November 2001
IMF Country Report No. 01/204

Romania: Request for a Stand-By Arrangement—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by Authorities of Romania

In the context of the request for a Stand-By Arrangement with Romania, the following documents have been released and are included in this package:

- the staff report for the Request for a Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **September 7, 2001** 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 17, 2001.** 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 Supplement of **October 30, 2001** updating information on recent economic developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its October 31, 2001 discussion** of the staff report that completed the request.

- a Statement by the Executive Director of Romania.

The documents listed below have been or will be separately released:
Letter of Intent by the authorities of Romania*
Memorandum of Economic and Financial Policies by the authorities of Romania*
Technical Memorandum of Understanding*

*May also be included in Staff Report.

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

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Washington, D.C.**

INTERNATIONAL MONETARY FUND

ROMANIA

Request for Stand-By Arrangement

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

(In consultation with other departments)

Approved by Susan Schadler and Liam P. Ebrill

October 17, 2001

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I. Introduction

1. The Government of Romania has requested an 18-month Stand-By Arrangement in the amount of SDR 300 million, or 29 percent of quota, for the program period October 2001–March 2003. The Letter of Intent (LOI) and the accompanying Memorandum on Economic and Financial Policies (MEFP) appear as Appendix IV.[1]

2. In concluding the last Article IV consultation on November 29, 2000 (SM/00/249), Executive Directors commended the authorities for their significant progress in stabilization and reform, facilitated by substantial fiscal and external adjustments, but noted that Romania still lagged behind most other transition economies in Eastern and Central Europe. Directors regretted that policy slippages with respect to the reduction in domestic arrears and the limits on the public sector wage bill had prevented the conclusion of the second review under the Stand-By Arrangement, and called on the government to implement a sustained and vigorous strategy of stabilization and structural reforms. Directors stressed the importance of further fiscal consolidation by recommending a budget deficit ceiling of 3 percent of GDP in 2001. This, along with prudent monetary policy, financial discipline in state-owned enterprises (SOEs), and rapid privatization was seen as crucial for successful disinflation and strengthening of Romania's external position.

3. **The left-wing Party for Social Democracy in Romania (PDSR), now the Social Democrat Party (PSD) returned to power in the wake of the parliamentary elections in late 2000.** Even though the PSD does not hold the majority in the Parliament, the government enjoys parliamentary support from the Hungarian Party and occasionally from two centrist parties of the previous ruling coalition. The nationalist Party for Greater Romania is the main opposition party, but it has lost much public support since the elections. The new government is strongly committed, with the backing of all political parties, to enrolling Romania in NATO and accelerating to EU accession.

4. **The World Bank is currently negotiating the second Private Sector Adjustment Loan (PSAL II), which will provide for a far-reaching privatization program, while also addressing the issues of the business environment and energy sector reform.** The

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[1] Agreement ad referendum on the LoI and MEFP was reached during the mission August 27–September 7, 2001, following two staff visits (in February and March), and the first negotiating mission in June. Supplementary understandings were reached through the resident representative's office in the second half of September. The mission team included Messrs. Mates (head), Westphal, Abiad, Gueorguiev (all EU1), Mr. Frecaut (MAE), Mr. Brown (PDR), and Ms. Santayana (staff assistant EU1), and was assisted by the Fund's resident representative Mr. Cosse. The mission held discussions with Prime Minister Năstase, Governor of the National Bank of Romania (NBR) Isarescu, Minister of Finance Tanasescu, Minister of Labor Sârbu, Minister of Industry Popescu, Minister of Privatization Musetescu, and several other high government officials.

negotiations are close to completion, with the principal outstanding issues remaining in the area of privatization.

II. Macroeconomic Background

5. **Over the last 10 years, Romania's transition process was slow and uneven compared with other accession economies in Central and Eastern Europe.** Owing to the difficult inheritance from the pre-transition era, but also to the lack of consistent policies and insufficient reform efforts, inflation remained among the highest in the region, and growth performance was sluggish and subject to boom-bust cycles. Moreover, progress in restructuring and privatization in the industrial sector was slow, particularly in energy-intensive heavy industry, while foreign direct investment, measured per capita, was among the lowest in the region. All five Fund-supported programs in the period 1990–2000 went off track, in most cases because of the government's failure to impose financial discipline in state-owned enterprises.

6. **In 1999, to address balance of payments pressures, the government implemented a stabilization program, supported by a Stand-By Arrangement, which set the stage for a recovery in 2000.** Following the deterioration in the external current account deficit in 1996–98, Romania became vulnerable to balance of payments pressures, which were eventually triggered by the Russian crisis in 1998. The stabilization program included a strong fiscal correction that, in combination with the currency depreciation, improved competitiveness and reduced the current account deficit to sustainable levels. Extensive bank restructuring created conditions for more effective monetary policy. In 2000, after three years of decline, GDP grew by 1.6 percent (Table 1), despite a sharp drought-related loss in agricultural production. Output growth was driven by strong exports in the first half of the year, and by domestic demand in the second half. On the back of the improved performance in the external sector, Romania successfully re-entered the international bond market in September 2000.

7. **The stabilization program supported by the Stand-By Arrangement, however, veered off track in the second half of 2000.** Owing primarily to the absence of wage discipline in public enterprises and a loosening of the fiscal stance, the inflation target was widely overshot. As a result of favorable terms of trade effects and growing transfers, the current account deficit declined for the year as a whole. But the impulse from strengthened domestic demand and the effects of the drought led to rapid growth in imports and a widening in the trade deficit in the second half of the year.

8. **During the first half of 2001 domestic demand grew strongly, the current account deficit widened, and inflation declined less than targeted.** GDP growth of 5 percent in the first half of 2001 was driven by domestic demand (Text Table 1), and particularly household consumption (see paragraph 9). Growth in fixed capital formation was modest, as private investment was reportedly stagnant. Export growth, though dampened by

a slowdown in trading partner demand, remained robust (Figure 1); developments in the ULC-based real effective exchange rate suggest that, owing to productivity growth, competitiveness has remained rather stable since the large depreciation in 1998 (Figure 2). However, imports grew by 30 percent in U.S. dollar terms, and as a result, the current account deficit more than doubled relative to the same period of 2000. Inflation slowed, but less than initially targeted, which led the authorities to revise the target for end-year inflation from 25 percent to 29 percent (Figure 3). The main factors behind the declining inflation rate were a rapid reduction in the rate of crawl (see below), the fading effects of the 2000 drought, and delays in administered price adjustments.

Table 1. Romania: Real GDP Growth, 1999-2001

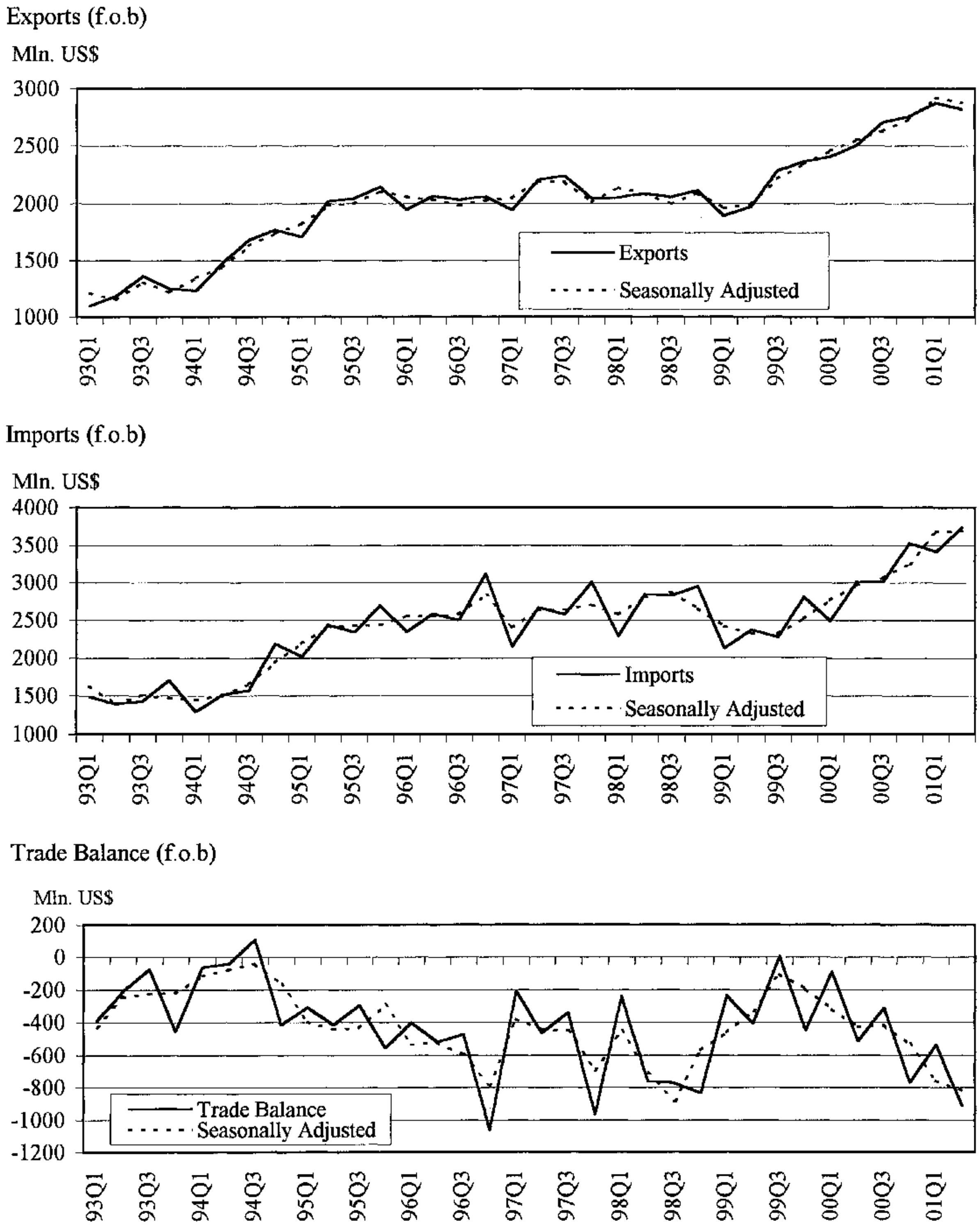
	2000				2001		1999	2000	2001	2002
	Q1	Q2	Q3	Q4	Q1	Q2			proj.	proj.
	(Percentage change over same quarter last year)						(Percentage change)			
GDP	1.2	2.0	2.2	1.3	4.8	5.0	-2.3	1.6	4.5	5.0
Domestic Demand	-0.4	4.9	3.2	9.1	10.1	7.8	-4.8	4.2	6.0	5.3
Final Consumption	-4.4	1.0	0.2	9.4	6.7	6.2	-4.4	1.7	5.0	3.6
Household Consumption	-6.5	-1.4	-0.8	5.5	7.2	7.9	-4.6	-1.2	5.0	4.5
Public Consumption 1/	6.0	12.6	5.7	26.5	4.3	-0.6	-3.7	15.6	4.9	-0.1
Gross Fixed Capital Formation	2.3	4.8	7.9	4.6	7.0	6.5	-4.2	5.5	8.9	11.2
Change in Stocks (contribution)	3.4	3.4	1.6	0.6	3.4	1.7	-0.4	1.9	0.4	0.4
Exports of Goods and Services	25.2	29.1	27.1	14.9	24.4	18.1	10.8	23.9	10.1	7.6
Imports of Goods and Services	17.0	33.1	28.4	38.3	36.2	23.2	-1.1	29.1	13.1	7.8
Net Exports (contribution)	1.7	-3.2	-1.1	-8.2	-5.5	-3.3	2.9	-2.8	-1.8	-0.8
Agriculture	0.2	2.4	-12.9	-19.4	-6.3	-1.1	3.4	-15.8	...	...
Industry	1.4	4.1	13.2	3.9	11.8	10.7	-1.5	6.1	...	...
Construction	-0.1	1.5	8.9	8.4	7.0	10.9	-2.3	6.3	...	...
Services	0.6	0.5	1.2	6.4	2.4	2.2	-3.4	3.1	...	...

Source: National Institute for Statistics; and Fund staff projections.

1/ Includes consumption of non-profit institutions serving households, mainly political parties.

9. **Rapid growth in public sector wages and in social transfers were the primary factors behind the growth in consumer spending.** In the run-up to parliamentary elections in November 2000, wage discipline in the public sector broke down. A substantial increase in the minimum wage and collective wage contracts signed in early 2001 exacerbated the problem. As a result, year-on-year public sector wage growth in the first quarter of this year was 52½ percent in nominal terms (9 percent in real terms), somewhat faster than economy-wide wages. In April–July growth in economy-wide net wages was somewhat lower, partly reflecting the effects of the higher employee social security tax, but public-sector wages continued to surpass wage growth in the private sector. In line with promises made in the election campaign, the budget approved by the new government also provided for an increase in social transfers of 8 percent in real terms.

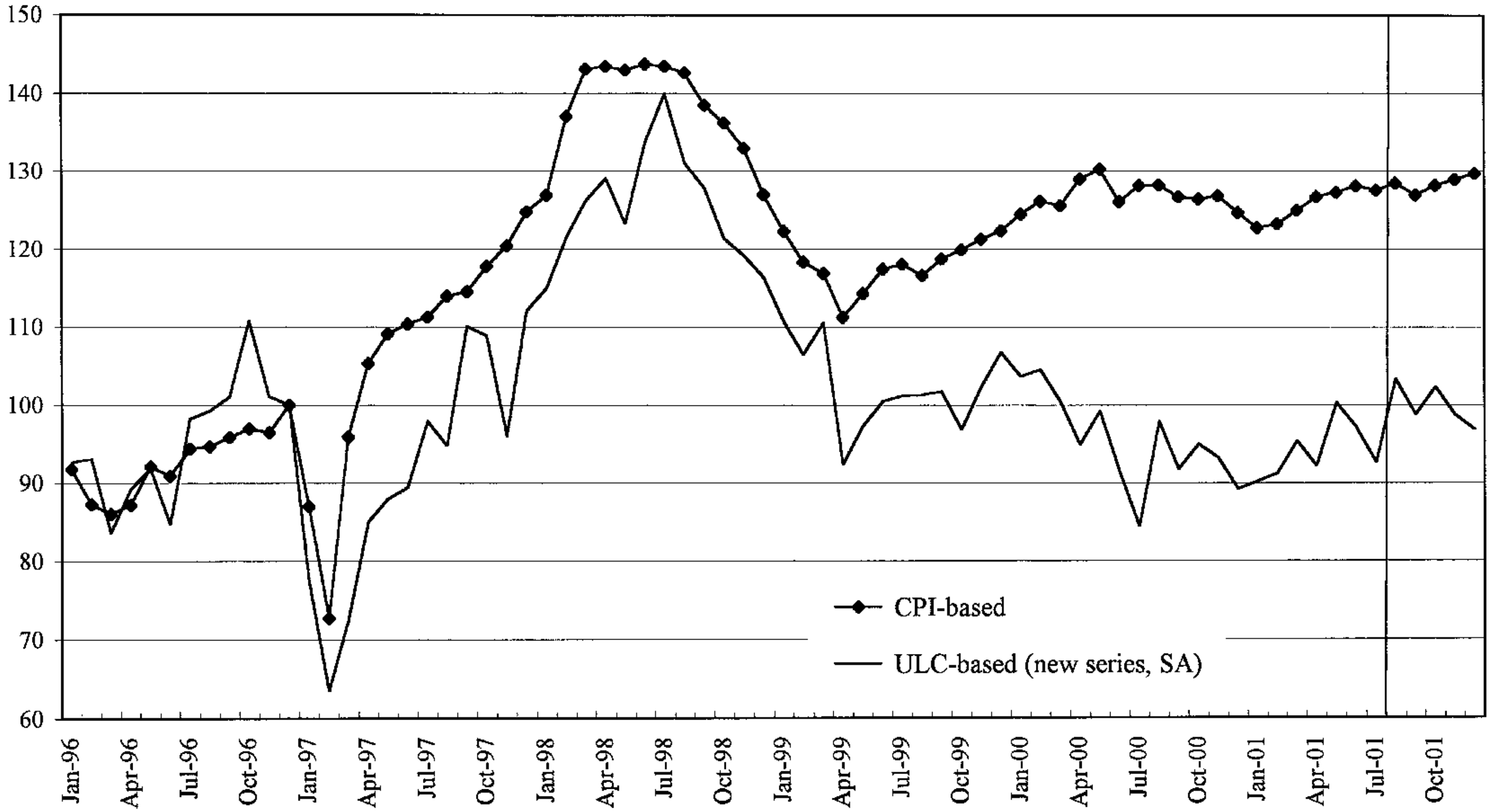
Figure 1. Romania: Exports, Imports and Trade Balance, 1993-2001



Source: Romanian Authorities; and Fund staff calculations.

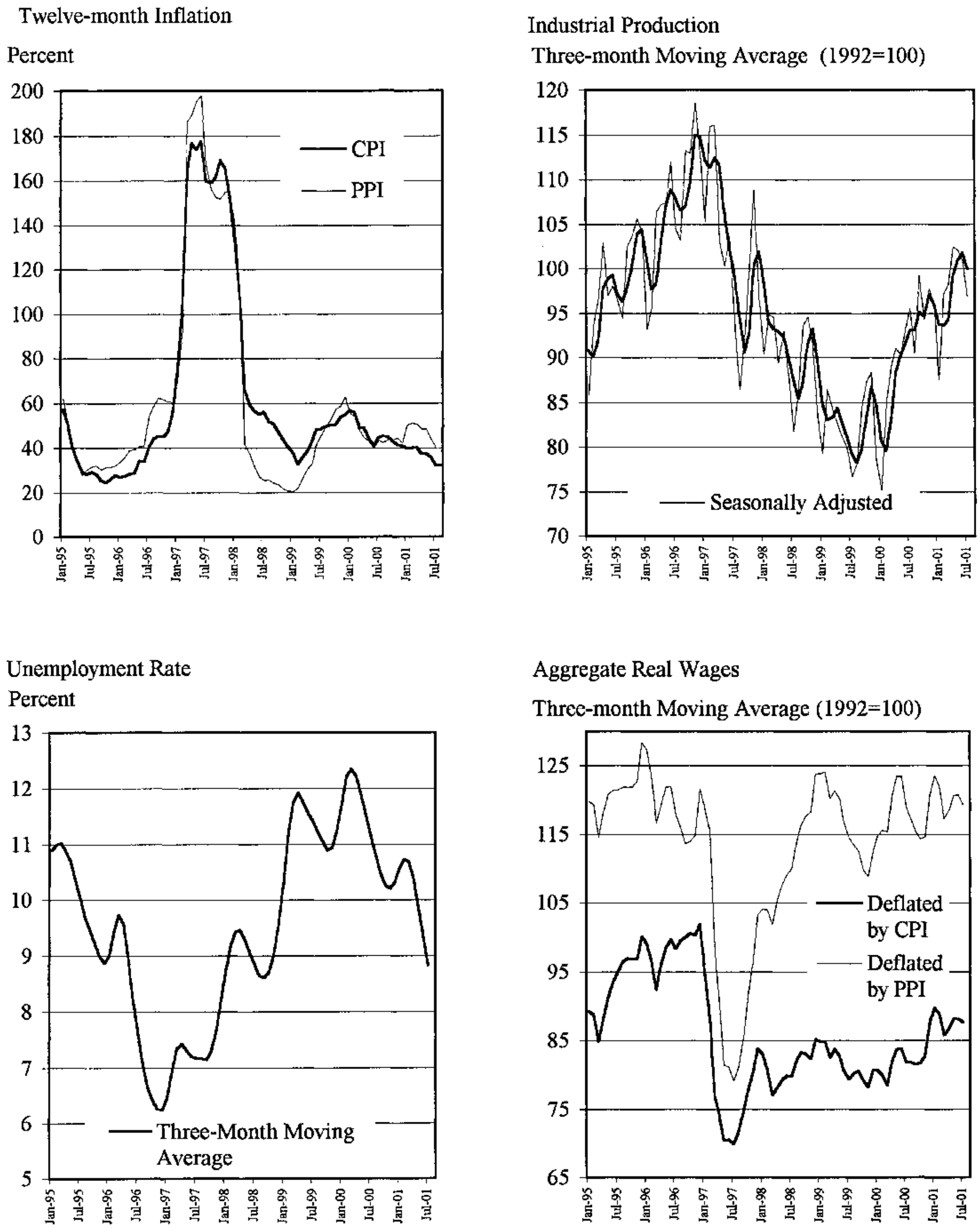
Figure 2. Romania: The Real Exchange Rate, 1996-2001

December 1996 = 100



Source: Romanian authorities; and Fund staff calculations.

Figure 3. Romania: Economic Indicators, 1995-2001



Source: Romanian authorities; and Fund staff calculations.

10. **Financial discipline of state-owned enterprises deteriorated.** Arrears of large state-owned enterprises, which are a perennial problem in the Romanian economy, increased in the year to July by 38 percent in real terms, owing to weak wage discipline and increased investment spending. The deterioration in the financial performance in the energy sector was particularly pronounced. Owing to the delayed adjustment in the electricity and heating prices and the faltering efficiency in collections, the losses in the main thermo-power supplier, Termoelectrica, more than doubled in the first half of 2001 relative to the same period in 2000, and in the absence of corrective measures would have reached more than 2 percent of GDP by end-2001. In the natural gas sector, as the user price was not adjusted in line with the rising import prices, the implicit subsidy to end-users was set to increase by 1 percentage point of GDP (see Box 1 on the losses and implicit subsidies of the energy sector).

11. **The latest data indicate that in the first eight months of the year, fiscal policy did not support disinflation.** The deficit in the first eight months of the year amounted to 2.4 percent of GDP up slightly from the same period of the previous year, despite stronger growth and a lower deficit target for the year as a whole. Moreover, with large savings on interest payments, noninterest expenditure of the general government grew by about 12 percent in real terms.

12. **The NBR has continued to conduct monetary policy in the framework of a managed float, with the objective of avoiding excessive real effective appreciation.** The average monthly depreciation rate relative to the U.S. dollar slowed from about 3.3 percent, in the second half of 2000, to 1.5 percent during June–August 2001 (Figure 4). However, the NBR succeeded in increasing its official reserves by about US$1.2 billion during January–August, in spite of the sharp widening in the current account deficit. This was a result of public net borrowing abroad, equivalent to US$955 million, and private sector inflows that were attracted by the growing differential between the crawling rate and the lei interest rates, as well as by the perception of a decline in the country risk. In the face of inflows, the NBR let nominal domestic interest rates decline in the second quarter of 2001 (Figure 5); however, with falling inflation, real interest rates remained at about 10 percent (Figure 6).

13. **Progress has been achieved in improving the soundness of the financial sector.** The major achievement in this regard is the sale of Banca Agricola to a reputable Austrian bank. Although the vast majority of the banking sector in terms of market share can now be considered as sound or fairly sound and the capital adequacy ratios are much above the usually recommended prudential levels, some significant weaknesses remain. The informativeness of prudential ratios needs to be enhanced by a move to international accounting standards by the banks. The recent problems with two small banks raised the issue of NBR's insufficient authority to screen purchases of shares by investors that act as a group, with each individual investor purchasing less than 5 percent of shares. The FNI scandal—a fraudulent collapse of the country's largest mutual fund in May 2000, which raised serious governance issues—still remains to be sanctioned by the court.

