GOVERNMENT OF ROMANIA

CONVERGENCE PROGRAMME

2015-2018

- April 2015 -

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INTRODUCTION

The updated 2015 version of the 2015 - 2018 Convergence Programme is based on the EC Council Regulation 1466/1997 on strengthening the supervision of budgetary positions and the supervision and coordination of economic policies, as amended in EC Council Regulation 1055/2005 and EU Regulation 1175/2011 of the European Parliament and the Council.

The Convergence Programme is in accordance with the *Code of Conduct regarding the specifications for the implementation of the Stability and Growth Pact* and the *Indicative Guidelines for the format and contents of the Stability and Convergence Programmes* of September 3, 2012.

The submission of the Convergence Programme by the Member States, and the assessment thereof by the European Commission, is a component of the "European Semester" that relates to strengthening the economic, structural and budgetary policies. The European Semester is the Europe 2020 Strategy's main instrument, the preventative instrument of the Stability and Growth Pact (amended by the 6-regulation pack which came into effect on December 13, 2011), the Macroeconomic Imbalance Procedure.

In 2014, the structural deficit of the general government was 1.0% of GDP, which is in line with the provisions of the Stability, Coordination and Governance Pact of the Economic and Monetary Union requiring the observance of the medium term objective (MTO).

The continuation of the reform process, in particular the fiscal consolidation on the basis of the preventative agreement concluded with EU, IMF and WB, provides coherence to the macroeconomic and financial policies, helping consolidate the investor confidence and preserve macroeconomic and fiscal stability.

In the medium term, the specific objective of the budget policy is to continue maintaining a budget deficit which complies with the Stability, Coordination and Governance Treaty within the European and Monetary Union. The planned targets are 1.45% of GDP in 2015, value which includes an adjustor of 0.25 percentage points of GDP for co-financing the projected supported by European Funds, and for the interval 2016-2018 a deficit below 1.2% of GDP (according to ESA methodology).

In the annual growth analysis for the year 2015, the European Commission identified the investments, the structural reforms and the budget accountability as the essential elements of the economic policy strategy of the European Union aimed at the creation of jobs and the economic growth. Under these circumstances, Romania plans to request the activation of the „structural reform clause", which involves a temporary deviation of the budget deficit of 0.5 pp of GDP.

Romania has taken the action towards the participation to the Single Resolution Fund and will take the necessary steps to join the Bank Union pillars. In parallel, the important economic progress in 2014 and the outlook of preserving this trend in the upcoming years allow an average time needed to meet the nominal convergence criteria and draw near to the real convergence.

The Government of Romania sticks to its commitment of the previous Convergence Programme referring to the adoption of the single European currency as of January 1, 2019.

In terms of real convergence, which is assessed based on the gap from the European average GDP per capita expressed as the purchasing power standards (PPS), Romania has made a significant progress in the past couple of years, and is now at about 55% as against the EU-28, compared to 54.5% in 2013 and 52.8% in 2012.

In fact, the process of real convergence of the Romanian economy continued in the years of crisis, with the GDP per capita rate by more than 2 percentage points above the rate of the European Union in 2009 – 2013.

Table 1 - Annual average GDP growth rate in 2009 – 2014 (%)

	EU-28	Romania
Real growth	0.0	-0.1
Deflator	1.1	4.1
Nominal growth	1.1	4.1
GDP per capita growth of PPS (2009-2013) (purchasing power standards)	0.5	3.0

Source: Eurostat and the National Prognosis Commission

The experience of new Member States which adopted the Euros currency before showed that this objective is realistic to the extent that the ratio of GDP per capita compared to the EU average is above 60%.

In line with the economic developments described herein, the real convergence in Romania will reach close to 65% in 2018, with prospects showing that in 2020 the gross domestic product per capita in terms of PPS could account for 71% of the European average.

Table 2 - Prospects of GDP per capita in PPS

	2013	2018	2020
GDP per capita in PPS	14500	18900	21100
- % of theEU-28 average	54.5	65.5	71.0

Source: Eurostat and the National Prognosis Commission

1. ECONOMIC POLICY FRAMEWORK

1.1. ECONOMIC POLICY BACKGROUND

In line with the Ruling Strategy and in consideration of the objectives included in the Europe 2020 Strategy and the Preventive Agreement with EU and IMF, as well as the Treaty for Stability, Coordination and Governance within the Economic and Monetary Union, the medium term economic strategy of the Romanian Government is oriented towards the promotion of competitiveness and employment, consolidation of the public finances and of the financial stability, the continued implementation of structural reforms, increase of EU fund absorption rate and the coherence of the economic policy mix. Economic strategy and policy rely on the balance between the fiscal consolidation policies, the support to the economic environment and social protection and solidarity.

Over the recent years, Romania has made significant steps towards reducing macroeconomic imbalances and rebuilding a room for fiscal and financial move, which in conjunction with the monetary policies and the structural reforms, either implemented or in progress, helped preserving the macroeconomic and financial stability.

In 2009 – 2011, Romania saw the highest budget deficits generated by the economic and financial crisis and the pro-cyclical fiscal policies in the years before the crisis, which put economic growth and stability at high risk. The fiscal consolidation measures were implemented as a move to curb the budget deficit and improve public finance standing.

In 2012-2014, important progress towards reducing risks was made possible by a budget policy based on prudential management of public sector expenditures and a significant improvement of debt management:

- In 2013, Romania got out of the excessive deficit procedure.
- The budget deficit according to the EU methodology went down by 3.8 percentage points in 2011-2014, i.e. from 5.3% in 2011 to 1.5% of GDP in 2014, with a relatively modest economic growth compared to the rates before the crisis, which confirms the continuation of fiscal consolidation and the observance of established parameters, as a result of a sustainable and prudential budget policy. The 2014 budget deficit accounts for 1.5% of GDP, which is far below the average in the Eurozone, i.e. 2.4% of GDP and EU-28 of 2.9% of GDP, placing Romania third in a top of lowest deficits.
- The structural deficit went significantly down. According to estimates, the cyclically adjusted budget deficit went down from 3.6% of GDP in 2011 to 1.0% of GDP in 2014, reaching the MTO level for Romania.

1.2. MONETARY AND EXCHANGE RATE POLICIES

In compliance with its Statute[1], the primary objective of the National Bank of Romania (NBR) is to ensure and maintain price stability. This is the best contribution monetary policy can make to sustainable economic growth. Starting August 2005, monetary policy has been implemented in the context of inflation targeting, which coexists with a managed floating regime. This exchange rate regime is in line with using inflation target as a nominal policy anchor and allows monetary policy to provide a flexible response to unforeseen shocks that may hit the economy.

According to its current institutional features, the NBR monetary policy has been and will continue to be firmly geared towards ensuring and maintaining price stability over the medium term, in line with the flat inflation target of 2.5 percent ±1 percentage point[2], as well as towards bringing down and consolidating the annual inflation rate, in the longer run, at levels compatible with the European Central Bank's quantitative definition of price stability.

From this perspective, the specific context of the year 2014 warranted/called for a quasi-steady, albeit prudent, adjustment of the monetary policy stance and of the parameters of some policy tools. The central bank actions and approach sought to foster the downtrend in medium-term inflation expectations and their firm anchoring in line with the flat inflation target, while supporting the rebound in lending, restoring confidence, and enhancing the monetary transmission mechanism, conducive to a sustainable economic recovery. A secondary objective was to continue to bring the minimum reserve requirements mechanism into line with the relevant standards and practices of the European Central Bank and of the major central banks in the EU Member States. Hence, aside from gradually lowering the policy rate (from 4 percent to 2.75 percent), the adjustment also implied the progressive reduction in minimum reserve requirement ratios on both lei- and foreign currency-denominated liabilities of credit institutions, as well as a gradual narrowing of the symmetrical corridor defined by interest rates on the NBR's standing facilities around the monetary policy rate.

In the first part of 2014, monetary policy was tailored primarily in view of the steep downtrend in both current readings of the annual inflation rate and its projected near-term values, and of its entrenching increasingly comfortably below the lower bound of the variation band of the flat target[3] and implicitly below the previously-forecasted values, amid the transitory effects of the 2013 positive supply-side shocks[4] overlapping the lasting impact exerted by the persistent negative output gap, by falling inflation expectations and the slowdown in Euros area inflation. However, the annual inflation rate was anticipated to return relatively quickly inside the variation band of the flat target and to remain close to its upper bound thereafter[5]. In addition to the foreseeable fading in 2014 H2 of the effects of supply-side shocks, such an outlook was also based on (i) the gradual reduction trend of the negative output gap and hence of its disinflationary pressures, a trend potentially spurred by

[1] Law 312 of 2004.

[2] Since December 2013, the NBR has adopted a multi-annual flat inflation target of 2.5 percent ±1 percentage point in, while previously the monetary policy strategy had been characterized by gradually decreasing annual inflation targets (Dec./Dec.), set for two-year horizons. These targets had been lowered from 7.5 percent ±1 percentage point in 2005 to 3.0 percent ±1 percentage point in 2011; the annual inflation targets for 2010 and 2012 had been left unchanged from a year earlier, i.e. 3.5 percent ±1 percentage point and 3 percent ±1 percentage point respectively.

[3] The annual inflation rate posted successive historical lows during that period, hitting a 24-year low of 0.66 percent in June.

[4] The major impact of the 2013 bumper crop on food prices and the cut in the VAT rate for some bakery products as of 1 September 2013 to 9 percent from 24 percent previously.

[5] These prospects were reconfirmed by the two quarterly projections updated during that period.

the larger-than-expected rebound in economic activity during 2013 Q4, and (ii) the assumption of normal agricultural output in 2014.

Against this background, the NBR extended the rate-cutting cycle[6] into January and February 2014 – lowering the monetary policy rate in two successive steps of 0.25 percentage points each – before discontinuing it in March and subsequently keeping the policy rate unchanged at 3.50 percent, a level deemed adequate for ensuring price stability over the medium term. In January 2014, the NBR also cut the minimum reserve requirements ratios on credit institutions' lei- and foreign-currency denominated liabilities (by 3 percentage points[7] and 2 percentage points[8] respectively), while the ratio on foreign currency-denominated liabilities was lowered by another 2 percentage points[9] in July. The three measures were meant to continue the harmonization of the reserve requirements mechanism with ECB standards in the field, while the first one was aimed primarily at supporting the sustainable recovery of lending.

The prudent rate-cutting cycle was however resumed in August and extended afterwards, also into January-February 2015, given that the annual inflation rate further ran quasi-steadily below the lower bound of the variation band of the flat target and hence below the previously-projected levels – dropping to 0.83 percent in December 2014[10] and to 0.41 percent in January 2015 – and its forecasted path witnessed repeated/significant downward adjustments, remaining, in the context of the quarterly forecast updated in February 2015, at levels markedly below the mid-point of the target even at the longer horizon . In the recent period and over the short term, the change in the behavior of inflation was exclusively due to the temporary impact of supply-side factors (abrupt decline in the international oil price and the expansion of the agricultural product supply, also fuelled by imports), while in the medium run it was mainly driven by the relatively more subdued expected developments of the annual adjusted CORE2 inflation rate[11].

Under the circumstances, the NBR lowered the monetary policy rate in five consecutive steps of 0.25 percentage points each, thus bringing it down to 2.25 percent in February 2015. In complement with the policy rate cuts, starting September 2014, the central bank progressively narrowed (by ±0.25 percentage points each time) the symmetrical corridor defined by interest rates on the NBR's standing facilities around the monetary policy rate, to ±2 percentage points in February 2015. The measure was aimed at reducing interbank money market rate volatility and consolidating the transmission of the policy rate signal, also in the context of the prospective widening of the structural liquidity surplus in the banking system, owing largely to Treasury operations associated with the use of EU funds. Moreover, in September and November, the NBR cut the minimum reserve requirements ratios on lei-denominated liabilities of credit institutions, and respectively on their foreign currency-denominated liabilities by an another 2 percentage points each, to 10 percent[12] and 14 percent[13] respectively.

