensure full transparency of the outstanding arrears in the health system and amounts already cleared, we published at end-August 2003 the report prepared by the National Control Authority (prior action).

- The revenue shortfall and the additional expenditure will be financed by savings in an amount equivalent to about 1½ percent of GDP, in particular savings in interest expenditures, pension fund expenditure, unemployment fund expenditure, a reduction in capital expenditure and material expenditure, lower-than-forecasted compensatory payments for the non-restitution of land and buildings under Law 10/2001, and the slower-than-expected disbursement of EU grants.

13. **The implementation of the comprehensive tax administration reform will continue.** We established a tax administration department in the Ministry of Public Finance in early 2003, which will be transformed on January 1, 2004 into a national agency for tax administration to which all regional tax administration directorates will be directly subordinated. Moreover, we have decided to implement the unification of the collection, audit, and enforcement of social security contributions under the Ministry of Public Finance in four steps: (a) Audit and enforcement will be moved to the Ministry of Public Finance by January 1, 2004; (b) we will establish the joint administration of files for large taxpayers by April 1, 2004; (c) we will establish the joint administration of files for small- and medium-size companies by August 1, 2004; (d) we will establish the joint administration of files for self-employed by January 1, 2005. The transfer of the collection function will proceed gradually during 2004.

B. Wage Policy

14. **We have decided to implement some adjustments, necessary to meet our wage bill targets for the remainder of the year.** First, to prevent a number of companies under the Ministries of Transportation and Agriculture from exceeding their original budgeted wage bills, we will eliminate Christmas bonuses and reduce overtime and night-shift payments as appropriate. Moreover, we decided to lay off 19,300 workers in five railway companies and their subsidiaries (prior action), although we have later reduced this number to 16,500 while implementing offsetting measures to reduce wages in other companies. We have also laid off 4,000 workers in two agricultural companies between August 1 and September 15, 2003 (prior action). Second, as large-scale layoffs in a number of cash-poor companies under the Authority for Privatization have resulted in significant wage bill savings, we have already adjusted these companies' budgeted wage bills down by lei 175 billion and will use the money for paying utility bills. Finally, to prevent the use of wage bill savings resulting from outsourcing a large number of employees for sizable wage increases of the remaining employees, we will cut the budgeted wage bills in a number of industrial companies by lei 375 billion, with the corresponding adjustment in budgeted employment (prior actions). All these measures are expected to result in overall wage bill savings of about lei 900 billion, an amount sufficient to ensure compliance with the annual wage bill target.

Details on the execution of these operations are specified in the *Technical Memorandum of Understanding* (TMU).

15. **To strengthen the wage bill target's ex-ante credibility, we will immediately implement several measures.** We have blocked 4 percent of the Q3 and Q4 wage bill in the monitored SOEs, which can only be released upon approval of the responsible Minister, after it becomes clear that the respective quarterly target will be reached (prior action). We have also imposed a complete hiring freeze in all monitored companies, except for unique positions, which cannot exceed 200 new employees in total from August 1 to December 31, 2003 (prior action).

C. Energy Sector Reforms

16. **To improve the financial performance of the energy sector, we adjusted administered prices as of September 1, 2003 (prior actions), and will implement further measures to reform the pricing system in the energy sector (Tables 2 and 3).** To offset losses resulting from higher-than-projected import prices and as a further step toward reaching import parity, we approved a decree on August 18 raising the end-user gas price by 22.5 percent for residential users and by 12.3 percent for non-residential users, which at the time of the decision was intended to result in a U.S. dollar equivalent of US$120/tcm for residential consumers and US$110/tcm for non-residential consumers (prior action), with a view to ensuring a producer (wellhead) price of over US$50/tcm. In line with our commitment to gradually adjust gas prices every quarter with a view to reaching import parity by 2007, we will implement another adjustment of 4 percent in lei prices for residential and non-residential users on November 1, 2003. We will announce, by end-2003, the schedule of future adjustments in gas prices in line with our commitment to reach import parity by 2007, which we consider crucial for providing incentives for new exploration, as recommended in a recent World Bank study, and for facilitating the privatization of Petrom.We also intend to reform the pricing scheme in the gas sector, to avoid having producer prices determined as a residual after import, distribution and storage costs. To mitigate the social impact of the price adjustment, we will provide sufficient budgetary resources for well-targeted transfers to low-income households. To restore cost-recovery pricing, we increased Termoelectrica's electricity tariff by 15 percent and its heating tariff by 14 percent on September 1 (prior action). We also raised all distribution tariffs for electricity by 16 percent, and all end-user electricity tariffs by 17½ percent (prior action). To mitigate the effects of higher energy bills on the most vulnerable households, we have provisioned in the supplementary 2003 budget an increase in the corresponding support allowance by lei 1,300 billion.

17. **We will strengthen the fight against the nonpayment of utility bills.** We will strictly enforce the disconnection deadlines for both electricity and gas payments, as specified in the TMU. However, throughout 2003, the budget will continue to assume payments of energy bills for a few large loss-makers (Siderurgica, Tractorul, Roman, ARO, C.M. Petrosani, Minvest and Remin), the disconnection of which would be socially disruptive. We will also intensify our efforts to improve collection from households,

particularly on heating bills. For that purpose, we will enforce seizure of assets of nonpayers through the judiciary system, as specified in Government Decision 400/2003. Moreover, to ensure full payment of the subsidies to local heating distributors by the local authorities, we will implement the following measures: (a) for a small and predetermined number of local authorities in disadvantaged areas, we will increase the share of the state budget in the total heating subsidies up to 100 percent; and (b) the transfer from the central government to the local authorities of their share in income tax revenue will be contingent on the full payment by the local authorities of the subsidies to the district heating companies.

18. **We will speed up the restructuring of the mining sector.** In the first half of 2003, we already cut employment in the sector by 4,744 positions. We have also decided to implement additional layoffs of 1,500 employees in the sector before September 15, 2003. In addition, we raised the price of hard coal to the equivalent of $11/Gcal as of September 1, 2003, a level close to import parity (prior action).

19. **We will achieve tangible progress in energy sector privatization, building on recommendations from the World Bank.** We will invite a binding offer for the ongoing privatization of two electricity distribution companies by end-November, 2003. In close consultation with the World Bank, we will speed up the elaboration of the privatization strategy for the two gas distributors and approve it by November 1, 2003. After finalizing our discussions with the World Bank on the privatization strategy for Petrom, we issued the tender for expressions of interest on August 26, 2003 (prior action), with a view to sign the sale contract before end-March 2004.

D. Privatization and Liquidation

20. **We will persevere in our privatization efforts.** By September 30, we will finalize the twelve large privatization deals concluded in the first half of 2003 by facilitating the achievement of debt rescheduling agreements between these companies and the energy utilities. We will sell three companies with more than 1,000 employees by end-September.

21. **We will initiate liquidation procedures against companies with particularly weak financial results.** By September 15, the Authority for Privatization will submit the liquidation files for Rulmenti Slatina and Verachim to court. As regards the perennial large loss-makers ARO and Roman, if no sale purchase agreements for the privatization of these two companies are initialed, the Managing Board of APAPS will make a formal decision to start the liquidation of these two companies by September 25, 2003 (prior action).

22. **We remain firmly committed to completing the sale of a minority share package in BCR to the EBRD and IFC.** On September 19, we agreed with the EBRD and IFC on the contract (prior action), which was approved by the cabinet on September 25. We now expect the EBRD and IFC boards to approve the operation in late October or early November.

E. Monetary Policy and Banking Issues

23. **Monetary policy will continue to pursue gradual disinflation, a strategy which has delivered positive results.** The NBR will guide the exchange rate along a path consistent with our inflation target and a sustainable real appreciation, considering movements of the leu against the euro/U.S. dollar basket. Following this policy under the recently re-emerging excess supply on the foreign exchange market, as well as achieving the targeted international reserve accumulation (paragraph 11) would require sizable (sterilized) purchases in the remainder of 2003. To fight off second-round effects from the forthcoming energy price increases, as well as to moderate booming credit, the NBR raised the interest rate by one percentage point on August 6; should this prove insufficient, the Bank will raise rates further or take other appropriate measures.

24. **We realize that accelerating credit to the non-government sector poses increasing macroeconomic and financial risks.** In addition to raising the policy interest rate, the NBR will continue to exercise close supervision of the most active lenders, including intensified on-site inspections, to ensure adequate credit risk assessment. If necessary, it will impose credit restrictions on imprudent risk-takers. The NBR will conduct stress tests on banks' portfolio on a high-frequency basis, using the methodology developed in the context of the FSAP.