Box 1. Romania: Energy Sector: Losing Money and Providing Subsidies

A failure to adjust energy prices, combined with poor collection and payments discipline, has put the energy sector in Romania in a precarious state. In the electricity and heating sector, the most acute problems are focused in Termoelectrica, which is the dominant thermo-power producer, supplying more than 50 percent of consumed electricity and about 40 percent of heat to industrial users and district heating companies. While the losses of Termoelectrica units in 1999 were modest, at about US$60 million, they skyrocketed to US$270 million in 2000, and without price adjustments in July and those envisaged under the program, would have reached US$580 million in 2001. The increase in losses reflected rising input costs, which resulted from a combination of more expensive fuel supplies, exchange rate depreciation, and delayed adjustments in lei denominated prices. In addition, Termoelectrica also has grave problems with collecting its bills, with the efficiency of collection of only 82 percent in 2000, which have worsened in the first half of 2001. By adjusting for the losses on collection, which under current Romanian accounting rules are not included in the above estimates, total losses would have increased by almost 1 percentage point of GDP in 2001 relative to 2000. While in the past the losses were financed primarily by tax arrears, Termoelectrica has recently started borrowing large amounts abroad using government guarantees.

The implemented adjustments of heating and electricity prices by 57 percent and 15 percent in July, respectively, along with further adjustments that the authorities have agreed to under the program, will bring Termoelectrica's electricity price to cost-recovery by April 2002, and its heating price to cost-recovery by July 2002. The authorities have publicly announced that prices will now be adjusted monthly, in line with the above-mentioned targets. Finally, the authorities target a substantial increase in the collection rate of Termoelectrica, by establishing escrow accounts for district heating payments, and by ensuring a 100 percent collection rate from the electricity distribution company to Termoelectrica. (The collection rate of the electricity distribution company is at a satisfactory level of about 97 percent, but revenue is not being transferred to Termoelectrica.) Together, these actions will ensure that Termoelectrica's loss in 2001 (as a percentage of GDP) will not increase relative to 2000, and will be reduced relative to GDP by almost 1 percentage point in 2002.

Table 1. Termoelectrica's Losses, 2000-2002

	2000	2001 (w/o adjustments)	2001 (w/ adjustments) 1/	2002 (w/ adjustments) 1/
Heating				
Cost recovery price ($/Gcal)	22.0	20.0	20.0	20.0
Current prices ($/Gcal, year-average)	10.5	10.4	12.4	17.0
Termoelectrica's heating output (million Gcal)	22.4	25.9	25.9	25.9
Termoelectrica's losses from heating ($m)	258	249	198	77
Thermal Electricity				
Cost recovery price ($/Mwh)	34.7	40.0	40.0	40.0
Current prices ($/Mwh, year-average)	34.3	28.5	31.8	38.4
Termoelectrica's electricity output (million Mwh)	28.6	28.6	28.6	28.6
Termoelectrica's losses from electricity ($m)	11	329	234	47
Total losses from operations ($m)	269	578	431	123
(In percent of GDP)	0.7	1.5	1.1	0.3
Collection rate (%)	82	75	95	98
Total losses including non-collection ($m)	485	848	493	162
(In percent of GDP)	1.3	2.2	1.3	0.4

Source: ANRE (electricity regulatory agency); World Bank; staff estimates.

1/ Based on increases in heating prices, electricity prices, and collection rates, as described in the LOI.

Box 1. Romania: Energy Sector: Losing Money and Providing Subsidies (Cont'd)

Another problem is the natural gas sector. Romania is a relatively large producer of natural gas, with production of about 14 billion cubic meters in 2000, but annual production has dropped by 26 percent since 1994, and is currently declining at about 6 percent per annum. As almost no new exploration is taking place, a rising share of consumption is covered by imports, which reached 17 percent of consumption in 2000. The decline in production reflects a low wellhead price for domestic production, which has recently been kept on average at US$35 per thousand cubic meters (tcm). Moreover, the collection rate of the gas distribution companies has been weak, in particular from industry and power generation, and has deteriorated so far in 2001. When import prices surged from about US$65/tcm in 1999 to US$120/tcm in 2000, the implicit subsidy to domestic users jumped from 1.6 percent of GDP in 1999 to 3.4 percent in 2000 (see Table 2 below). Without an adjustment in prices, and with import prices increasing even further to $130/tcm, the implicit subsidy would have reached 4.5 percent of GDP in 2001. It is possible that the expansion of exports in several sectors in 2000 and 2001 reflected the increase in implicit subsidies through below market gas price and partial collection for deliveries. Moreover, until recently, prices for industrial users have varied widely on a discretionary basis, which created additional distortions.

In August, the authorities unified end-user prices for natural gas, and raised prices substantially (90 percent for households), and they plan to maintain the dollar price of natural gas via quarterly adjustments in the lei price. Collection rates are also to be improved substantially, through the use of escrow accounts and special task forces within the gas distribution companies. With these decisions, the value of the implicit subsidy on an annual basis will be held to 3.6 percent of GDP in 2001, and reduced to 2.8 percent of GDP in 2002.

Combined, as a result of the implemented measures, losses in the energy sector and the implicit subsidies provided to energy users are set to decline by 1.7 percentage points of GDP in 2002. This will, however, be partly offset by higher investment in the energy sector, a transitory weakening in the financial performance of energy-intensive state-owned enterprises and higher tax payments to the budget, which will reduce the net effect on the saving-investment balance to about ¾ percentage points of GDP.

Table 2. Implicit Subsidy From Natural Gas, 1999-2002

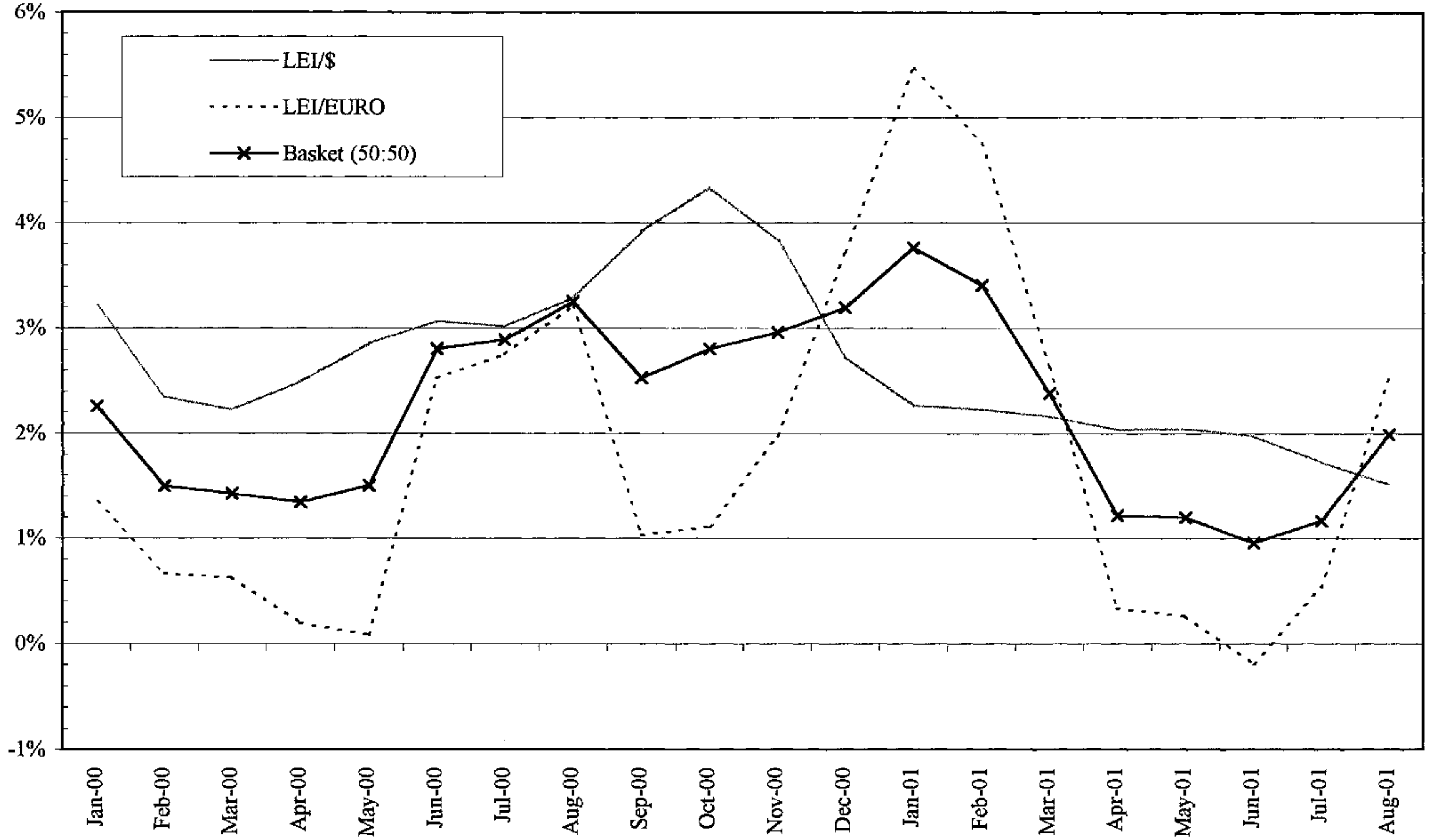
	1999	2000	2001 (w/o adjustments)	2001 (w/ adjustments) 1/	2002 (w/ adjustments) 1/
Natural Gas Production					
Import price (average, $/tcm)	65	120	130	130	120
Domestic wellhead price (average, $/tcm)	35	35	26	35	46
Domestic output (million tcm)	14	14	14	14	14
Loss from low prices ($m)	420	1190	1455	1327	1025
Total supply to end-users, incl. transp. & dist. ($m)	568	566	1103	1103	1155
Collection rate (% of billing collected)	74	87	76	95	98
Losses from non-collection ($m)	148	74	270	55	29
Total implicit subsidy ($m), of which:	568	1264	1725	1382	1054
Total implicit subsidy (In percent of GDP):	1.6	3.4	4.5	3.6	2.8

Source: ANRGN (gas regulatory agency); World Bank; staff estimates.

1/ Unified price for natural gas increased to $82.50/tcm on August 10, 2001, and maintained at that dollar price by regular quarterly adjustments to end-2002. Cumulative collection rate of Distrigaz Nord and Distrigaz Sud improved to 95 percent by end-2001, 97.5 percent by end-2002.

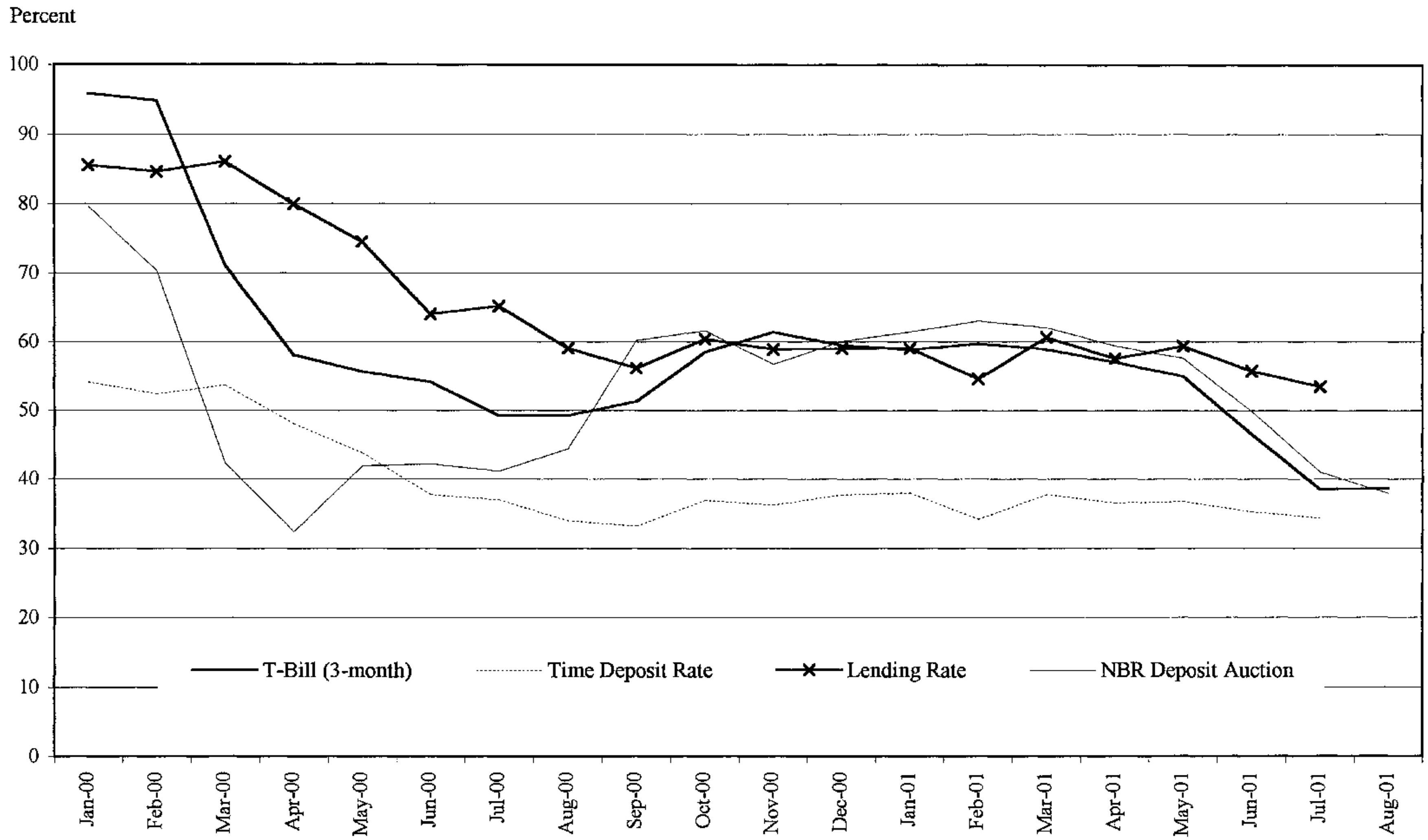
Figure 4. Romania: Monthly Depreciation Rate of Lei, 2000-01

(Three-month Moving Average)



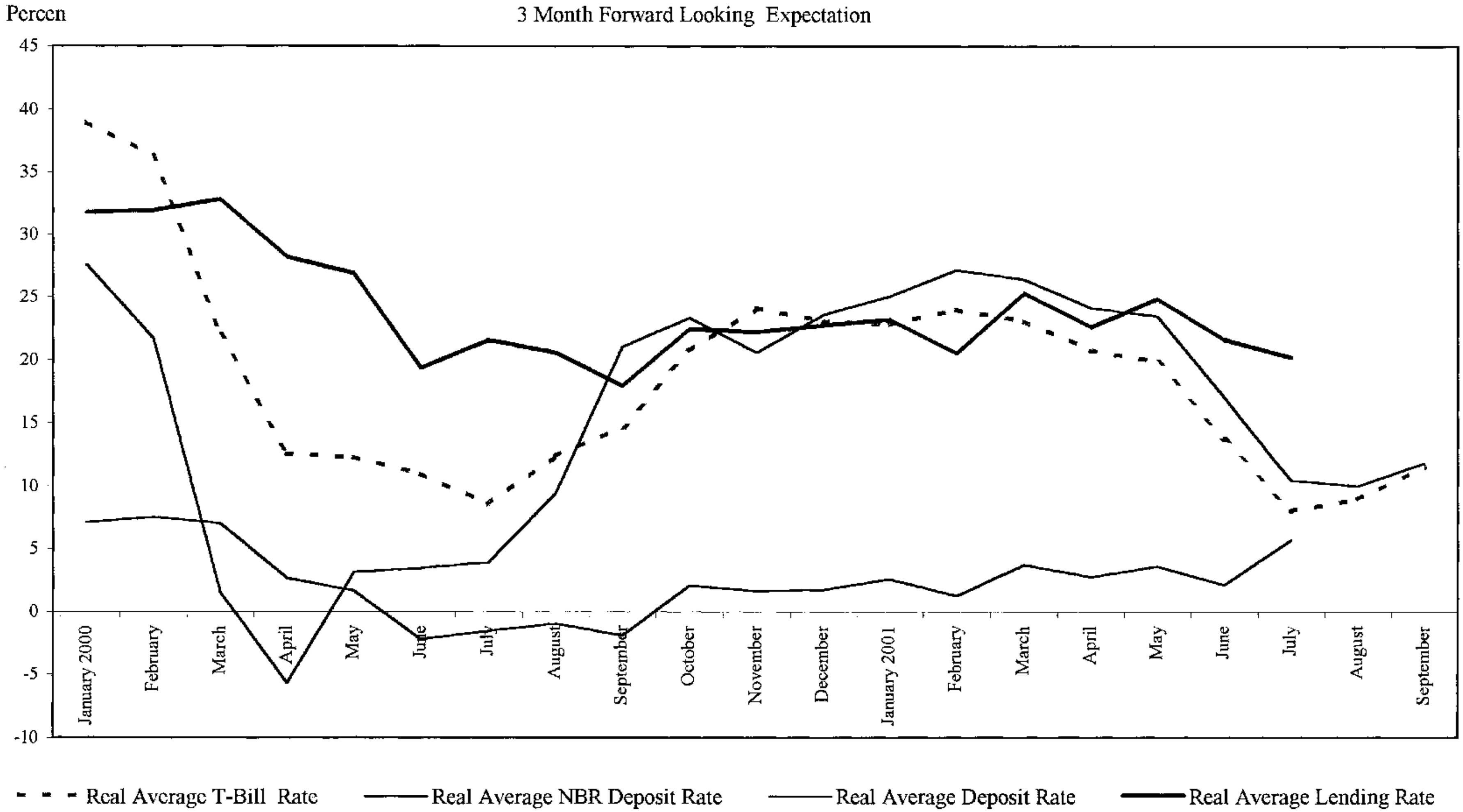
Source: Romanian Authorities; and Fund staff calculations.

Figure 5. Romania: Evolution of Nominal Interest Rates, 2000-01



Source: Romanian Authorities; and Fund staff calculations.

Figure 6. Romania: Evolution of Real Interest Rates, 2000-01



Source: Romanian Authorities; and Fund staff calculations.

14. **Privatization in the enterprise sector was extremely slow in the second half of 2000, and in the first half of 2001.** Although a large number of companies were to be prepared for privatization under the PSAL I operation, which was completed in mid-2000, the actual privatization was very slow. Moreover, two mid-size privatization deals unraveled. The authorities have signed a privatization contract for the largest state-owned steel producer, SIDEX, but this deal is still subject to uncertainty given its complexity. The main reasons for the slow pace and set-backs in privatization, appear to be large tax debts of the state-owned companies, and the government's practice of insisting on investors' commitment to large investment plans and limiting layoffs for an extended period. The use of open and transparent tenders for privatization has remained insufficient.

III. The Authorities' Program of Macroeconomic Stabilization and Reform

15. **The authorities' program aims at gradual disinflation and containing the external current account deficit, while keeping the positive growth momentum and accelerating structural reforms.** The gradual approach to disinflation—from 40 percent in early 2000, to 22 percent at end-2002—reflects difficulties in eliminating the backward looking wage indexation. The targeted decline in the external current account, from an annual rate of 7 percent of GDP in the first half of 2001, to 5½ percent of GDP in 2002 reflects assumptions that output will continue to grow at about 5 percent, primarily on account of a strong pick-up in private investment.[2] To achieve these goals, the key points of the program are: (i) fiscal adjustment equivalent to ½ percentage point of GDP in 2002; (ii) a reduction in the energy sector losses by 1.7 percentage points of GDP, which will, conservatively estimated, improve the saving/investment balance of public sector enterprises by at least ¾ percentage points of GDP; (iii) public sector wage policy consistent with the disinflation target, and lower labor costs in state-owned enterprises; (iv) a gradual reduction in the depreciation rate, with an eye on external viability; (v) structural reforms that include an ambitious privatization agenda to downsize the public sector and measures to improve the business climate; and (vi) strengthening of the regulatory framework and supervision in the financial system.

[2] Data probably overstate the size of the current account deficit insofar as sizable errors and omissions likely include unreported remittances. FDI inflows are probably understated as they too may be partially recorded in errors and omissions.

A. Fiscal Policy

16. **The measures agreed under the program provide for fiscal tightening in the remainder of 2001 and in 2002.** In the budget rectification approved in August, the government tightened the general government deficit target to 3.5 percent of GDP (the original target was 3.7 percent of GDP; see Table 3), which will imply substantial tightening in the remainder of 2001. In this context, the authorities agreed to a mechanism that would provide for cuts in discretionary spending, including a partial freeze of capital expenditure in the fourth quarter. The higher-than-expected deficit in the first eight months of the year indicates that the authorities will indeed need to apply this mechanism (¶9[3]). Further fiscal consolidation is envisaged for 2002, with the deficit declining to 3.0 percent of GDP, in line with the medium-term economic strategy submitted to the EU. The mission and the authorities also agreed on a prudent revenue envelope for the 2002 budget, which takes into account a downward risk in growth (¶11).

17. **The program provides for an ambitious set of measures to improve the structure of the tax system and to bolster the business climate (¶12).** Payroll taxes will be reduced by 3 percentage points with a view to offsetting a similar increase in 2001 of social security taxes, which were already extremely high. As a major effort to improve the business climate, the new profit tax law will eliminate distortionary incentives under several laws and replace them with a uniform 20 percent investment tax allowance. Customs duty and VAT exemptions for raw materials imported by small- and medium-size enterprises will be eliminated. The new VAT law, effective on January 1, 2002, will substantially lower the number of VAT exemptions and items subject to the zero-rate and will reduce delays in VAT refunds to less than 30 days. The authorities also imposed restrictions on tax rescheduling, extended in practice primarily to state-owned companies; such rescheduling had started to be seen by the private sector as creating an uneven playing field.

18. **The authorities agreed on several other important measures to improve transparency in fiscal operations (¶8 and 16).** The plan to convert called guarantees into government-owned equity, which would have led to an unintended re-nationalization of some privatized enterprises, will be replaced by stronger efforts to improve collections, including the sale of claims to the private sector. Measures under the program will also discourage pressures to extend government guarantees for enterprises. Furthermore, the government agreed to discontinue the practice of using privatization receipts as collateral for bank lending to state-owned companies.

19. **On the expenditure side, the 2002 budget will balance expenditure saving measures with measures to improve social protection (¶13–14).** After substantial increases in late 2000 and the respective carry-over effects in 2001, budget sector average wages will remain constant in real terms in 2002. Subsidies will be reduced by 11 percent in real terms, which will improve incentives for private and public companies to become more

[3] Indicates the paragraph in the Memorandum of Economic and Financial Policies.

competitive. The new Minimum Income Guarantee scheme—involving additional spending of about ½ percent of GDP—will substantially improve the system for supporting the poorest groups of the population and mitigate the impact of the energy sector reforms. The child allowance will also be increased and its targeting improved. To compensate for the inequitable treatment of pensioners who retired before 1999, the government will adjust their pensions over a three-year period, while mitigating the impact of this measure by adjusting pensions with less than the forecasted inflation (¶15).