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[6] The central bank had resumed this cycle in July 2013 and carried out six consecutive policy rate cuts (cumulating 1.75 percentage points) over an eight-month period.
[7] To 12 percent from 15 percent, starting with the 24 January - 23 February 2014 maintenance period.
[8] To 18 percent from 20 percent, starting with the 24 January - 23 February 2014 maintenance period.
[9] Starting with the 24 July - 23 August 2014 maintenance period.
[10] Thus, the average annual inflation rate fell to a 25-year low of 1.1 percent in 2014.
[11] This reflected the influence of the downward revision of the inflation forecasts in the euro area and other EU countries, as well as the stronger disinflationary action assumed to be exerted by medium-tem inflation expectations, only partly counterbalanced by the impact of the relatively more pronounced narrowing tendency of the forecasted negative output gap readings.
[12] Starting with the 24 October - 23 November 2014 maintenance period.

Looking ahead, including over the medium-term horizon, monetary policy will further seek to ensure price stability in the medium run, via the solid anchoring of inflation expectations and in a manner supportive of economic growth - also by restoring confidence and reinvigorating lending - , while maintaining its time consistency and synchronizing it with the monetary policy cycles of central banks in the region and the Euros area.

Both in the short run and over the longer horizon, the parameters of the monetary policy instruments will be calibrated, in the context of tailoring real broad monetary conditions and hence the monetary policy stance, primarily in line with the intensity of the disinflationary pressures of the negative output gap (seen gradually abating) and with the behavior of inflation expectations over the medium term, as well as with the risks to that behavior stemming from potential domestic and/or external shocks. In addition, a paramount role in substantiating monetary policy decisions will continue to play the uncertainties and the configuration of the balance of risks associated to the inflation forecast, including the likelihood of their materialization, as well as the pace of improvement of the monetary policy transmission mechanism and hence of lending to the private sector and of economic agents' saving/investment behavior. In correlation with prevailing macroeconomic developments and with the particularities of the functioning of various financial market segments, the NBR will also continue the adjustment of the features of certain components of the monetary policy operational framework, aimed at reducing interbank money market rate volatility and consolidating the transmission of the monetary policy rate signal, on one hand, and at further bringing these instruments into line with the relevant standards and practices of the European Central Bank and of the major central banks in the EU Member States, on the other hand.

The viability and effectiveness of such a monetary policy configuration are however conditional upon further fiscal consolidation and stepped-up structural reforms, along with a pick-up in raising EU funds, in line with the provisions of the agreements with the EU, the IMF and the World Bank, which are of the essence in averting an increase in the sovereign risk premium and hence in ensuring and maintaining medium-term price stability, seen as a prerequisite for lasting and sustainable economic growth.

2. ECONOMIC OUTLOOK

2.1. ECONOMY AT GLOBAL LEVEL / TECHNICAL ASSUMPTIONS

The winter forecast of the European Commission sees 2015 as the third year of economic growth for the European Union (EU), still at low levels, without reaching the rates of the pre-crisis times. Hence, after an increase of the real GDP of 1.7 % in the EU and 1.3% in the Eurozone in 2015, the activity is expected to intensify in 2016 and reach 2.1 % in EU and 1.9 % in the Eurozone. Each of these numbers is an upward revision of 0.2percentage points compared to the forecast released in the fall of 2014.

The world's economic growth was 3.4% in 2014, reflecting a slight recovery of the demand in the advanced economies compared to the year 2013 and a slowdown of the growth on the markets of the emergent and developing economies.

IMF estimates included in the April 2015 World Economic Outlook foresee an increase of the global economy by 3.5% in 2015 and by 3.8% in 2016, with the GDP growth rate remaining at

[13] Starting with the 24 November - 23 December 2014 maintenance period.

the same level of that estimated in the 2015 January forecast. For the advanced economies, the growth was expected to be stronger in 2015 than 2014, but slower in the emerging markets and blurred perspectives for some emerging market economies, large oil exporters.

In this context, it is assumed that in many advanced economies, preserving a relaxed monetary policies is essential to support the economy. In addition, some economies need to increase the infrastructure investments and implement structural reforms. In many emerging economies, the room available for maneuver provided by the macroeconomic policy as a move to support growth is limited. However, in some of these states, the low oil price will help curb inflation and reduce external vulnerability, which will relieve the pressure put on central banks to push up interest rates.

Under these circumstances, an increase of GDP by 2.4% in the advanced companies is expected in 2015 and 2016 compared to 1.8% in 2014. In addition, an economic growth in the Eurozone is expected of 1.5% in 2015 and 1.6% in 2016.

Germany, Romania's main partner in foreign trade, which is at the same time the engine of the European Union, has a positive performance in both 2015 and the following year. Hence, the growth rate will remain in 2015 at the level of 2014, namely 1.6% to raise in 2016 by 1.7%, thus helping support the Romanian exports.

About Italy we may say that after a GDP drop by 0.4% in 2014, a slight growth of 0.5% is expected in 2015 followed by an acceleration of the growth rate in 2016 , until 1.1%.

France's economy is expected to pick up in 2015, with a 1.2% growth compared to only 0.4% in 2014. For 2016, IMF revised upwards the estimates regarding the French economy, up to 1.5%.

The projection of the brent oil price was revised downwards, from 96.3$/barrel in 2014 to 58.1$/barrel in 2015. In 2016 a slight increase is expected compared to 2015, with the brent oil price expected to go up to 65.7 $/barrel.

Considering the evolution of the global economy in the upcoming period of time, in Romania in the interval 2015-2016 exports of goods are expected to grow annually by 7.2% and imports of goods by 7.7%, in average. After a share to GDP of 4.0% of the FOB-CIF trade deficit, it is expected to trend up and reach 4.5% in 2016.

2.2. CYCLICAL DEVELOPMENTS AND CURRENT PERSPECTIVES

CURRENT PERSPECTIVES

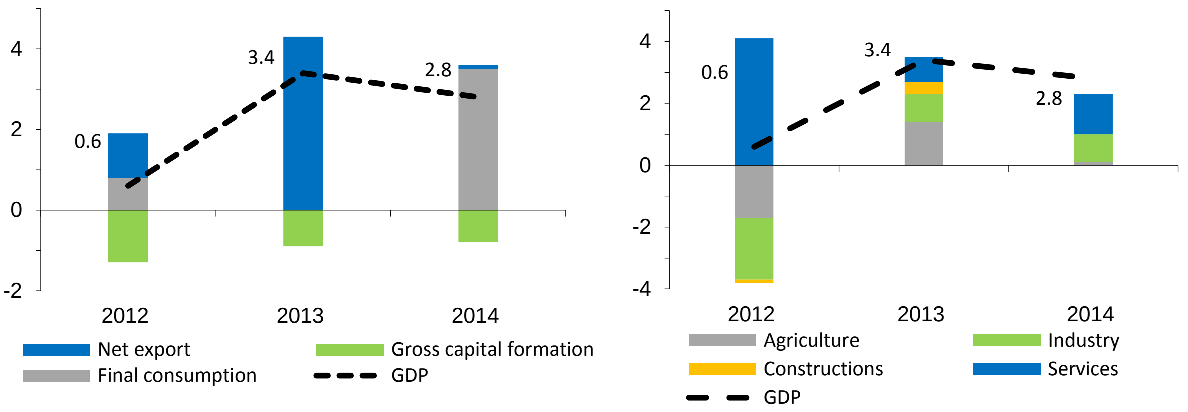
In Romania, GDP rose by 2.8% in 2014, the fourth year of growth in a row (1.1% in 2011, 0.6% in 2012, 3.4% in 2013), which consolidates the trend of recovery from the economic and financial crisis which affected Romania too, in 2009 and 2010. This raise in 2014 came, in principal, from the positive contribution of the domestic demand. The main growth driver was the private consumption, supported by a strong increase of the real wage and the interest rates down to minimum rates ever.

Final consumption increased by 4.6% due to a 4.5% raise of the private consumption, with a low inflation rate and a 5.3% increase of the government consumption.

Investment activities were slow, with the gross fixed capital formation on trending down by 3.5%. This has been caused by a high incertitude among investors, in particular foreign investors, as well as a low contribution from the part of government investments.

Exports of goods and services went up by 8.1%, while imports increased by 7.7%, with an almost zero contribution of the net export.

Chart 1 – Contributions to real GDP growth



Source: National Prognosis Commission

In which regards the domestic supply, the gross valued-added went up in all economic sectors: in the industry by 3.6%, services by 2.6%, agriculture by 1.5%, and constructions by 0.3%.

At the end of 2014 the annual inflation reached down to its minimum rate after 1990, i.e. 0.83%, by 0.72 percentage points under the rate at the end of 2013. In terms of annual average, the inflation was 1.07%, by 2.91 percentage points below the previous year's average.

Disinflation took place with the agro-foods prices decrease. The decrease was made possible by an output above the average and the fact that some important distribution markets were closed, but it also came from a substantial decline of the oil international quotations in the last quarter of 2014. The positive effect coming from the postponed gas price liberalization at the beginning of October added to all the above.

However, in 2014, at European Union level, Romania had the highest annual inflation rate at end-year, with most countries reporting a deflation process.

Consumer prices in March 2015 compared to December 2014 increased by 1.17%, in particular due to a rise by 1.39% of food goods. The highest impact on the price increase for food goods came from the increase of the prices of fruits and vegetables.

The annual inflation in March 2015 was 0.79%, trending down by 0.25 percentage points compared to March 2014.

In 2015, the inflation is expected to go down to a new historical minimum level, i.e. 0.7% at end-year, with an annual average of 0.2%. Estimates considered the impact of the reduced VAT rate from 24% to 9% for all food products, non-alcoholic drinks and public food supply services, a measure applicable as of June 1, 2015.

In 2014, according to the National Accounts data, employment went up by 1.0% as a result of an increase in the industry by 3.2%, the service sector by 2.1%, and constructions by 1.4%, whereas in agriculture it went down by 2.1%. However, the number of employees in the economy increased by 2.0%, following an increase in the industry sector by 2.9%, in agriculture by 2.2% and in the service sector by 2.0%, whereas in the constructions sector the number of employees declined by 1.5%.

The AMIGO unemployment rate declined from 7,1% in 2013 to 6.8% in 2014.

CYCLICAL DEVELOPMENTS

The growth of the potential gross domestic product continued to improve in 2014 despite a non-favorable development, though more attenuated compared to 2013, of the gross fixed capital formation (GFCF). The final consumption's higher contribution to the economic growth closes the output-gap) in 2017, even with a potential GDP increase[14] expected to go over 3% in the medium run[15].

The substantial acceleration of the potential growth in 2015-2018 occurs against the background of a substantial contribution of the total factor productivity (*TFP*), which shows the intensive nature of the economic growth and reflects the structural changes which have been implemented in the Romanian economy over the recent years. After declines in 2013 and 2014, GFCF gradually grows and causes an improved contribution of the capital stock to the potential growth. Lower net investments in machinery and transport means improved in 2014 (-6.4% compared to -13.1%) reflecting a tendency to resume the construction of production capacities.

The labor factor contribution (expressed as the total number of worked hours in the economy) will return to positive values during the forecast interval. With the natural unemployment rate (NAWRU) slightly declining and its effects compensated by the unfavorable demographic developments, the positive contribution of the number of hours worked is the result of positive dynamics of the employed population (due to the improved conditions on the labor market) and the average number of hours worked in the economy.

[14] Calculated based on the ECFIN method adopted in the legislation of all MS.