F. Business Climate and Governance Issues

25. **Our efforts to improve the business climate and eliminate corruption continue.** In cooperation with the World Bank, we will evaluate the impact of the new Labor Code on the labor market and employment and amend it accordingly. We will conduct all privatizations in an open and transparent manner and refrain from introducing measures that impose a burden on private investors. On September 12, we published a report on our efforts to prosecute individuals involved in financial wrongdoings, including FNI, Banca Romana de Scont, and other recent cases (prior action).

Table 1. Romania: Quantitative Performance Criteria and Indicative Targets for 2001-03 1/

	End-Dec. 2001			End-March 2002			End-June 2002				End-Sept. 2002				End-Dec. 2002			
	Prog.	Adj.	Act.	Prog.	Adj.	Act.	Prog.	Rev. prog.	Adj.	Act.	Prog.	Rev. prog.	Adj.	Act.	Prog.	Rev. prog.	Adj.	Act.
(In trillions of lei)																		
1. Ceilings on the Average Net Domestic Assets of the National Bank of Romania	-48.1	-44.0	-49.7	-56.2	-51.0	-61.3	-61.4	-85.6	-84.8	-89.7	-67.0	-79.8	-77.0	-94.2	-73.3	-80.6	-91.2	-104.1
(In millions of U.S. Dollars)																		
2. Floors on Net Foreign Assets of the National Bank of Romania	3,527	3,396	3,725	3,601	3,444	3,923	3,816	4,534	4,391	4,588	3,924	4,702	4,497	4,965	4,094	4,838	4,800	5,257
(In trillions of lei)																		
3. Ceilings on the Deficit of the General Government	38.754	38.754	38.615	9.940	9.797	6.803	19.872	20.772	20.673	17.862	31.104	32.704	32.704	24.109	43.200	43.200	43.200	39.827
4. Ceilings on Aggregate Wage Bills of Monitored State-owned Enterprises 2/ 6/	40.7	40.7	41.6	9.4	9.4	11.1	21.28	23.60	22.68	23.13	34.88	36.04	33.99	35.16	49.48	49.20	45.25	46.43
5. Indicative Targets for Ceilings on Arrears of Monitored State-owned Enterprises to the Consolidated General Government	52.5	40.2	49.2	51.7	39.4	52.8	...	...	...	...	...	...			...	...	...	...
(In percent)																		
6. Floors on Cumulative Aggregate Collection Rates of: 3/																		
a. Distrigaz Nord and Distrigaz Sud (aggregate)	95.0	95.0	80.9	97.5	97.5	93.3	97.5	83.0	...	95.4	97.5	87.0	87.0	97.1	97.5	90.0	90.0	98.8
- Distrigaz Nord (indicative target)						...		85.0	...	95.6		87.0	87.0	96.7		90.0	90.0	98.2
- Distrigaz Sud (indicative target)						...		83.0	...	95.2		87.0	87.0	97.4		90.0	90.0	99.2
b. Termoelectrica, including transferred units (aggregate of electricity and heating)	95.0	95.0	83.4	97.5	97.5	84.6	97.5	85.0	...	85.2	97.5	87.5	87.5	89.8	97.5	90.0	90.0	90.7
- Aggregate of Termoelectrica and transferred units in electricity (indicative target)						...		87.5	...	87.6		90.0	90.0	94.3		92.5	92.5	94.4
- Termoelectrica district heating (indicative target)						...		82.0	...	76.2		84.0	84.0	76.1		86.0	86.0	74.2
- Heating in the transferred units (indicative target)	...	...	...	...		...	...	82.0	...	80.0	...	84.0	84.0	80.8	...	86.0	86.0	87.5
c. Electrica (indicative target)			92.9			92.2		92.5	...	90.5		92.5	92.5	93.2		92.5	92.5	93.7
(In billions of lei)																		
7. Ceilings on Assumption of Enterprise Debt to Banks and Issuance of Domestic Guarantees Extended by Government	469	469	469	1,110	1,110	469	1,110	1,110	1,110	469	1,110	1,110	1,110	1,106	1,110	1,110	1,110	1,101
(In millions of U.S. Dollars)																		
8. Ceilings on Contracting or Guaranteeing of External Debt 4/																		
a. One-year or less maturity	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
b. More than one- and up to three-year maturity	300	300	240	300	300	7	400	400	400	119	450	450	450	144	600	600	600	171
Of which: off-budget	165	165	11	10	10	0	15	15	15	0	20	20	20	4	20	20	20	11
c. More than one-year maturity	2,800	2,800	2,356	1,000	1,000	206	1,200	1,200	1,200	1,294	1,800	2,000	2,000	1,452	3,400	3,600	3,600	2,915
Of which: off-budget	165	165	156	50	50	17	75	75	75	17	100	300	300	41	100	300	300	299
(In trillions of lei)																		
9. Indicative Targets for Ceilings on Average Reserve Money	63.1	63.0	66.0	62.2	62.1	67.4	69.4	75.0	71.0	70.9	73.3	80.4	76.1	77.2	79.4	89.2	77.2	79.7
10. Indicative Targets for Ceilings on Broad Money	252.2	252.2	271.9	258.9	258.9	277.0	280.0	294.0	294.0	303.9	293.5	311.1	311.1	322.7	323.7	350.3	350.3	378.7
11. Indicative Targets on Banking Sector Exposure to State-owned Enterprises 5/	29.1	29.1	33.4	30.7	30.7	38.6	32.5	36.2	36.2	37.2	34.6	38.1	38.1	38.3	36.3	43.4	43.4	49.4
Of which: BCR Exposure	14.5	14.5	16.9	15.3	15.3	18.8	16.2	17.2	17.2	17.7	17.2	18.2	18.2	17.3	18.0	20.4	20.4	19.8

1/ The performance criteria and indicative targets envisaged under the program are defined in the Technical Memorandum of Understanding (TMU).
The figures in bold for end-December 2001, end-March 2002, end-September 2002 (revised program), end-December 2002 (revised program) and end-June 2003 are performance criteria, unless indicated otherwise, while end-June 2002, end-March 2003 and end-September 2003 figures are indicative targets.
2/ Adjusted to reflect the decrease in the pool of monitored companies, owing to privatization and mergers, from 86 to 82 in 2002 and to 76 in 2003.
3/ The definition of the collection rates was changed for June 2002 and afterwards, as defined in the TMU. The June 2003 target for Electrica becomes a performance criterion.
4/ Nonaccumulation of external payments arrears of the government will be a performance criterion monitored on a continuous basis.
5/ The higher-than-targeted end-December 2002 outcome reflects bank guarantees for investment in a Bucharest hospital and in the communication sector, as well as a higher share of domestic versus foreign borrowing by the energy sector.
6/ After it became clear that the target for December 2002 would be missed, the staff and the authorities agreed on a new target of lei 50.3 trillion (adjusted target of lei 46.35 trillion), which was to be met as a prior action.

Table 1. (continued) Romania: Quantitative Performance Criteria and Indicative Targets for 2001-03 1/