B. Measures to Address the Quasi-Fiscal Deficit

20. **The government's program includes strong measures to reduce losses in the electricity and heating sector and eliminate the implicit subsidy to natural gas users (¶18–19).** Following the adjustments in electricity, heating and gas prices already approved in July, the authorities decided to give priority to further raising the electricity price to the cost recovery level by April 2002; this is also a condition for continued World Bank lending to the electricity sector. The national reference price for heating, as set in July, will be preserved in U.S. dollar terms through the coming winter season, but then it will be increased to a level of cost recovery for the largest heat producer as of July 2002. The natural gas price would also be preserved constant in U.S. dollar terms until the end of 2002. The gap relative to the gas market price in the region will then start to be closed further as of January 2003; by that time, the government will amend tax legislation to recover part of the windfall gains of domestic producers.[4]

21. **Measures to improve the collection rates of the main utilities will additionally enhance the financial performance of the energy sector (¶19).** Following the recommendations of World Bank experts, the government has agreed to establish a system of escrow accounts to ensure that a fixed percentage of the final customer payments, as well as subsidy payments by the government, is immediately transferred to the main thermo-power supplier and the two gas companies, circumventing the local heat-distribution companies which have poor payment records. In addition, the government will create special task forces in charge of improving collections and reducing arrears from the 20 largest nonpayers to gas companies; the Ministry of Industry will prepare monthly reports on the progress in this area and share it with Fund and World Bank staff.

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[4] The World Bank and Fund staff discussed how to coordinate the approach to energy price issues and to the problem of reducing arrears under the two parallel operations, the PSAL II and the Stand-By Arrangement. At the initiative of the Bank, it was agreed that in light of quarterly reviews, the Stand-By Arrangement would provide a better opportunity to monitor progress in the implementation of jointly developed positions on both issues.

C. Wage Policy

22. **On public sector wage policy, the government has agreed to prevent any increase in wages in 2001 above that in the approved budgets of state-owned companies, and to approve a comprehensive program for containing wage growth and reducing employment in the state-owned companies in 2002 (¶21).** After the substantial increases in wage costs in 2001, growth in wage bills of state-owned companies will be limited on average to 22 percent, implying a reduction of about 3 percent in real terms. To achieve this, as prior actions, the government will impose a partial hiring freeze in state-owned industries and it will decide on ceilings for wage growth on individual companies consistent with the above-referenced target. Moreover, the budgets for the state-owned companies will be approved before the end of 2001. The government will also ensure that the 2002 social pact with the trade unions is consistent with the above-referenced objectives, and it will slow down the implementation of its plan to raise the statutory minimum wage.

D. Monetary Policy and Financial Sector Reform

23. **In the field of exchange rate policy, the mission and the authorities agreed that the current framework of managed float is appropriate for achieving further disinflation and preserving the external equilibrium (¶22).** Aided by the strict implementation of wage and fiscal policies, the NBR will attach more weight to the inflation objective, while not putting external viability at risk. The exchange rate's average monthly depreciation will be lowered further in 2002, consistent with the disinflation objective. The weight of the euro in the notional basket used by the NBR to decide on interventions will be gradually increased, to provide more stability vis-à-vis the main trading partners. By reducing the frequency of interventions, the NBR will also provide wider room for fluctuations in the exchange rate to discourage short-term capital inflows. The NBR also agreed that, at this stage, nonresident short-term investments in lei instruments should not be encouraged by eliminating the existing legal restrictions.

24. **In the context of the recent rapid decline in nominal interest rates, understandings were reached that their further reduction needed to be postponed until after the tightening in the fiscal and quasi fiscal stance has become effective.** It was also agreed that, should substantial pressures on the external position develop, the NBR would defend the inflation objective and the exchange rate primarily by increasing interest rates; interventions in the foreign exchange market would be limited, with a view to safeguarding reserves.

25. **The monetary program reflects money demand projections consistent with nominal GDP growth and a continuing gradual remonetization.** Broad money is projected to increase by 5½ percent in real terms (Table 4). The program also cautiously assumes that the government will reduce its borrowing from non-banks, and that the commercial banks will increase their net foreign assets to cover part of the growth in their liabilities for foreign currency deposits. As a result, credit to the private sector (both lei and foreign currency denominated) can grow by about 7 percent in real terms. Reserve money is

prudently projected to increase by only 3 percent in real terms. Based on this, the NDA ceiling for the NBR is set to allow the targeted increase in NFA equivalent to US$500 million, and in the official reserves of US$600 million.

26. **The staff and NBR agreed that the recent decline in spreads and the increase in deposit rates in real terms was conducive to the disinflation effort.** In this context, the mission supported the NBR's intention to further lower the mandatory reserves requirement on lei deposits to 25 percent in October (¶23). Monetary effects of this measure will be sterilized with open market operations. The authorities will consult staff about possible further reductions in the future.

27. **The mission and the authorities fully shared views on the measures to strengthen the supervisory and regulatory framework of the financial sector (¶24).** These measures would move Romania closer to the best international practices, as defined in the Basel Core Principles, and toward European Union harmonization, bolstering confidence in the financial system. The quality and reliability of financial data will be much improved through the introduction of International Accounting Standards. More robust prudential norms will be introduced—in particular as regards loan classification and foreign exchange exposure—to better prevent the recurrence of financial sector problems, while the powers vested in supervisors will be enlarged to accelerate the completion of the clean-up of banks.

E. Privatization

28. **After a slow start, the government is now firmly committed to moving ahead with several major projects.** As a prior action, by early October the government has approved the privatization strategy for the largest state-owned bank, BCR, which will involve the complete sale of the state's share of the capital and transfer of control to a strategic investor by end-2002 (¶30). Both gas distribution companies and two out of eight electricity distribution companies are to be privatized by end-2002, steps that would provide for a long-term solution for the efficiency of collections and the elimination of arrears (¶19). The PSAL II includes privatization of a large number of mid-size companies (¶32). The mission also encouraged the authorities to use the opportunity to privatize two profitable companies in the aluminum sector (ALRO and ALPROM), and one in the oil sector (Petrom) in an open and transparent manner, which would not only attract a larger number of competitors, but could also send an extremely effective signal to other potential investors that the investment climate is improving. The authorities also agreed to accelerate privatization by writing off tax debts of companies at the moment of their sale, the amount of which would be stipulated in privatization tenders.

IV. Medium-Term Outlook, External Vulnerability, and Prospects For Repaying the Fund

29. **With the implementation of the program's policies, the medium-term outlook is favorable.** The sharpness of the projected widening of the current account deficit this year is due in large part to the impact of the drought and the increased quasi-fiscal stimulus.

However, continued strong export growth and real exchange rate developments suggest that competitiveness remains sound. With effective policy implementation over the program period and medium term, the current account deficit is projected to decline to 5 percent of GDP (Table 5), a level consistent with the projected pick-up in private sector investment, FDI, and GDP growth. The projected current account deficits also imply only a minor increase in foreign debt-to-GDP ratio, to a still moderate level of 32 percent of GDP, while the net external debt will decline. Import growth will slow in response to the fiscal contraction in 2002, and reductions in the quasi-fiscal stimulus, as a result of, inter alia, further improvements in energy sector profitability and privatization. The contractionary impact of these measures will be partially offset by higher private sector import demand due to continued strong growth, and a further strengthening of investment (Table 6). Given the expenditure priorities associated with structural reform, in particular measures to accelerate EU accession, the general government deficit will only gradually be reduced over the medium term.

30. **The strong increases in official reserves in 2000, and thus far in 2001, have lessened Romania's external vulnerability in the short term.** Reserve levels, though somewhat low in months of imports, currently exceed short-term debt by remaining maturity (Table 8). However, sustained capital inflows will be essential to maintain external viability over the medium term, and until the recent widening in the current account deficit is reversed, Romania will remain somewhat more vulnerable to a deterioration in market sentiment. Projected financing gaps would be fully covered by exceptional financing from the IMF, World Bank and EU (Table 7).

31. **A Potential external risk to the program is a global slowdown in growth in 2002 that could now be more pronounced after the terrorist attack on the U.S.** This could affect Romania through the export and investment channels, and through disturbances in financial markets. Romania's recent robust export performance indicates that the impact of a slowdown could be moderate, particularly since it is expected that Romania's main trading partners in the EU will avoid recession. The envisaged measures for improving the business climate and accelerating the privatization could also attract foreign investment despite the slowdown elsewhere. The successful placement of Petrom's eurobond in late September, and moderate widening in sovereign spread, indicate that Romania has retained access to financial markets. However, given the planned sovereign issues for 2002, Romania could face substantial financing gaps if market sentiment toward transition economies deteriorates. The situation will, therefore, need to be monitored, and possible modifications to the program, which could include a combination of additional adjustment and financing, could be considered at the time of the first review.

32. **The staff believe Romania has the capacity to make timely repurchases from the Fund.** Over the medium term, debt service to the Fund, including on prospective purchases, would be moderate, averaging 3.8 percent of total external debt service or 0.8 percent of export of goods and non factor services (Table 9). The medium-term debt service profile is fairly smooth, though with some quarterly peaks due to maturing bond obligations. Although public sector external borrowing increased substantially this year, largely due to the financial

difficulties of the energy sector, it is projected to drop in 2002, and remain roughly constant over the medium term.

33. **An external audit of the NBR's financial statements is expected to be completed in October, and staff will inform the Board about the outcome.** A full stage one safeguards assessment is expected to be completed by the first review of the program. Staff is in the process of obtaining the necessary information from the NBR.

V. Design of the Proposed Stand-By Arrangement

A. Modalities of the Arrangement

34. **The arrangement is proposed to be for 18 months with a program period from end-September 2001 to end-March 2003.** Under the arrangement total access of SDR 300 million (29 percent of quota or 20 percent of quota on an annualized basis) would be made available in seven purchases (Table 10). This access level, which is low relative to Romania's quota, reflects the projected balance of payments financing need, and is consistent with strengthening Romania's reserve position and catalyzing additional financing, from both official and private sources. Romania's outstanding use of Fund credit is low at 29 percent of quota, and, as discussed in paragraph 32, debt service to the Fund will remain at comfortable levels. Test dates are set at the end of each quarter and purchases are evenly phased, given the lack of an exceptional immediate balance of payments need.

B. Program Monitoring

35. **To reduce the implementation risk, the program provides for several prior actions as specified in Attachment I of the MEFP.** The government has already implemented several of these actions, including the submission of the budget to parliament, the approval of the privatization strategy for BCR, cancellation of Emergency Ordinances 195/2000 and 62/2001, and the required increase in electricity and heating prices. Substantial progress has been made on several other prior actions: an order to establish escrow accounts in district heating has been issued, but the implementation has to be confirmed; and a report on improving collections in gas distribution needs to be discussed by the government so that it can be communicated to the Fund staff. The government is aiming to complete all the remaining prior actions by October 19.

36. **Reviews will be conducted on a quarterly basis.** In addition to the main financial performance indicators, they will be devoted to assessing progress in implementing the structural elements of the program, in particular those regarding energy price adjustments, wage discipline, and steps to privatize BCR. Agreement on the 2003 budget will be a condition for completing a review.

37. **Structural conditionality, limited to four performance criteria and four structural benchmarks, is listed in Annex B of the MEFP.** As discussed in Box 2, structural conditionality is focused on core areas such as wage restraint, fiscal reform, and banking sector reform. Conditionality set in noncore areas, namely energy sector reform and

privatization, concentrates on measures which the staff deem critical to the success of the program: (i) adjustment in energy prices and the improvement in efficiency of collections of the main utilities are critical for reducing the quasi-fiscal deficit; (ii) the privatization of the state-owned bank, BCR, is a major step toward disengaging the government from commercial banking.

Box 2. Romania: Structural Conditionality

1. Coverage of Structural Conditionality in the Proposed Program

Structural conditionality is set on measures in the following areas: (i) financial sector reform; (ii) fiscal reform; (iii) incomes policy; (iv) measures for addressing the quasi-fiscal deficit in the energy sector; and (v) privatization and restructuring of state-owned enterprises. Reforms in all these areas are macro-relevant and critical for the achievement of the program's macroeconomic objectives. In particular, measures on price adjustments and improving the collection efficiency in the energy sector are both critical to reducing the quasi-fiscal deficit, and re-establishing financial viability in this key sector. As mentioned in the footnote 4 of the text, conditionality in this area has been established in close cooperation with the World Bank and its inclusion in the Stand-By Arrangement reflects a common view that this is a more effective way to monitor its implementation. Conditionality on the privatization of the largest bank, BCR, holding 40 percent of banking sector assets, reflects its importance for strengthening banking sector soundness.

2. Status of Structural Conditionality from Earlier Programs

Under the last Stand-By Arrangement (see EBS/00/87), structural conditionality was set in the following areas: (i) fiscal reform; (ii) financial sector reform; (iii) privatization; and (iv) the recovery of bad assets by the Asset Recovery Agency (AVAB). The fiscal and financial reform measures were met with the exception of the measure on BCR, which has now been taken over and strengthened under the proposed program. Regarding enterprise privatization, most of the structural conditions remained unfulfilled. Nevertheless, conditionality in this area has been significantly streamlined, as these measures will be covered under the World Bank's PSAL II program. Targets on AVAB's recoveries were met, though recent changes to the agency make the outlook for future recoveries less certain. However, given what has been achieved and the availability of other sources of finance for the fiscal deficit, this area is no longer deemed critical to the program's macroeconomic objectives and conditionality has therefore been dropped.

3. Structural Areas Covered by World Bank Lending and Conditionality

The authorities are shortly expected to complete negotiations on a second Private Sector Adjustment Loan (PSAL II) with the World Bank, in which conditionality will be set in four areas relevant to the Fund program: (i) enterprise reform and privatization; (ii) energy sector reform; (iii) improving the business environment; and (iv) social sector and pension reform. In addition, there is an ongoing energy sector loan in support of restructuring and privatization efforts in that sector.

4. Other Relevant Structural Conditions not Included in the Proposed Program

There are no direct structural conditions related to improving governance for several reasons: (i) it is expected that structural conditions in other areas, for example financial sector reform and privatization, will help to improve governance; and (ii), other agencies, in particular the EU and to a lesser extent the World Bank, are taking a leading role on this issue.

VI. Staff Appraisal

38. **The Romanian authorities, in cooperation with Fund staff, have prepared an 18-month program of macroeconomic stabilization and structural reforms and have requested support for the program under a Stand-By Arrangement.** The main macroeconomic objectives of the program are to bring down inflation, contain the external current account deficit at a sustainable level, and implement structural reforms that will assure that the Romanian economy stays on a rapid and sustainable growth path. The authorities' program reflects their strong commitment to accelerate EU accession and achieve NATO membership for their country.

39. **To establish foundations for a more balanced growth, the program includes measures for fiscal consolidation in the remaining period of 2001 and in 2002.** The tightening in the general government budget deficit of ½ percent of GDP, and in the quasi-fiscal stance of about ¾ percentage points of GDP, will support disinflation and will contain the recent overly fast growth in domestic consumption, while reducing the burden imposed on monetary policy.

40. **To address the quasi-fiscal deficit, the authorities' program includes long-overdue measures to adjust energy prices and address the widespread practice of non-payment**. As the main beneficiaries of the implicit subsidies are state-owned enterprises, this will increase pressure for their privatization or liquidation. In addition, the privatization of the distribution companies in the natural gas sector, and partially in the power sector, will contribute to further strengthening in financial discipline that has been critically lacking so far.

41. **The authorities' program provides for prudent wage policies in the budgetary sector and in public enterprises.** In support of the disinflation objective, the program appropriately targets a modest reduction in the aggregate real wage bill of monitored state-owned enterprises. Following the slippages of wage policies in state-owned enterprises in 2000 and 2001, the program envisages an improved coordination of all elements of wage and employment policies. To this end, the staff welcomes the government's decision to approve the 2002 budgets of state-owned enterprises by end-2001, a measure that will help ensure the achievement of wage growth targets in 2002.

42. **Monetary policy will be a major tool in furthering the disinflation effort.** This will require that overheating is prevented via interest rate policy, while the currency depreciation is slowed down in a sustainable manner. Developments so far have shown that the NBR is in a strong position to control the targeted time paths of these instruments and thus to play a major part in achieving the disinflation objective.

43. **The agreed legislative changes for strengthening the supervisory and regulatory framework in the banking sector are welcome, particularly in the context of the pick-up in private sector credit.** In particular, the new regulation on non-performing loans will limit

the practice of ever-greening, while the enlarged powers of supervisors will reduce the risk of delays in the implementation of corrective measures.

44. **The program includes tax reform measures designed to improve the business climate.** The reduction in payroll taxes, the elimination of distortionary and nontransparent tax incentives under several laws, including those for small and medium-size enterprises, the measures for a timely refund of VAT, and constraints on tax rescheduling and write-offs for state-owned enterprises, seen as unfair by private competitors, constitute important steps for improving the business climate. It will be important for the government to resist pressures to grant ad hoc tax incentives, which has been a detrimental practice in the past.

45. **The government's privatization program, if consistently implemented, will be a crucial step toward completing the transition to a full-fledged market economy.** In particular, the privatization of the largest commercial bank BCR will ensure that credit decisions are based solely on the assessment of risks and expected profits, while government interference will be ruled out. Moreover, the use of possibly large privatization proceeds to retire public debt could increase the room for maneuver for fiscal policy over the medium term, which would be particularly important in case of an economic slowdown or weaker access to the international bond market. The government will, however, need to substantially increase the transparency of the privatization process, including by broadening the scope of privatization through international tenders, as several recent privatization projects have raised concerns in this regard.

46. **Although there are some areas of weakness, Romania's statistical base is adequate for surveillance and program purposes.** Steps have been taken to follow up on the recommendations of the last STA mission. However, the staff urges the authorities to continue to improve the quality of the data, in particular the consistency of the fiscal and financing data. The staff welcomes further efforts that are being made in this regard, in particular the measures to improve monitoring of externally financed investment spending by line ministries.

47. **The implementation risk for the program remains substantial.** Romania's track record under previous governments was extremely weak, and this government's economic policies lacked focus in early 2001. However, the authorities are implementing numerous and substantial up-front actions in key areas, including an early approval of the 2002 state budget and the budgets of state-owned enterprises, which provide assurances for a more consistent policy implementation than under the past arrangements. The quarterly reviews envisaged under the arrangement will assure that corrective measures, if necessary, are implemented in a timely manner.

48. **The main external risks for the program are a more protracted global slowdown after the terrorist attacks in the United States, and instability in financial markets.** The immediate consequences of the terrorist attacks on Romania's growth prospects, through either the export or the investment channel, appear at this stage to be modest, but they have increased the downside risk. The situation will therefore need to be monitored, to ensure that

any needed adjustments are made as early as possible. The approval of the Stand-By Arrangement and the consistent implementation of the associated economic program should, however, limit the extent to which a deterioration in the international market sentiment could affect Romania.

49. **The staff considers that the government's program is strong and that the government is committed to implement it.** The rapid progress in the implementation of the agreed prior actions and the recent close cooperation with staff are encouraging and provide assurances that the program will be implemented. Moreover, the authorities are aware that a persistent effort and the successful implementation of the program are highly important for their objective to accelerate EU accession. The authorities have also assured the staff that they stand ready to consult in case adverse developments require corrective measures. The staff therefore recommends that the Board approves the proposed Stand-By Arrangement.

Table 1. Romania: Main Economic Indicators

	1995	1996	1997	1998	1999	2000	2001 1/	2002 1/
Real economy (change in percent)								
Real GDP	7.1	3.9	-6.1	-5.4	-2.3	1.6	4.5	5.0
CPI (average)	32.3	38.8	154.8	59.1	45.8	45.7	34.1	26.0
CPI (end of period)	27.8	56.9	151.4	40.6	54.8	40.7	29.0	22.0
Unemployment rate (end of period; percent)	9.5	6.5	8.9	10.4	11.8	10.5	8.6	8.0
Gross national saving (percent of GDP)	19.4	18.5	14.5	10.8	13.1	15.7	13.5	14.1
Gross domestic investment (percent of GDP)	24.3	25.9	20.6	17.9	17.2	19.4	19.5	19.7
Public finance (general government, percent of GDP)								
Overall balance	-3.4	-4.8	-5.3	-5.5	-3.8	-4.0	-3.5	-3.0
Primary balance	-2.0	-3.1	-1.4	-0.7	2.4	0.8	0.6	0.6
Money and credit (end of year, percent change)								
Real domestic credit	50.1	15.5	-52.5	21.8	-9.2	7.4	16.6	9.5
Broad money	71.6	66.0	104.8	48.9	44.9	38.0	36.3	28.3
Interest rates (percent)								
NBR interest rates (end of period) 2/	67.0	66.9	138.8	105.0	88.7	60.1	39.8 3/	...
Treasury bill rate (end of period)	...	...	133.5	103.8	99.9	59.4	39.5 3/	...
Balance of payments (percent of GDP)								
Trade balance	-4.5	-7.1	-5.6	-6.3	-3.6	-4.6	-7.3	-7.4
Current account balance 4/	-4.9	-7.4	-6.1	-7.1	-4.1	-3.7	-6.0	-5.6
Official reserves (end-year, US$ million)	1,380	1,593	3,075	2,299	2,472	3,396	4,417	5,038
Reserve cover (months of imports of GNFS) 5/	1.3	1.5	2.9	2.4	2.1	2.4	3.0	3.2
Fund position (end-August 2001)								
Holdings of currency (percent of quota)	...	...	...	...	...	...	128.6	...
Holdings of SDRs (percent of allocation)	...	...	...	...	...	...	1.7	...
Quota (SDR million)	...	...	...	...	...	...	1,030.2	...
Exchange rate								
Exchange rate regime				Float				
Lei per US$ (end of period)	2,558	3,750	7,985	10,951	18,250	25,926	30,235 3/	...
Nominal effective rate (Dec 1996=100)	126	87	42	35	21	16	13	...
Real effective rate (average, CPI-based, Dec 1996=100)	102	93	107	138	118	127	127	...

Sources: Romanian authorities; and Fund staff estimates.

1/ Program, except where indicated.

2/ Weighted NBR average interest rate; from 1997 interbank rate.

3/ September 2001.

4/ In 2000, the current account deficit was revised upwards by 0.7 percent of GDP due to methodological revision of the recording of imports financed by financial leases.

5/ Including gold. Imports of goods and services of the following year.