[15] It must be mentioned that if the macroeconomic forecast until 2016 is the only one to be taken into account, the potential growth slightly slows down to 2.3% in 2015 and 2.7% in 2016, which results in an output-gap of -0.7% in 2015 the closing of the output-gap in 2016.

Table 3 – Factor contribution to potential GDP growth

	Contributions - % -				
	Potential GDP	Capital	Labor	TFP	Output Gap
2014	**2.0**	0.6	-0.1	1.5	**-1.7**
2015	**2.5**	0.7	0.2	1.5	**-1.0**
2016	**2.9**	0.9	0.4	1.6	**-0.6**
2017	**3.1**	1.0	0.5	1.6	**0.0**
2018	**3.2**	1.2	0.4	1.7	**0.7**

Source: National Prognosis Commission

2.3. MEDIUM-TERM SCENARIO

Building on the assumption that the most recent EC and IMF forecasting reports reveal an acceleration of the EU economic activity and that the domestic economic environment will improved as a result of the GEO nr. 6/2015 on VAT reduction, between 2015 and 2018 the Romanian economy is expected to perform better and better, so that the decline of 2009 – 2010 could be recovered.

In 2015, the gross domestic product will grow by 3.2% due to the positive contribution of the domestic demand. In the upcoming years, the GDP growth rate is expected to gradually speed up and reach 4.0% in 2018.

The private consumption is also expected to grow with annual rates from 3.5% in 2015 to 4.1% in 2018. The Government consumption will be determined by a budgetary policy focused on stabilizing the employment in the public sector and streamlining expenditures with goods and services.

If we see the development of the gross fixed capital formation in 2014 as a one-off situation, we can estimate that in 2015 – 2018 the increase will be supported by more substantial European funds. Hence, the increase will speed up annually, from 4.5% in 2015 to 6.8% in 2018.

The net export will reduce its contribution to the real GDP growth, compared to 2014, and will have a negative contribution throughout the whole interval 2015-2018, with 0.2 percent in 2015, reaching 0.4 percent in 2018, due to the increase of imports of goods and services, generated by the rising investments, which will exceed the increase of exports.

Table 4 – GDP Components

- annual changes, % -

	2015	2016	2017	2018
Real GDP	3.2	3.4	3.7	4.0
Private consumption expenditures	3.5	3.6	3.9	4.1
Government consumption expenditures	1.0	2.0	1.6	1.5
Gross fixed capital formation	4.5	5.5	6.3	6.8
Exports of goods and services	6.1	5.8	6.2	6.3
Imports of goods and services	6.5	6.8	7.2	7.2

Source: The National Prognosis Commission

The medium term economic growth will create the conditions for an improved employment, in particular in respect of the number of employees. Hence, it is estimated that the employment will go up, in average, by 1.2% annually, and the number of employees will increase by 2.1%.

The AMIGO unemployment rate, will go down from 6.7% in 2015 to 6.4% in 2018.

As of 2016, the inflation will remain relatively flat, with an annual average between 2.0% in 2016 and 2.5% in 2018. The lower rate in 2016 is due to the persistent basic effect of VAT reduction for food products by 15 percentage points. The continued process of keeping the inflation at low levels will be sustained by preserving a firm monetary policy conduct, to ensure stability of prices on a medium term. The forecast took into account normal agricultural years and a low volatility of the international oil price.

In addition, the new calculation methodology for the excise duty rates, which takes into account the evolution of the inflation, aims to make the impact of excise duties on the price of excisable goods more predictable. This, together with the continuation of structural reforms, will maintain the disinflation process on a sustainable path.

At the same time, the continuation of the disinflation process will help reducing more the inflation expectations, by the fact that the domestic currency will start appreciating again, in real terms, compared to Euros. This is possible if we consider the perspective of a more rapid growth of productivity in the Romanian economy, compared to its main foreign partners. The impact of the exchange rate will be modest, and it will be in the sense of supporting the disinflation process.

2.4. SECTORAL BALANCES

In 2014, the growth of Romanian exports, compared to 2013, was of 5.8%, with imports having increased by 5.9%. Under the circumstances, the FOB-CIF trade deficit went up by 5.9% compared to the one in 2013.

In the first two months of 2015, the Romanian exports went up by 3.6% while imports increased by 3.3%, compared to the same interval of the year 2014. Therefore, the trade balance (FOB-CIF) in the first 2 months of 2015 closed on a deficit in amount of 563.3 million Euros, trending down by 0.8% compared to the corresponding interval of the previous year.

Like in the previous year, the export in 2015 will remain a component of the demand, which will support the economic growth in Romania. Hence, for 2015 we estimate a 7.2% increase of the exports of goods, while the imports of goods will go up by 7.6%.

Overall, the forecast for the year 2015 shows that the trade deficit will amount to around 7 billion Euros, with a share to GDP of 4.3%.

The intra-Community exports slowed down over the recent years, from 19.1% in 2011 to 8.1% in 2014, even decreasing by 1.4% in 2012. In 2015, the intra-Community export is expected to grow slightly compared to 2014, and reach 8.2%. In this context, the pace of extra-Community exports will be higher than the intra-Community exports rate by 3.5 percentage points. The intra-Community imports growth rate will go up to 6.8% this year, while the extra- Community imports will increase by 9.9%. Considering the expected performance of imports and exports, the intra-Community area will see a trade deficit of 6.7 billion Euros, with a small surplus for extra-Community area.

Taking into account the world's economy performance in the upcoming period, for the interval 2016-2018 the exported goods are expected to see an annual average increase of 7.3%, with imports of goods expected to raise by 7.9%. After a 4.0% share to GDP of the FOB-CIF trade deficit in 2014, in 2018 it will reach up to 5.1%. Exports to EU are projected to see an annual average rate of 8.4%, with intra-Community imports growing annually by an average rate of 7.4%. Exports and extra-Community imports are estimated to grow in average by 4.5% and 9.5%, respectively.

In 2014, the balance of payments current account run a deficit lower by around 40% compared to 2013, reaching a share to GDP of only 0.5%. The current account deficit was covered entirely from foreign direct investments. FDIs amounted to 2.4 billion Euros and were lower by around 11% compared to 2.7 billion Euros in 2013.

In the first 2 months of 2015, the balance of payments current account closed on a surplus of 285 million Euros, compared to a deficit of 201 million Euros in the same interval of 2014, with a declining deficit of the primary income balance, an increased surplus of the balance of goods and services and the deficit of the secondary income balance turning into a surplus.

In 2015, the current account deficit of the foreign balance of payments is expected to amount to 1.9 billion Euros, which accounts for 1.2% of GDP. FDIs will fully cover the current account deficit.

In the medium run, the current account deficit will remain within the range of 2.3 – 2.8 billion Euros, with a share to GDP of 1.4% in 2016 and 1.5% in 2018. In 2016-2018, the share to GDP of the net balance with the rest of the world, considering the capital account as well, will remain positive and trending slightly down, with a higher contribution of the capital account. It is worth mentioning that the capital account share to GDP will go down from a 2.4% expected in 2016 to 2.2% in 2018.

2.5 MEDIUM TERM MACROECONOMIC SCENARIO UNDER THE CIRCUMSTANCES OF THE NEW FISCAL CODE

The implementation of the new Fiscal Code as of 2016 will positively impact the economy in general, and private consumption and investments, in particular.

Compared to the baseline scenario contained by the current Convergence Programme, the growth forecast in the context created by the fiscal measures estimates a slight increase of the gross domestic product, in real terms, of 0.5 – 0.8 percentage points.

Table 5 - GDP Components – alternative scenario

- annual change, % -

	2015	2016	2017	2018
Real GDP	3.2	4.0	4.2	4.8
Private consumption expenditures	3.5	4.5	4.8	5.4
Government consumption expenditures	1.0	2.0	1.6	1.8
Gross fixed capital formation	4.5	6.0	6.6	7.3
Exports of goods and services	6.1	5.8	6.2	6.3
Imports of goods and services	6.5	7.0	7.6	7.5

Source: The National Prognosis Commission

The domestic demand will speed up and its contributions to the growth of the gross domestic product will be of around 4.8 per cent, annually. The private consumption will substantially increase, at average annual rates of around 4.9% compared to the baseline scenario’s 3.9%. The gross fixed capital formation will go up by around 6.6% in average, from the baseline scenario’s 6.2%.

Covering the additional domestic demand will require escalating imports in addition to increased domestic resources, so that the net export will have a more negative contribution to the real growth of the gross domestic product.

The effects of the new fiscal measures will be seen in the social environment as well. Hence, the additional economic growth will generate, on one hand, a higher number of employees and, on the other hand, an increase in the population income, depending on the behavior of the economic agents.

Table 6 - Evolution of the labor market

	2015	2016	2017	2018
	RATE OF CHANGE			
1. Employment[1)]	1.1	1.2	1.3	1.3
3. Unemployment rate -%[2)]	6.7	6.5	6.4	6.3
4. Labor productivity[3)]	2.0	2.7	2.9	3.4
7. Compensation per employee - lei	3.7	4.2	4.4	5.0

[1)]Employment, the definition for the domestic concept of the national accounts
[2)]Definition harmonized with Eurostat (Labour Force Survey – AMIGO)
[3)]Real GDPper employed person

Compared to the baseline scenario, the alternativescenario estimates a more accelerated increase of imports in 2016-2018, without affecting in any way the estimates for the ongoing year. This fact leads to an increased current account deficit both as amount and as share to GDP, over this time interval.

Hence, compared to the baseline scenario, in the alternativescenario the imports of goods in the balance of payments are expected to increase by 0.3 pp in 2016and0.4 pp in 2017and 2018. This will result in an increase of the current account deficit share to GDP from 1.4% to1.5%in 2016and from 1.5% to1.7% in 2017andin 2018. If we consider the capital account too, the net balance with the rest of the world continues to stay positive, but it will drop as share to GDP.

Table 7 - Sectoral Balances

% of GDP	2015	2016	2017	2018
1. Net balance, vis-a-vis the rest of the world	1.2	0.9	0.6	0.5
Of which:				
- balance of goods and services	0.2	0.2	-0.1	-0.4
- balance of primary and secondary income	-1.4	-1.7	-1.6	-1.4
- capital account	2.4	2.4	2.3	2.2

Source: The National Prognosis Commission

In 2016, the inflation will remain low, namely 1% as annual average. This is due to the base effect of the measure of reducing the VAT rate for food products by 15 pp. as of June 2015, but a reduced VAT rate from 24% to 20% as of January 1, 2016 is considered as well.

In the years 2017 and 2018 the inflation is expected to start trending up again, with the effects of the reduced VAT rates fading up. Hence, the average annual inflation is estimated at 2.7% and 2.5%, respectively.

In terms of cyclical developments, an accentuated TFP to potential growth is projected, with a marginal improvement of the contribution of worked hours, reflecting an increased labor productivity compared to the baseline scenario. The annual average of potential growth amounts to 3.3% in the alternative scenario, as against 2.9% in the baseline scenario. While the output-gap continues to trend down and close in 2017, the potential growth at the horizon of 2018 comes closer to the rates needed to provide the real convergence with the EU[16].

Table 8 - Factor contribution to potential GDP increase – alternative scenario

[16]If the alternative scenario is implemented until 2016, the resulting potential growth amounts to 2.4% in 2015 and 2.8% in 2016, while the output-gap becomes positive in 2016.

Contributions - % -					
	Potential GDP	**Capital**	**Labor**	**TFP**	**Output Gap**
2014	**2.1**	0.6	-0.1	1.6	**-1.8**
2015	**2.7**	0.7	0.3	1.7	**-1.4**
2016	**3.2**	0.9	0.5	1.8	**-0.6**
2017	**3.5**	1.0	0.5	2.0	**0.0**
2018	**3.7**	1.2	0.4	2.0	**1.1**

Source: National Prognosis Commission

3. GENERAL GOVERNMENT AND DEBT BALANCE

3.1. POLICY STRATEGY

In average, the annual structural effort over the recent years was 1.2 percentage points, trending down from 5,9 % of GDP in 2010 to 1.0% of GDP in 2014.