	End-March 2003			End-June 2003			End-Sept. 2003		End-Dec. 2003	
	Prog.	Adj.	Act.	Prog.	Adj.	Act.	Prog.	Rev. prog.	Prog.	Rev. prog.
1. Ceilings on the Average Net Domestic Assets of the National Bank of Romania	-85.7	-97.0	-89.2	-106.8	-102.6	-79.4	-114.0	*-78.2*	-106.7	*-74.0*
2. Floors on Net Foreign Assets of the National Bank of Romania	5,522	5,460	5,270	6,075	5,544	4,919	6,410	*5,709*	6,310	*5,797*
3. Ceilings on the Deficit of the General Government	10.600	10.600	6.508	22.352	22.352	16.623	31.309	*31.309*	49.520	*48.920*
4. Ceilings on Aggregate Wage Bills of Monitored State-owned Enterprises 2/	12.84	12.72	12.38	26.50	25.75	25.22	39.82	*39.82*	53.15	*53.15*
5. Indicative Targets for Ceilings on Arrears of Monitored State-owned Enterprises to the Consolidated General Government	...			...			...		...	
6. Floors on Cumulative Aggregate Collection Rates of: 3/										
a. Distrigaz Nord and Distrigaz Sud (aggregate)	94.0	94.0	101.0	95.0	95.0	97.5	95.0	*95.0*	96.0	*96.0*
- Distrigaz Nord (indicative target)	94.0	94.0	101.2	95.0	95.0	96.6	95.0	*95.0*	96.0	*96.0*
- Distrigaz Sud (indicative target)	94.0	94.0	101.0	95.0	95.0	98.2	95.0	*95.0*	96.0	*96.0*
b. Termoelectrica, including transferred units (aggregate of electricity and heating)	91.0	91.0	88.2	91.0	91.0	88.5	93.5	*90.0*	95.0	*91.0*
- Aggregate of Termoelectrica and transferred units in electricity (indicative target)	94.0	94.0	92.5	94.0	94.0	92.9	96.0	*94.0*	97.0	*95.0*
- Termoelectrica district heating (indicative target)	84.0	84.0	73.2	84.0	84.0	76.0	89.0	*78.0*	92.0	*80.0*
- Heating in the transferred units (indicative target)	84.0	84.0	82.3	84.0	84.0	81.4	89.0	*83.0*	92.0	*85.0*
c. Electrica	94.0	94.0	94.1	95.0	95.0	95.7	96.0	*96.0*	97.0	*96.0*
7. Ceilings on Assumption of Enterprise Debt to Banks and Issuance of Domestic Guarantees Extended by Government	1,410	1,410	1,033	1,510	1,510	1,028	1,610	*1,610*	1,710	*1,710*
8. Ceilings on Contracting or Guaranteeing of External Debt 4/										
a. One-year or less maturity	0	0	0	0	0	0	0	*0*	0	*0*
b. More than one- and up to three-year maturity	300	300	2	400	400	7	450	*450*	600	*600*
Of which: off-budget	10	10	0	15	15	0	20	*20*	20	*20*
c. More than one-year maturity	805	805	549	2,094	2094	1,018	2,645	*2,645*	3,400	*3,400*
Of which: off-budget	360	360	334	500	500	340	600	*600*	650	*650*
9. Indicative Targets for Ceilings on Average Reserve Money	96.2	82.9	85.4	103.4	89.1	90.1	115.0	*110.6*	124.9	*123.6*
10. Indicative Targets for Ceilings on Broad Money	385.7	385.7	370.4	415.5	415.5	397.9	448.0	*413.0*	506.2	*471.6*
11. Indicative Targets on Banking Sector Exposure to State-owned Enterprises	49.7	49.7	49.0	51.5	51.5	52.6	53.2	*53.3*	59.8	*60.1*
Of which: BCR Exposure	22.4	22.4	21.0	23.3	23.3	23.2	23.9	*24.1*	27.3	*27.4*

1/ The performance criteria and indicative targets envisaged under the program are defined in the Technical Memorandum of Understanding (TMU).
The figures in bold for end-December 2001, end-March 2002, end-September 2002 (revised program), end-December 2002 (revised program) and end-June 2003 are performance criteria, unless indicated otherwise, while end-June 2002, end-March 2003 and end-September 2003 figures are indicative targets.

2/ Adjusted to reflect the decrease in the pool of monitored companies, owing to privatization and mergers, from 86 to 82 in 2002 and to 76 in 2003.

3/ The definition of the collection rates was changed for June 2002 and afterwards, as defined in the TMU. The June 2003 target for Electrica becomes a performance criterion.

4/ Nonaccumulation of external payments arrears of the government will be a performance criterion monitored on a continuous basis.

Table 2. Prior Actions, Structural Performance Criteria and Benchmarks

Measures	Status
Prior Actions:	
• Implementation of 19,300 layoffs in the five railway companies and their subsidiaries between August 1 and September 15, 2003 as described in para. 14.	The government delivered 16,520 layoffs.
• A government decision by September 15 to rectify the budgets of five railway companies (and respective ministerial decisions for their subsidiaries) as well as of two agricultural companies, with a view to cancel Christmas bonuses, as described in para. 14.	Done.
• Implementation of 4,000 layoffs in two agricultural companies between August 1 and September 15, 2003 as described in para. 14.	Done.
• Downward revision by September 15 in the wage bills in a number of industrial companies, as specified in the TMU, by lei 375 billion in line with para. 14.	Done
• By September 15, decisions by all ministers managing monitored SOEs (as specified in the TMU) to block 4 percent of the Q3 and Q4 wage bill in these SOEs, as well as to impose a complete hiring freeze, as specified in para.15.	Done with delay.
• Increase in energy prices as of September 1, 2003 as described in para. 16:	
o Increase in the end-user price for gas to US$110/tcm for non-residential consumers and to US$120/tcm for residential consumers;	Done[1].
o Increase in Termoelectrica's electricity tariff by 15 percent;	Done.
o Increase in electricity distribution tariffs by 16 percent;	Done.
o Increase in all end-user electricity tariffs by 17.5 percent;	Done.
o Increase in Termoelectrica's heating tariff 14 percent.	Done.
• Increase in the price of hard coal to the equivalent of US$11/Gcal as of September 1, 2003, as specified in para. 18.	Done with delay.
• Issuance of the privatization tender for Petrom by September 1, 2003 in line with para. 19.	Done.
• Formal decision of the Managing Board of APAPS to start the liquidation of ARO and Roman by September 25, 2003, unless privatization contracts are signed, as discussed in para. 21.	Done based on preliminary information, to be verified.
• Initialing the contract with the EBRD and the IFC on selling a share package of 25 percent plus two shares in BCR by September 15, in line with para. 22.	Done.
• Publication by end-August 2003 of the report of the National Control Authority on arrears in the health system, as specified in para. 12.	Done.
• Publication of a report by September 15, 2003 on government actions to prosecute individuals involved in financial wrongdoings, including FNI and Banca Romana de Scont, as described in para. 25.	Done.

[1] At the exchange rate as of August 6.

Table 2 (continued). Prior Actions, Structural Performance Criteria and Benchmarks

Structural Performance Criteria:	
• Adjust end-user electricity prices on July 1, 2003 to keep them constant in US$ terms at the level of July 1, 2002.	Observed.
• Parliamentary approval by end-May 2003 of legislation amending the laws on the pension, unemployment, and health insurance funds (in particular law 19/2000, law 76/2002, and Emergency Ordinance 150/2002) to harmonize procedures for collection, enforcement and auditing.	Observed.
• Implementation of 18,000 layoffs in a group of 22 companies by June 30, 2003.	Observed.
• Adjust Termoelectrica's producer price for electricity to the equivalent of a minimum of US$39/Mwh as of July 1, 2003.	Observed.
• Increase the unified end-user price for natural gas to the equivalent of US$93/tcm as of July 1, 2003.	Observed.
• Adjust the National Reference Price for heating to the equivalent of US$20/Gcal as of July 1, 2003.	Observed.
• Sign the contract for the sale of 25 percent plus two shares of the BCR capital to the EBRD and the IFC by July 31, 2003.	Waiver requested. Converted to a prior action, and met.
Structural Benchmarks:	
• The government will refrain from introducing tax holidays or any other new distortionary tax incentives or postponing the discontinuation of expiring ones.	Continuous. Complied, except for cancellation of arrears of selected firms and privatization-related tax exemptions.
• All transferred heating units should not receive fuel at Termoelectrica's expense.	Continuous. Observed.
• The largest industrial nonpayers to the three utilities will stay disconnected until full payments for all bills from December 2002 onwards have been received by the utilities.	Continuous. Mostly observed.
• The Agency for Privatization will privatize six large companies in Q2 of 2003.	Contracts for 7 large companies signed. The share transfer for 3 has awaited arrears cancelation, approved by the cabinet on September 25.
• Immediate initiation of liquidation procedures for three companies (Polirom, Siderca, Sidermet).	Met, except for Polirom, which was privatized on September 26.
• Initiations of liquidation procedures for seven perennial loss-makers (Verachim, Oltplast, Corapet, Rulmentul Slatina, Chimcomplex, Tepro and Carom) on July 1, 2003, unless they are privatized by June 30.	Mostly met, except for Verachim, for which shareholders approved liquidation on September 26.
• Launching of the tenders for expressions of interest in the privatization of Petrom, in consultation with the World Bank, by June 30, 2003.	Met with a delay on August 26.