Table 2. Romania: Balance of Payments, 2000-01

(In millions of U.S. dollars)

	2000	2001				2001	2002
	Act.	Q1 (act.)	Q2 (act.)	Q3	Q4	Prog.	Prog.
Current account	-1,363	-455	-882	-316	-642	-2,295	-2,294
Ratio to GDP	-3.7	...	...	...	...	-6.0	-5.6
Trade balance	-1,684	-536	-916	-451	-878	-2,781	-3,039
Exports	10,366	2,875	2,821	3,025	3,099	11,819	12,699
Imports 1/	-12,050	-3,411	-3,737	-3,476	-3,976	-14,600	-15,738
Services account, net	-539	-91	-215	-120	-39	-465	-433
Receipts	2,020	493	574	503	718	2,288	2,587
Payments	-2,627	-584	-789	-623	-757	-2,753	-3,020
Of which : Interest, net	-472	-38	-105	-136	-91	-470	-460
Unrequited transfers (net)	860	172	249	255	275	951	1,178
Capital account	2,372	754	1,102	397	725	2,978	2,430
Direct investment and capital transfers	1,072	274	285	283	377	1,219	1,457
Portfolio investment	-7	-8	-17	0	135	110	50
Borrowing by public sector 2/	766	288	668	75	122	1,153	523
Loans (net)	632	150	16	75	122	363	380
Disbursements	1,370	374	236	389	358	1,357	1,520
Of which : Direct debt	844	113	84	186	170	552	690
Of which : Government guaranteed	526	262	152	203	188	804	830
Amortization	-739	-224	-220	-314	-236	-994	-1,140
Bonds (net)	134	138	652	0	0	790	143
Disbursements	259	138	652	0	0	790	440
Amortization	-125	0	0	0	0	0	-297
Borrowing by private sector (net)	570	49	186	39	21	295	399
Disbursements	894	110	233	237	261	841	1,075
Amortization	-324	-61	-47	-198	-240	-546	-676
Trade credit (net)	-29	151	-20	0	70	201	0
o/w short-term (net)	5	150	-20	0	70	200	0
Net errors and omissions	526	138	452	42	-140	492	300
Overall balance	1,534	437	672	122	-57	1,175	437
Financing	-1,534	-437	-672	-122	-258	-1,489	-797
Net foreign assets NBR (increase, -)	-1,094	-413	-829	-51	-258	-1,551	-717
Assets (increase, -)	-928	-369	-790	69	69	-1,021	-621
Liabilities	-166	-44	-39	-120	-327	-530	-97
IMF, net	20	-19	-39	-20	-40	-118	-97
Purchases	115	0	0	0	0	0	0
Repurchases	-95	-19	-39	-20	-40	-118	-97
Others, net	-186	-25	0	-100	-287	-412	0
Short-term	-14	0	0	-100	0	-100	0
Medium-and long-term, net	-172	-25	0	0	-287	-312	0
Disbursements	0	0	0	0	0	0	0
Repayments	-172	-25	0	0	-287	-312	0
Net foreign assets DMBs (increase, -)	-440	-24	157	-71	0	62	-80
Assets (increase, -)	-336	16	114	0	0	130	-80
Liabilities	-104	-40	43	-71	0	-68	0
Financing gap	0	0	0	0	315	314	361
Memorandum items:							
Current account balance plus FDI	-291	...	...	...	...	-1,075	-836
Ratio to GDP	-0.8	...	...	...	...	-2.8	-2.0
Export growth (percent)	21.9	...	...	...	...	14.0	7.4
Of which : Volume growth (percent)	23.9	...	...	...	...	11.7	7.4
Import growth (percent)	23.7	...	...	...	...	21.2	7.8
Of which : Volume growth (percent)	29.1	...	...	...	...	16.0	7.1
Terms of trade (percentage change)	2.7	...	...	...	...	-2.3	-0.6
External debt (US$)	9,855	...	...	...	...	11,220	12,407
Of which : Public and publicly guaranteed	6,936	...	...	...	...	7,874	8,661
External debt/GDP (percent)	26.8	...	...	...	...	29.5	30.4
Debt service (US$)	2,091.6	...	...	...	...	2,814.1	3,069.7
Debt service ratio	16.9	...	...	...	...	19.9	20.1
Gross official reserves of the NBR 3/	3,396	...	...	...	...	4,417	5,038
(in months of imports of goods and services)	2.4	...	...	...	...	3.0	3.2
(as percent of short-term debt)	141.8	...	...	...	...	165.7	183.4
Net external financing of the budget (US$ mln)	890	...	...	...	...	1,038	711
Nominal GDP (US$ bln)	36.7	...	...	...	...	38.0	40.8

Sources: Romanian authorities; and Fund staff estimates.

1/ Includes revised leasing data.

2/ Including public enterprises.

3/ Includes gold.

Table 3. Romania: Summary of Consolidated General Government, 1998-2002

	1998 Actual	1999 Actual	2000 Actual	2001 Budget 12-Apr-01	2001 Suppl. Budget 20-Aug-01	2002 Draft Budget 28-Sep-01	1998 Actual	1999 Actual	2000 Actual	2001 Budget 12-Apr-01	2001 Suppl. Budget 20-Aug-01	2002 Draft Budget 28-Sep-01
	(in billions of lei)						(in percent of GDP)					
Total revenue and grants	111,000	173,838	251,095	353,975	359,442	458,301	30.1	33.3	31.5	32.7	32.6	31.8
Current	110,867	173,337	249,945	353,237	358,682	457,545	30.1	33.2	31.4	32.6	32.5	31.8
Tax	103,992	164,026	235,048	336,133	335,847	431,918	28.2	31.4	29.5	31.0	30.4	30.0
Profits	11,067	17,037	20,334	25,777	25,101	33,205	3.0	3.3	2.6	2.4	2.3	2.3
Wages and salaries 1/	15,093	17,834	26,998	32,730	37,222	44,363	4.1	3.4	3.4	3.0	3.4	3.1
Social security 1/	33,425	57,667	86,557	128,932	130,475	174,108	9.1	11.1	10.9	11.9	11.8	12.1
Other direct taxes	3,882	8,276	10,059	13,982	12,617	11,612	1.1	1.6	1.3	1.3	1.1	0.8
VAT	22,493	32,471	50,439	71,517	71,844	93,382	6.1	6.2	6.3	6.6	6.5	6.5
Customs	5,741	7,847	8,702	10,409	8,697	9,506	1.6	1.5	1.1	1.0	0.8	0.7
Excise	8,431	16,958	18,701	31,562	28,555	38,252	2.3	3.3	2.3	2.9	2.6	2.7
Other indirect taxes	3,859	5,937	13,258	21,224	21,336	27,490	1.0	1.1	1.7	2.0	1.9	1.9
Nontax	6,875	9,311	14,897	17,104	22,835	25,627	1.9	1.8	1.9	1.6	2.1	1.8
Capital	133	297	826	318	341	349	0.0	0.1	0.1	0.0	0.0	0.0
Grants	0	204	325	420	420	407	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	131,123	193,567	283,351	394,079	398,196	501,501	35.6	37.1	35.6	36.4	36.1	34.8
Current	115,394	177,835	255,276	354,976	357,511	451,155	31.3	34.1	32.0	32.7	32.4	31.3
Wages and salaries	18,671	26,259	43,894	57,442	59,281	74,300	5.1	5.0	5.5	5.3	5.4	5.2
Materials and operating expenditures	21,173	57,504	56,292	73,789	80,574	98,936	5.7	11.0	7.1	6.8	7.3	6.9
o/w: health insurance fund	170	22,597	24,997	34,005	36,370	46,794	0.0	4.3	3.1	3.1	3.3	3.2
Interest	17,450	28,796	38,973	48,278	45,740	54,842	4.7	5.5	4.9	4.5	4.1	3.8
Subsidies and transfers	55,206	80,239	115,905	173,658	170,761	221,157	15.0	15.4	14.6	16.0	15.5	15.4
Subsidies	6,211	9,303	17,581	22,990	23,434	26,095	1.7	1.8	2.2	2.1	2.1	1.8
Transfers	48,995	70,936	98,324	150,668	147,327	195,063	13.3	13.6	12.3	13.9	13.3	13.5
o/w: Pensions	25,088	37,854	53,579	79,271	79,130	108,047	6.8	7.3	6.7	7.3	7.2	7.5
Capital	13,530	15,015	24,482	37,861	39,573	49,234	3.7	2.9	3.1	3.5	3.6	3.4
Lending minus repayments	2,198	717	3,594	1,242	1,112	1,113	0.6	0.1	0.5	0.1	0.1	0.1
Overall balance (cash, excluding grants)	-20,123	-19,933	-32,581	-40,524	-39,174	-43,607	-5.5	-3.8	-4.1	-3.7	-3.5	-3.0
Overall balance (cash, including grants)	-20,123	-19,729	-32,256	-40,104	-38,754	-43,200	-5.5	-3.8	-4.0	-3.7	-3.5	-3.0
Financing	21,013	18,080	28,322	40,104	38,754	43,200	5.7	3.5	3.6	3.7	3.5	3.0
Domestic	14,459	8,614	-1,913	2,508	-1,265	13,413	3.9	1.7	-0.2	0.2	-0.1	0.9
External	-154	2,360	22,575	27,096	30,119	25,767	0.0	0.5	2.8	2.5	2.7	1.8
Privatization proceeds	6,708	6,859	5,062	8,000	7,300	2,220	1.8	1.3	0.6	0.7	0.7	0.2
Bank asset recoveries	0	247	2,597	2,500	2,600	1,800	0.0	0.0	0.3	0.2	0.2	0.1
Discrepancy 2/	890	-1,649	-3,934	0	0	0	0.2	-0.3	-0.5	0.0	0.0	0.0
Memorandum items:												
Primary expenditure 3/	113,673	160,956	244,167	345,801	352,457	446,659	30.9	30.9	30.7	31.9	31.9	31.0
Primary balance (cash, excluding grants) 3/	-2,673	12,679	6,604	7,754	6,566	11,235	-0.7	2.4	0.8	0.7	0.6	0.8
Nominal GDP (billions lei) 4/	368,261	521,736	796,534	1,083,900	1,103,950	1,440,004	368,261	521,736	796,534	1,083,900	1,103,950	1,440,004

Sources: Ministry of Finance; and Fund staff estimates.

1/ 1998 and 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/ Excluding cash expenditure for bank restructuring.
4/ Program GDP for EBS/99/141 adjusted for the subsequent upward change in base-period GDP.

Table 4. Romania: Monetary Survey, 2000-2002

(In billions of lei, current exchange rates)

	2000	2001				2002			
						Program			
	December	March	June	September	December	March	June	September	December
Monetary Survey									
Net foreign assets (including valuation changes)	92,022	107,921	136,087	146,192	159,279	169,197	182,488	194,899	210,381
(In millions of U.S. dollars)	3,549	3,918	4,667	4,789	4,980	5,074	5,249	5,377	5,567
Of which: Commercial banks	948	890	717	788	788	808	828	848	868
NBR	2,602	3,028	3,950	4,001	4,192	4,266	4,421	4,529	4,699
Net domestic assets	93,038	83,630	72,411	79,162	92,958	89,724	97,528	98,648	113,277
Domestic credit	114,285	116,886	115,204	129,803	139,312	149,943	158,836	172,345	188,113
Government	37,878	32,458	22,319	26,856	28,061	30,453	30,481	35,772	42,204
Of which: T-bills for bank restructuring 1/	27,342	26,978	27,312	22,734	14,681	14,294	13,879	9,905	5,005
Non-government	76,407	84,428	92,885	102,948	111,251	119,490	128,355	136,573	145,909
In foreign currency	45,996	51,029	55,649	60,565	65,215	69,593	74,226	79,127	84,311
(in millions of U.S. dollars)	1,774	1,851	1,908	1,984	2,039	2,087	2,135	2,183	2,231
In lei	30,411	33,399	37,236	42,383	46,036	49,897	54,129	57,445	61,597
Other items net	-21,247	-33,256	-42,793	-50,642	-46,354	-60,219	-61,308	-73,698	-74,836
Broad money	185,060	191,551	208,498	225,353	252,237	258,921	280,015	293,547	323,658
Of which: Lei denominated (M2)	110,204	108,292	118,567	124,614	143,490	142,875	156,245	161,606	183,074
Currency in circulation	25,742	23,774	29,645	31,270	34,703	31,602	39,208	40,462	44,276
Lei deposits	84,462	84,518	88,921	93,344	108,787	111,273	117,038	121,144	138,798
Foreign currency deposits	74,856	83,259	89,931	100,740	108,747	116,046	123,770	131,941	140,584
(In millions of U.S. dollars)	2,887	3,020	3,084	3,300	3,400	3,480	3,560	3,640	3,720
Memorandum items: 3/									
Broad money (M2X) growth	38.0	40.7	40.4	38.0	36.3	35.2	34.3	30.3	28.3
NFA contribution	39.3	47.3	52.0	39.5	36.3	32.0	22.3	21.6	20.3
NDA contribution	-1.3	-6.5	-11.6	-1.5	0.0	3.2	12.0	8.6	8.1
Lei-denominated money growth (M2)	31.8	27.6	30.5	31.1	30.2	31.9	31.8	29.7	27.6
Growth of currency in circulation	48.2	47.9	38.1	37.4	34.8	32.9	32.3	29.4	27.6
Real broad money growth	-1.9	0.3	3.4	5.4	5.7	5.6	5.5	4.9	5.2
Real lei-denominated money growth (M2)	-6.4	-9.1	-3.8	0.1	0.9	3.1	3.5	4.5	4.6
Real growth of currency in circulation	5.3	5.4	1.8	4.9	4.5	3.8	3.9	4.2	4.6
Growth of lei credit to nongovernment, adjusted 2/	36.9	36.9	47.9	47.5	48.4	49.4	45.4	35.5	33.8
Growth of lei credit to nongovernment, adusted, real 2/	-2.7	-2.4	8.9	12.8	15.2	16.9	14.4	9.2	9.7
Growth of foreign-currency denominated credit, adjusted, in US$ 2/	13.7	15.8	15.6	27.7	17.5	12.7	11.9	10.0	9.4
Growth of credit to non-government, composite 2/ 4/	7.4	8.9	13.0	21.9	16.6	14.5	12.9	9.7	9.5
CPI inflation	40.7	40.3	35.7	31.0	29.0	28.0	27.3	24.1	22.0
M2X velocity	5.0	5.4	5.2	5.1	4.9	5.3	5.2	5.1	4.8
M2 velocity	8.4	9.5	9.2	9.3	8.6	9.6	9.3	9.2	8.5
M2X+Tbill velocity	4.6	4.7	4.6	4.5	4.3	4.7	4.6	4.5	4.4
M2X+Tbill growth	45.5	48.7	48.2	44.0	41.1	34.0	31.1	31.6	38.3

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. Owing to the 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, 2000-2002 1/

(In billions of lei, fixed exchange rates, monthly averages)

	2000	2001				2002			
						Program			
	December	March	June	September	December	March	June	September	December
National Bank of Romania									
Net foreign assets (excluding valuation) 2/	37,451	43,963	62,404	79,876	85,942	88,393	93,744	97,632	104,011
(In millions of U.S. dollars)	1,846	2,087	2,733	3,310	3,501	3,575	3,730	3,838	4,008
Net domestic assets	13,831	7,668	-4,874	-20,229	-22,846	-26,191	-24,341	-24,339	-24,619
Total credit	12,267	6,424	-1,719	-12,152	-17,749	-22,097	-18,378	-19,181	-22,986
Credit to banks	1,066	-3,681	-6,788	-14,938	-20,235	-25,523	-24,379	-23,873	-24,781
NBR refinancing (including to DGF and Law 101)	7,834	8,710	6,747	5,280	4,980	4,693	4,693	3,832	3,198
NBR refinancing to litigous debtor	1,749	1,749	1,749	284	284	284	284	284	284
NBR credit line to Deposit Guarantee Fund	3,863	3,854	3,846	3,847	3,547	3,547	3,547	3,547	2,914
Law 101 (Bancorex) & Special credit to BA	2,223	3,107	1,152	1,148	1,148	861	861	0	0
Deposit taking operations	-3,817	-7,929	-9,221	-15,904	-20,901	-25,903	-24,758	-23,391	-23,666
Reverse repo	-2,951	-4,462	-4,313	-4,313	-4,313	-4,313	-4,313	-4,313	-4,313
Credit to government	11,201	10,105	5,070	2,785	2,486	3,427	6,001	4,691	1,795
Treasury balance (+deficit, -surplus)	-5,306	-5,018	-10,007	-7,702	-5,717	-4,776	-2,202	-1,860	-2,815
Treasury overdraft	-1,856	-1,952	-2,432	-1,000	0	-1,299	-1,043	-348	0
Treasury deposits	3,450	3,066	7,575	6,702	5,717	3,477	1,159	1,512	2,815
Treasury bills	16,507	15,123	15,077	10,487	8,203	8,203	8,203	6,551	4,609
Other items net	1,564	1,245	-3,155	-8,077	-5,097	-4,094	-6,250	-6,306	-3,415
Lei reserve money	51,282	51,631	57,530	59,647	63,096	62,202	69,403	73,292	79,392
Currency	27,393	25,333	29,091	32,204	35,465	32,714	39,910	41,189	44,693
Bank deposits	23,889	26,298	28,439	27,443	27,632	29,487	29,493	32,103	34,699
Memorandum items:									
Lei reserve money growth 3/	48.0	0.7	12.2	16.3	23.0	-1.4	10.0	16.2	25.8
NFA contribution	65.1	12.7	48.7	82.7	94.6	3.9	12.4	18.5	28.6
NDA contribution	-17.1	-12.0	-36.5	-66.4	-71.5	-5.3	-2.4	-2.4	-2.8
Real reserve money growth	5.1	-6.9	-2.2	-3.8	-4.6	-8.2	-2.9	-0.2	3.1
Real growth of reserve money (adjusted)	2.6	-7.1	-2.5	0.9	3.5	-7.6	-3.3	-0.4	2.9
Adjusted lei reserve money growth 4/	44.3	0.5	11.9	22.0	33.5	-0.8	9.5	16.0	25.6
NDA contribution	-38.7	-15.6	-47.4	-86.4	-93.0	-4.9	-2.2	-2.2	-2.6
NFA contribution	83.1	16.5	63.3	107.6	123.0	3.6	11.3	17.0	26.3
CPI inflation	40.7	8.2	14.7	20.9	29.0	7.4	13.2	16.4	22.0

Sources: Romanian authorities; and Fund staff estimates.

1/ For the program, 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. These figures differ from those in the monetary survey by this adjustment, and due to the fact that these figures describe monthly average levels.

3/ From December of the previous year

4/ 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.
Small deficiencies persisted throughout 2000 and 2001 and are assumed to disappear after Q1'2002
(ii) Minimum reserve requirement for lei deposits was increased from 15 percent to 20 perecnt in mid-July, to 25 percent on November 1, and to 30 percent on December 1, 1999.
In 2001, it was decreased to 27 percent on July 1 and further to 25 percent on October 1.

Table 5. Romania: Medium-Term Balance of Payments Outlook, 2000-05

(In millions of U.S. dollars)

	2000 Act.	2001 Prog.	2002 Prog.	2003 Prog.	2004 Proj.	2005 Proj.
Current account	-1,363	-2,295	-2,294	-2,261	-2,368	-2,478
Ratio to GDP	-3.7	-6.0	-5.6	-5.2	-5.1	-5.0
Trade balance	-1,684	-2,781	-3,039	-3,167	-3,367	-3,579
Exports	10,366	11,819	12,699	13,397	14,067	14,770
Imports 1/	-12,050	-14,600	-15,738	-16,564	-17,434	-18,349
Services account, net	-539	-465	-433	-406	-405	-414
Of which: interest, net	-472	-470	-460	-466	-460	-462
Unrequited transfers	860	951	1,178	1,312	1,404	1,514
Capital account	2,372	2,978	2,430	2,908	2,870	3,045
Direct investment and capital transfers	1,072	1,219	1,457	1,825	1,667	1,687
Portfolio Investment	-7	110	50	50	50	50
Borrowing by public sector 2/	766	1,153	523	624	701	746
Loans (net)	632	363	380	424	301	496
Disbursements	1,370	1,357	1,520	1,644	1,703	1,690
Amortization	-739	-994	-1,140	-1,221	-1,402	-1,194
Bonds (net)	134	790	143	200	400	250
Disbursements	259	790	440	340	541	674
Amortization	-125	0	-297	-140	-141	-424
Borrowing by private sector	570	295	399	409	452	562
Disbursements	894	841	1,075	1,236	1,422	1,621
Amortization	-324	-546	-676	-827	-969	-1,059
Short-term (net)	5	200	0	0	0	0
Credit extended	-34	1	0	0	0	0
Net errors and ommisions 3/	526	492	300	300	300	300
Overall balance	1,534	1,175	437	946	802	867
Financing	-1,534	-1,489	-797	-1,053	-802	-868
Net foreign assets NBR (increase, -)	-1,094	-1,551	-717	-967	-712	-772
Assets (increase, -)	-928	-1,021	-621	-865	-610	-671
Liabilities	-166	-530	-97	-102	-101	-101
IMF, net	20	-118	-97	-102	-101	-101
Purchases	115	0	0	0	0	0
Repurchases	-95	-118	-97	-102	-101	-101
Other, net	-186	-412	0	0	0	0
Net foreign assets DMBs (increase, -)	-440	62	-80	-86	-91	-96
Assets (increase, -)	-336	130	-80	-86	-91	-96
Liabilities	-104	-68	0	0	0	0
Financing gap	0	314	361	107	0	0
Export growth (percent)	21.9	14.0	7.4	5.5	5.0	5.0
Import growth (percent)	23.7	21.2	7.8	5.3	5.3	5.3
Net Resource Balance/GDP (percent)	-3.1	-5.2	-4.7	-4.2	-4.2	-4.1
External debt/GDP (percent)	26.8	29.5	30.4	30.6	30.9	31.4
Public and publicly guaranteed debt/GDP (percent)	18.9	20.9	21.7	21.4	21.1	21.0
Net External Indebtedness/GDP (percent)	13.5	14.8	14.5	13.7	13.6	13.6
Debt service ratio	16.9	19.9	20.1	19.9	21.3	21.6
Gross reserves of NBR (in US$ mns.) 4/	3,396	4,417	5,038	5,903	6,513	7,184
(over short-term debt by remaining maturity)	141.8	165.7	183.4	192.3	201.4	209.4
(in months of imports)	2.4	3.0	3.2	3.6	3.8	3.9

Sources: Romanian authorities; and Fund staff estimates.

1/ Includes revised leasing data

2/ Including public enterprises.

3/ Net errors and omissions are projected to be non-zero due to known gaps in the balance of payments data.

4/ Includes gold.

Table 6. Romania: Medium-Term Projections, 2000-05

	2000	2001	2002	2003	2004	2005
		Projected				
Income and prices						
Nominal GDP (in billions of lei)	796,534	1,103,950	1,442,752	1,779,285	2,075,291	2,336,370
Nominal GDP (in billions of US dollars)	36.7	38.0	40.8	43.9	46.9	50.1
			(In percent)			
Real GDP	1.6	4.5	5.0	5.0	5.0	5.0
Domestic Demand	4.2	6.0	5.3	4.6	5.1	5.1
Household consumption	-1.2	5.0	4.5	3.4	4.1	4.2
Government consumption	15.6	4.9	-0.1	4.6	0.9	1.1
Gross fixed investment	5.5	8.9	11.2	11.0	11.0	10.7
Increase in stocks (contribution) 1/	1.9	0.4	0.4	-0.3	0.2	0.1
External Demand (contribution)	-2.8	-1.8	-0.8	-0.1	-0.6	-0.6
Exports of goods and services	23.9	10.1	7.6	6.4	5.0	5.0
Imports of goods and services	29.1	13.1	7.8	5.2	5.2	5.2
GDP deflator	45.3	32.6	24.5	17.5	11.1	7.2
CPI, e.o.p.	40.7	29.0	22.0	15.0	9.0	6.0
CPI, p.a.	45.7	34.1	26.0	17.5	11.1	7.2
Saving and investment balance						
Total domestic saving	14.7	12.2	12.3	13.3	14.2	15.0
Net factor receipts and transfers from abroad	1.1	1.3	1.8	1.6	1.7	1.8
Total national saving	15.7	13.5	14.1	14.9	15.9	16.8
Non-government	16.8	13.5	13.8	14.5	15.2	15.9
Government	-1.1	0.0	0.3	0.4	0.8	0.9
Total investment	19.4	19.5	19.7	20.1	21.0	21.8
Non-government	16.5	16.0	16.4	16.6	17.4	18.2
Government	2.9	3.5	3.3	3.4	3.6	3.5
Saving and investment balance	-3.7	-6.0	-5.6	-5.2	-5.1	-5.0
Non-government	0.3	-2.5	-2.7	-2.1	-2.3	-2.4
Government	-4.0	-3.5	-3.0	-3.0	-2.8	-2.6
Foreign saving	3.7	6.0	5.6	5.2	5.1	5.0

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

1/ Includes statistical discrepancy.