Given the progress made toward fiscal consolidation and economic governance, the fiscal adjustment will continue, though slower than in 2009 - 2012, with a modulation of the fiscal effort through differentiated strategies favorable to the economic growth, to be adopted on both the revenue and the expenditure side.

In the framework of the budget expenditure policy, the major concern is the optimization of the expenditure structure targeting an architecture aimed at encouraging sustainable economic development, in particular by re-directing public investment expenditures in order to to gradually move from the investments which are fully funded from domestic sources to investments which are financed in a joint effort with the EU.

It is intended to preserve the 2015 budget deficit in line with the Treaty on Stability, Coordination and Governance within the Economic and Monetary Union, a target which has been planned and set on the basis of the preventive agreement with EU and IMF at 1.45% of GDP and includes an adjustor of 0.25 percentage points of GDP for the cofinancing of projects supported from EU funds.

Table 9 – The Evolution of Budget Deficits

- % of GDP -

	2010	2011	2012	2013	2014	2015*)
ESA Deficit	-6.6	-5.3	-2.9	-2.2	-1.5	-1.45
Structural Deficit	-5.9	-3.6	-2.4	-1.4	-1.0	-1.25

*) This is a committed target which includes an adjustor of 0.25 pp for the cofinancing of projects supported from EU funds.

3.2. 2015 BUDGETARY POLICY[17]

The cash budget deficit target was set at 1.8% of GDP, which corresponds to an ESA deficit of 1.2% of GDP and a structural deficit of 1.0% of GDP (plus 0.25 percentage points - the adjustor of 0.25 pp for the cofinancing of projects supported from EU funds).

I. *Fiscal and Budgetary Policy in 2015*[18]

Continuation of the fiscal consolidation through reducing the ESA deficit from 2.2% of GDP in 2013 to 1.5% of GDP in 2014, and the cash deficit from 2.5% of GDP in 2013 to 1.9% of GDP in 2014.

On the revenue side, the effects of some previous measures will become visible, such as reduced social security contributions by 5 pp for the employers, the corporate income tax exemption for the reinvested profit, the reduced rate of the special construction tax from 1.5% to 1%. At the same time, consideration has been

[17] If no otherwise specified, the numbers in this section are according to the cash methodology.
[18]If no otherwise specified, the numbers in this section are according to the cash methodology.

given to enlarging the reduced 9% VAT rate application base to food products and restaurant services.

Table 10 – The Impact of extending the 9% VAT reduced rate

- billion lei -

	2015 (6 months)
Gross impact on the reduced VAT rate base enlargement	-2.8
Of which, recovery of revenues through:	4.1
1. the economic developments*	1.1
2. Additional collections by NAFA (Q1)	3.0

*) Implications on the industrial production, the gross domestic product, the household consumption and jobs

This measure is applicable as of June 1, 2015, and the negative impact on the budget revenues is estimated to be compensated both by the effects of multiplication in the economy and the increase of budget revenues collected as a result of the structural measures implemented by NAFA which are aimed at the efficiency of the revenue collection system.

On the expenditure side:

- Increase the funds allocated to the cofinancing and supporting the implementation of European-funded projects;
- Increase the minimum wage to 975 lei as of January 1 and 1.050 lei as of July 1;
- Increase the wages of the teaching and supporting staff in education by 5% as of March 1 and by 5% as of September 1;
- Increase the wages of the staff in the healthcare system and the public social security system by 100 lei as of January 1;
- Increase pensions by 5%. In 2015, the pension point will be increased by 5%, namely from 790.7 lei to 830.2 lei;
- Increase social benefits to the poorest families, pensioners and people with disabilities.

II. ***NAFA Objectives set for 2015 support the achievement of fiscal-budgetary and economic policies objectives, as follows:***

Conduct a strong fight against tax evasion - priority actions:

- Develop a generalized risk assessment for the whole tax administration activity, on the basis of the tax information about taxpayers; develop IT applications to conduct analyses of the fiscal inspection missions initiated based on the risk assessment, to confirm the risk criteria and supply the information for future risk assessments;
- Increase the share of DGFA audits aimed at dismantling the tax evasion chains, in particular targeting the VAT fraud and shell companies;
- Strengthen the use of administrative cooperation instruments on matters related to VAT, including multilateral audits;
- Optimize the VAT registration procedures for taxpayers or the VAT codes cancellation, as a move to reduce administrative barriers;

- Raise taxpayer awareness on the need to use the cash registers and issue tax receipts, by introducing the measure of suspending the activity in the non-complying locations and by encouraging consumers to request tax receipts; („Fiscal Lottery”);
- Strengthen the action of auditing under-reported income tax and social contributions by rolling out the project aimed at reducing the number of under-reported wages by encouraging the voluntary compliance;
- Expand the program which uses the indirect proof methods to verify the tax situation of a taxpayer at national level, through the NAFA territorial structures, to all categories with a fiscal risk; set up dedicated tax verification services at regional level and train the staff to perform the related tasks;
- Continue the initiative related to high net wealth individuals (HNWI), which requires verifications conducted in line with the tax procedure code and a new soft letter campaign among taxpayers with a risk of non-filing the form income from abroad;
- Strengthen and improve efficiency of customs control.

Improve voluntary compliance

- simplify taxpayers' access to their tax files by introducing the possibility to access the information on the taxpayer's own tax obligations (SMS, e-mail) and to pay these obligations in an electronic environment (by card, SMS) ;
- continue to simplify tax forms and develop electronic filing;
- conduct a census of taxpayers to verify all registration attributes;
- take the necessary action to implement, in a joint effort with Ministry of Public Finance, the payment by card and integrate this facility, to the extent possible, into the "Virtual Private Space";
- continue to develop the HNWI Program through verifications based on risk assessment and implement specific projects to improve voluntary compliance – soft letter campaigns, meetings with organizations and professionals in the tax sector;
- improve the quality of taxpayer services

Improve revenue collection efficiency

- implement the RAMP Project of modernizing the tax administration;
- finalize the technologic centralization of the Receivables Management System (RMS) and implement a new version of the IT system aimed at the accounting of receivables;
- re-allocate the portfolio of large and medium-sized taxpayers and place them under the management of regional structures;
- develop a human resources strategy, as part of a human resources strategy of the MoPF;
- consolidate the agency's workforce considering that the total NAFA staff compared to the portfolio of taxpayers is consistent with the average of the tax administrations of other European countries (including having DGFA fully operational by the end of 2015);
- implement a firm program of investments focused on the consolidation, repair and extension of the Bucharest offices, including through the consolidation of the office

of the future structure dedicated to the large and medium-sized taxpayers in the Bucharest-Ilfov Region and starting investing in the new HQ of the agency and the new data center.

3.3. MEDIUM TERM BUDGETARY OUTLOOK

Assuming that the actual fiscal and budgetary policies will be preserved on the medium term, expectations are that Romania will observe the requirements of the Stability and Growth Pact in respect of the MTO.

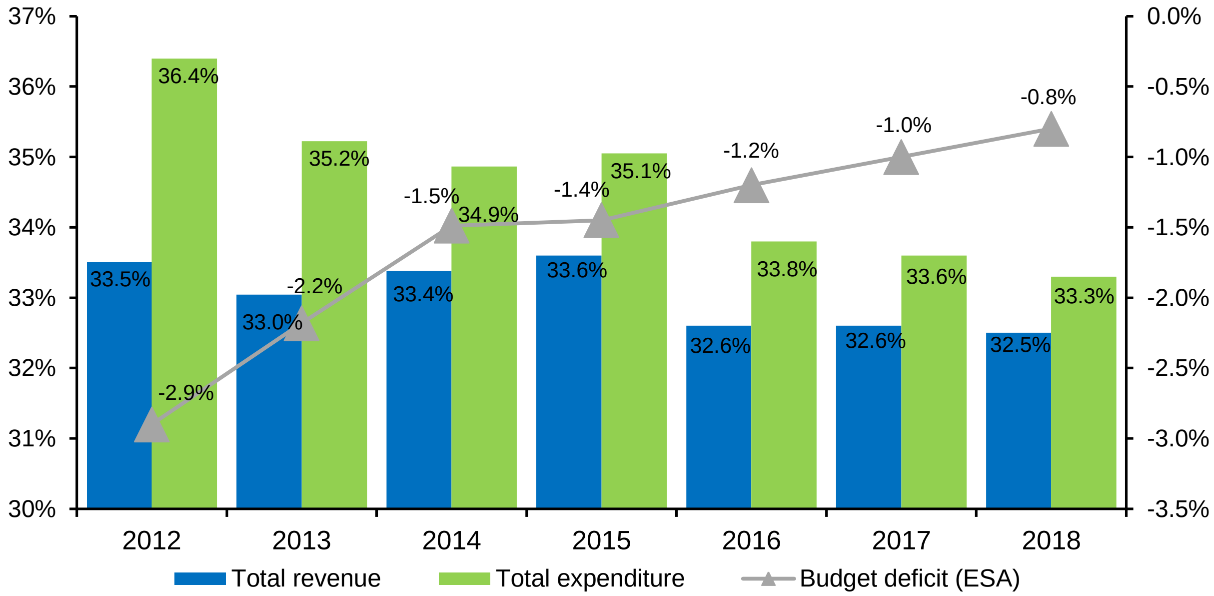
Table 11 – General Government Balance (%GDP)

	2015 Committed targets	**2016** Estimates	**2017** Estimates	**2018** Estimates
BALANCE according to ESA	-1.45*)	-1.2**)	-1.0**)	-0.8**)
Structural BALANCE	-1.25*)	-1.0**)	-1.0**)	-1.0**)

*) Includes an adjustor of 0.25pp for co-financing the EU-funds supported programs.

**) It does not include the adjustor for investments or structural reforms with direct positive budgetary effect, including by strengthening the sustainable growth potential, which may be granted pursuant to the provisions of article 9 in the EC Regulations 1466/97.

Chart 2 - Consolidated budget position (ESA 2010, % of GDP)[19]



Source: Ministry of Public Finance

I. In the medium term, the Government set the following elements of fiscal and budgetary policy consolidation:

On the revenue side:

- maintaining the reduction of social security contributions on the employers' side by 5 pp;
- introduce the profits tax exemption for the reinvested profit, a measure in force until December 31, 2016;

[19] The relationship revenues-expenditures=balance may show differences due to roundups to one decimal.

- maintain the reduced special construction tax of 1%;
- revise the royalty legislation and establish a new tax in the oil sector. It will replace the taxation in the oil and gas sector so that the collections may be at least at the previous level in this sector. maintain the 9% VAT reduced rate for food and restaurant services

On the expenditure side:

- Provide a sustainable level to expenditures with wages and pensions in the public sector;
- Re-direct public investment expenditures so that a gradual transition can be made from the investments funded 100% from national funds to investments made with the participation of European Funds;
- Direct available resources to drive public investments in the fields of infrastructure, rural development, energy and high technology;
- Speed up the pace of spending EU funds to improve the absorption rate;
- Revisit public procurements in the light of criteria such as timing, priority, efficiency;
- Continue funding the state aid schemes in 2016-2018, to help create jobs, make investments which use new technologies, reach out to innovative products, services and technologies, impacting the economic growth and securing the economic stability;
- Implement multi-annual budget programming and program budgeting, to allow budget savings and improve the predictibility and efficiency of public spending.

In 2016, the wage policy will be promoted consistently with the most recent domestic and international environment development, the legal framework in force, and the fiscal and budgetary measures which are to be implemented in this time interval.