Table 3. The Authorities' Plan to Adjust Prices of Electricity, Heating and Natural Gas

Energy Price	Adjustment		
End-user Electricity Price	Increase in percent		
October 1, 2001	3.6	1/	3/
November 1, 2001	3.6	2/	3/
December 1, 2001	3.6	2/	3/
January 1, 2002	3.6	2/	3/
February 1, 2002	3.6	2/	3/
March 1, 2002	3.6	2/	4/
April 1, 2002	14.0	1/	3/
July 1, 2002	1.5	1/	3/
End-user electricity prices will be adjusted on October 1, 2002, January 1, 2003, April 1, 2003 and July 1, 2003 to keep them constant in U.S. dollar terms at the level as of July 1, 2002.			
October 1, 2002		2/	3/
January 1, 2003		2/	3/
April 1, 2003		2/	3/
July 1, 2003		2/	3/
	Percent increase in the tariff in lei		
September 1, 2003	17.5	5/	3/
Electricity Producer Price for Termoelectrica	Adjust price to the equivalent of U.S. dollars		
April 1, 2002	39.00	1/	3/
July 1, 2002	39.00	1/	3/
October 1, 2002	39.00	2/	3/
January 1, 2003	39.00	1/	3/
April 1, 2003	39.00	1/	3/
July 1, 2003	39.00	2/	3/
	Percent increase in the tariff in lei		
September 1, 2003	15.0	5/	3/
Electricity distribution tariff	Percent increase in the tariff in lei		
September 1, 2003	16.0	5/	3/
Heat Producer Price for Termoelectrica	Adjust price to the equivalent of U.S. dollars		
October 1, 2001	15.00	1/	3/
January 1, 2002	15.00	2/	3/
April 1, 2002	15.00	1/	3/
July 1, 2002	20.00	1/	3/
July 1, 2003	20.00	1/	3/
	Percent increase in the tariff in lei		
September 1, 2003	14.0	5/	3/
National Reference Price for Heating	Adjust price to the equivalent of U.S. dollars		
January 1, 2002	15.40	2/	3/
April 1, 2002	15.40	1/	3/
July 1, 2002	20.00	1/	3/
July 1, 2003	20.00	2/	3/
Unified End-user Natural Gas Price	Adjust price to the equivalent of U.S. dollars		
October 1, 2001	82.5	1/	3/
January 1, 2002	82.5	1/	3/
April 1, 2002	82.5	1/	3/
July 1, 2002	82.5	1/	3/
October 1, 2002	82.5	2/	3/
March 1, 2003	90.0	5/	3/
July 1, 2003	93.0	2/	3/
End-User Natural Gas Price for Non-residential Consumers			
September 1, 2003	110.0	5/	3/
End-User Natural Gas Price for Residential Consumers			
September 1, 2003	120.0	5/	3/

1/ Indicative target.
2/ Structural performance criterion.
3/ Implemented.
4/ Not observed.
5/ Prior action.

Supplementary Technical Memorandum of Understanding for Stand-By Arrangement

I. Ceilings on the Average Net Domestic Assets of the National Bank of Romania

II. Targets for Floor on Net Foreign Assets of the National Bank of Romania

III. Ceilings on the Cumulative Deficit of the Consolidated General Government

IV. Ceilings on Aggregate Wage Bill of Monitored State-Owned Enterprises and Wage Bill and Employment Adjustments in Selected Companies

V. Indicative Target for Ceilings on Arrears of Monitored State-Owned Enterprises to the Consolidated General Government

VI. Floors on Cumulative Aggregate Collection Rates of Distrigaz Sud, Distrigaz Nord, and Termoelectrica

VII. Ceilings on the Assumption of Enterprise Debt to Banks by the Consolidated General Government and on the Issuance of Domestic Government Guarantees on Bank Lending to Enterprises

VIII. Ceilings on Contracting or Guaranteeing of External Debt

IX. Indicative Targets for Ceilings on Average Reserve Money

X. Indicative Targets for Ceilings on Broad Money

XI. Indicative Targets for Ceilings on Banking Sector's Total Exposure to State-Owned Enterprises

I. Ceilings on the Average Net Domestic Assets of the National Bank of Romania

The average net domestic assets of the National Bank of Romania (NBR) are defined as the difference between average reserve money (as defined in Section IX of this attachment) and average of net foreign assets (as defined in Section II of this attachment for the indicated month, excluding the adjustment for foreign currency denominated treasury bills), both expressed in local currency. Average net foreign asset stocks will be converted into lei for the purposes of calculating average net domestic assets at the average monthly lei/U.S. dollar rates specified in consultation with Fund staff. The average stock of NFA is defined as the average of the daily NFA as defined in Section II. The limits will be monitored from daily data on the accounts of the NBR supplied weekly to the IMF by the NBR. The average NDA as of September 2001 was lei 39,559 billion.

The ceiling on average net domestic assets of the NBR will be adjusted under the following circumstances:

(1) Downwards (upwards) in a proportional fashion, for the fraction of the month that gross foreign financing exceeds (falls short of) programmed levels, specified in Section II.

(2) For any change in reserve requirements as described in Section IX. Before undertaking any such changes, the NBR will consult IMF staff.

(3) Upwards (downwards) in a proportional fashion, by the lei equivalent of the decrease (increase) in the stock of foreign currency denominated Treasury bills (cumulative from end-December 2002).

(4) Downwards in a proportional fashion by the lei equivalent of the increase in foreign currency receipts from large privatizations (sale price above $10 million) (cumulative from end-December 2002)

(5) Downwards by the shortfall in actual reserves from required reserves for any individual bank.

II. Targets for Floor on Net Foreign Assets of the National Bank of Romania

Net foreign assets of the NBR consist of reserve assets minus foreign liabilities. For the purposes of the program, reserve assets shall be defined as monetary gold, holdings of SDRs, any reserve position in the IMF, and holdings of foreign exchange in convertible currencies by the NBR. Excluded from gross reserves are long-term assets, NBR redeposits at the commercial banks, any assets in nonconvertible currencies, encumbered reserve assets, reserve assets pledged as collateral for foreign loans, reserve assets pledged through forward contracts, and precious metals other than gold. Monetary gold shall be valued at an accounting price of US$280.4 per ounce and SDRs at US$1.355109 per SDR. NFA stocks are measured at the last working day of the respective month.

For the purposes of the program, foreign liabilities shall be defined as loan, deposit, swap (including any portion of the NBR gold that is collateralized), and forward liabilities of the NBR in convertible currencies including, foreign currency deposits of resident commercial banks at the NBR; IMF purchases; borrowing from international capital markets; and bridge loans from the BIS, foreign banks, foreign governments, or other financial institutions, irrespective of their maturity.

All assets and liabilities denominated in convertible currencies, other than the U.S. dollar, shall be converted at their respective exchange rates against the U.S. dollar on December 31, 1999. All changes of definition or valuation of assets or liabilities as well as details of operations concerning sales, purchases, or swap operations of gold shall also be communicated to the IMF staff.

The NFA of the NBR will be adjusted:

(i) upwards/downwards by 100 percent of the excess/shortfall of gross foreign financing[1] from the programmed levels:

on a cumulative basis from end-September 2001:

December 2001	US$248 million
March 2002	US$248 million
June 2002	US$953 million
September 2002	US$953 million
December 2002	US$953 million

on a cumulative basis from end-December 2002:

March 2003	US$50 million
June 2003	US$450 million
September 2003	US$450 million
December 2003	US$620 million.

(ii) by the change in the stock of foreign currency denominated Ministry of Finance Treasury Bills including those issued for bank restructuring (on a cumulative basis from end-December 2002). The outstanding stock on December 31, 2002 was $478.9 million evaluated at the program exchange rates.

(iii) upwards by the amount of foreign currency receipts from large privatizations (sale price above $10 million) (cumulative from end-December 2002).

The NFA will be monitored on the basis of daily operational data through to end-March 2002, after which monetary survey data will be used. Daily data will still be used to calculate

[1] Foreign financing is defined as disbursements of balance of payments support loans to the government with a maturity of more than a year from multilateral and bilateral creditors and resources with a maturity of more than one year raised in the international capital markets by the government. This excludes use of IMF resources.

average NFA. All data is provided by the NBR. The NFA figure was US$ 3,311 million on September 30, 2001, and US$ 5,257 million on December 31, 2002.

III. Ceilings on the Cumulative Deficit of the Consolidated General Government

The consolidated general government includes the state budget; the budgets of the local authorities; the social protection funds;[2] the "Special Fund for Modernizing Roads", the "Special Fund for the Development of the Energetic System", the "Special Reinsurance Fund", the "Authority for Privatization" (APAPS), the "Fund for the Development of Romanian Agriculture", the "National Administration of Roads (NAR)", other extra-budgetary funds managed by the Ministry of Finance or other Ministries and agencies outside the budgetary framework; other extra-budgetary operations of ministries financed by foreign loans; and the counterpart funds created from the proceeds of foreign loans. Any new funds created during the program period to undertake operations of a fiscal nature as defined in the IMF's *Manual on Government Finance Statistics* will be incorporated within the definition of consolidated general government.