Table 7. Romania: External Financing Requirements and Sources, 1999-2002
(In millions of U.S. dollars)

	1999	2000	Staff Projections 2001	2002
Gross financing requirements	3,731	4,196	5,256	5,204
External current account deficit	1,446	1,363	2,295	2,294
Debt amortization	2,244	1,474	1,952	2,113
Public sector	1,610	1,150	1,406	1,437
of which : Bonds and notes	747	297	312	297
Private sector	634	324	546	676
Repayment of arrears	0	0	0	0
Gross reserves accumulation	-98	1,264	891	701
IMF repurchases and repayments	139	95	118	97
Available financing	3,192	3,636	4,941	4,843
FDI and capital transfers (net)	1,070	1,072	1,219	1,457
Public sector borrowing	815	1,284	2,147	1,960
Loans	815	1,025	1,357	1,520
Bonds	0	259	790	440
Private sector borrowing	780	790	773	1,075
Other flows 1/	527	490	803	350
Financing gap	539	560	315	361
Balance of payments financing	539	560	315	361
IMF	73	115	67	211
Other	466	445	248	150
Accumulation of arrears (exceptional)	0	0	0	0
Residual financing gap	0	0	0	0

Sources: Romanian authorities; and Fund staff estimates.

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

Table 8. Romania: Indicators of External Vulnerability, 1996-2001 1/

(In percent of GDP unless otherwise specified)

	1996	1997	1998	1999	2000	2001
Financial indicators						
Public sector debt	23.5	25.5	25.6	29.9	27.8	29.6
Broad money (percent change, 12-month basis)	66.1	104.8	48.9	44.9	38.0	28.3
Credit to non-government (percent change, 12-month basis) 2/	63.3	33.7	64.7	43.2	50.3	46.5
Real credit to non-government (percent change, 12-month basis) 2/	4.2	-46.9	17.0	-9.2	7.4	16.6
Monthly weighted average t-bill rate	...	133.5	82.4	105.2	62.4	49.4 4/
Monthly weighted average real t-bill rate 3/	...	-8.3	14.6	40.7	11.5	11.4 4/
External Indicators						
Exports (percent change, 12-month basis in US$)	2.3	4.6	-1.6	2.4	21.9	14.0
Imports (percent change, 12-month basis in US$)	11.3	-1.4	4.8	-12.1	23.7	21.2
Terms of Trade (percent change, 12-month basis)	1.4	9.0	-4.0	0.2	2.7	-2.3
Current account balance	-7.4	-6.1	-7.1	-4.1	-3.7	-6.0
Current account balance after FDI	-6.6	-2.6	-2.2	-1.2	-0.8	-2.8
Errors and omissions	2.1	3.0	1.3	2.4	1.4	1.3
Gross official reserves (in US$ millions)	1,593	3,075	2,299	2,472	3,396	4,417
(in months of imports GNFS of the following year)	1.5	2.9	2.4	2.1	2.4	3.0
Central Bank short-term foreign liabilities (in US$ millions)	0	100	0	170	100	0
Gross reserves of the banking system (in US$ millions)	3,145	4,763	3,789	3,633	4,893	5,578
(in months of imports GNFS of the following year)	3.0	4.5	3.9	3.1	3.5	3.7
Short term foreign liabilities of the commercial banks (in US$)	602	267	188	221	225	349 5/
Open foreign currency position of the commercial banks (in US$)	1,023	835	1,112	-391	-165	-435 5/
Official reserves/Broad money (M2)	19.7	39.5	27.2	33.1	47.0	57.3
Official reserves/Narrow money (M0) 6/	49.9	237.7	107.1	142.0	175.3	217.0
Total short term external debt by remaining maturity 7/	7.4	7.4	7.0	5.4	6.5	7.0
In percent of reserves	163.8	84.3	126.8	76.5	70.5	60.3
In percent of total debt	28.5	27.4	29.6	23.7	24.3	23.8
Total external debt (in US$ millions)	8,597	9,467	9,903	8,784	9,855	11,220
Of which: Public and Publicly guaranteed debt	6,507	6,855	7,001	6,169	6,936	7,874
Total external debt (in percent of exports of G&S)	88.6	93.2	99.7	87.7	79.6	79.5
Total external debt/ GDP	24.5	26.9	23.9	24.9	26.8	29.5
External interest payments (in percent of exports of G&S)	3.7	5.0	5.6	5.1	5.1	5.4
External amortization payments (in percent of exports of G&S)	9.9	15.9	17.7	23.9	12.1	15.1
Exchange rate (per US$, period average)	3,084	7,195	8,881	15,274	21,688	...
REER appreciation (+) (12-month basis)	-9.6	16.5	30.0	-14.8	9.5	...
Financial Market Indicators						
Foreign currency debt ratings						
Moody's	Ba3	Ba3	B3	B3	B3	B3 8/
Standard and Poor's	BB-	BB-	B-	B-	B-	B 8/
Spread of benchmark bonds (basis points, end of period)	364	350	1,300	780	562	576 9/

Sources: Romanian authorities; and Fund staff estimates.

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

2/ Adjusted for bad loans transferred to AVAB and written off.

3/ Real rate is based on ex-post 12-month CPI inflation. CPI for 2001 is a staff estimate.

4/ As of September 28, 2001.

5/ As of August 31, 2001. Excludes holdings of domestic foreign currency T-Bills.

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

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

8/ As of September 28, 2001.

9/ In 2001 the benchmark bond is the '05, while for earlier years it is the '02. As of September 28, 2001.

Table 9. Romania: Indicators of Fund Credit, 1998-2005

(In percent, unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005
Outstanding Fund Credit								
(end of period)								
In millions of SDRs	382.8	333.8	347.9	308.0	397.6	400.7	321.7	243.0
In millions of U.S. dollars	519.0	462.1	458.8	397.9	506.5	514.1	412.7	311.8
In percent of quota	50.8	32.4	33.8	29.9	38.6	38.9	31.2	23.6
In percent of GDP	1.3	1.3	1.2	1.0	1.2	1.2	0.9	0.6
In percent of exports of goods and services	5.4	4.7	3.8	2.9	3.4	3.3	2.5	1.8
In percent of official reserves	22.6	18.7	13.5	9.0	10.1	8.7	6.3	4.3
Debt service due to the Fund								
(in millions of U.S. dollars)	147.7	167.4	120.3	118.7	118.5	128.6	124.5	120.1
In percent of quota	19.6	16.2	11.7	11.5	11.5	12.5	12.1	11.7
In percent of GDP	0.4	0.5	0.3	0.3	0.3	0.3	0.3	0.2
In percent of exports of goods and services	1.5	1.7	1.0	0.9	0.8	0.8	0.8	0.7
In percent of official reserves	6.4	6.8	3.5	2.7	2.4	2.2	1.9	1.7

Sources: Treasurer's Department; Romanian authorities; and Fund staff calculations.

Table 10. Romania: Schedule of Purchases Under the Stand-By Arrangement

Date	Amounts in millions of SDRs	In percent of quota[1]	Conditions
October 2001	52	5.047	Board approval of Stand-By Arrangement
February 2002	41.333	4.01	Observance of end-December performance criteria and completion of quarterly review
May 2002	41.333	4.01	Observance of end-March performance criteria and completion of quarterly review
August 2002	41.333	4.01	Observance of end-June performance criteria and completion of quarterly review
November 2002	41.333	4.01	Observance of end-September performance criteria and completion of quarterly review
February 2003	41.333	4.01	Observance of end-December performance criteria and completion of quarterly review
April 2003	41.335	4.01	Observance of end-March performance Criteria and completion of quarterly review
Total	300	29.11	

[1] The quota is SDR 1,030.2 million.

ROMANIA—RELATIONS WITH THE FUND
(As of August 31, 2001)

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

		SDR million	% Quota
II.	General resources account:	SDR million	% Quota
	Quota	1,030.20	100.0
	Fund holdings of currency	1,324.52	128.6
III.	SDR department:	SDR million	% Allocation
	Net cumulative allocation	75.95	100.0
	Holdings	1.26	1.7
IV.	Outstanding purchases and loans:	SDR million	% Quota
	Stand-by Arrangements	200.05	19.4
	Systemic Transformation	94.26	9.1

V. Financial arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
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 obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	07/31/01	2001	2002	2003	2004	2005
Principal		38.3	75.7	79.6	79.0	21.7
Charges/interest		7.8	12.6	9.6	5.8	3.1
Total		46.1	88.3	89.2	84.8	24.8

VII. Exchange rate arrangements

The foreign exchange market in Romania was unified in November 1991. From June 1992, the exchange rate was determined daily through an auction organized by the NBR in which bids and offers had to be channeled through the commercial banks; however, the price determination rule employed did not ensure that the price set in the auction was a market-clearing price. In April 1994, the auction mechanism was modified to ensure clearing of the market. From August 1994, a decentralized direct dealing interbank market was in operation. The official reference rate published by the NBR is an average of rates reported for interbank and client transactions. The market was effectively dismantled in March 1996, when the NBR revoked the licenses of 22 dealer banks (including all foreign banks), leaving only four state-controlled dealer banks. Functioning of the market was restored on February 18, 1997 when these licenses were reissued. Romania has accepted the obligations of Article VIII, Sections 2, 3, and 4, with effect from March 25, 1998.

VIII. Article IV consultation

Romania is on a 12-month consultation cycle. The last consultation was concluded on November 29, 2000.

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.

X. Resident representative

The Fund has had a resident representative in Bucharest since 1991. Mr. Stephane Cosse assumed the post in December 1999.

ROMANIA: RELATIONS WITH THE WORLD BANK

1. The World Bank has been active in Romania since 1991 and has built up a portfolio of 31 Bank-financed operations, of which 21 are active. Aggregate lending for the 31 operations amounts to US$3.3 billion. Of this, US$2.3 billion had been disbursed as of June 30, 2001. The Bank operations' primary focus has been poverty reduction and has included policy-based balance of payments support, infrastructure and energy sector restructuring and rehabilitation, social sector projects, and technical assistance.

2. The performance of the Bank's portfolio has reflected hesitations on the part of the Romanian Government in pursuing structural reforms, as well as weaknesses in the policy environment for key sectors, including the financial, utilities, and social sectors. Agricultural sector reforms have also wavered over the last few years, which, along with the lack of a satisfactory macro-economic program, led to the eventual cancellation of the last tranche of the Agricultural Sector Adjustment Loan (ASAL) in December last year. On other fronts, however, the Government has made substantial progress. This includes initial steps toward enterprise privatization, gradual improvements of the business climate and the closure of insolvent banks. In view of this substantial progress, the final tranche of the first Private Sector Adjustment Loan (PSAL) was disbursed in June 2000.

3. A new Country Assistance Strategy (CAS), covering the three-year period of FY02-FY04, 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 is one of the pilot countries. About one half of the FY02-04 lending program is adjustment lending. The first adjustment operation, a follow-up to PSAL, would support reforms encouraging private sector development—including reform of the enterprise, energy, and financial sectors. Subsequent adjustment operations would support reforms of the Government's institutional, regulatory, and governance framework, as well as continued reforms for private sector development.

4. The World Bank has maintained a highly collaborative relationship with its counterparts at the IMF. The PSAL, approved in June 1999 and completed one year later, complemented the IMF's standby arrangement and was developed in close consultation with the IMF's Romania team and management. Similar consultations are taking place in the development and design for the second PSAL.

5. As of August 2001, IFC's portfolio included 16 projects with US$163 million for IFC's own account and US$218 million in syndicated loans. Looking forward, the level of IFC activity will depend on the extent of improvements in the enabling environment for business in the country. IFC will attempt to complement the Bank's efforts in private sector development by focusing on four key areas: restructuring of municipal infrastructure, financing for post-privatization restructuring; supporting financial markets development and SME growth, and selected private sector investments. IFC will continue to catalyze the entry of FDI into the key industrial and financial sectors.

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 over the past three years with the help of Fund TA missions, although more needs to be done, in particular in the area of balance of payments, and the consistency between monetary and fiscal data. Romania has participated in the GDDS since February 2001. A STA mission visited Romania in November 2000 to assist the authorities in preparing metadata. The mission also prepared a draft data module for the ROSC, which after comments from the authorities, is in the final stages of submission to the Executive Board.

Real Sector

2. The national accounts statistics produced by the National Institute for Statistics (INS) for quarterly and annual series on Gross Domestic Product are methodologically sound, but arrive with lag of about 3 months. Furthermore, harmonization of quarterly and annual national accounts is not done on a regular basis and late revisions can sometimes be significant; the 1999 GDP growth rate, previously reported as –3.2 percent, was revised to –2.3 percent in April 2001. 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. 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 a reliable source. However, 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. The INS planned to reinstate export coverage with the next index revision sometime in 2001.

Public Finance

4. Consolidated data on central government operations are occasionally reported for the *GFS Yearbook* (transaction data, but not debt data, only through 1997 are in the GFS Yearbook 2000) and often reported 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 been receiving 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. In addition, data on foreign grants are not formally identified and included in the accounts for central government budgetary units. However, under the new Public Finance Law, grants will henceforth be included in the accounts of public institution budgets, including central budgetary units (art.66). Work continues on the establishment of a new aid coordination unit to monitor data on grants.

Money and Banking

5. The National Bank of Romania (NBR) reports money and banking statistics for *IFS* on a regular and timely basis. In general, the authorities have implemented recommendations of past missions. While there are no major statistical issues, the multi-sector mission in December 1999 stressed again that the institutional coverage of the NBR's monetary statistics is incomplete. The Article IV mission encouraged the authorities to include deposit-taking institutions, which operate under the cooperative law, in the coverage of the monetary statistics.

Balance of Payments

6. The National Bank of Romania routinely reports balance of payments statistics in a timely fashion. Data collection and compilation have improved following technical assistance. The recent multi-sector mission found that a number of problems still exist including (a) a lack of detailed information available to the NBR from the international transactions reporting system; (b) undercoverage of direct investment flows and positions; and (c) undercoverage of grants and other transfers to Romania from abroad.

Table 1: Romania: Core Statistical Indicators
as of September 24, 2001

	Exchange Rates	Interna-tional Reserves	Central Bank Balance Sheet	Reserve/ Base money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	Sept. 21, 2001	Sept. 21, 2001	July 31, 2001	Sept.14, 2001	July 31, 2001	Sept. 21, 2001	August 2001	July 2001	July 2001	Aug.31, 2001	H1 2001	July 31, 2001
Date Received	Sept. 21, 2001	Sept. 21, 2001	Aug. 23, 2001	Sept.18, 2001	Aug. 23, 2001	Sept. 24, 2001	Sept. 11, 2001	Sept. 2, 2001	Sept. 24, 2001	Sept. 24 2001	Sept. 6, 2001	Sept. 2, 2001
Frequency of Data	D	D	M	D	M	D	M	M	M	M	Q	M
Frequency of Reporting	D	D	M	BW	M	D	M	M	M	M	Q	M
Source of Update	A	A	A	A	A	A	N	A	A	A	C	A
Mode of Reporting	C	E	E	E	E	C	C	E	E	E	C	E
Confidentiality	C	A	A	A	A	C	C	A	C	A	C	A
Frequency of Publication	D	M	M	M	M	D	M	M	Q	M	Q	Q

October 17, 2001

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

Dear Mr. Köhler:

Notwithstanding the important progress in stabilization and reform over the past two years, Romania still has to fully achieve macroeconomic stability and bring inflation down to a low and stable level. Moreover, we continue to face a challenging agenda for accelerating the process of accession to the European Union and we will need to address the structural weaknesses of the economy to accelerate growth that will help us to reduce the development gap relative to the European Union. We have therefore formulated and started to implement a comprehensive program of stabilization and reform, which is described in the attached Memorandum of the Government of Romania on Economic and Financial Policies. In support of this program, we hereby request on behalf of the Government of Romania an 18-month Stand-By Arrangement in the amount of SDR 300 million, for a program period October 2001-March 2003.

We are determined to meet all of our commitments under the program and we believe that the policies and measures described in the attached memorandum are sufficient to achieve the objectives of the program, but we stand ready to take additional measures and seek new understandings with the IMF if necessary to keep the program on track. The Government of Romania will remain in close consultation with the IMF in accordance with the IMF's policies on such consultations, and it will provide the IMF with all the information that it requests to assess the implementation of the program. The program will be reviewed by the IMF on a quarterly basis during the period of the Stand-By Arrangement.

Yours sincerely,

/s/

Mihai Tanasescu
Minister of Public Finance
Ministry of Public Finance

/s/

Mugur Isarescu
Governor
National Bank of Romania

MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES OF THE GOVERNMENT OF ROMANIA 2001–02

I. INTRODUCTION

1. This memorandum sets forth the main economic and financial objectives and policies of the government and the National Bank of Romania (NBR) for the period 2001–02. The program described below reflects our strong commitment to fully achieve macroeconomic stability and address structural problems in the enterprise and banking sectors, with a view to setting our economy on a sustainable rapid growth path and accelerating the process of accession to the European Union (EU).

II. BACKGROUND

2. **As a result of the implementation of the stabilization program in 1999 and 2000, we greatly improved our external position, and laid the basis for a return to positive output growth in 2000, following three years of declining output.** On the back of the strengthened competitiveness, achieved by a combination of depreciation and fiscal tightening in 1999, exports of goods and services increased by 24 percent in volume terms in 2000, and real GDP by 1.6 percent, despite the large drought-related decline in agricultural production. The current account balance relative to GDP further improved by about 0.4 percentage points in 2000, to a deficit of 3.7 percent, while official reserves grew by about US$1 billion, to US$3.4 billion by end-2000. The improved external performance made it possible for our country to re-enter the international bond market in late 2000, and was also reflected in this year's upgrade of Romania's sovereign bond ratings.

3. **Output strongly picked up in the first half of 2001, but the trade deficit widened.** Exports have continued to perform well, as evidenced by merchandise export growth of about 15½ percent in U.S. dollar terms in January–July. However, imports continue to outpace exports, increasing in the same period by 27 percent, while the trade deficit reached US$1,452 million, compared with US$586 million in the same period of 2000. In addition to transitory drought-related factors, the growth in imports reflects an increase in domestic demand. In particular, following the large rises in public sector wages in late 2000 and early 2001, and the weakening in the financial performance of state-owned enterprises (as evidenced by the large increase in their arrears and the use of credit financing), domestic demand grew by 10 percent in real terms in the first quarter of 2001, a level which, if it persists, would endanger our disinflation objectives and external viability. These tendencies continued in the second quarter of 2001, albeit with somewhat lower intensity.

4. **Notwithstanding the important progress in stabilization and reform over the past two years, Romania continues to face a challenging agenda for accelerating the process of accession to the EU.** We need to achieve further progress in establishing macroeconomic stability, as evidenced by the fact that the inflation rate is still among the highest in Europe. Moreover, structural weaknesses in the large sector of state-owned enterprises remain to be addressed in the period ahead, in order to establish an efficient and

fully functioning market economy. Romania also has yet to boost private investment to a level required to achieve a sustainable high growth rate and attract foreign direct investment, which has remained modest compared with other transition economies in the region.

III. Macroeconomic and Financial Policies

A. Basic Strategy and Objectives

5. **The main macroeconomic objectives of our 2001–02 program are to reduce inflation to 22 percent by end-2002, achieve output growth of about 5 percent, to contain the external current account deficit below 6 percent of GDP, and to increase official reserves to about three months of imports**. The macroeconomic policies to achieve these objectives will focus on a supportive fiscal stance; prudent wage policy in the budgetary sector and public enterprises; measures for reducing quasi-fiscal spending and losses in the energy sector and other public enterprises, including the acceleration of privatization; and tight monetary policy. Our disinflation strategy will not rely on the postponement of necessary adjustment in administered prices, and we will continue to eschew any direct intervention with respect to liberalized prices.

6. **Our main macroeconomic objectives over the medium term, 2001–05, are as follows:** Although the inflation outcome in 2000 and early 2001 was higher than envisaged in our Medium-Term Economic Strategy, we intend to make steady progress to reach a single-digit inflation rate by 2004 or 2005 at the latest. With substantial projected foreign direct investment inflows and EU pre-accession aid, we expect that the current account deficit, after reaching about 6 percent of GDP in 2001, will decline to around 5 percent of GDP by 2005, a level that will assure that our overall foreign debt-to-GDP ratio increases only moderately, while the net foreign debt-to-GDP ratio will start declining already in 2002. We expect that our economy will grow in this period on average by 5–6 percent, helping to reduce the development gap relative to the EU.

B. Fiscal Policy

7. **Fiscal policy in 2001 and in 2002 will strongly support the disinflation objective and help to contain the external current account deficit**. In light of the larger-than-expected current account deficit in early 2001 and somewhat higher-than-targeted inflation, we have decided to tighten the fiscal target for 2001, and limit the deficit of the consolidated general government to 3.5 percent of GDP. For 2002, we will limit the deficit to 3.0 percent of GDP, in line with the Medium-Term Economic Framework submitted to the EU, and reflecting our expectation that the economy will grow by about 5 percent. Moreover, to improve the coordination of macroeconomic policies, we have decided to submit the 2002 budget to parliament in October 2001. We expect that the targeted reduction in the budget deficit and the measures to control wage growth in state-owned enterprises and improved financial performance will contain the recent strong growth in domestic demand and will result in an improvement in the external current account deficit in the second half of 2001 and 2002. However, should this not be the case, we stand ready to implement corrective

measures, including further tightening fiscal policy in the first half of 2002, particularly if the external environment turns worse than currently assumed.

8. **The following additional measures are intended to improve revenue performance in 2001**. We have simplified the taxation of micro-enterprises introducing a 1.5 percent turnover based tax on September 1, 2001. Furthermore, we have revised the regulations for the rescheduling of tax arrears and the cancellation of associated penalties with a view to limiting the access to these facilities to a small number of companies under restructuring and eliminated the respective authority of regional tax administration offices. With respect to the rescheduling of tax arrears exceeding lei 500 billion or the cancellation of penalties exceeding lei 50 billion, each individual case has to be approved by the cabinet. In order to strengthen financial discipline, we will strictly limit the conversion of claims on account of called guarantees into equity (debt-for-equity swap) to special laws preparing individual companies for privatization and will abolish Emergency Ordinance 62/2001, which allowed for a substantially broader application of this instrument (prior action). Instead, we will explore the option of selling claims on account of called guarantees to the private sector. Emergency Ordinance 195/2000 granting the exemption from VAT and customs duties for selected imports of state-owned companies will be abolished by the end of September 2001 (for Termoelectrica the cancellation will be effective on March 1, 2002); this will be a prior action for the presentation of the program to the Board. We will review the ordinance on micro-enterprise taxation with the goal of eliminating distortionary tax incentives by end-2001.

9. **To ensure that we can achieve the 2001 deficit target, we have implemented several precautionary measures on the expenditure side.** *First*, the cumulative state budget spending at the end of the third quarter of 2001 was limited to 73.0 percent of total annual expenditure in the rectified state budget. *Second*, we have approved an ordinance that blocked 50 percent of the capital expenditure entitlement for the fourth quarter of 2001 (lei 2,580 billion) for the state budget, the social security budgets, and the special funds, which can be released only if revenue targets for September and the following months have been met (see Technical Memorandum of Understanding). *Third*, the government, at the proposal of the Ministry of Finance, can approve state budget expenditure ceilings for November and December that can be lower than the expenditure appropriations.