The following are considered for the year in 2016:

- the gradual increase of the minimum wage, in the first half of the year from 1050 lei to 1125 lei, and in the second half to 1200 lei;
- increase the wages of the teaching and supporting staff in the education sector, by 5% as of April 1, 2016 and another 5% from October 1, 2016.

In 2016, the occupation of vacancies in the public system will be based on the provisions of article 31 of the Government Emergency Ordinance nr. 83/2014 on the wage policy in the public sector in 2015, and other measures related to public expenditures, as approved with amendments and supplements in Law nr. 71/2015; according to those provisions, the budget managers are entitled to set the maximum number of positions which can be financed so that all wages could be paid according to the law, in observance of the staff expenditures approved in the budget.

The staff expenditures of the 2016 general consolidated budget include the funds needed to cover the tranche of payments to be made in 2016 granted by court rulings as wage entitlements to the staff of public authorities and institutions, and which are to be paid in installments, in accordance with the legal provisions in force.

In 2013, the Law nr. 165/2013 was approved, on measures aimed at the finalization of the restitution proccess, either in kind or equivalent, as a compensation for the property abusively taken by the Romanian communist regime. According to this law, the refund applications which can not be solved through the restitution in kind to the entities entrusted by law, shall be solved by granting compensatory measures in the form of points, awarded by the decision of compensation that can be used to purchase the property at public auction from the National fund starting on January 1, 2016. Within 3 years from the compensation decision through points, but no earlier than January 1, 2017, the holder can opt for capitalization and cash points. Thus, the holder may request annually after January 1, 2017, the National Authority for Property Restitution issue of a payment of maximum 14% of the points awarded by compensation decision and unrealized at the national property auction. The last installment will be 16% of the points awarded.

At the same time, the Law no. 165/2013 provides in art. 41 that amounts of money in compensation in cases approved before the effective date of this law, and the amounts set by court decisions, final and irrevocable upon the entry into force of the law, is paid within 5 year period, in annual equal installments, starting from January 1, 2014.

In 2014, the Law nr. 164/2014 was approved, referring to a set of measures aimed at speeding up and complete the resolution of applications formulated based on the Law nr. 9/1998 on compensations to the Romanian citizens for the property which passed under the ownership of the Bulgarian Republic in accordance of the Treaty between Romania and Bulgaria, signed in Craiova on September 7, 1940, and Law nr. 290/2003 on damages to Romanian citizens for the property confiscated, retained of remained in Basarabia, North Bucovina and Herţa, following the war and the application of the Peace Treaty between Romania and the Associated and Allied Forces, signed in Paris on February 10, 1947, and amending other pieces of legislation, that the amounts assessed in administrative documents (a ruling of the county board, an order issued by the Prime Minister’s Chancellery, a payment ruling issued by NAPR) issued before the effective date of the that law (December 2014) as well as those ruled in final and irrevocable court rulings shall be paid in the chronological order of their issuance, in equal annual installments, for a period of five years, starting with January 1, 2015.

These amounts shall be updated, based on a decision by NAPR, with the price consumer index for the time starting with the date on which they became final and irrevocable, or the time of their issuance, and until the effective date of the law, and they represent payment obligations.

The amounts established in validation decisions of NAPR in accordance with the Law nr. 164/2014 shall be paid in the chronological order of their issuance, in equal annual installments, for five years, starting with the year following the validation decisions.

The funds needed to cover the compensations in 2016-2018 that are covered by the Law nr. 165/2013 and the Law nr. 164/2014 amount to around 760 million lei per year.

II. NAFA Objectives for 2016 – 2018, based on a set of priority actions, are as follows:

Conduct a strong fight against tax evasion - priority actions:

- develop a generalized risk assessment for the whole tax administration activity, on the basis of the tax information about taxpayers; develop IT applications to conduct analyses of the fiscal inspection missions initiated based on the risk assessment, to confirm the risk criteria and supply the information for future risk assessments;
- expand the program which uses the indirect proof methods to verify the tax affairs of a taxpayer at national level, through the NAFA territorial structures, to all categories with a fiscal risk;
- continue the initiative related to high net wealth individuals (HNWI), which requires verifications conducted in line with the tax procedure code and a new soft letter campaign among taxpayers with a risk of non-filing the form income from abroad
- continue to develop the HNWI Program through verifications based on risk assessment and implement specific projects to improve voluntary compliance – soft letter campaigns, meetings with organizations and professionals in the tax sector;
- Strengthen and improve efficiency of customs control

Improve voluntary compliance

- continue to simplify tax forms and develop electronic filing;
- improve the quality of taxpayer services;

Improve revenue collection efficiency

- implement the „Revenue Administration Modernization Program” (RAMP)
- consolidate the agency’s workforce considering that the total NAFA staff compared to the portfolio of taxpayers is consistent with the average of the tax administrations of other European countries;
- implement an integrated and unitary IT system, the best value-for-money choice;
- automate and improve the efficiency of NAFA business processes, using the IT&C resources, in the context of the NAFA reorganization.

3.4. IMPACT OF EU ACCESSION ON PUBLIC FINANCES

3.4.1. EU BUDGET ALLOCATION FOR ROMANIA -2007-2013 MFF

The absorption of non-refundable European funds is the Romanian Government’s top priority. Romania must make the best use of the substantial EU allocation (around 35 billion Euros) under the current multi-annual financial framework (MFF), as this is a key development resource to the Romanian economy and society in medium and long run, as well as a central element of budget sustainability judging from the investment strategy perspective and considering that these funds are not refundable.

The total funds allocated to Romania under 2007-2013 MFF amount to around 35 billion Euros:

a. *Structural and Cohesion Funds – 19.67 billion Euros;*
b. *European Agricultural Fund for Rural Development (EAFRD) – 8.12 billion . Euros;*
c. *European Fishery Fund (EFF) – 0.23 billion . Euros;*
d. *European Agricultural Guarantee Fund (EAGF) – 6.58 billion Euros.*

STRUCTURAL AND COHESION FUNDS FOR 2007-2013 MFF

The SCF allocation for Romania in 2007-2013 is 19.67 billion Euros, of which 19.21 billion Euros are intended for the operational programs of the "Convergence" Objective and 0.46 billion Euros are allocated to the „European Territorial Cooperation". Out of the 19.21 billion Euros, the „Convergence" objective, the amount of 12.66 billion Euros is from structural funds (European Regional Development Fund and the European Social Fund), and 6.55 billion Euros come from the Cohesion Fund.

The total amount received by Romania until March 31 2015 from the European Commission in structural and cohesion funds for the period 2007-2013 is 11.42 billion Euros, which accounts for 60% of the EU allocation for 2007-2013. Out of this amount 11% comes from pre-financing, and 49% from the reimbursements made by the European Commission.

The reimbursements by the EC in 2014 only amounted to 3.54 billion Euros, which accounts for 41% of the total amounts reimbursed by the European Commission for the entire 2007 – 2014 interval.

The year 2015 is the last year of eligibility for the expenses made from the funds allocated by EU for the 2007 – 2013 MFF. We estimate that at the end of the implementation period 2007-2013 MFF, the absorption rate of European Funds will exceed 80% of the relevant financial allocation.

THE FUNDS OF THE COMMON AGRICULTURAL POLICY FOR 2007-2013 MFF

European Agricultural Fund for Rural Development (EAFRD)

The EAFRD allocation to Romania under 2007-2013 MFF is 8.12 billion Euros. The payments made from EARFD (declared eligible by the European Commission) cumulated from 2007 until December 2014 amounted to 6.14 billion Euros (plus the advance payment received by Romania in 2008 from the EU budget, which was needed to secure the funds and start and implement the 0.56 billion Euros Programme), which results in a rate of absorption from EARFD of over 82%.

European Fishery Fund (EFF)

The financial allocation varied because of the decommitment from the financial allocations of 2009, 2010 and 2011 totaling 34.53 million Euros. In 2014, the fact that 12.11 million Euros was decommitted from the 2011 financial allocation, resulted in a decrease of the initial amount of 230.71 million Euros to 196.18 million Euros.

The total amount reimbursed under EFF under 2007-2013 MFF, until March 31, 2015 was 79.71 million Euros, which accounts for around 41% of the EU allocation for the interval 2007-2013.

European Agricultural Guarantee Fund (EAGF)EAGF allocation to Romania under 2007-2013 MFF amounted to 6.58 billion Euros. Starting with 2007, APIA has implemented support measures funded from both the national budget and the European funds. The European

Agricultural Guarantee Fund (EAGF) is used to make direct payments and cover the market measures, the foreign trade and promotion of agro-foods. The EAGF payments made from 2007 until March 31 2015 amounted to approx. 7.33 billion Euros. If we compare this amount with the allocated financial ceilings, the resulting annual absorption rate is over 98%. This high rate of absorption shows that Romanian farmers are interested in accessing European funds and that the money received by the farmers helped them develop their business.

3.4.2. NET FINANCIAL POSITION IN RESPECT OF EU BUDGET (2007-2015)

The net financial balance sets the net position in respect of the Community Budget. As early as the first year from the accession, Romania has been a net beneficiary in the financial relationship with the EU, with a positive balance.

Table 12 - Romania: Net Financial Balance in the relationship with the European Union for the 2007-2013 MFF

Billion Euros

tem	Achieved 2007	Achieved 2008	Achieved 2009	Achieved 2010	Achieved 2011	Achieved 2012	Achieved 2013	Achieved 2014	Achieved 2015 (execution on 31.03.2015)	Achieved 2007-2015 (execution on 31.03.2015)
I. AMOUNTS RECEIVED FROM EU BUDGET (A+B)	**1.60**	**2.64**	**2.93**	**2.29**	**2.62**	**3.44**	**5.56**	**5.93**	**2.83**	**29.85**
A. Pre-accession funds	***0.81***	***0.75***	***0.62***	***0.27***	***0.13***	***0.04***	***0.03***	***0.02***	***0.02***	***2.70***
B. Post-accession funds, of which:	***0.79***	***1.89***	***2.31***	***2.02***	***2.49***	***3.40***	***5.53***	***5.91***	***2.81***	***27.15***
B1. Structural and Cohesion Funds (SCF)	0.42	0.65	0.92	0.51	0.71	1.17	2.96	3.59	0.73	11.65
B2. Rural Development and Fishery Funds (EFF+EAFRD)	0.02	0.58	0.57	0.76	0.88	1.09	1.23	0.84	0. 79	6.75
B3. European Agricultural Guarantee Fund (EAGF)	0.01	0.46	0.58	0.66	0.77	0.99	1.17	1.33	1.28	7.25
B4. Other (post-accession)	0.34	0.21	0.25	0.09	0.13	0.15	0.16	0.16	0.01	1.50
II. AMOUNTS PAID TO EU	**1.15**	**1.27**	**1.36**	**1.16**	**1.30**	**1.43**	**1.53**	**1.62**	**0.53**	**11.35**
III. Balance of flows = I - II	**0.45**	**1.37**	**1.57**	**1.13**	**1.33**	**2.01**	**4.02**	**4.31**	**2.31**	**18.50**

In 2014, the absorption process became more efficient and the rate of EU funds absorption was the highest since the accession, in line with the trend started in 2013.

The year 2015 is the last year in which the expenses from the funds allocated under 2007-2013 MFF are still eligible for reimbursement, therefore this will be a key year, in which Romania has the task to request an amount as high as possible in reimbursements from the European Commission.

3.4.3. ALLOCATIONS FROM THE EU BUDGET –2014-2020 MFF

At EU level, 2014 was the start of a new 7-year MFF, which will last until; 2020. The structure or programs under 2014-2020 MFF differs from that of the 2007-2013 MFF. The MFF is a mechanism which provides predictability to the EU expenses and, at the same time, a strict budgetary discipline.