Under the program, the deficit of the consolidated general government will be measured based on revenue and expenditure data provided by the Ministry of Finance, and also based on "below the line" data, that is, by the sum of domestic and external financing of the budget as well as privatization proceeds received by all entities of the consolidated general government and proceeds from the recovery of bank asset by AVAB. All efforts will be made to reconcile the measurement of the deficit from "below" and from "above the line". However, should these efforts not succeed in eliminating the discrepancies, the respectively higher deficit number will be used for program purposes.

For program purposes, net credit of the banking system to the consolidated general government is defined as all claims of the banking system on the consolidated general government less all deposits of the consolidated general government with the banking system. Foreign-currency denominated credit to government outstanding at December 31, 2001 will be converted in U.S. dollars at the end-December 1999 exchange rate and from dollars into lei using the rates specified in consultation with Fund staff. Foreign-currency denominated credit newly issued in 2001 and 2002 will be valued at the exchange rates specified in consultation with Fund staff. Government loans to banks at an interest rate less than the reference rate of the NBR to finance on lending to economic agents are excluded from government deposits; an agreed listing of the accounts to be treated as government deposits for program purposes is contained in the FAD aide memoir "Romania: Measuring the Fiscal Deficit", Part II, Appendix 11, February 1994.

For program purposes, the ceilings on the quarterly cumulative deficit of the consolidated general government in 2003 will be adjusted downwards by a shortfall of the cumulative quarterly privatization proceeds received by the consolidated general government. Privatization receipts denominated in foreign currency will be converted into U.S. dollars

[2] These include the State Social Security Fund, the Insurance Fund for Work-Related Accidents, the Unemployment Fund, and the Health Social Insurance Fund.

using the exchange rates on December 31, 1999, and from dollars into lei using the rates specified in consultation with Fund staff. The floor for these proceeds is as follows:

	Floor	Actual
	(billion of lei)	
Cumulative quarterly privatization proceeds of the general consolidated government for 2003:		
March 31, 2003 (minimum target)	1,000	1,589
June 30, 2003 (minimum target)	2,000	2,611
September 30, 2003 (minimum target)	3,000	
December 31, 2003 (minimum target)	4,000	

To achieve the 2003 deficit target the cumulative monthly expenditure entitlements for the state budget during January-June 2003 will be limited to the ceilings agreed with Fund staff. In addition, should the cumulative monthly revenues of the general consolidated budget fall short of the revenue targets agreed with Fund staff, the monthly state budget expenditure ceilings will be adjusted downwards to compensate for this shortfall.

	Revenue targets	Actual
	(billion of lei)	
Consolidated General Government (excluding "National Administration of Roads"; cumulative total revenues including grants)		
January 31, 2003 (actual)		44,246
February 28, 2003 (indicative revenue target)	85,732	82,348
March 31, 2003 (indicative revenue target)	128,797	121,965
April 30, 2003 (indicative revenue target)	177,248	171,187
May 31, 2003 (indicative revenue target)	221,602	216,694
June 30, 2003 (indicative revenue target)	267,507	260,162

	Expenditure ceilings	Actual
	(billion of lei)	
State Budget (cumulative total expenditure)		
January 31, 2003 (actual)		19,616
February 28, 2003 (indicative ceiling)	39,901	38,042
March 31, 2003 (indicative ceiling)	65,215	58,701
April 30, 2003 (indicative ceiling)	88,987	81,400
May 31, 2003 (indicative ceiling)	113,120	105,103
June 30, 2003 (indicative ceiling)	137,764	125,802

IV. Ceiling on Aggregate Wage Bill of Monitored State-Owned Enterprises and Wage Bill and Employment Adjustments in Selected Companies

A. Ceiling on Aggregate Wage Bill of Monitored State-Owned Enterprises.

The set of 76 state-owned enterprises, whose wages are to be monitored under Emergency Ordinance 79/2001, is specified in Government Decision 866/2001.The wage bill of this set of state-owned enterprises has been adjusted for the decrease in the number of enterprises from 82 in 2002 and 86 in 2001.

The wage bill will be adjusted as follows:

(i) downwards by the amount of savings due to "externalization" (defined as the spinning off of a unit or its transfer to another entity, or temporary/permanent transfers of employees when the sum of these transfers exceeds 100 employees per month). In each month, savings from externalization will be calculated on a company by company basis as the product of the number of externalized employees so far and the company's average wage.

(ii) if a company is privatized, downwards by the budgeted wage bill of the privatized company, starting with the month following the month of signing the privatization contract.

The wage bills will be measured on a cumulative basis across the different sectors, on a monthly basis. The Ministry of Labor and Social Protection will undertake the responsibility of collecting data from the various line ministries (RAs and national companies) and APAPS (commercial companies), and will report the wage bills and employment figures for each of the monitored enterprises (including aggregate figures for each ministry and for the overall total) to the IMF on a monthly basis. Employment reduction resulting from all forms of outsourcing will be reported in the "externalization" column of the respective tables, with a footnote, if necessary.

B. Wage Bill and Employment Adjustments in Selected Companies

As specified in paragraph 14 of the SMEFP-3, the government will eliminate Christmas bonuses and cut employment in five railway companies (CFR, CFR Marfa, CFR Calatori, SAAF, Metrorex) and their subsidiaries and two agricultural companies (A Padurilor and Imbunatatiri Functiare). In addition, overtime and night-shift mark-ups in the two agricultural companies will be reduced as needed to meet their budgeted wage bills. Layoffs are considered accomplished when personal and irrevocable notifications (after possible appeals are considered) are sent to the employees to be laid off.

The authorities will adjust the budgeted wage bill and the overall budgets of the following companies:

1. Industrial companies:

SN Petrom	- lei 250 billion;
SN Carbune Ploesti	- lei 30 billion;
CN Minvest	- lei 30 billion;
SC Termoelectrica	- lei 30 billion;

2. Other companies:

RA Rami Dacia	- lei 19 billion;
CN Remin	- lei 8 billion;
SC Romaero	- lei 7 billion;
SC CUG	- lei 50 billion;
SC Faur	- lei 66 billion;
SC Rocar	- lei 45 billion;
SC Tractorul	- lei 16 billion;
Administratia Port Constanta	- lei 27 billion;
AND	- lei 26 billion;
SAAF	- lei 11 billion;
Metrorex	- lei 8 billion.

V. Indicative Target for Ceilings on Arrears of Monitored State-owned Enterprises to the Consolidated General Government

The ceiling applies to the outstanding stock of arrears of the set of 76 monitored state-owned enterprises, whose arrears are to be monitored under Emergency Ordinance 79/2001 and Government Decision 866/2001. Under the ordinance, arrears are defined as accounts payable past the due date stipulated explicitly in the contracts, or if no such explicit date exist, 30 days after services/products are provided. The reporting on total arrears will have the following subcategories: to the state budget, to the social security budget; to the local budget; to special funds; and to other creditors. Arrears to the consolidated general government are defined as the sum of the first four categories. Amounts reflecting tax arrears exclusive of penalties will be reported separately. For arrears which have been rescheduled/canceled, the rescheduled/canceled amounts (including penalties) will not be counted as arrears reduction, and has to be reported. The report will include a breakdown of arrears to the ten largest creditors for each company. The report will also include data on overdue claims of each of the monitored companies, as reported under Emergency Ordinance 79/2001. For changes to the set of monitored companies, the targets will be adjusted downwards/upwards by the amount of arrears of the companies removed/added to the set. Data for monitoring purposes shall be supplied monthly to the IMF by the Ministry of Finance. The stock of arrears at end-December 2000 was lei 47.2 trillion.

VI. Floors on Cumulative Aggregate Collection Rates of Distrigaz Sud, Distrigaz Nord, Termoelectrica and Electrica

Floors will be set on the cumulative collection rates of the following companies:

- the combined rate (performance criterion) of Distrigaz Nord and Distrigaz Sud (indicative targets on the individual company collection rates);

- on the combined collection rate for heating and electricity of Termoelectrica, including the production units transferred to local authorities (performance criterion). Indicative targets will be set on the collection rates for (i) electricity for both Termoelectrica and the production units transferred to local authorities; (ii) Termoelectrica's district heating; (iii) heating in the transferred units;

- on Electrica's collection rate (indicative target till March 2003, performance criterion as of June 2003).