10. **We remain strongly committed to keeping the growth in the budgetary sector wages and pensions as approved in the original 2001 budget**. We firmly intend not to grant any increase in budget sector wages in 2001 in addition to what was stipulated in Emergency Ordinance 33/2001. The annual bonus, to be paid in January 2002, will be limited to an equivalent of one month's salary in 2001. Taking into account the need to consolidate the pension fund, we are determined not to exceed the scheduled rise in pensions in December.

11. **The 2002 budget will be based on estimated revenues of the consolidated general government of lei 458.3 trillion, a general government deficit target of lei 43.2 trillion, implying an expenditure ceiling of lei 501.5 trillion**. To achieve this deficit target, we will

include in the 2002 budget law the possibility for the government to approve monthly expenditure ceilings for the state budget in the second half of the year, which can be lower than the expenditure appropriations in the budget if necessary. A prior action for the presentation of the program to the IMF Executive Board will be the submission of the 2002 budget, as agreed with the IMF staff, to parliament. In addition, approval by parliament of the 2002 budget consistent with this program will be a condition for the completion of the first review.

12. **Tax policy in 2002 will focus on reducing the payroll taxes, eliminating distortionary tax incentives and modernizing the tax system.**

- To offset the rise in the social security tax rates triggered by the new pension law, we will abolish the 2 percent payroll tax (previously used to finance the special education fund) and cut by 1 percentage point the payroll tax for the former special fund for handicapped persons that has already been incorporated into the state budget.

- We are committed to approve a new profit tax law by end-2001 that will unify existing regulations under several laws and eliminate distortionary tax incentives (inter alia by replacing profit tax reductions and exemptions in Law 133/1999 and the tax allowance in Law 189/2001 with a uniform 20 percent investment tax allowance). Moreover, we are firmly committed not to introduce tax holidays or any new discretionary tax incentives. The new profit tax law will also gradually increase the extraordinarily low profit tax rate for exporting activities towards the standard profit tax rate, with a first adjustment from 5 percent to 6 percent, being made in 2002.

- We will eliminate customs duty and VAT exemptions for raw materials imported by small and medium-size enterprises under Law 133/1999 by end-December 2001. Henceforth, all customs duty exemptions will exclusively be regulated through the customs duty tariff and will be uniform for all economic agents.

- The new VAT law, effective on January 1, 2002, will substantially reduce the number of VAT exemptions and items subject to the zero rate and will abolish the automatic link between customs duty tax holidays and VAT exemptions, except for goods and services imported by the budgetary sector and for health and other social programs. At the same time, the new law will ensure the institutional framework necessary for reducing delays in VAT refunds to no more than 30 days. As a transitory measure, we will introduce a uniform system of VAT suspension for investment goods, which will replace VAT exemptions and tax holidays for investment goods under several laws.

- The new excise tax law, expected to become effective on January 1, 2002, will codify excise taxation, and will gradually increase the rates to EU standards.

- Owing to substantial expenditure commitments, we will have to postpone the reform of personal income taxation (including the reduction in tax rates and the change in brackets), and a possible reduction in the VAT rates to 2003–04.

- To strengthen the tax administration, we will increase the number of tax inspectors by 500 in 2002.

- To strengthen the revenue performance of the social security funds, we will integrate the financial control departments of the pension fund and the unemployment fund by end-December 2001. Furthermore, we will approve and enforce by November 1, 2001, a joint order by the Minister of Labor and the Minister of Finance providing for common control teams for the collection of revenues of the pension fund and the unemployment fund. Moreover, we will approve before end-March 2002 a program for optimizing the organization of the collection and control of the revenues of the pension fund, the unemployment fund and the health insurance fund. This system will become effective by end-2002.

13. **We are in the process of finalizing the expenditure side of the 2002 budget.** We have already decided to maintain budgetary sector average wages constant in real terms in 2002. Toward that end, we will approve, before end-2001, legislation stipulating the schedule for the increase of budgetary sector wages in 2002 based on the forecast increase in the consumer price index. We will not distribute lunch vouchers to employees in public institutions financed entirely by or receiving subsidies from the state budget, the social security budget, the local authorities or the special funds. Following the substantial decline in employment in the civil sector of the state budget in 2001, we envisage reducing budgetary sector employment by at least 6,150 employees. To improve incentives for private as well as for public companies to become more competitive, we will continue our policy to gradually reduce subsidies from the general consolidated budget by limiting their increase to 11.6 percent in nominal terms in 2002. The reforms in the heating sector will allow us to reduce the subsidies from the local budgets in real terms and, concomitantly, to reduce the respective amounts out of income tax revenue transferred from the state budget to local authorities.

14. **To improve the social safety net in the context of restructuring our economy, we will implement a new set of policies to promote social stability and reduce poverty.** A means-tested income support (Minimum Income Guarantee) will become effective on January 1, 2002 for the poorest categories of the Romanian population, with the necessary financing provided from income tax revenue transferred from the state budget to the local authorities. Additional expenditure, as the new program will partially replace the existing programs, will not exceed 0.4 percent of GDP in 2002. At the same time, the new law on the prevention of and fight against social marginalization, which consolidates the responsibilities of the institutions involved in the delivery of social benefits and services, will become effective. Our efforts to reduce unemployment will focus on wage restraint and active labor market policies. Regarding the support of children, following the doubling of the state child allowance in November 2000, this allowance will be raised by 15 percent in January 2002, and by 20 percent in July 2002, while the benefits will be incorporated into the global income tax starting from January 1, 2002. The increases in the state child allowance allow us to keep the supplementary child allowance unchanged in nominal terms.

15. **We are committed to recorrelating the pensions of those pensioners with full length of service, and their survivors, who retired before 1999**. The recorrelation will be implemented in six steps over 2002–04, with the first step taking place on January 1, 2002. To provide a tangible increase for the pensioners with the lowest benefits as soon as possible, the distribution of the recorrelation amounts over time will be front-loaded for low pensions and back-loaded for higher pensions, with pensions above three pension points not benefiting from recorrelation. Taking into account the substantial financial resources needed for the recorrelation and the large deficit of the pension fund, the recorrelation can be achieved only by limiting the general indexation of pensions to 85 percent of the forecasted inflation in 2002, 88 percent in 2003, and 90 percent in 2004, while farmers' pensions will benefit from full indexation. This will allow us to limit the rise in total state social security pension expenditure to 7.3 percent in real terms in 2002, and to keep it at a prudent level in the following years. Furthermore, in order to restore the sustainability of the public pension system, we are committed to implementing further reforms that will tighten eligibility criteria for pension benefits and to strictly enforcing the criteria for invalidity pensions. To contain the non-pension related expenditure of the pension fund, we are committed to strengthening the control mechanisms for the issuance of medical certificates and payments of sick leave benefits.

16. **We will implement several measures to strengthen fiscal transparency and contain extrabudgetary spending.** All proceeds from privatization and the recovery of bad loans received by the Privatization Authority (APAPS) or other line ministries and the Assets Recovery Agency (AVAB), respectively, will be transferred to the treasury in order to retire public debt, except for amounts required to cover the operating costs of the two agencies and the directly related privatization costs of the respective line ministries. Furthermore, we will immediately discontinue the use by APAPS of privatization receipts as collateral for borrowing by state-owned companies. The use of privatization receipts from the sale of state-owned farms by the extrabudgetary "Romanian Agricultural Development Fund" under the Ministry for Agriculture to finance subsidies, will be discontinued at end-December 2002, and the fund will be incorporated into the state budget. We will establish a registry of local government foreign borrowing, which will complete our monitoring system for public and publicly guaranteed domestic and foreign debt (prior action). The overall ceiling for domestic government guarantees, as stipulated in Annex C, Table VII, will be a quantitative performance criterion under the program. To address the issue of arrears from the central and local governments as well as from special funds, we have established a quarterly reporting system effective end-June 2001 and approved an ordinance in order to reduce the arrears from hospitals that account for the largest share of total budgetary sector arrears.

17. **We will finance the 2002 budget deficit with a balanced composition of domestic and foreign financing**. We will limit net foreign financing of the budget to1.8 percent of GDP in 2002, compared with 2.4 percent of GDP in 2001, which will help us to contain growth in foreign government and government-guaranteed debt and in avoiding unsustainable upward pressure on the exchange rate.

C. Quasi-Fiscal Deficits in the Energy Sector and Other Public Enterprises

18. **We are aware that the performance of public companies in the energy sector is crucial to improving the overall financial discipline in the public sector and achieving a reduction in the quasi-fiscal deficit.** As a first step, we have increased the electricity price by 15 percent as of July 11, the heating producer price of Termoelectrica by 50 percent as of July 17, the end-user heating price (National Reference Price) by 57 percent as of August 9, and the natural gas price for households by 90 percent on August 10. Moreover, we have allowed local governments to raise the end-user heating price above the level of the National Reference Price, which will create scope for a further reduction in across-the-board subsidies. To mitigate the impact of these price adjustments on low-income households, we have concurrently strengthened the system of targeted income-tested transfers to poor households under the new minimum-income guarantee scheme.

19. **Further steps will, however, be needed to increase the electricity and heating prices to the cost-recovery level, eliminate losses due to weak collections, and to bring the gas prices to the import parity level. In particular:**

- As agreed in close cooperation with the World Bank, we will adjust the electricity and heating prices as follows: (i) end-user electricity price will be increased by 3.6 percent at the beginning of every month in the October 2001-March 2002 period (the October increase is a prior action); a further adjustment will be implemented, consistent with increasing Termoelectrica's producer price to US$40/Mwh, as of April 1, 2002; (ii) the heating producer price of Termoelectrica will be increased to US$15 per gigacalorie (Gcal) as of October 1, 2001 (prior action), and preserved at that level in U.S. dollar terms by additional adjustments on January 1 and April 1, 2002, and further increased to the equivalent of $20/Gcal on July 1, 2002; and (iii) the National Reference Price for heating will be increased to the equivalent of US$20/Gcal on July 1, 2002. In the meantime, the price will be adjusted on January 1 and April 1 to keep it at the current level of US$15.4/Gcal. The price adjustments in electricity and heating will be structural performance criteria.

- Regarding natural gas, at the beginning of every quarter, starting with October 1, 2001, we will adjust the uniform end-user price so as to keep it at the level of US$82.5 per thousand cubic meters (tcm) established in August this year. We will allow this price to rise to at least US$90/tcm as of January 1, 2003, to bring it closer to import parity level, currently at about US$130. To capture some of the windfall profits of domestic producers, we plan to utilize technical assistance funded from a World Bank loan with a view to amending the taxation system in the oil and gas sector by mid-2002. We will continue technical work on the new tariff methodology, which will lead to differentiation of prices for household and industrial users, with a view to implementing it before end-2002.

- To improve the collection rate for Termoelectrica and the two gas distribution companies (Distrigaz Nord and Sud), following the recommendations of the

World Bank experts, we will implement the following measures: (i) by October 1, as a prior action, we will establish a system of escrow accounts, which will receive customer payments for heating, and the subsidies, and distribute the proceeds between suppliers (Termoelectrica and gas distribution companies), and district heating companies (We may exempt from this regulation district heating companies that are current on their obligations.); (ii) the collection rate for deliveries from Termoelectrica to distribution company Electrica will be raised to 100 percent by October 30, and preserved at this level for every following month; (iii) we will immediately form special task forces in the two gas distribution companies, chaired by high-level management officials, which will be in charge of improving collections and reducing arrears from the 20 largest nonpayers. By the end of the first week of the following month, the Ministry of Industry will prepare a monthly report, which will be shared with the IMF and World Bank staff, on the implementation of measures to improve collections. The submission of the reports for September will be a prior action for the Board; and (iv) we will issue clear instructions to management in state-run utilities to use cash on delivery, letters of credit, escrow accounts, and disconnections as measures to improve collections and we will forbid political interventions in favor of nonpaying companies. The overall collection rates for Termoelectrica and the two gas distribution companies will be a quantitative performance criteria under the program.

- As a longer-term solution for the problem of nonpayment, we will push forward with the privatization of the gas distribution companies, Distrigaz Nord and Distrigaz Sud. (We have decided that splitting the two companies into eight would inappropriately delay the process and would reduce the interest of potential investors.) To achieve this objective, we intend to hire a privatization adviser for both companies by end-February 2002; approve a privatization strategy for both companies by end-June 2002; and announce an international tender for sale to a strategic investor, by end-September 2002.

- In the electricity sector, we will conclude the privatization of two distribution companies by end-2002. To achieve this, we will agree with the World Bank and the EU on the privatization strategy for these two companies by end-2001, and undertake an international tender for sale to a strategic investor during 2002.

20. **We will also implement other measures to strengthen financial discipline in state-owned enterprises.** We have passed an ordinance (EO79/2001) linking management salaries in these enterprises with key performance indicators, including reduction in the level of arrears and claims, and the observance of wage bill ceilings. This ordinance will be applied to all state-owned enterprises and institutions starting with the approval of 2001 enterprises' budgets, and the Ministry of Finance will monitor the performance of 86 large state-owned enterprises on a monthly basis. We intend to target a reduction of arrears and claims in nominal terms by the end of 2001 as compared with end-June 2001, excluding the effects of rescheduling. In addition, we have set up a monitoring system in the Ministry of Finance for tax arrears. This system currently covers some 1,000 entities, 2,600 accounts,

representing about 70 percent of total payables to the budget, and it will be used to strengthen the efficiency of tax collections.

D. Wage Policy in Public Enterprises

21. **Public sector wage discipline is essential to the financial performance of state-owned enterprises and, by providing a signal for private sector wage settlements, to reducing inflation and preserving external competitiveness.** Owing to the carryover effects of the increases in late 2000 and the insufficient coordination in the approval of collective contracts, the budgets of state-owned companies, and the minimum wage regulations in early 2001, wage growth in state-owned enterprises will be higher this year than what we consider prudent and consistent with our objective of improving financial discipline among public sector enterprises. Although we had only limited means to address this issue late in 2001, we have decided to lay off in the remainder of the year about 5,213 employees in eight loss-making companies in the industry sector, to outsource another 3,724 positions, and to eliminate about 500 positions as a result of turnover and retirement. Moreover, in 11 companies with about 116,000 employees, only half of the December bonuses will be paid. We have also decided to resist firmly any pressures from enterprises for additional wage increases in the remaining period of 2001. For 2002, we have decided to implement a much stronger control over wages in public enterprises. In particular:

- We will approve the 2002 budgets of regies autonomes, national companies, and state-owned commercial companies by end-2001 (structural performance criterion), and will ensure that they provide for savings on aggregate wage costs. Growth in the aggregate wage bill will be limited to 22 percent compared with the wage bill in 2001, or proportionally less if outsourcing is higher than 1 percent. Within that, we will impose tighter limits on companies with excessive wage hikes in 2001 and on those that operate with losses. The cumulative aggregate wage bill for public enterprises will be a quantitative performance criterion under the program.

- We will immediately start preparing a program for reducing employment and containing wage growth in the 86 state-owned enterprises monitored under the program. This program will include a partial hiring freeze in at least 75 percent of the state-owned companies in the industrial sector, (as measured by employment) which will limit hiring to 50 percent of the vacated positions in each company. It will also include ceilings for the 2002 wage bills and targets for employment cuts for each specific company consistent with the aggregate nominal wage bill target. The approval by the government of the program for containing wages and reducing employment (including the partial hiring freeze) in these state-owned companies will be a prior action for the consideration of the program by the IMF Board. Based on the program approved by the government, the Ministry of Finance will approve norms for elaborating the budgets of the state-owned companies which will be published in the Official Gazette (component of the prior action). The partial hiring freeze will also be included in the budgets of the state-owned companies which will be approved before end-2001. We will also ensure that the social pact that we intend to sign with the trade unions and other partners is not inconsistent with this program for containing wages and reducing employment in state-owned enterprises.

- We will decide (prior action) that the economy-wide minimum wage, currently at lei 1.4 million, will be raised to lei 1.75 million on March 1, 2002, with no further adjustments being made in the remainder of the year. We consider this measure important for supporting our wage policy, given the links between the minimum wage and the wage scales in several collective wage contracts.

- We will ensure that collective contracts are signed only after the approval of state-owned enterprises' budgets, and that future collective contracts do not link the wage scale to the minimum wage.

E. Monetary and Exchange Rate Policy, and Banking Supervision

22. **Monetary policy will continue to be conducted in the current framework of a managed float.** As the credibility of wage and fiscal policies is established, the National Bank of Romania (NBR) will attach more weight to the inflation objective, while not putting at risk the viability of the external accounts. The NBR will also provide wider room for fluctuation of the exchange rate to discourage short-term capital inflows. In its decisions on interventions in the foreign exchange rate, the NBR will gradually increase the weight of the euro in the notional basket used as a benchmark and reduce the role of the U.S. dollar. In view of the recent pickup in domestic demand and credit, we will step up our sterilization efforts and raise interest rates, which have recently declined due to the high volume of inflows, until after inflationary expectations have been credibly brought down. The Ministry of Finance will continue assisting the NBR in achieving this objective by retaining part of the proceeds from its recent Eurobond placement at the foreign currency account with the NBR. Should substantial pressures on the external position develop, the NBR will raise interest rates to defend the inflation objective and the exchange rate; the exchange interventions will be limited so as to safeguard official reserves. This objective will be supported by performance criteria under the program for the quarterly floors on net foreign assets of the NBR and ceilings on its net domestic assets. The NBR will also strictly enforce supervision requirements with the goal of preventing unhealthy credit expansion, particularly to state-owned enterprises.

23. **To lower the costs of intermediation, the NBR has decided to reduce the mandatory reserves requirement.** The requirement on lei deposits has been lowered from 30 percent to 27 percent as of July 1, and further to 25 percent as of October 1, which should contribute to narrowing the wide spread between the lending and deposit rates, helping the commercial banks to keep the deposit rate positive in real terms, in line with the objective of reducing inflation. Monetary effects of this measure will be sterilized with open market operations. The NBR's decisions on monetary policy, and in particular on sterilization operations, will not be affected by their effects on profit and loss accounts, even if it results in an operating loss. We will consult the staff on a further reduction in the reserve

requirements, with a view to eventual unification of lei and foreign exchange deposit reserve requirements.

24. **We will further strengthen the legal and regulatory framework of the financial sector, and will complete the cleanup of the banking system**. In particular, we will implement the following measures:

- We will issue, as a prior action, new ordinances amending and completing the banking laws in the following three priority areas: (i) the NBR will be granted additional powers to monitor all bank ownership transfers, including those that are performed by groups of individuals with the purpose of avoiding the 5 percent shareholding threshold, so that effective compliance with Basel Committee Core Principle (BCP) 4 can be achieved; (ii) banking supervisors will be provided with immunity and legal protection in line with the provisions of BCP 1 (5); and (iii) stricter criteria will be defined for the fit and proper test applicable to both shareholders and managers of banks, in line with BCP 3, and the new criteria will be applied to all existing bank managers and shareholders by end-June 2002.

- Furthermore, as numerous incidents have shown the weakness of the exit mechanism in the banking system, the government will approve a new draft law on bankruptcy in the banking industry prepared by the NBR by end-October 2001, in line with BCP 22, and ensure that it is applicable by end-November 2001, either through parliamentary approval or as a government ordinance.

- The regulation on loan classification and provisioning, currently based exclusively on repayment history and the existence of legal action against the borrower, will be strengthened according to BCP 8 and international best practices by end-October 2001 and will become applicable as of July 1, 2002. The amended regulation, which will be developed in close consultation with the banking community, will introduce additional criteria for downgrading the assessment of the borrowers' capacity to repay, based on their financial condition and creditworthiness. The revisions in prudential loan classification and provisioning criteria will also be incorporated in fiscal legislation for tax deductibility (structural benchmark).

- A new regulation limiting banks' exposures to open foreign exchange positions, both for individual currencies and in aggregate, is currently being finalized and will be issued by October 31, 2001, to become applicable on January 1, 2002.

- A new regulation enforcing the "know-your-customer" principle, to promote high ethical and professional standards, in line with BCP 15, is also currently being finalized by the NBR. It will be issued by December 31, 2001, and it will be immediately implemented.

- To improve the accuracy of financial reports, we are introducing the International Accounting Standards (IAS) to Romania in the banking sector. A regulation to this effect is being finalized in the NBR. It will be issued by end-October 2001, and will become applicable on January 1, 2002. The fiscal and other relevant legislation will be adjusted accordingly.

- To improve the stability of the financial system and the credibility of financial intermediaries, we deem essential the full enforcement of all applicable laws and the systematic prosecution of those responsible for financial scandals, including the FNI case.

- Cooperation with financial sector supervisors domestically, and banking supervisors internationally, will be strengthened, in line with BCPs 1, 24, and 25. To this end, proper legislation on confidentiality and exchange of information will be adopted by end-October 2001. In addition to the cooperation agreement with Moldova signed in July 2001, several similar international agreements, as well as the agreement between domestic financial sector supervisory authorities, will be finalized in the coming months.

- We will adopt and implement on schedule the financial sector reforms agreed with the World Bank to enhance supervision and address structural problems in the nonbank financial sector, in particular the insurance industry and the capital markets.

25. **The NBR will adopt a yearly financial audit of its operations and financial position under the international accounting standards**. In November 2000, the IMF completed a review of Romania's external audit mechanism as required under the IMF's safeguards assessment policy. Based on the review, the NBR has appointed a private sector accounting firm to undertake an audit of the NBR's financial statements in accordance with internationally accepted standards. The initial audit is expected to be completed by mid-October 2001, and publication of the audited financial statements is expected soon thereafter; we will fully cooperate with IMF staff in all aspects of the safeguard assessment.

F. Balance of Payments and External Debt Management

26. **The current account deficit is projected to widen from 3.7 percent of GDP in 2000 to 6.0 percent of GDP in 2001, owing to the continued effects of the drought as well as further strengthening of domestic demand.** Official reserves are projected to increase by about US$1.0 billion, to the equivalent of 3 months of imports. We are confident that with the programmed exceptional financing from the World Bank, EU, and the IMF, which will cover the projected financing gap, we will be able to meet this target. We will not issue any further sovereign-guaranteed international bonds in 2001. In 2002, though the impact of the drought will have passed, the current account deficit is projected to decline only modestly, owing to a continued buoyant demand for imports, driven in particular by private sector investment. Foreign direct investment is projected to grow thanks to accelerated privatization and greenfield investment, but the financing of the current account deficits and the reserve accumulation as programmed will also depend on continued public sector external borrowing as well as access to international capital markets.

27. **We will limit the contracting and guaranteeing of new nonconcessional medium- and long-term external debt by the government to US$2,800 million for 2001, of which no more than US$300 million will have maturities between one and three years (excluding new Termoelectrica loans).** Within these ceilings (which will be quantitative performance criteria), we will limit new off-budget guarantees from private creditors to US$165 million for 2001 (excluding Termoelectrica and Distrigaz loans). Borrowing by, or for, Termoelectrica in addition to the amounts borrowed up to end-May 2001 will be limited to US$400 million. Following the Petrom Eurobond placement, state-owned enterprises will not directly contract any new borrowing in 2001. For 2002, we will limit the contracting and guaranteeing of new medium- and long-term debt by the government to US$3,400 million, of which no more than US$100 million will be allowed for guarantees to off-budget entities. Within these ceilings, debt with maturities of one to three years will be limited to US$600 million, with no more than US$20 million allowed for off-budget entities (excluding Termoelectrica and Distrigaz). As a matter of good debt-management practice, we will not contract/guarantee debt instruments with embedded put options, and will seek to ensure a relatively smooth time profile for future debt service. In order to avoid allowing disbursements of external loans to line ministries to exceed the expenditure ceilings in the budget law, we are determined to strengthen the preventive control mechanism in the Ministry of Finance and have improved the reporting system for the disbursement of external loans based on reports from creditors.