Romania’s allocation for 2014-2020 MFF amounts to around 43 billion Euros:

- *Cohesion Policy - 22.99 billion Euros*
  - European Fund for Regional Development -10.73 billion Euros
  - European Social Fund - 4.77 billion Euros
  - Young People Employment Initiative - 0.10 billion Euros
  - Cohesion Fund - 6.94 billion Euros
  - Territorial Cooperation - 0.45 billion Euros
- *Common Agricultural Policy - 18.98 billion Euros*
  - European Agricultural Fund for Rural Development - 8.13 billion Euros
  - European Agricultural Guarantee Fund – 10.85 billion Euros
- *Integrated Maritime Policy - 0.17 billion Euros*
  - European Maritime and Fisheries Fund - 0.17 billion Euros
- *Fund for European Aid to the Most Deprived - 0.44 billion Euros*

3.5. GOVERNMENT DEBT LEVEL AND PERFORMANCE [20]

PUBLIC DEBT AND THE GOVERNMENT PUBLIC DEBT MANAGEMENT STRATEGY

The government debt according to EU methodology accounted at the end of 2014 for 39.8% of GDP, far below the 60% ceiling required by the Maastricht Treaty. In the government debt, at the end of 2014, the general government domestic debt accounted for 19.1% of GDP and the general government external debt amounted to 20.7% of GDP, as the consequence of a financing process in the previous years focused on a significant external funding component.

The objectives of the government public debt strategy for 2015-2017, recently approved by the Government, are as follows:

- Cover the central government's financing needs and the payment obligations, while minimizing the costs on medium and long term;
- Limit the financial risks associated to the government public debt portfolio;
- Develop the domestic market of government securities.

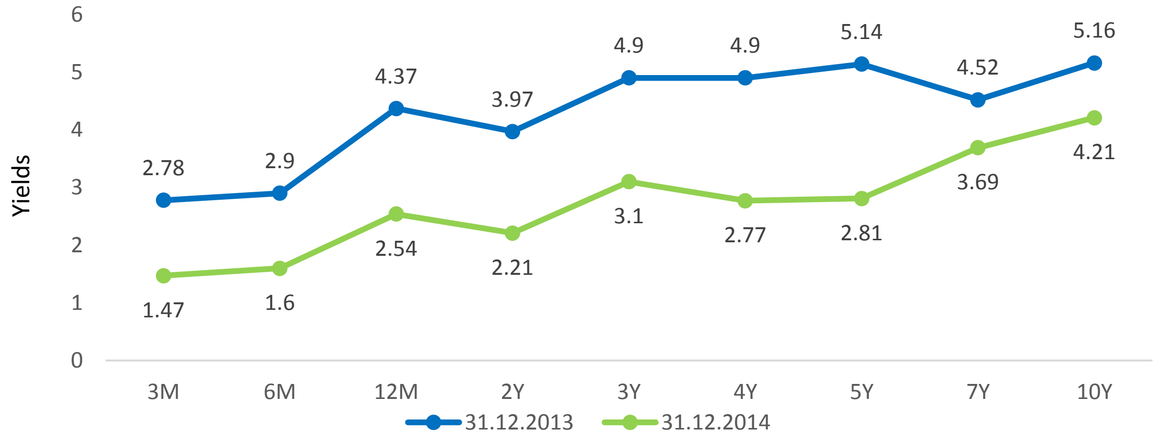
Around 60% of the deficit financing in 2015 will be provided from domestic sources supplemented by foreign sources, whereas for the upcoming years MoPF intends to raise the share of domestic financing sources, taking into account the objective of developing the domestic market of government securities and reducing the exposure to currency risk. Under these circumstances, the annual amount of government securities which will be issued in the following years to cover the budget deficit and refinance the public debt is expected to amount to maximum RON 45 billion, the level estimated for 2016.

The financing strategy from domestic sources provides in principal for the use of T-Bills denominated in lei, including with short and very short maturities (1 to 3 months) and to continue the issuance of 6 and 12 months T-Bills and medium and long term benchmark bonds, depending on the market demand and taking into account the objective of consolidating the yield curve in domestic currency. The yields of government securities trended down over the past two years, against the background of the relaxed policy measures conducted by NBR, with the yields being influenced by the liquidity conditions of the money market as well, the reduced rates of the minimum reserve requirements in respect of the liabilities in RON of the lending institutions and the appetite of non-resident investors.

As in the Chart below, at the end of 2014, the interest rates of short and medium term government securities went sharply down, given the high supply on these segments of maturity, below the level of the NBR monetary policy interest rate.

[20] All indicators used in this chapter are consistent with the EU methodology.

Chart 3 – Yields of government securities on the primary market



Source: Ministry of Public Finance

A key factor which helped increasing the demand for the government securities was the decision made by S&P to include Romania in the „investment grade” category, therefore the government bonds were included, since July 2014, among the indexes of the emerging market.

In order to reduce the costs of financing and for a better functioning of the secondary market, MoPF plans to continue the policy of building the liquid benchmark bonds along the length of the yield curve, simultaneously with a transparent policy of issuing the government securities, namely the number of benchmark bonds to be issued, the intervals in respect of the amount of an issuance and inform the market on the amounts, frequency of issuances/reopenings for some maturity categories. As part of this policy, MoPF plans to gradually do away with the government securities denominated issued in Euros on the domestic market, on the medium term.

In order to improve the secondary market activity, MoPF intends to introduce the electronic trading platform (ETP), in the first half of 2015, expected to contribute to a higher transparency of quotations and, implicitly, of the government securities price formation, thus providing the environment for cutting the trading costs of participants to the secondary market. At the same time, during 2015, after the procedural and operational framework will be established, MoPF intends to use operations which are specific to the secondary market, such as „buy back” and „bond exchange”, to speed up the creation of liquid benchmark bonds and facilitate the refinancing of high amount series coming due. For an efficient cash management, MoPF wants to use „reverse repos” after consultations with NBR, as a move to coordinate the financing and cash management policies with the monetary policies.

External financing sources in the medium run will come in principal from Eurobonds issued on the external capital markets under the MTN Programme and in addition loans contracted with official creditors (international financial institutions and government agencies). MoPF intends to remain present in the international capital markets, even though through lower amounts, since the domestic market will be the main financing source. Most of the bond issuances on the foreign market will be denominated in EUR, as a move to consolidate and expand the price benchmarks for the government securities, particularly for longer maturities depending on the market conditions. However, the issuances denominated in USD on the foreign markets or in other currency, may provide advantages due to longer maturities, increased market absorption capacity for the new issuances and a diversified investor base. This financing source is particularly important to Romania, as alternative financing in the case of foreign events which could limit the access to financing on the European market.

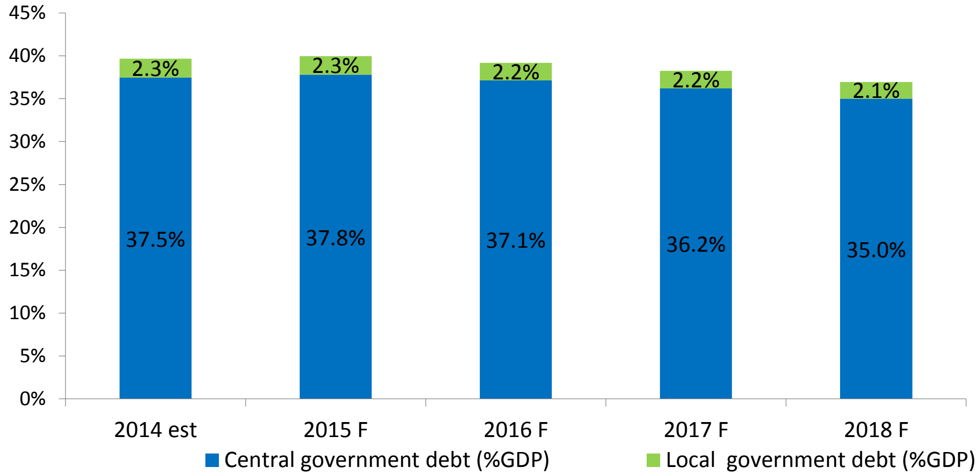
MoPF will preserve its flexibility in respect of the time to access the foreign market and the amount of foreign issuances, taking into account the associated costs, the risk factors and potential implications on the objectives and policies of the central bank, as well as the evolution of the local market. In addition, MoPF intends to use secondary market specific operations, such as buy back and bond exchange, as a move to facilitate the refinancing of high amount and high interest series which come due in the upcoming period.

Adding to all the above, the implementation of structural reforms in key sectors of the economy, as well as the implementation of priority projects/programs for the Romanian economy will continue to be funded from the loans contracted with the international financial institutions (World Bank, EIB, EBRD, the Council of Europe Development Bank).

The sources needed to refinance the government public debt will come from the markets on which the debt was issued, as well as from the State Treasury foreign currency financial reserve. To improve debt management and avoid seasonal pressures in securing the budget deficit financing and public government debt refinancing sources, the financial foreign currency buffer of the State Treasury will be preserved, at a comfortable level, to reduce the risks in times of high financial market volatility. For 2015, the buffer will be consolidated so as to cover 4 months of gross financing needs.

With an average annual economic growth of 3.7% of GDP and deficits calculated according to EU methodology below 1.2% of GDP, in 2016 – 2018 the share of the gross government debt is not expected to exceed 40% of GDP, as in the Chart below.

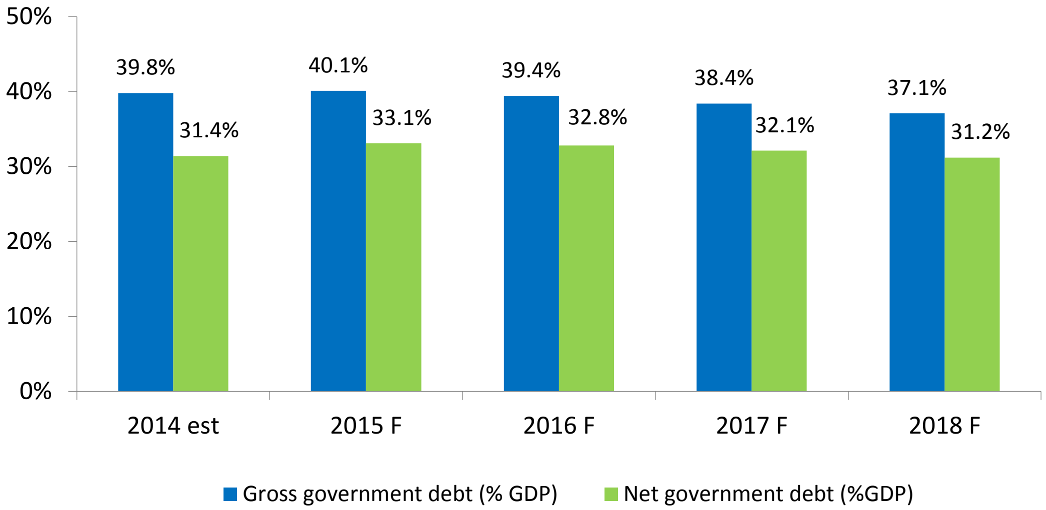
Chart 4 – Gross Government Debt according to EU Methodology



Source: Ministry of Public Finance

If the liquid financial assets are considered[21], the netgeneral government debt(gross debt minus liquid financial assets) in the interval under review will not exceed 33% of GDP.

Chart 5 – Government Debt according to EU Methodology



Source: Ministry of Public Finance

The factors which influence the change of debt share to GDP during 2015-2018, including stocks—flows adjustments, are included in annex 4.

21 AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted on stock exchange; including mutual fund shares).

3.6. IMPACT OF THE DRAFT FISCAL CODE ON THE GOVERNMENT BALANCE

The fundamental objectives of taxation are simplification and predictability within a fiscal and budgetary framework encouraging the development of the private and public economic environment.