The floors and outcomes for end-September, end-December 2001, and end-March 2002 are measured using cumulative collection rates defined as the ratio of collections to billings, measured from the start of the year to the specified date. For the remaining test dates floors on collection rates are defined as follows:

(i) Termoelectrica and local authority units (Heating sector), Distrigaz Nord and Sud: Heating and gas bills are lagged by one month. Definition of 12-month moving collection rate c(m) for the month m=1,2..12.:

c(m) = sum(heating collections(m):heating collections(m-12) divided by sum(heating bills(m-1):heating bills(m-13)).

(ii) Termoelectrica and local authority units (Electricity sector); Electrica; Definition of 12-month moving collection rate c(m) for the month m=1,2..12:

c(m) = sum(electricity collections(m):electricity collections(m-12) divided by sum(electricity bills(m):electricity bills(m-12)).

Using these definitions the collection rate of Termoelectrica at end-December 2001 was 85.5, of Electrica 92.9, and of the two gas companies, 85.5.

Data for these companies will be collected by the Ministry of Industry and reported to the IMF on a monthly basis. Revenue resulting from obtaining shares through debt-equity swaps will be excluded from collections, unless the shares are sold for cash. The Ministry of Industry will include in this report data on billings and collections registered by Distrigaz Nord, Distrigaz Sud, Electrica and Termoelectrica, as well as information on possible dis- and reconnections for the following industrial (a) and heating (b) companies.

a) SC Siderurgica, COS Targoviste, Minvest SM-Rosia Poieni, Moldomin, Minvest-SM, Balan, Snif, SC Industria Sarmei, Gavazzi Steel, Minvest-SM Baia de Aries, SC Turnu, CUG Cluj, SC Apaterm Galati, SC Tractorul UTB, SC Chimcomplex, Minvest- SM Brad, Apa Nova (RGAB), Minvest -SM Coranda Certej, Minvest -SM Poiana Rusca Teliuc, Siderca, SC Electrocarbon, Tepro, Nitramonia, Viromet, Amonil, Oltchim, Sere Codlea, US Govora, Republica, Zahar Bod, Stirom Bucuresti, Danubiana, Gerom Buzau, Colorom Codlea, Roman Brasov, Metrom Brasov, Carfil Brasov, Stiaz Azuga, Faur Bucuresti, UPSOM SA Ocna Mureş, Bicapa SA Târnăveni, SC Ind.Sârmei C.Turzii, SC Stipo SA Dorohoi, Ampellum SA Zlatna, SC Cugir SA, SC Melana Săvineşti, Letea Bacau, Rafo SA Oneşti, SC Fortus SA Iaşi, Ambro SA Suceava, Stratusmob SA Blaj, SC Sticla Turda, Iris SA Cluj, Metalurgica Aiud.

b) Radet Bucuresti,Radet Constanta, Apaterm Galati, RA Termoficare Craiova, SC Apaterm, SA Deva, Termica SA Targoviste, Termoficare Petrosani, Dalkia Ploiesti, SC Termoficare Petrosani, SC Universal Lupeni, Aptercol Braila, SC Citadin Aninoasa, RA Termoficare Cluj, SC Aqua Calor P. Neamt, RA Energomur Tg Mures, SC Energ. Temica Sibiu, Termoloc Populatie Bacau, RA Goscom Roman, Proditerm Bistrita, Rail Hunedoara, Comunala RA Satu Mare, Termica SA Botosani, Radet Bucuresti, Enet Focsani, Cet Braila, Cet Govora, RA Termo Craiova, Ram Buzau, RA Termo Brasov, Aquaterm Tg. Jiu, Aquaterm 98 Pitesti.

VII. Ceilings on the Assumption of Enterprise Debt to Banks by the Consolidated General Government and on the Issuance of Domestic Government Guarantees on Bank Lending to Enterprises

The ceilings apply to the cumulative stock from end-September 2001 of newly guaranteed or assumed domestic debt by the consolidated general government. For program purposes, the assumption of enterprise debt to banks by the consolidated general government and the issuing of a guarantee to assume enterprise debt to banks are treated as being equivalent. This limit includes any loan on which the government pays or guarantees interest, even if the principal is not guaranteed. The consolidated general government is defined in Section III of this attachment. The criterion also applies to the use of APAPS resources for recapitalizing enterprises or as collateral for bank loans. Foreign currency denominated loans will be converted at accounting exchange rates specified in consultation with Fund staff. These limits exclude:

- the contracting or guaranteeing of external debt, for which separate limits are set out in Section VIII of this attachment;

- debt transferred in the process of bank restructuring, privatization or liquidation of state-owned enterprises.

- the assumption of debt as a result of an activation of a guarantee or collateral.

- domestic guarantees for loans for fuel imports for the 22 heat-producing units which were transferred from Termoelectrica to local authorities, to the extent that external off-budget guarantees issued for this purpose (see Section VIII) fall short of US$120 million (i.e., the sum of domestic and external guarantees issued for this purpose must not exceed US$120 million).

Data for monitoring purposes shall be supplied monthly to the IMF by the Ministry of Finance. The stock of guarantees and debt assumed as described in this section was lei 469 billion as of end-September 2001.

VIII. Ceilings on Contracting or Guaranteeing of External Debt

The ceilings apply to the cumulative stock for each year of newly contracted or guaranteed external debt by the consolidated general government. The consolidated general government is defined in Section III of this attachment. This performance criterion applies not only to debt as defined in point No. 9 of the IMF Guidelines on Performance Criteria with Respect to Foreign debt adopted on August 24, 2000 (Executive Board Decision No. 12274-(00/85)) but also to commitments contracted or guaranteed for which value has not been received. The ceilings also apply to any assumption of loans for debt outstanding which were not previously contracted or guaranteed by the consolidated general government. Excluded from the ceilings are liabilities to the IMF and bridge loans from the BIS, foreign banks, foreign governments, or any other financial institution. Debt falling within the ceilings shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective. Loans considered concessional are also excluded from the ceilings. Off-budget debt includes all debt to non-budget entities from private sector creditors guaranteed by the Ministry of Finance. Loans for fuel imports for Distrigaz, Romgaz, Termoelectrica, and the 22 heat-producing units which were transferred from Termoelectrica to local authorities are included in the overall ceilings, while being excluded from the off-budget guaranteed debt ceilings. With respect to new loans contracted to ensure fuel imports for the heating period 2002/2003, they are excluded from the off-budget guaranteed debt ceilings up to an amount of US$200 million for Termoelectrica and Electrocentrale and US$120 million for the transferred heating units. Fuel import loans contracted by Termoelectrica and the transferred heating units are excluded from the ceilings on debt with maturities between one and three years.

Concessional loans are defined as those with a grant element of at least 35 percent of the value of the loan, using currency-specific discount rates based on the commercial interest reference rates reported by the OECD (CIRRS) in effect at the time of contracting or guaranteeing the loan.

The ceilings shall be monitored from data supplied monthly to the IMF by the Ministry of Finance. The stock of debt at end-June 2001 was $1,194 million for maturities over one year ($83 million of which was off-budget), $196 million for the subceiling of debt with maturity of one to three years (none of which was off-budget), zero for debt with less than one year maturity.

Nonaccumulation of external payments arrears of the government will be a performance criterion monitored on a continuous basis. For program purposes, arrears with respect to called-up sovereign loan guarantees are defined as external payments overdue more than 30 days.

IX. Indicative Targets for Ceilings on Average Reserve Money

Average reserve money is defined as the sum of average currency in circulation outside the NBR and average deposits (required plus excess reserves) of the commercial banks at the NBR for the indicated month. Commercial bank deposits exclude required and excess reserves in foreign exchange for foreign exchange deposits. Data on reserve money will be monitored from the daily indicators data of the NBR, which shall be supplied to the IMF weekly by the NBR. The stock of average reserve money as of September 2001 was lei 60,442 billion.

The ceilings on average reserve money will be adjusted in the following circumstances:

(1) Should reserve requirements be increased/decreased from 25 percent on all required reserves held in lei, the reserve money targets would be increased/decreased by the product of the change in the reserve requirements and the programmed deposits for which required reserves are held in lei. The level of the programmed deposits is lei 189,866 billion for March 2003, lei 204,549 billion for June 2003, lei 194,983 billion for September 2003 and lei 238,815 for December 2003.

(2) The reserve money targets will be lowered by the shortfall in actual reserves from required reserves for any individual bank, measured from the 24th of the previous month to the 23rd of the test-date month, as provided for in the relevant NBR regulation.