28. **We are determined not to introduce new, or intensify existing exchange restrictions, to allow multiple currency practice or impose or intensify import restrictions for balance of payments/fiscal purposes**. In this connection, in line with the schedule agreed with the WTO, we eliminated the import surcharge of 2 percent at the beginning of 2001. We will eliminate a ban on exports by the end of the year on logs and scrap metal, and refrain from resorting to preferential import tax rates for selected goods when domestic supply is scarce. We will amend Emergency Ordinance 93/2001 on the environment fund to remove taxes on exports. Until amended, the Emergency Ordinance will not be applied. Moreover, we have reached an agreement with Sweden on the settlement of disputed external arrears, under which we have agreed to pay Sweden US$120 million to settle the debt.

IV. Structural Reform

29. **We are fully committed to privatization of the still very large state-owned sector, as this is a crucial requirement for establishing a vibrant market economy, attracting FDI, and catching up with other EU accession countries**. To this end, we expect to complete negotiations soon with the World Bank on structural reforms and a privatization strategy under the Private Sector Adjustment Loan (PSAL) II program. The main elements of our privatization strategy for 2001 will be the following.

30. **To continue to reduce the government's role in the banking industry, we will attach the highest priority to the privatization of BCR**. Although with a delay, privatization advisors have now resumed their work on updating the necessary documents for

BCR's privatization. As a prior action for the program, in early October the government will approve a privatization strategy for BCR involving the complete sale of the state's share of the capital and transfer of the control over the bank to a strategic investor (either a bank or a consortium) by end-2002. By end-February 2002, we will announce a tender with an invitation for expressions of interest (structural performance criterion). By end-June, we will obtain a firm bid from a strategic investor on the sale of BCR as evidenced by a "bid bond." We expect to complete the privatization of the total state shareholding of BCR by end-December 2002 (structural performance criterion).

31. **Reform measures will also be implemented concerning two other state-owned banks, CEC and Eximbank.** We will adhere to the timetable agreed with the EU for the implementation of the restructuring plan for CEC, in preparation for the bank's privatization, and will prepare a feasibility study on refocusing Eximbank on the promotion of export and import activities while terminating its commercial banking activities.

32. **In the enterprise sector, following the very slow pace in the second half of 2000 and the first half of 2001, we will accelerate privatization and focus on completing several large projects to send a strong signal.** In particular:

- We will take all the necessary measures to complete the transfer of SIDEX to the investor by end-October 2001.
- We will privatize Alro and Alprom by March 2002, in a manner agreed with the World Bank.
- We will privatize at least four companies with more than 1,000 employees by end-October 2001, another four by end-December 2001, and another four by end-March 2002 (structural benchmark).
- For the companies that were to be restructured/liquidated under PSAL I, we will complete the sales of 50 percent of the assets of Clujana, and for IUG Craiova, we will initial a draft purchase and sales agreement with a buyer by end-2001. For Roman, Siderurgica ,and Nitramonia, we will start the implementation of the restructuring plan (unbundling into viable and nonviable entities) by end-2001. During the first half of 2002, we will start liquidation of the nonviable entities and offer for sale the viable entities. By end-2002, we will start the liquidation of the viable entities that have not yet been sold.
- To help reduce significantly any further accumulation of losses in state-owned enterprises, we will start legal proceedings for the liquidation of at least 15 companies that are nonviable (with arrears of more than 50 percent of assets) by end-October and another 20 by end-2001 (structural benchmark).
- We are committed to surpassing the targets agreed with the World Bank under PSAL II, especially in light of the importance of privatization to controlling quasi-

fiscal costs. All privatization will be conducted in a transparent manner and in line with internationally accepted standards to improve the government's credibility in good governance. Progress in achieving our privatization targets will be assessed in terms of the context of the reviews of the Stand-By Arrangement.

- To speed up the process of privatization, the government will decide—for companies to be privatized—the amount of outstanding debt to the budget, including the penalties, that will be written off at the moment the company is privatized and transferred to investors. This amount will be announced in advance and included in the bidding documents.

V. PROGRAM MONITORING

33. **The program will be monitored on the basis of the performance criteria and indicative targets as described in the next paragraphs**. The program will be reviewed by the IMF on a quarterly basis during the period of the Stand-By Arrangement (September 2001–March 2003). In addition to the main financial performance indicators, the reviews will be devoted to assessing progress in implementing the structural elements of the program, in particular those regarding energy price adjustments, wage discipline, and steps to privatize BCR. An additional topic for the first review will be the 2002 budget, as approved by parliament. Agreement on the 2003 budget will also be a condition for completing a review.

34. **The quantitative performance criteria are as follows:** (i) quarterly ceilings on net domestic assets of the NBR; (ii) quarterly floors on net foreign assets of the NBR; (iii) quarterly ceilings on the deficit of the general government, with a downward adjuster in the case of lower-than-projected privatization proceeds; (iv) quarterly ceilings on cumulative nominal wage bills for selected state-owned enterprises (regies autonomes and large loss-making state-owned enterprises); (v) quarterly floors on collection rates of three utilities; (vi) quarterly ceilings on domestic guarantees by the general government under public debt law and other laws, excluding export promotion guarantees; (vii) quarterly ceilings on the contracting or guaranteeing by the government of nonconcessional external debt; and (viii) a continuous performance criterion of no accumulation of external payments arrears will also apply.

35. **The indicative targets under the program are as follows:** (i) quarterly ceilings on arrears of monitored state-owned enterprises to the consolidated general government; (ii) quarterly ceilings on average reserve money; (iii) quarterly ceilings on broad money; and (iv) the exposure of commercial banks to state-owned enterprises.

36. All quantitative performance criteria are specified in Table 1; the list of prior actions, structural performance criteria, and benchmarks appears in Annex B. The main definitions appear in the Technical Memorandum of Understanding as Annex C.

Table 1. Romania: Quantitative Performance Criteria and Indicative Targets for 2001-02 1/

	End-Dec. 2001 Prog.	End-March 2002 Prog.	End-June 2002 Prog.	End-Sept. 2002 Prog.	End-Dec. 2002 Prog.
			(In trillions of lei)		
1. Ceilings on the Average Net Domestic Assets of the National Bank of Romania	-48.1	-56.2	-61.4	-67.0	-73.3
			(In millions of U.S. Dollars)		
2. Targets for Floor on Net Foreign Assets of the National Bank of Romania	3,527	3,601	3,816	3,924	4,094
			(In trillions of lei)		
3. Ceilings on the Deficit of the General Government	38.754	9.940	19.872	31.104	43.200
4. Ceilings on Aggregate Wage Bills of Monitored State-owned Enterprises	40.7	9.4	21.3	34.9	49.5
5. Indicative Targets for Ceilings on Arrears of Monitored State-owned Enterprises to the Consolidated General Government	52.5	51.7	51.0	50.2	49.4
			(In percent)		
6. Floors on Cumulative Aggregate Collection Rates of:					
a. Distrigaz Nord and Distrigaz Sud (aggregate)	95	97.5	97.5	97.5	97.5
b. Termoelectrica	95	97.5	97.5	97.5	97.5
			(In billions of lei)		
7. Ceilings on Domestic Guarantees Extended by Government	469	1,110	1,110	1,110	1,110
			(In millions of U.S. Dollars)		
8. Ceilings on Contracting or Guaranteeing of External Debt 2/					
a. One-year or less maturity	0	0	0	0	0
a. More than one- and up to three-year maturity	300	300	400	450	600
Of which: off-budget	165	10	15	20	20
b. More than one-year maturity	2,800	1,000	1,200	1,800	3,400
Of which: off-budget	165	50	75	100	100
			(In trillions of lei)		
9. Indicative Targets for Ceilings on Average Reserve Money	63.1	62.2	69.4	73.3	79.4
10. Indicative Targets for Ceilings on Broad Money	252.2	258.9	280.0	293.5	323.7
11. Indicative Targets on Banking Sector Lending to the State-owned Enterprises	29.1	30.7	32.5	34.6	36.3
Of which: Lending by BCR	14.5	15.3	16.2	17.2	18.0

1/ The performance criteria and indicative targets envisaged under the program are defined in the Technical Memorandum of Understanding.
End-December 2001 and end-March 2002 figures are performance criteria, while end-June 2002, end-September 2002,and end-December 2002 figures are indicative targets.
2/ Nonaccumulation of external payment arrears of the government will be a performance criterion monitored on a continuous basis.

Prior Actions, Structural Performance Criteria and Benchmarks

Prior Actions

1. Fiscal Policy
   - The submission of the 2002 budget, as agreed with IMF staff, to parliament;
   - Cancellation of the Emergency Ordinance 195/2000 on VAT and customs duties exemptions for selected state-owned companies effective immediately, except for Termoelectrica for which the cancellation will be effective as of March 1, 2002;
   - Cancellation of Emergency Ordinance 62/2001 on debt-for-equity swaps for called guarantees;
   - Establishment of a registry of local authority foreign borrowing.

2. Incomes Policy and Arrears Reduction
   - Approval by the government of the program for containing wages and reducing employment (including a partial hiring freeze) in regies autonomes and state-owned commercial companies (as described in paragraph 21, second bullet), and approval of the Ministry of Finance of norms for elaborating the budgets of the state-owned companies, which will be published in the Official Gazette;
   - Government decision increasing the economy-wide minimum wage to no more than lei 1.75 million as of March 1, 2002.

3. Banking Privatization and Supervision
   - Government approval of a privatization strategy for BCR involving the complete sale of the state's share of the capital to strategic banking investor;
   - Issuance of new ordinances amending and completing the banking laws in the following three priority areas: (i) bank ownership transfers; (ii) immunity and legal protection for banking supervisors; and (iii) stricter criteria for the fit and proper test.

4. Energy Sector Reform
   - Increase in end-user electricity prices by 3.6 percent, and increase of Termoelectrica's heating producer price to the equivalent of US$15/Gcal, on October 1, 2001.

   - Establishment of fully functioning escrow accounts for consumer payment of heating supplied by Termoelectrica, and by natural gas provided by Distrigaz Nord and Sud to district heating suppliers;

   - Submission by the Ministry of Industry of the September monthly report, to be shared with IMF and World Bank staff, on the implementation of measures to improve collections of Distrigaz Nord and Distrigaz Sud.

Structural Performance Criteria

6. Announcement of tender for BCR by end-February 2002.

7. Completion of the privatization of BCR by end-December 2002.

8. Approval of the budgets of regies autonomes and state-owned commercial companies, consistent with the wage policy objectives for 2002 in paragraph 18 by end-December 2001.

9. The implementation of the authorities' plan to increase electricity and heating prices, as stipulated in the attached Table 1.

Structural Benchmarks

10. Privatization of at least 4 companies with more than 1,000 employees by end-October 2001, and at least another 4 by end-December 2001, and a further 4 companies by end-March 2002. Commencement of legal proceedings for the liquidation of at least 15 companies that are nonviable (with arrears more than 50 percent of assets, and each with assets of at least lei 25 billion) by end-October, and another 20 companies by end-December 2001.

11. The regulation on loan classification and provisioning, to be revised by end-October 2001, and brought into force by July 2002.

12. Elimination of custom duty and VAT exemptions for raw materials for small and medium-sized enterprises under Law 133/1999, by end-December 2001.

13. Submission of monthly reports on the implementation of measures to improve collections of Distrigaz Nord and Distrigaz Sud.

Table 1. 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/
November 1, 2001	3.6	2/
December 1, 2001	3.6	2/
January 1, 2002	3.6	2/
February 1, 2002	3.6	2/
March 1, 2002	3.6	2/
April 1, 2002	16.0	3/
Heat Producer Price for Termoelectrica	Increase to: (in U.S. dollars)	
October 1, 2001	$15.00	1/
January 1, 2002	$15.00	2/
April 1, 2002	$15.00	3/
July 1, 2002	$20.00	3/
National Reference Price for Heating	(in U.S. dollars)	
January 1, 2002	$15.40	2/
April 1, 2002	$15.40	3/
July 1, 2002	$20.00	3/
Unified End-user Natural Gas Price	(in U.S. dollars)	
October 1, 2001	$82.50	3/
January 1, 2002	$82.50	3/
April 1, 2002	$82.50	3/
July 1, 2002	$82.50	3/
October 1, 2002	$82.50	3/
January 1, 2003	$90.00	3/

1/ Prior action.
2/ Structural performance criteria.
3/ Indicative target will be converted to structural performance criteria at first review.

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

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

	Ceiling	Actual
	(In billions of lei)	
Stock as of:		
June 30, 2001		-21,544
September 30, 2001	-40,594	
December 31, 2001 (performance criterion)	-48,099	
March 31, 2002 (performance criterion)	-56,180	
June 30, 2002 (indicative target)	-61,444	
September 30, 2002 (indicative target)	-67,015	
December 31, 2002 (indicative target)	-73,271	

The average net domestic assets of the National Bank of Romania (NBR) are defined as the difference between average reserve money (as defined in Table IX of this attachment) and average of net foreign assets (as defined in Table II of this attachment for the indicated month, excluding the adjustment for foreign currency denominated treasury bills), both expressed in local currency.

For the purposes of the program, 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 agreed with Fund staff. The average stock of NFA is defined as the average of the daily NFA as defined in Table II.

The limits will be monitored from daily data on the accounts of the NBR supplied weekly to the IMF by the NBR.

The ceiling on average net domestic assets of the NBR will be adjusted under the following circumstances:
(1) The ceiling would be adjusted downwards in a proportional fashion, for the fraction of the month that gross foreign financing, as defined in Table II, exceeds programmed levels, specified in Table II.
(2) The ceiling would be adjusted upwards one-for-one, in a proportional fashion for the fraction of the month and to the extent the floor on NFA is adjusted downwards in Table II as a result of shortfalls in gross foreign financing.
(3) The ceilings would be adjusted for any change in reserve requirements as described in Table IX. Before undertaking any such changes, the NBR will consult IMF staff.

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

	Floor	Actual
	(In millions of U.S. dollars)	
Stock as of:		
June 30, 2001		3,285
September 30, 2001	3,336	
December 31, 2001 (performance criterion)	3,527	
March 31, 2002 (performance criterion)	3,601	
June 30, 2002 (indicative target)	3,816	
September 30, 2002 (indicative target)	3,924	
December 31, 2002 (indicative target)	4,094	

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. The NBR's Samurai bond will be valued at its swap rate of 111.9 Yen/U.S. dollar. 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 automatically adjusted for the deviation 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$748 million
September 2002	US$748 million
December 2002	US$898 million

Specifically, if the proceeds from foreign financing:
(1) exceed the program limits, the NFA floor for the quarter will be increased by 100 percent of the additional financing;
(2) fall short of the program limits, the NFA floor will be reduced by 100 percent of the shortfall by December 2001, and by up to US$350 million to end-September 2002, and by up to 500 million by end-December 2002.

The NFA floor will be adjusted by the change in the stock of foreign currency denominated Ministry of Finance Treasury Bills. The outstanding stock on June 30, 2001 was $485 million evaluated at the above exchange rates.

[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.

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

	Ceiling	Actual
	(In billions of lei)	
Deficit as of:		
March 31, 2001 (actual)		9,108
June 30, 2001 (actual)		17,852
September 30, 2001 (indicative target)	28,445	
December 31, 2001 (performance criterion)	38,754	
March 31, 2002 (performance criterion)	9,940	
June 30, 2002 (indicative target)	19,872	
September 30, 2002 (indicative target)	31,104	
December 31, 2002 (indicative target)	43,200	

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", 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", 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, 2000 will be converted at the end-December 2000 exchange rate. Foreign-currency denominated credit newly issued in 2001 and 2002 will be valued at

[2] These include the State Social Security Fund, the Unemployment Fund, and the Health Social Insurance Fund.

actual exchange rates at the time of disbursement. 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 memoire "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 2002 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 dollars using the exchange rates on December 31, 2000, and from dollars into lei using the above listed rates. The floor for these proceeds is as follows:

	Floor	Actual
	(In billions of lei)	
Cumulative quarterly privatization proceeds of the general consolidated Government for 2002:		
March 31, 2002 (minimum target)	1,000	
June 30, 2002 (minimum target)	2,000	
September 30, 2002 (minimum target)	3,000	
December 31, 2002 (minimum target)	4,000	

As a contingency measure to achieve the deficit target of 3.5 percent of GDP in 2001 the Government approved in the budget rectification ordinance the blocking of 50 percent of the capital expenditure entitlement for the fourth quarter of 2001 (lei 2,580 billion) for the state budget, the social protection funds; the "Special Fund for Modernizing Roads", and the "Special Fund for the Development of the Energetic System." The blocked expenditure can be released at the earliest as of October 25, 2001, provided that the end-September revenue target has been met. The revenue target refers to the estimate of total cumulative revenue agreed between the Ministry of Public Finance and IMF staff for the general consolidated budget for the first three quarters of 2001 (see below). If this revenue target is not met on October 25, the expenditures will be unblocked if and when the agreed cumulative monthly revenue targets are met in the two following months.

In addition, for November and December 2001 the Government at the proposal of the Ministry of Public Finance will approve by the end of October and November, respectively, after consultation with IMF staff expenditure ceilings for the state budget which can be lower than the expenditure appropriations approved in the budget rectification ordinance. These ceilings will depend upon the revenue performance for the general consolidated budget as of the end of September and October, respectively (measured against the agreed monthly revenue targets), while also taking into account the development of revenues, expenditures and the deficit of the state budget during October and November, respectively, as well as the expected trend through the end of the year.

	Agreed revenue targets	Actual
	(In billions of lei)	
Consolidated general government (cumulative total revenues including grants)		
March 31, 2001 (actual)		74,370
June 30, 2001 (actual)		160,893
September 30, 2001 (agreed revenue target)	253,857	
October 31, 2001 (agreed revenue target)	288,816	
November 30, 2001 (agreed revenue target)	321,563	
December 31, 2001 (agreed revenue target)	359,442	

IV. Ceiling on Aggregate Wage Bill of Monitored State-owned Enterprises

The set of 53 *régies autonomes* (RAs) and national companies and 33 large state-owned commercial companies, whose wages are to be monitored under Emergency Ordinance 79/2001, is specified in Government Decision 866/2001.The wage bills of this set of state-owned enterprises will be restricted along the following lines:

The growth in the 2001 aggregate wage bills in the set of monitored state-owned enterprises will be limited to 44 percent relative to the annual wage bill in 2000. Additionally, employment cuts totaling 9,428 will be undertaken between September 1 and December 31, 2001 in eight companies under the Ministry of Industry: CN Huila, SN Carbune, CN Minvest, CN Remin, CN Lignit Oltenia, CN Transelectrica, SC Termoelectrica, and SC Electrica. Total employment in these enterprises should be no more than 123,439 on December 31, 2001.

For 2002, the growth in the aggregate wage bill for these enterprises will be limited to 22 percent relative to the 2001 wage bill, or proportionally less if "externalization" (defined as the spinning off of a unit or its transfer to another entity) is higher than 1 percent.

The cumulative ceilings for the aggregate wage bill of the set of monitored state-owned enterprises will be:

January–June 2001:	lei 18.6 trillion (actual)
January–September 2001:	lei 28.3 trillion (estimate)
January–December 2001:	lei 40.7 trillion (performance criterion)
January–March 2002:	lei 9.4 trillion (performance criterion)
January–June 2002:	lei 21.3 trillion (indicative target)
January–September 2002:	lei 34.9 trillion (indicative target)
January–December 2002:	lei 49.5 trillion (indicative target)

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.

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

	Ceilings	Actual
	(In trillions of lei)	
Stock of arrears as of: December 31, 2000		47.2
Stock of arrears as of: July 31, 2001		60.8
December 31, 2001 (performance criterion)	52.5	
March 31, 2002 (performance criterion)	51.7	
June 30, 2002 (indicative target)	51.0	
September 30, 2002 (indicative target)	50.2	
December 31, 2002 (indicative target)	49.4	

The set of 53 *régies autonomes* (RAs) and national companies and 33 large state-owned commercial companies, whose arrears are to be monitored under Emergency Ordinance 79/2001, is specified in 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. For arrears which have been rescheduled, the rescheduled amount (including penalties) cannot be counted as arrears reduction, and has to be reported. Data for monitoring purposes shall be supplied monthly to the IMF by the Ministry of Finance. The report will include arrears data, including a breakdown by creditor (as well as the subtotal for arrears to the government), for each of the companies in the monitored list; it will also include aggregate figures for each ministry and for the overall total. The report will also include data on overdue claims of each of the monitored companies, as reported under Emergency Ordinance 79/2001.

The reports collected by the Ministry of Finance will also include data indicating the breakdown of arrears to the ten largest creditors for each company, which will be available for review by IMF staff during missions.

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

Floors will be set on the cumulative collection rates of the following companies: Distrigaz Nord, Distrigaz Sud and Termoelectrica. Cumulative collection rates are defined as the ratio of collections to billings, measured from the start of the year to a specified date. The floors are set as follows:

	Floor	Actual
	(In percent)	
Distrigaz Nord and Distrigaz Sud:		
September 30, 2001	92.0	
December 31, 2001 (performance criterion)	95.0	
March 31, 2002 (performance criterion)	97.5	
June 30, 2002 (indicative target)	97.5	
September 30, 2002 (indicative target)	97.5	
December 31, 2002 (indicative target)	97.5	
Termoelectrica:		
September 30, 2001	92.0	
December 31, 2001 (performance criterion)	95.0	
March 31, 2002 (performance criterion)	97.5	
June 30, 2002 (indicative target)	97.5	
September 30, 2002 (indicative target)	97.5	
December 31, 2002 (indicative target)	97.5	

Data for these companies will be collected by the Ministry of Finance and reported to the IMF on a monthly basis.

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

Domestic Guarantees Extended by Government	Ceiling	Actual
	(In billions of lei)	
June 30, 2001[3]		320
September 30, 2001	469	
December 31, 2001 (performance criterion)	469	
March 31, 2002 (performance criterion)	1,110	
June 30, 2002 (indicative target)	1,110	
September 30, 2002 (indicative target)	1,110	
December 31, 2002 (indicative target)	1,110	

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 Table 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 lei/$ exchange rates of 29,835 for 2001, and 36, 867 for 2002.

These limits exclude:

- the contracting or guaranteeing of external debt, for which separate limits are set out in Table V and Table VI of this attachment;
- debt transferred to AVAB in the process of bank restructuring.

Data for monitoring purposes shall be supplied monthly to the IMF by the Ministry of Finance.

[3] The actual for March 31, 2000, includes loans extended to ROMAN, and TRACTORUL, guaranteed by APAPS deposits.

VIII. Ceilings on Contracting or Guaranteeing of External Debt

	(In millions of U.S. dollars)					
	One-year or less maturity		More than one- and up to three-year maturity		More than one-year maturity	
	Ceiling	Actual	Ceiling	Actual	Ceiling	Actual
June 30, 2001	0			196		1,194
Of which off-budget:	0			0		83
September 31, 2000	0		300		2,500	
Of which off-budget:	0		165		165	
December 31, 2000 1/	0		300		2,800	
Of which off-budget:	0		165		165	
March 31, 2002 1/	0		300		1,000	
Of which off-budget:	0		10		50	
June 30, 2000 2/	0		400		1,200	
Of which off-budget:	0		15		75	
September 31, 2000 2/	0		450		1,800	
Of which off-budget:	0		20		100	
December 31, 2000 2/	0		600		3,400	
Of which off-budget:	0		20		100	

1/ Performance criterion
2/ Indicative target

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 Table 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 and Termoelectrica are included in the overall ceilings, but not in the off-budget guaranteed debt ceilings, and

Termoelectrica's fuel import loans 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.