The way that economic, social and political reality evolved from 2003 to 2014, the context created by the international economic and financial crisis and, not least, Romania's accession to the European Union made it necessary to repeatedly amend and supplement the Fiscal Code Law nr. 571/2003.

Since its adoption in December 2003, the Fiscal Code has been many times amended and supplemented, with the most important amendments and supplements brought by the Law nr. 343/2006, a piece of legislation by which the Community regulations related to taxation were adopted in the national legislation, a major EU accession pre-requirement.

While there has been a constant concern for the improving and simplifying the Fiscal Code provisions, the Code is perceived by the economic and social environment as being difficult to implement and permanently risking a non-consistent interpretation of its provisions. The frequent changes, which were needed for a good functioning of the system of taxes and fees in Romania, generates some difficulties when it comes to interpreting the Code and implementing some legal provisions with impact on the tax field.

The dynamic development of the business environment and, implicitly, of the related legislation, the obligation to adopt in the national legislation the rulings of the EU Court of Justice, as well as the revisions/supplements brought to the regulations, directives or other Community acts, are only a few of the major factors requiring the permanent revision and supplementation of the national tax laws.

At the same time, the many successive revisions and supplements to the Fiscal Code, through ordinances and emergency ordinances approved in laws or still in process to be approved, pieces of legislation which all refer to one another, made the process to republish the Code in the Official Gazette a process that is hard to manage.

In this context, the Government of Romania has planned, on a medium term, by re-writing the Fiscal Code to get to the following results:

- clarity and accessibility in the implementation of the Fiscal Code provisions, by restructuring, on a systematic basis, the fiscal rules;
- transparency in presenting the fiscal principles, in defining the concepts, the notions and methods, used in the construction and administration of the coherent system of taxes and social contributions, as regulated by the Fiscal Code, for the purpose of a correct understanding and avoid interpretations in the implementation of fiscal rules;
- provide the correlation between the provisions of the Fiscal Code and the provisions of the Fiscal Procedure Code as re-written, as well as consistency with the contiguous legislation;
- improve the efficiency in the management of taxes, duties, social contributions, as provided for by the Fiscal Code;
- reduce the tax and duty management costs, as provided for by the Fiscal code and the compliance costs of the taxpayers;

- encourage the free initiative and investments in Romania by introducing the exemption from the tax on dividends.

The main measures considered by the new Fiscal Code are:

- Reduce the standard VAT rate from 24% to 20%, starting on January 1, 2016;
- Reduce the standard VAT rate from 20% to 18% as of January 1, 2018
- Set up a differentiated tax rate for the micro-businesses, depending on the number of employees;
- Reduce the tax on dividends as of January 1, 2016, from 16% to 5%;
- Reduce the corporate income tax rate from the current 16% to 14% as of January 1, 2019;
- Reduce the personal income tax rate from the current 16% to 14% starting on January 1, 2019;
- Reduce the employee's social security contribution rate from 10.5% to 7.5% as of January 1, 2018;
- Reduce the employer's social security contribution rate depending on working conditions, as follows:
  - for normal working conditions from 15.8% to 13.5%
  - for specific working conditions from 20.8% to 18.5%
  - for special and other working conditions from 25.8% to 23.5%

- Introduce the ceiling of maximum 5 gross average wages for the monthly calculation base of the social insurance and health contributions;
- Abolish the tax on special constructions as of January 1, 2016.

Tabel 13 – Fiscal Code

Million Lei

	Impact 2016	Impact 2017	Impact 2018
Total	**-12024.4**	**13152.7**	**26361.2**
of which the main measures refer to: ***The corporate income tax***			
The profit invested in technological equipment – machinery, plants and working installations (…) shall be tax exempt.	-56	19	-
The tax on micro-business income			
Introduce a differentiated system of tax rates, ranging from 1% and 3%, depending on the number of employees	-254	-264	-274
The personal income tax			
Income from independent activities – revise the way that the taxable base is established for taxpayers which make an income from intellectual property rights and choose to have their income tax as final tax, in the sense of providing the deductibility of mandatory social contributions withheld by the payers and the lump sum expense rates, as applicable (40%)	-25.7	-26.7	-25.7
Income from wages and assimilated to wages – Apply the same fiscal treatment to the gift vouchers, namely exempt them from taxation if granted in the form of gifts, up to the limit of 150 lei, on specific occasions. Apply the same tax arrangements to gifts and gift vouchers given to employees, if up to the set limit and on the specific occasions.	-43.6	-44.8	-45.9

Income from wages, assimilated to wages and income from pensions. Provide the special tax allowance for the loans which have been restructured according to new repayment schedules, for the calculation of the taxable base. The allowance is granted once a month, for a period of time which is equal to the extension of the initial loan term, but not for more than two years, and it represents the monthly repayment amount during the respective period, but no more than 1,500 lei/month.	-516.3	-556.2	-
Rental income – Increase the lump sum expense rates from 25% to 40% for the rental income, including the net income from the lease of land	-111.8	-114.8	-117.6
Investment income – revise this chapter to reflect the revisions proposed in the fiscal code re-writing draft, other than income from dividends .	-230.3	-245.3	-261.50
Investment income – Reduce the tax rate for the dividends paid to individuals, from 16% to 5%.	-1205.1	-1400.1	-1492.5
Income from pensions - Increase the non-taxable monthly amount which has been taken into account in setting up the monthly taxable income from pensions to 1050 lei, starting with the payments for the month of January 2016. The monthly non-taxable ceiling of 1,050 lei in the fiscal year 2016 will be increased by 50 lei in each fiscal year, starting with the payments for the month of January, until the non-taxable income ceiling amounts to 1,200 lei per month.	-151.5	-170.7	-176.4
Income from pensions - Give the taxpayers the possibility to choose to redirect an amount representing up to 2% of their tax payment, to support the not-for-profit entities incorporated and operating according to the law, to institutions of cult, as well as make this money available for private scholarships, according to the law.	-12.30	-12.70	-13.10
Mandatory social contributions			
Reduce the individual public social security contribution rate by 3 pp (from 10.5% to 7.5%) and the employer’s rate by 2.3 pp (from 15.8% for normal working conditions to 13.5%). This measure will be applied as of January 1, 2018.			-8396.5
Eliminate the exception which allows the individuals to not pay the social insurance contribution on the income from independent activities if they have an income from wages at the same time.	200.4	362.1	330.8
Introduce pre-payments for the social insurance contribution, with the monthly base representing 35% of the gross average wage income in the year for which the amount of pre-payments is established, for the individuals which make an income from independent activities and set their net income in real system/the net annual income based on income tax brackets for self-employment. The payers of social insurance contributions are individuals which make an income from independent activities which is above the minimum threshold of 35% of the earnings. In the next year, the adjustments are made based on the actual additional income, based on the income tax return. The optional payment of the social security contribution, in part or in full established for normal working conditions. SSC base may not be higher than 5 times the gross average wage. Increase the flat share of expense for intellectual property rights from 20% to 40%.	-161.8	229.1	197.3
Introduce the obligation to pay the health social insurance on both the income from investments and wages of individuals. SHC base can not be greater than the amount representing 5 gross average wages.	416.9	482.1	511.9
Introduce the obligation to pay the social health contribution only for the income from investments, intellectual property and other sources, for the individuals, considering only the income which IS NOT tax exempt according to the current fiscal code. SHC base can not be greater than the amount representing 5 gross average wages.	-15.0	-17.4	-18.5

Introduce a maximum ceiling for the monthly calculation base of the social health insurance contribution (SHC). The ceiling has been set as 5 gross average wages.	-933.2	-1,079.1	-1,146.0
The tax on non-residents' income in Romania and the tax on foreign representation offices set up by foreign companies in Romania			
Reduce the tax on dividend income paid in Romania to non-resident from 16% to 5%.	-52.2	-61.3	-63.3
The value-added tax			
Reduce the standard VAT rate from 24% to 20%, starting with January 1, 2016, and further from 20% to 18% as of January 1, 2018.	-7219.1	-8454.4	-14295.5
Excises and other special duties			
Re-assess the excise duty system for alcoholic beverages.	-312.5	-324.0	-337.0
Remove other excisable goods from the scope of excise duty application.	-71.8	-75.1	-79.4
Remove the crude oil from the domestic production from the scope of excise duty application.	-17.6	-18.2	-19.0
Local taxes and fees			
Change the way that tax on buildings is calculated depending on what the building is intended for – residential or non-residential purpose.	333.7	365.4	398.4
Eliminate the hotel accommodation fee.	-16.9	-17.4	-17.8

The negative impact generated by the measures of the draft law of the Fiscal Code will be offset in the year 2016 and subsequent years by the additional revenues earned as a result of macroeconomic and social impact, respectively from the additional economic growth and on the other part from increasing budget revenues collected as a result of the implementation of the National Agency for Fiscal Administration structural measures to streamline the system of revenue collection and increase the level of voluntary compliance, both declaration and payment.

The obligations and general consolidated budget revenues are expected to increase as a result of the economic multiplier effects arising from fiscal relaxation measures provided in the draft law of the Fiscal Code, translated into increased investment and jobs.

According to estimates, in 2016-2019, the private sector will use the additional cash on hand resulted from the application of the new fiscal code which will bring additional revenues of about 1.5 billion in 2016 and about 2.5 billion lei per year between 2017 -2018.

The increase of budget revenues collected by the National Agency for Fiscal Administration is also substantiated by the measures which have been already taken and will continue be applied in th upcoming period; these measures refer to:

- reducing the fiscal gap in VAT collection. The measures to increase administrative capacity are structural measures which, in the period 2016 - 2018 will lead to further reduction of the fiscal gap by at least 4 percentage points annually, respectively to an increase in revenues by approx. 4-5 billion lei annually.
- the implementation at national level of the project for the prevention of undeclared work and/or under-declared in order to support fair competition in business and protect employees by increasing social security, which will attract additional revenue estimated only in 2015 to approx. 1 billion lei in income tax and 1.5 billion lei in social contributions.
- changes introduced by the new insolvency law have created a downward trend in the number of new insolvency cases filed with the courts, a fact confirmed also by data

published by the National Trade Register Office according to which the number of insolvent companies fell from 29,587 in 2013 to only 20,696 in 2014. This can lead to a significant increase in budget revenues on this segment because a significant number of companies remain in the current administration and will pay accrued and outstanding liabilities as current liabilities, using installments/postponment agreements.

- voluntary compliance on tax payment obligations will improve by approx. 2 percentage points per year (equivalent to 3.2 billion lei), reaching at the end of 2018 to approx. 90%. Thus, given the cumulative effect of the structural measures taken by NAFA, expectations are that additional revenues of about 14 billion will be collected 2016, with additional 18 billion lei collected annually in 2017-2018.

3.7. STRUCTURAL REFORM CLAUSE

In the annual growth assessment for the year 2015, the European Commission identified investments, structural reforms and budget accountability as the essential elements of the EU economic policy strategy aimed at creating jobs and ensure growth. Article 5 and Article 9 of Regulation nr. 1466/1997 clarify the way that Member States should act to reach a sound budget position, and how the so—called "structural reform clause" may be considered in the preventive component of structural reforms. By applying the structural reform clause, Member States (MS) which implement major structural reforms with a long-term positive impact are allowed to a temporary deviation from the path to MTO or even from the MTO itself.