X. Indicative Targets for Ceilings on Broad Money

Broad money is defined as the liabilities of the banking system with the non-bank public. Broad money includes foreign currency deposits of residents, but excludes government deposits and deposits of foreign monetary institutions and other non-residents. For the purposes of the program, deposits which are denominated in foreign currency will be converted into lei at the accounting exchange rates specified in consultation with Fund staff.

Data on broad money will be monitored from the monthly data on the accounts of the banks and the banking system, which shall be supplied to the IMF monthly by the NBR. The stock of broad money at program exchange rates as of September 30, 2001 was lei 235,363 billion.

XI. Indicative Targets for Ceilings on Banking Sector's Total Exposure to State-Owned Enterprises

Total exposure covers all loans, advances, holdings of debt and off-balance sheet exposure of resident banks to state-owned enterprises. Data on loans will also be reported separately from total exposure. State-owned enterprises are all regis autonomes and commercial companies with majority ownership by the government or APAPS. For the purposes of monitoring, foreign currency denominated debt will be converted in lei at end-month lei/dollar exchange rates specified in consultation with Fund staff. Foreign currency denominated credit in convertible currencies, other than the U.S. dollar, shall be converted at their respective exchange rates against the U.S. dollar as specified in Section II of this attachment. Data on banking sector lending to state-owned enterprises will be monitored from monthly data provided by the NBR.

The amount of total exposure, as reported by the NBR, will include (on a cumulative basis from end-March 2002):

(i) exposure to companies where the majority ownership shifted to the private sector. For this purpose, APAPS and the relevant ministries will provide a monthly update of their portfolio to the NBR;

(ii) any amount of debt or off-balance sheet write-offs;

(iii) any assumption of debt or off-balance sheet items by the government or other public bodies.

Additionally, the NBR will report monthly on total exposure of the banking system to state-owned enterprises with outstanding exposure over lei 100 billion, on a company-by-company basis. The stock of banking sector exposure to state-owned enterprises at program exchange rates as of September 30, 2001 was lei 27,052 billion of which lei 13,541 billion was to BCR.

Statement by the IMF Staff Representative
October 15, 2003

1. This statement summarizes information that has become available since the issuance of the staff report for the fourth review under the Stand-by Arrangement and request for waiver of performance criteria. The statement does not change the appraisal in the report.

2. Recently released macroeconomic data are broadly in line with projections in the staff report:

   - Industrial production in July-August rose about 6 percent year-on-year, suggesting that the weakness earlier in the year was temporary and that GDP growth prospects remain in line with program projections, at about 4.5-4.7 percent.

   - Inflation in September was 2.1 percent, raising the 12-month rate to 15.9 percent. The administered prices, including for electricity and gas, contributed about 1½ percentage points to September inflation, suggesting that underlying inflation remains in line with the program target.

   - Real net wage growth in state-owned enterprises (SOEs) moderated to 4.2 percent year-on-year in August, dropping below economy-wide average wage growth for the second month in a row.

   - The general government budget deficit was contained to 0.7 percent of GDP in January-August, reflecting improved revenue performance in Q3 and continuing expenditure restraint.

   - The indicative end-September targets for NFA and NDA of the National Bank of Romania were met. However, commercial bank credit to the private sector continued to expand unabated, with the 12-months real growth rate reaching 49 percent in August, mainly driven by consumer and mortgage loans to households. In response, the NBR increased its interest rate by another percentage point to 21¾ percent on October 6. The authorities are also reviewing the implications for insurance companies of their increasing exposure to consumer credit risk.

   - The current account deficit for the seven months through July reached 2.8 percent of GDP, in line with the annual estimate of 4.8 percent of GDP. The trade deficit in August was in line with program projections.

   - S&P upgraded Romania one notch to BB on September 17, 2003.

3. The decision on the additional 4 percent gas price increase was published on October 10 and will become effective on November 1. By October 7, 2003, 16,520 employees of the railway companies were laid off, about 400 more than reported in the staff report. The

prior action on the privatization of Roman and ARO was met with a delay of one day, although some uncertainties remain whether all units of the former will eventually be managed by private investors. The Privatization Agency shortlisted 11 investors interested in acquiring a majority share in Petrom.

4. Following the approval of the Operational Guidance for Assessments of Countries with a Longer-Term Program Engagement, staff has started work on an ex-post assessment of the current stand-by arrangement. The assessment will be summarized in the next staff report presented to the Executive Board by April 2004, on either a possible request for UFR or the next Article IV discussions.

Press Release No. 03/171
FOR IMMEDIATE RELEASE
October 15, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Fourth Review Under Stand-By Arrangement for Romania, Approves US$158 Million Disbursement and Grants Waivers

The Executive Board of the International Monetary Fund (IMF) today completed the fourth and final review of Romania's economic performance under a Stand-By Arrangement, which will enable Romania to draw the remaining SDR 110.2 million (about US$158 million) from the IMF immediately. The Executive Board also approved Romania's request for waivers on non-observance of four performance criteria.

The 18-month Stand-By Arrangement was approved on October 31, 2001 (see Press Release No. 01/43) for a total amount of SDR 300 million (about US$431 million). On April 25, 2003, the Board extended the arrangement through October 15, 2003 (see Press Release No. 03/60). So far, Romania has drawn SDR 189.8 million (US$273 million) under the arrangement from the IMF.

Following the Executive Board discussion, Anne Krueger, First Deputy Managing Director and Acting Chair, said:

"The Romanian authorities are to be commended for the broadly satisfactory implementation of their IMF-supported program. Sound macroeconomic policies and progress in structural reforms have contributed to continuing disinflation and robust economic growth, despite economic weakness in Romania's main trading partners. However, the current account deficit, albeit still within acceptable limits, has widened, reflecting expansion in credit to the private sector, the effects on household demand of the substantial minimum wage increase, and investment activity accompanying the pick-up in foreign direct investment. Looking ahead, it will be important to contain the strong growth in domestic demand, including through strict wage control in the state-owned enterprises (SOEs) and by avoiding a further real increase in the statutory minimum wage in 2004. Steadfast implementation of the remaining reform agenda will also be crucial for ensuring a fully-functioning market economy and prospects for sustainable growth.

"Prudent budgetary policy has contributed to achieving the authorities' current account and disinflation targets, and a relaxation of the budget stance in 2004 should be avoided unless accompanied by strong and credible measures to improve the saving-investment balance of SOEs. It will also be important to resist measures that could erode the success of the recent profit tax and VAT reforms.

"To resume the earlier significant reduction in energy sector losses, the authorities are committed to gradually increase gas prices to import parity levels by 2007, while at the same time ensuring regular quarterly adjustments in other energy prices to keep them at cost-recovery levels. The improved collection performance in the gas and electricity sectors will need to be sustained, including the collection of heating bills which has so far remained weak.

"Notable progress has been made on the reform of SOEs, including the downsizing of large lossmaking SOEs, the completion of a number of difficult privatization projects, the decision to abandon or scale down conditions imposed on investors to preserve employment and commit to investment, and the agreement on the acquisition by the European Bank for Reconstruction and Development and International Finance Corp. of a minority share in Romania's largest bank, BCR, with a view to preparing this bank for the sale to a strategic investor. Progress in completing privatization projects in the energy sector has, however, remained slow, and the authorities will need to expedite the implementation of the reform agenda in this area, along with sustained further efforts to improve the business and investment climate.

"Monetary policy continues to pursue gradual disinflation while preserving external competitiveness. To fend off inflation risks posed by the rapid growth in credit to the private sector, the National Bank of Romania has appropriately increased the main policy interest rate and stands ready to tighten monetary policy further if needed," Ms. Krueger said.

Statement by Yuriy Yakusha, Alternate Executive Director for Romania
October 15, 2003

I would like to convey to the management and staff of the Fund the appreciation of the Romanian authorities for their continuing support, frankness in discussion and constructive policy advice. The staff report presents a well balanced assessment of recent economic and policy developments.

Over the past two years, Romania has achieved considerable progress on macroeconomic stabilization and has made important steps forward in the area of structural reform. In the enterprise restructuring process during the period covered by the present SBA, the government implemented a program of layoffs totaling more than 57,000 employees, almost 50 percent more than required by the conditionality of the program. This reflects the determined implementation by the authorities.