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

For Program purposes, arrears with respect to called-up soverign loan guarantees are defined as external payments overdue more than 30 days.

IX. Indicative Targets for Ceilings on Average Reserve Money

	Ceilings	Actual
	(In billions of lei)	
Stock as of:		
June 30, 2001		57,530
September 30, 2001[4]	59,647	
December 31, 2001	63,096	
March 31, 2002	62,202	
June 30, 2002	69,403	
September 30, 2002	73,292	
December 31, 2002	79,392	

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 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.

(2) The reserve money targets will be lowered proportionally to the extent the total reserve of the banking system falls short of the minimum reserve requirements.

[4] Based on lei deposit reserve requirement of 27 percent; starting October 1, it will be decreased to 25 percent.

X. Indicative Targets for Ceilings on Broad Money

	Ceilings	Actual
	(In billions of lei)	
Stock as of:		
June 30, 2001		208,498
September 30, 2001	225,353	
December 31, 2001	252,237	
March 31, 2002	258,921	
June 30, 2002	280,015	
September 30, 2002	293,547	
December 31, 2002	323,658	

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 agreed with 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.

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

	Ceilings		Actual	
	Total	*Of which:* BCR	Total	*Of which:* BCR
	(In billions of lei)			
Stocks as of :				
June 30, 2001			24,799	13,182
September 30, 2001	27,548	13,756		
December 31, 2001	29,143	14,532		
March 31, 2002	30,672	15,273		
June 30, 2002	32,473	16,163		
September 30, 2002	34,551	17,212		
December 31, 2002	36,250	18,021		

Total exposure covers all loans, advances, holdings of debt and off-balance sheet exposure of resident banks to state-owned enterprises. State-owned enterprises are all regies 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 agreed 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 Table 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 be adjusted upwards by:
(i) exposure to companies where the majority ownership shifted to the private sector since June 30, 2001. For this purpose, APAPS and the relevant ministries will provide a quarterly 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 90 billion, on a company-by-company basis.

INTERNATIONAL MONETARY FUND

ROMANIA

Request for Stand-By Arrangement
Supplementary Information

Prepared by European I and
the Policy Development and Review Departments

(In consultation with other departments)

Approved by Susan Schadler and Liam P. Ebrill

October 30, 2001

1. This supplement reports on recent macroeconomic developments and the implementation of prior actions since the issuance of the staff report (EBS/01/175). As discussed in paragraph 4, all but one prior actions were met five days before the Board meeting. While the remaining prior action has been only partially implemented, the authorities have demonstrated a strong commitment to complete this action soon. The staff appraisal remains appropriate and the staff reaffirms its recommendation that the proposed Arrangement be approved.

2. **Macroeconomic developments have remained consistent with the program projections.** Inflation declined in September to 31 percent, in line with the end-December target of 29 percent. The balance of payments data for July and August indicate stronger growth in current transfers than assumed, which is expected to lower the current account deficit by about ⅓-½ percent of GDP in 2001 relative to the projection, and will probably carry-over into 2002. The trade deficit in August was consistent with projections, while both exports and imports were somewhat lower. Monetary aggregates at end-September were also broadly in line with the program projections. The projected NFA level was reached, while the one for NDA was overrun by about lei 1 trillion (2.5 percent) due to faster than projected reserve money growth, subsequently reversed in October.

3. **The cumulative general government budget deficit at 2.6 percent of GDP in September was in line with the program projection, but revenue performance was weaker than expected.** Revenue collections, which grew in the third quarter by 5.8 percent in real terms year-on-year, were less than projected, resulting in a revenue shortfall of about 0.38 percent of GDP. While the high variability of monthly collections (exceptionally good performance in July, weak in August and September) complicates the assessment of the underlying trends, the revenue shortfall for the year is estimated at 0.6 percent of GDP. The

weakness of revenues appears to be partly due to profit tax exemptions and other tax incentives in place in 2001 (several of these incentives will be eliminated or reduced in 2002 in the new profit tax law) and the lower-than-expected inflows to the pension fund, which remains to be explained. Committed to achieving the deficit target, the government cancelled investment appropriations in the amount of 0.23 percent of GDP previously set aside, and decided to implement the following additional measures: (i) tighter monitoring and eligibility control on the application of the profit tax preferences; (ii) stepping up arrears collection; and (iii) additional expenditure cuts, mainly in public investment and some types of transfers to public institutions. In his letter to the Managing Director dated October 26, the Minister of Finance provided assurances that the government was fully committed to keeping the budget deficit within the program ceiling for 2001 and the staff considers that the appropriate policies are in place to meet the end-December performance criteria. Taking into consideration the elimination of various tax incentives at the beginning of 2002, and the envisaged measures to improve the revenue collection of the pension fund, the staff does not expect the revenue shortfall to impact significantly the 2002 budget. If this turns out not to be the case, the authorities have assured us they will take appropriate additional measures.

4. **Ten out of eleven prior actions have been met** - nine of them on time, and one scheduled for October 1, became effective on October 10. A delay has been experienced in the full implementation of the measure on establishing fully functioning escrow accounts in the heating sector, intended to improve the very low collection rates in the energy sector.[1] While the corresponding decree was approved on September 28, the Ministry of Industry moved slowly to encourage the reluctant local heat distribution companies to conclude the appropriate contracts establishing the escrow accounts with Termoelectrica as the supplier. As of October 26, for the electricity sector 23 out of 28 escrow accounts, including the one in Bucharest, have been established. In the gas sector 118 out of 157 contracts were signed though not all appear to be functioning. All other municipalities have been informed separately by Termoelectrica, the gas companies, and the Ministry of Industry, that heat and gas delivery will not start before the contracts have been signed. While the authorities are only in partial compliance with this prior action, the staff is confident that their strong recent efforts provide assurances that the measure will soon be fully implemented.

5. In light of recent data, the staff maintains its view that the **impact of recent global events on Romania appears to be modest.** Looking forward, the staff expects this to continue, with a potential weakening of global growth offset in part by lower oil prices. However, though recent developments suggest that capital markets are taking an increasingly favorable view of Romania, the planned bond issues for 2002 leave Romania somewhat exposed should a more broad-based disruption to capital markets occur. If there were a

[1] For the importance of this measure for reducing the quasi-fiscal deficit, see paragraph 21 in the staff report, and paragraph 19 in the Memorandum on Economic and Financial Policies.

protracted disruption, an appropriate policy response would include some additional fiscal adjustment, a revised reserve accumulation target, and additional Fund financing.

6. **Following the recommendations of the transitional safeguard assessment, the authorities initiated an external audit of the NBR's financial statements, which has been completed recently.** The authorities have provided to the Fund (TRE) all documents requested, and have authorized the external auditor to discuss with and disclose to the Fund all information necessary to perform the assessment. A full Stage One safeguards assessment, which will include a review of the external audit, is in progress.

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October 31, 2001

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves 18-month, US$383 Million Stand-By Credit to Romania

The Executive Board of the International Monetary Fund (IMF) today approved an 18-month stand-by credit for SDR 300 million (about US$383 million) to Romania. The decision will enable Romania to draw SDR 52 million (about US$66 million) immediately from the IMF.

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

"Reflecting their commitment to accelerate EU accession, the Romanian authorities have initiated a program aimed at ensuring macroeconomic stability, high sustainable growth, and effective transition to a market-based economic structure. With several previous programs having gone off track before completion, the authorities indicated their very strong commitment to realize all the components of the proposed program. The program comprises comprehensive policies for fiscal, quasi-fiscal, and wage restraint. The structural adjustment policies mostly reflect the need to move ahead as quickly as possible with privatization and put the energy sector on the road to profitability. Important macroeconomic and structural measures, including recent fiscal measures and submission of the 2002 budget to Parliament, have been implemented up front. Further timely implementation of scheduled measures along with resolve to engage in a vigorous and sustained strategy of stabilization and structural reform will be important to the success of the program.

"A crucial component of the program is the reduction in the quasi-fiscal deficit and particularly in the large losses in the state-owned energy sector. The government's program therefore includes adjustments in energy prices, measures to improve the collection rates of the main utilities, and containment of wage growth as well as lower employment in state-owned companies in 2002. The implementation of these measures will be of critical importance both for enterprise profitability and for the success of the disinflation strategy.

"Monetary policy, implemented in a framework centered on a managed floating exchange rate, will balance the objectives of reducing inflation and protecting external sustainability. The authorities' choice of a gradual disinflation strategy reflects the difficulties in eliminating the backward-looking wage indexation mechanism and imposing firm financial discipline in public enterprises.

'The government is firmly committed to reducing the size of the state sector and moving ahead with several major privatization projects. It has already approved the privatization strategy for the largest state-owned bank, BCR, which will involve the complete sale of the state's capital share and transfer of control to a strategic investor. Privatization in the gas and electricity distribution sectors planned for the program period, as well as foreign direct investment, will be essential in stemming financial losses and improving real performance in those sectors. It is important that privatization take place according to fully transparent procedures," Ms. Krueger said.

ANNEX

Recent Economic Developments

During the first half of 2001, GDP growth of 5 percent was driven mainly by domestic demand. The current account deficit widened and inflation declined somewhat less than targeted. Although export growth remained robust, imports grew by 30 percent in U.S. dollar terms, and as a result, the current account deficit more than doubled relative to the same period of 2000. Inflation slowed, but less than initially targeted. The fiscal deficit in the first eight months of 2001 amounted to 2.4 percent of GDP, up slightly from the same period of the previous year, despite stronger growth and a lower deficit target for the year as a whole. The National Bank of Romania continued to conduct monetary policy in the framework of a managed float, with the objective of avoiding excessive real effective appreciation.

Program Summary

The program aims at gradual disinflation and containing the external current account deficit, while accelerating structural reforms and strengthening growth prospects. The gradual approach to disinflation—the inflation rate is targeted to fall from 40 percent in early 2001 to 22 percent at end-2002 and to single-digit inflation rates in the medium term—reflects difficulties in eliminating the inflation inertia in the presence of established backward-looking wage indexation, as well as the need for the adjustment of relative prices. The targeted decline in the external current account deficit in 2002 reflects the expectation that growth will remain strong, primarily on account of an expected pickup in private investment.

To achieve these goals, the key points of the program are as follows: (i) a fiscal adjustment equivalent to ½ percentage point of GDP in 2002; (ii) a reduction in the energy sector losses of about 1½ percent of GDP, which will improve the saving/investment balance of public sector enterprises by at least ¾ percentage point of GDP; (iii) public sector wage policy consistent with the disinflation target and, together with employment cuts, lower labor costs in state-owned enterprises; (iv) a monetary program consistent with the inflation target and balance of payments developments; (v) structural reforms that include an ambitious privatization agenda to downsize the public sector and measures to improve the business climate; and (vi) strengthening of the regulatory framework and supervision in the financial system.

On exchange rate policy, the authorities will maintain the current framework of managed float for achieving further disinflation and preserving the external equilibrium. The monetary program reflects money demand projections consistent with targeted inflation, GDP growth, and continuing gradual remonetization. Broad money is projected to increase by 5½ percent in real terms and private sector credit by about 7 percent in real terms. Aided by the strict implementation of wage and fiscal policies, the NBR in its monetary and exchange rate management, will increase the weight attached to the inflation objective, while not putting external viability at risk. The weight of the euro in the notional basket used by the NBR to decide on interventions will be gradually increased, to provide more stability vis-à-vis the main trading partners. The measures to strengthen the supervisory and regulatory framework of the financial sector would move Romania closer to best international practices, as defined in the Basel Core Principles, and toward European Union harmonization, and bolster confidence in the financial system.

With the implementation of the program's policies, the medium-term outlook is favorable. Continued strong export growth and real exchange rate developments suggest that competitiveness remains sound. With effective policy implementation over the program period and the medium term, the current account deficit is projected to decline to 5 percent of GDP, a level consistent with the projected pickup in private sector investment, foreign direct investment, and GDP growth. The projected current account deficits also imply only a small increase in the gross foreign debt relative to GDP, to a still moderate level of 32 percent, while net external debt will decline.

Romania became a member of the IMF on December 15, 1972. Its quota[1] is SDR 1.03 billion (about US$1.3 billion), and its outstanding use of IMF credit currently totals SDR 185 million (about US$236 million).

[1] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Table 1. Romania: Main Economic Indicators

	1995	1996	1997	1998	1999	2000	2001 1/	2002 1/
Real economy (change in percent)								
Real GDP	7.1	3.9	-6.1	-5.4	-2.3	1.6	4.5	5.0
CPI (average)	32.3	38.8	154.8	59.1	45.8	45.7	34.1	26.0
CPI (end of period)	27.8	56.9	151.4	40.6	54.8	40.7	29.0	22.0
Unemployment rate (end of period; percent)	9.5	6.5	8.9	10.4	11.8	10.5	8.6	8.0
Gross national saving (percent of GDP)	19.4	18.5	14.5	10.8	13.1	15.7	13.5	14.1
Gross domestic investment (percent of GDP)	24.3	25.9	20.6	17.9	17.2	19.4	19.5	19.7
Public finance (general government, percent of GDP)								
Overall balance	-3.4	-4.8	-5.3	-5.5	-3.8	-4.0	-3.5	-3.0
Primary balance	-2.0	-3.1	-1.4	-0.7	2.4	0.8	0.6	0.6
Money and credit (end of year, percent change)								
Real domestic credit	50.1	15.5	-52.5	21.8	-9.2	7.4	16.6	9.5
Broad money	71.6	66.0	104.8	48.9	44.9	38.0	36.3	28.3
Interest rates (percent)								
NBR interest rates (end of period) 2/	67.0	66.9	138.8	105.0	88.7	60.1	39.8 3/	...
Treasury bill rate (end of period)	...	...	133.5	103.8	99.9	59.4	39.5 3/	...
Balance of payments (percent of GDP)								
Trade balance	-4.5	-7.1	-5.6	-6.3	-3.6	-4.6	-7.3	-7.4
Current account balance 4/	-4.9	-7.4	-6.1	-7.1	-4.1	-3.7	-6.0	-5.6
Official reserves (end-year, US$ million)	1,380	1,593	3,075	2,299	2,472	3,396	4,417	5,038
Reserve cover (months of imports of GNFS) 5/	1.3	1.5	2.9	2.4	2.1	2.4	3.0	3.2
Fund position (end-August 2001)								
Holdings of currency (percent of quota)	...	...	...	...	...	...	128.6	...
Holdings of SDRs (percent of allocation)	...	...	...	...	...	...	1.7	...
Quota (SDR million)	...	...	...	...	...	...	1,030.2	...
Exchange rate								
Exchange rate regime				Float				
Lei per US$ (end of period)	2,558	3,750	7,985	10,951	18,250	25,926	30,235 3/	...
Nominal effective rate (Dec 1996=100)	126	87	42	35	21	16	13	...
Real effective rate (average, CPI-based, Dec 1996=100)	102	93	107	138	118	127	127	...

Sources: Romanian authorities; and IMF staff estimates.

1/ Program, except where indicated.
2/ Weighted NBR average interest rate; from 1997 interbank rate.
3/ September 2001.
4/ In 2000, the current account deficit was revised upwards by 0.7 percent of GDP due to methodological revision of the recording of imports financed by financial leases.
5/ Including gold. Imports of goods and services of the following year.

Statement by J. de Beaufort Wijnholds, Executive Director for Romania
October 31, 2001

The staff report presents a candid but fair assessment of Romania's economic achievements and its remaining vulnerabilities. The Romanian authorities are grateful to staff for their efforts and would like to express their appreciation for the fruitful discussions and continued support in designing this program.

The favorable trends under the stabilization program set up in 2000 and the successful track record this year gives confidence that this program will succeed and that Romania will get a chance to catch up with the rest of the countries that are candidates for European Union accession.

During the first half of 2001 Romania achieved one of the highest economic growth rates in the region, as reflected in the 4.8 percent increase in GDP and the 10.8 percent increase in industrial output. Moreover, exports continued to perform very well, reflecting gains in competitiveness that were achieved by the real effective depreciation and fiscal consolidation started last year. This positive performance shows that the economy has entered a recovery path, and that the set of economic and social policies is ensuring further and more sustainable economic growth. The current account position started to deteriorate in the beginning of 2001, as a result of high rates of growth in Romanian imports, induced mainly by the high income elasticity of imports, even though certain imported goods were related to new capital investments. The external position of the country has continuously improved since end-1999, with foreign exchange reserves growing steadily, reaching around USD3.7 million at end-September. Romania's position on the international capital markets has also become stronger and a Eurobond issue was successfully concluded end-June. The recent progress on the macroeconomic front and in implementing market reforms has led Standard & Poor's to upgrade all its ratings on Romania at the beginning of June.

The program under discussion is comprehensive, front loaded in terms of policy implementation and consistent with the country's medium-term strategy for EU accession. The measures contained in the LOI and MEFP will help foster sustainable growth while reducing inflation. The authorities' objectives are to consolidate macroeconomic performance by stepping up structural reforms and assuring financial discipline by curbing inflation, accelerating and deepening fiscal reform, improving the control on budgetary expenditures and increasing the efficiency of tax collection, speeding up privatization and the restructuring process and improving the business environment on the basis of an adequate economic and financial framework.

Fiscal policy has a key role in this process. In 2001 the authorities focused their efforts on controlling the budget deficit. Following substantial wage increases at the end of 2000 and at the beginning of 2001 and a larger-than-expected current account deficit, a new package of fiscal measures was introduced at midyear, aimed at keeping expenditures under control and improving revenue collection. Thus, a budget amendment in August tightened the fiscal deficit target from 3.7 to 3.5 percent of GDP. At the same time, the authorities submitted the 2002 budget to Parliament at the beginning of October (a prior action under the program) limiting the fiscal deficit for 2002 to 3 percent of GDP, in line with the country's medium-term strategy submitted last year to the European Union. In order to prevent any slippages from this year's target, the Government implemented some additional measures as described in the MEFP. In this respect, on the revenue side, the Government limited the conversion of claims on account of called guarantees into equity and will eliminate exemptions from VAT and custom duties for selected imports before end-2001. As regards expenditures, as a precautionary measure, the government blocked further capital expenditure for the remainder of this year, and approved lower expenditure ceilings than initially projected for October and November.

To ensure strong public sector wage discipline next year, the authorities approved a program aimed at containing wages and reducing employment, including a partial hiring freeze. At the same time, all the 2002 budgets of state-owned companies and régies autonomes will be approved by the cabinet by the end of 2001. Furthermore, the authorities envisage to implement a set of measures to improve tax collection and broaden the tax base, inter alia by further curbing exemptions on taxes and duties. The strategy is focused on simplifying and unifying the existing tax regulations in one tax code by the end of 2002, and restoring tax discipline in profitable companies and in utilities. In the medium term, these efforts will contribute to increasing the share of budget revenues in GDP, in order to finance the cost of increasing needs for social, health and education expenditures and to cope with higher costs of the EU accession.

Inflation, historically the highest in the region, will be monitored vigilantly. The Government is determined to act together with the NBR in accelerating the process of disinflation and reforming further the fiscal system in such a manner that it will reinforce investment incentives and make the Romanian business environment more attractive and competitive. In 2001 the inflation rate (Dec/Dec) is estimated to decrease to 29 percent from 40.7 percent in December 2000, somewhat less than planned, due to nominal wage increases in the beginning of the year and to adjustments made to energy prices. The September rate of 1.9 percent (month/month) and the September/December rate of 21.2 percent give the authorities confidence they can meet the projected target for 2001. The NBR will conduct monetary policy in the current framework of a managed float. Excess liquidity is mopped up through daily auctions of deposit taking and reverse repo operations. The NBR is intervening less on the foreign exchange market and is gradually shifting the composition of its notional Euro/Dollar basket. The monthly nominal depreciation remains within the target. The exchange rate movements are now exclusively the result of transactions by banks, with the NBR only intervening occasionally for the purpose of increasing international reserves.

The expected stability and increase in FDI inflows, together with the measures that will be taken for macro stabilization, will contribute to stabilizing the current account deficit at a level of 5.6 percent of GDP in the next year.

The financial sector has been strengthened and the successful privatization of Banca Agricola in the first half of the year increased confidence in the authorities' commitment to improve the business environment. The share of state-owned banks in total capital and total assets has decreased over the past few years. Private capital now represents 54 percent of total assets. Plans are set for further downsizing the state's stake in the banking sector through the privatization of BCR (the largest bank in the system), for which the strategy was approved in October, and CEC (the Savings Bank). At the same time, the government will decide on Eximbank recapitalization by the end of October, in order to enhance its ability to promote and support Romania's exports. Eximbank will remain the only state-run bank in the system. On October 1, 2001 the NBR reduced the mandatory reserve requirement for lei deposits from 27 to 25 percent as a second step after the reduction by 3 percentage points in June. The gradual reduction will continue until the ratio for lei-denominated deposits will equal the reserve ratio for foreign currency deposits, namely 20 percent. The amount released this way (roughly USD25 million) will be sterilized by the NBR.

The first external audit of the NBR's 2000 financial operations was concluded last week and the audited statements and related reports were sent to the Fund for the safeguards assessment.

The NBR and The National Securities Commission will jointly monitor the financial system, according to a protocol recently signed by the two institutions (early October), with the goal of avoiding systemic crises and developing a competitive and undiscriminating environment for all players on the financial market.

The performance of public companies in the energy sector is a consistent concern of the authorities in dealing with the issue of arrears. Energy price increases have been done according to the agreed program with the Fund and the World Bank in order to substantially reduce losses of energy producers. In close cooperation with the World Bank and in line with the second Private Sector Adjustment Loan (PSAL II) the energy sector will be restructured. In this context, the Stand-By Arrangement provides for the privatization of two electricity distribution companies by end-2002 and the announcement of an international tender for the sale of the two gas distribution companies by end-September 2002. Until then, steps have been taken for setting up a better mechanism for improving collection of payments to utilities. A system of escrow accounts is being put in place, with a majority of the accounts already operational.

The Government of Romania is fully committed to speeding up the restructuring and privatization process. In the first 7 months of 2001 the Authority for Privatization and Management of State Ownership privatized from its portfolio 59 companies, of which 7 large and 9 medium-size ones. The Government has taken the final step in the sale of the largest Romanian and East European steel mill company –Sidex to the U.K. based steel group LNM-Ispat. As the second largest generator of arrears in the economy and with more than 27,000 workers, Sidex's sale is considered as a milestone in the country's privatization program.

To improve governance, the Government recently approved the National Program against Corruption. The main focus of the program is on institutional and legal system reform, as well as public administration reform, which will help foster institutional stability, acceleration of the decentralization process in public services, and transparency.

The Government concluded an agreement with the government of the Kingdom of Sweden, with respect to a long outstanding debt issue. The first tranche of USDollar30 million will be paid on October 31, 2001.

The main objective of the macroeconomic policies in the period ahead is to maintain momentum and put the economy on a durable growth path, with the ultimate goal of increasing the living standard in Romania. In addition, the authorities are fully committed to creating a fully functioning market economy, able to cope in the medium term with competitive pressures within the European market.