All prior actions for the fourth review under the SBA and additional measures for correcting slippages on some structural areas were observed. Out of seven structural performance criteria, only that referring to the signing of the contract for the sale of 25 percent of the BCR capital to the EBRD and IFC by July 2003 was not observed, but it was subsequently converted to a prior action for the review and met. The quantitative performance criterion on the collection rate of the main thermo-power producer was missed; nevertheless a substantial improvement in the collection rate was achieved. This is a difficult area in Romania as well as in other transition economies, which my authorities are now addressing, inter alia, by providing larger amounts of heating support to vulnerable households.

Since the last review in April, macroeconomic developments have continued to be favorable and broadly in line with program targets. Two intermediate quantitative performance criteria on the NFA and NDA of the National Bank of Romania were not observed in June owing to a temporary reversal in capital inflows that created difficulties for monetary policy, but now they are back on track.

At the same time, Romania made further progress towards its goal of EU accession. The economic strategy should be seen in the context of the aim to assume the obligations of EU membership by 2007, as envisaged at the Copenhagen summit last December. In this respect, the negotiations on all chapters of the acquis communautaire have been opened, and 19 of them provisionally closed.

Despite the encouraging macroeconomic achievements, the Romanian authorities are fully aware that further structural reforms and a balanced development of domestic demand are of utmost importance. In the area of structural reform, the challenging agenda covers mainly enterprise restructuring, financial discipline and privatization in the energy sector. Therefore, the Romanian authorities wish to restate their determination to continue with implementation of the economic policies aimed at ensuring long-term sustainable growth.

Economic developments

The Romanian economy grew at moderate rates in the first two quarters (4.4 and 4.2 percent as compared to the same period of last year, respectively). Recent data indicate that domestic demand also picked up, fueled by net real wages and credit to the private sector. Inflation declined faster than targeted, from 30 percent at end-2001 to 18 percent at end-2002, and 14 percent in August 2003.

Weaker external demand and exports and more brisk domestic demand resulted in a widening of the current account deficit by 1/4 percent of GDP above projection. In response, the authorities developed and implemented corrective measures (presented in the SMEFP-3). Thus, fiscal adjustment, monetary tightening and strengthened control over wages in the public sector have helped to consolidate Romania's fiscal sustainability and prevent further deterioration of the external account. As outlined in the current staff report and the 2003 Article IV staff report, the current account deficit is expected to range within sustainable limits.

After their stronger than anticipated increase in 2002, official reserves declined by 0.5 percent of GDP in the first half of 2003 owing to delays in disbursing some public and private loans. However, in July reserves resumed growth, reaching a comfortable level of about 3.7 months of prospective imports of goods and services as of end-August 2003. Total public and publicly guaranteed debt has remained under 27 percent of GDP, while domestic public debt was reduced to 6 percent of GDP at the end of 2002.

Access to the international market has been consolidated. After a temporary slowdown of their downward trajectory, following the issuance of euro 700 million eurobond this year, spreads continued to narrow to around 220 bps. Romania's impressive macroeconomic performance has been recognized by the recent credit rating upgrade to BB by Standard &Poor's, who also confirmed their positive outlook. Moreover, Romania's success in macroeconomic stabilization and economic restructuring in the past few years led to the US's recognition of the country as a functioning market economy.

Fiscal Policy

Fiscal consolidation has been at the center of Romania's adjustment policies. With a deficit of 0.3 percent below the program target in the first semester of 2003, fiscal policy continued to support disinflation and current account sustainability. Despite weaker-than-projected revenues and substantial additional expenditure, the authorities decided in late-August to reprioritize on the expenditure side so as to reduce the general government deficit for the current year to 2.7 percent of GDP and thus protect Romania's current account.

The authorities have been paying special attention to improving revenue performance. The new VAT and profit tax laws have limited the number of tax exemptions and tax incentives, thus creating room for higher budget revenues and better resource allocation. A comprehensive reform of the tax administration is under way. The authorities have already decided to transform the tax administration department under the Ministry of Finance into a semi-autonomous agency by January 1, 2004. During 2004, this agency will gradually integrate the audit, collection and enforcement of social security contributions. On the expenditure side, the authorities have made efforts to create more scope for capital expenditure, repayment of health institution arrears accumulated in 2002 and improvement of the social safety net.

Wage policy

To prevent the spillover effect from the minimum wage increase in January from disrupting macroeconomic stabilization or slowing down disinflation, the wage policy has been strengthened from the beginning of 2003. The 2003 budgets of the monitored SOEs were approved timely in December 2002. The authorities have notified monitored SOEs that the wage bills would have to be adjusted in case of outsourcing of employees, and imposed a partial hiring freeze. Thus, wage discipline has become more credible and the wage bill targets in Q1 and Q2 were observed. However, wage dynamics in mid-2003 had made it necessary for the government to intervene with additional measures to secure the September and December wage bill targets. These measures are expected to generate wage bill savings in an amount sufficient to ensure compliance with the annual wage bill target. The authorities are aware that prudent policy will continue to be crucial for reducing SOE losses and containing domestic demand within sustainable limits and are determined to strengthen wage control measures developed under this SBA.

Monetary policy

As mentioned in the SMEFP-3, the NBR will continue to pursue gradual disinflation without putting external competitiveness at risk. The NBR considers this policy to remain appropriate for the near future, until conditions for introducing inflation targeting are strongly settled. Following this policy, the NBR has limited its interventions on the market during the first semester of 2003 when demand has been outstripping the increasing supply on the domestic foreign exchange market. Under the recently re-emerging excess supply on the foreign exchange market, to achieve the targeted international reserve accumulation, the NBR committed to sizable purchases in the remainder of 2003 and to adequate liquidity sterilization.

To moderate booming credit and to fight off second round effects form energy price increases, the NBR raised the policy interest rates twice by one percentage point each time, on August 6 and October 6. The Bank also expressed its willingness to raise rates further or take other appropriate measures should this prove necessary to ensure the inflation target. The Romanian central bank considers that high credit growth was inevitable and is desirable in the context of a degree of bank intermediation of only 11.9 percent[1] (as of 2002) and financial deepening of only 24.7 percent of GDP[2]. However, the Bank considers that credit increase should be within sustainable limits and carefully watched. In addition to increased

[1] Credit to non-government as percent of GDP.

[2] M2 as percent of GDP.

interest rates, the NBR advised banks to be more selective in choosing their clients, continued with on-site inspections to the most active lenders and with bank-by-bank stress assessments, as recommended by the FSAP mission. It also helps that the banking legislation is now at a high degree of alignment with international standards. The authorities consider Romania's participation in FSAP, which started in March 2003, a useful experience, both with regard to the general assessment of the financial system, and with the opportunity to define areas of concern.

Structural reforms

Structural reforms remain a key challenge for Romania. Progress is being made as regards this area, but the authorities are fully aware that further effort is needed, in order to sustain macroeconomic stabilization gains and to ensure the fully functioning market, able to cope with EU pressures. Therefore, a decisive approach to strengthening financial discipline, private sector development and improvement of the business climate has been taken this year.

To improve financial discipline and to reduce losses in the energy sector, the authorities adjusted administered prices as of September 1 and continued to implement disconnections to the larger non-payers. The authorities are committed to implementing further measures to reform the pricing scheme in the gas sector to avoid having producer prices determined as a residual after import, distribution and storage costs. In line with their commitment to gradually adjust gas prices every quarter, they have decided to implement another adjustment of 4 percent in lei prices of gas on November 1, 2003. The schedule of future adjustments in gas prices aimed at reaching import parity in 2007 will be announced by end-2003. In the authorities' view this is essential for new exploration, as recommended in a recent World Bank study, and for facilitating the privatization of Petrom, the largest oil company in Romania.

Notable progress has been made in privatizing companies under the Authority for Privatization. The agency implemented a program of layoffs for more than 22,000 employees, thus overperforming on the end-June structural PC. Moreover, the Agency signed contracts for the sale of seven large companies in the second quarter, compared with the structural benchmark of six. Steps for privatization of oil company Petrom are within the target, with the tender for expression of interest issued on August 26, after finalizing discussion with the World Bank on the privatization strategy. The sale contract for Petrom is expected to be signed before end-March 2004. However, privatization in the energy sector has been slow, with the ongoing negotiations for the privatization of the two electricity distribution companies clouded by uncertainties about future tariffs and the deadline for privatization of gas companies postponed by 6 months, to June 2004. The negotiations on the EBRD's and the IFC's participation in the largest bank BCR were successfully concluded on September 19 and approved by the government on September 25.

Given the importance for Romania and the broad and sustained policy efforts that have been made, the authorities look forward to the successful completion of this review and thus of the Program.