In accordance with the priority reform measures for Romania, as assumed in the National Reform Program (NRP), measures which are relevant to the specific country recommendations and to reaching the objectives assumed in the Europe 2020 Strategy, the following major areas of intervention and structural modernization are proposed for the structural reform clause:

- Improve the capacity and achievements of the research system as a move to increase investments in the RDI field. To this purpose, the measures aimed at developing the research capacity in the private sector will have priority, as this sector will have to raise its contribution from around 0.1%, as currently, to the commitment made in the Europe 202 Strategy, which is to provide 1% of the sector's financing from private sources. In addition, the public financial contribution will have to go up from 0.3% in 2013 to 1% in the year 2020.
- Continue the healthcare system reform and promote social inclusion. The following will be of priority: improve the efficiency and financial sustainability of the health system and improve access to healthcare and quality social services, in particular for vulnerable persons.

In the case of social services, a new program called the *minimum insertion income* will provide the minimum standard of living defined as the limit expressed in lei that covers the basic needs such as: food, clothing, personal hygiene and the sanitation and maintenance of dwellings. It is calculated in relation to the poverty line, according to the methodology used in the Member States of the European Union.

- The minimum insertion income is a new concept which combines poverty fighting measures and will significantly contribute to achieving the strategic target of reducing the number of poor people by 580.000, a target committed under the Europe 2020 Strategy and the National Reform Programme (NRP).

- The estimated budget required to implement the minimum insertion income amounts to approximately 2.7 billion according to the Project of modernization of social security, carried out with the World Bank loan of 500 million euros, approved by the Law no.68 / 2012.

We believe that all the measures viewed as necessary in the healthcare and social services sector require important budget allocations to improve the infrastructure, supply medical equipment, provide specialized care to local communities as well as prevention and treatment services in the health sector.

The healthcare system reform is, in fact, a crucial component, in addition to the reform of the pension system, including encouraging private pension and health insurance to provide long term fiscal sustainability.

- The pension system reform is aimed at two main objectives, namely increase the retirement age and strengthen the capacity if the pension pillar 2, which will require a substantial budgetary effort.

The support of classic pension system (Pillar I) by the existence of a complementary pension system based on capitalization (Pillar II).

The expected results of the reform are:

- improved collection rates and better financial discipline;
- limited demographic impact on pension income;
- reduced pressure on the public pension system since 2025, when the first Pillar II pensions will be paid to contributors (standard age for women first).

Currently, from the individual social security share of 10.5% a percent of 5% is transferred to private pension funds, respectively 380.7 million lei /month and approximately 4569 million lei/year.

In 2016, for the 3.7 million participants to the Pension Pillar II, the contribution rate will be increased from 5% to 6% , being composed of 0.5% for the year 2016 and 0.5% outstanding from 2009.

The amounts to be transferred in 2016 will increase by 80 million monthly, so that the contributions collected by private pension funds will be higher by 960 million lei in 2016 compared to 2015.

According to estimates, in 2032, approximately 950,000 people will receive a pension both from public and private systems and the expense from the public system will be reduced by approximately 15% (only for these people), representing an annual saving of 2,850 million lei.

- The reform of the business environment and infrastructure development is, considering the specific circumstances in Romania, a major area of intervention. In addition, the success of Romania’s participation to the European Investment Plan (the Junker Plan), with investment projects complying with the multiplication requirements set by the European Commission, depends on the above-mentioned reforms. In fact, an improved business environment and the access of SMEs to financing are fundamental objectives of the European Investment Plan.

- To facilitate the transition from unemployment or inactivity to employment, as recommended in the 2015 Country Report for Romania, the Government will continue the active measures for occupation and training programs dedicated to people looking for a job, thus over 424,000 people being employed in the last 12 months.
- In 2015 – 2016, Romania plans to implement a series of additional measures, financed from both ESF 2014 - 2020 and Youth Employment Initiative (YEI) and the EAFRD 2014 - 2020, aimed at increasing labor market participation and improving access to quality jobs.
- NEET[22] young people is one of the most vulnerable groups risking unemployment associated with social exclusion. For labor market integration of young people NEET, the Romanian Government continues to implement the Plan for the implementation of guarantee for youth 2014 - 2015, whereby approximately 66,400 young people have already been employed in the first four months after their registration at the employment agencies.
- According to *The Integrated Guideline on improving the supply of labor and skills*[23], during 2015 will be launched in implementing new measures such as the Youth Guarantee, with funding from ESF 2014-2020 and YEI. Complementary, NEA will run *The employment program for young people at risk of social exclusion,* thus being ensured for them personalized social accompaniment measures, together with measures of subsidizing employers for the employment insertion of young people.
- To streamline the implementation of these measures, the NEA is to operationalize *the Electronic Register Youth NEET* (the project CHANCE4NEET).
- In line with *The Integrated Guideline on improving the supply of labor and skills*, Romania considers important **to ensure employees' access to lifelong training**, ESF 2014 - 2020 is financing the employee training to meet the changing characteristics of jobs, generated by the transition to new business models and the orientation towards certain sectors identified as having competitive potential.
- Reducing job loss as a result of restructuring and re-engineering of enterprises, represents a priority of the Romanian Government. In this sense, funds are allocated by ESF 2014 - 2020 for **the adjustment of workers, enterprises and entrepreneurs to changes in the business environment**.

[22] Young people aged between 16 and 25 who are not enrolled in any form of education or any training and are not employed.
[23] Proposal for a Council Decision on guidelines for the employment policies of the Member States' labor COM (2015) 98 final.

Within this framework, Romania considers that the provision of the funding sources needed to implement the 2014 – 2020 Transport Master Plan (MPGT) is mandatory to the economic development and to achieve the real convergence.

For the purpose of a comprehensive assessment of the expenditures and budget advantages in view of requesting, until June this year, access to the "structural reform clause", the following lines of action were approved in a Government Memorandum:

- The main budget managers shall submit to the Ministry of Finance their own structural reform measure proposals, together with an estimate of their impact on the budget;
- MoPF reviews the proposed measures submitted by the main budget managers and will send out the application for the clause, after all the requirements established by the EC are met.

Consistently with the measures set by the Government and the initial program adopted by the European Commission as „Dedicated structural reform plan" and in order for the request for a temporary deviation from the MTO by up to 0.5% of GDP to be submitted until the month of June, Romania will add to the Convergence Program review all the pieces of information needed to access the „structural reform clause" until the end of June.

4. SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS VERSION OF THE CONVERGENCE PROGRAMME

4.1 RISKS

The main international developments which may impact the Romanian economy are:

- a substantial cut of the oil price;
- a sharp inflation decline and even a deflation in the European Union;
- difficulties in resuming the European investment process.

In March 2015, the annual inflation rate measured by the harmonized consumer price index was second (0.8%) with most countries facing a situation of deflation. In the first 3 months of 2015, the price of agro-foods only dropped in Romania (-0.07% compared to March 2014). In the case of services, the price increase was 1.55%.

If we refer to the oil price, we need to take into account the fact that the oil industry is well developed in Romania, with important exports. The price decline allowed the production to go up, therefore the exports. The oil product industry output went up in 2014 by 13.7%, with the export of oil products accounting for around 65% of the crude oil imports. As a consequence, we expect the cut in the oil price to have a positive impact estimated at 0.2% of GDP.

With regard to investments, we estimate that the reduction of the gross fixed capital formation in the European area, in 2012, (-2.8% in EU-28) and 2013 (-1.5% in EU-28) reduced the investors' propensity to direct their investments to other countries.

However, the Romanian investment market continued to be preferred by investors. Hence, in 2014, the capital subscribed by the Italian companies went up by around 150 million Euros. The highest flows to Romania came from Netherlands, with a plus of around one billion Euros to the share capital of foreign companies, as well as from Austria and France, each with a plus of over 300 million Euros to the subscribed share capital.

The risks on the positive side, including for the investment process, come from the recent monetary policy measures implemented by the European Central Bank and the expected implementation of the Investment Plan for Europe (The Junker Plan). The impact of the already underway quantitative relaxation process could have a higher positive impact in the sense of attenuation of the disinflation pressures with a positive consequence on the final demand and the investment climate in the Eurozone.

On the negative side, the risks come mainly from the situation in Greece, Ukraine and the Eurozone. The uncertainty about the Greeks' capacity to get a new bailout and the speculations about Greece potentially leaving the Eurozone and the spillover effect in the region may also have a bad impact on the economies in the region.

On the domestic side, risks are generally balanced when it comes to the impact on the domestic demand and supply. After two very good years in agriculture, 2013 and 2014, should the weather be bad for agriculture in 2015, the crops could sharply decline with a direct impact on the inflation and the economic growth.

Among internal risks impacting all economic sectors, in particular the SMEs, the banking sector's restrictive lending policy needs to be mentioned, despite of the fact that the monetary policy rate has been relaxed. We expect the bank lending to pick up, but in order to achieve the economic growth objectives in 2014 the lending process to companies and the population needs to be significantly increased. In this context, it is important to underline the need to boost the Romanian companies' competitiveness, particularly with a view to the adoption of the Euro currency in 2019. From this viewpoint, the relaxation measures taken by the Government will be stimulating for investments and modernization of production capacities, so that the private sector may increase its contribution to the economic growth.

Another risk for the growth is the absorption of EU Funds. However, the absorption rate improved considerably in the recent years and the Government still has, among its objective, a substantial and immediate improvement of the absorption rate of structural funds, a crucial condition to providing sustainable economic growth and capping the foreign debt. As a consequence, we believe that in 2015 the positive impact on the economic growth will exceed the initial estimates.

Domestic risks are counteracted by the fiscal relief measures. The exemption of reinvested profits, the lower rates of SSC and VAT for food, measures which shall produce effects as early as 2015, are powerful encouragement for investments and growth. All these will be doubled by the effects of the measures provided for by the new Fiscal Code.

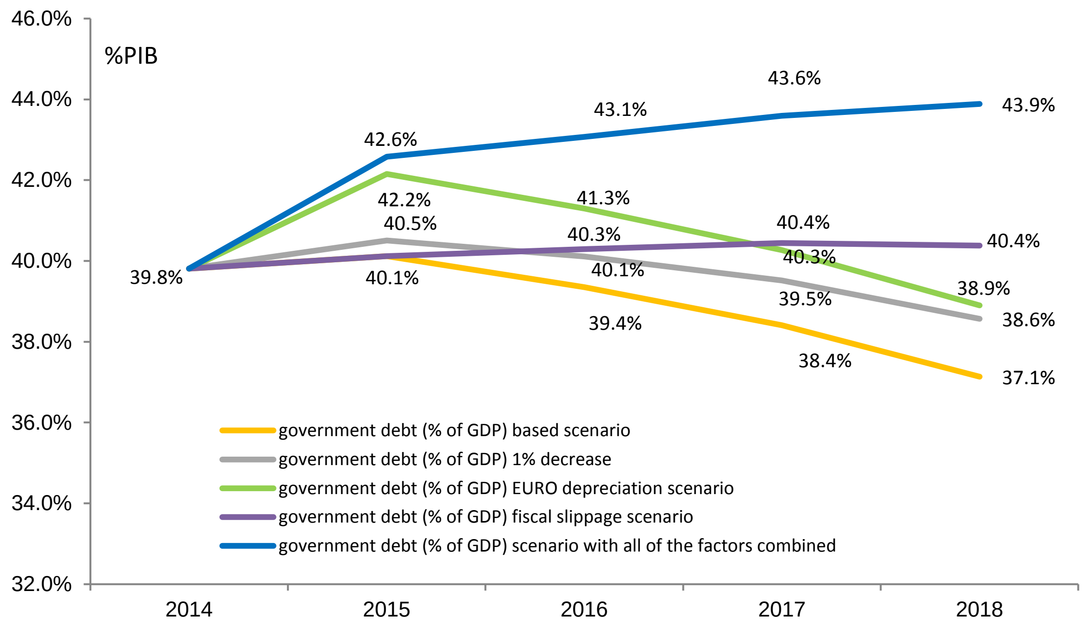
4.2. PUBLIC DEBT SENSITIVITY

Sensitivity analysis of public debt [24]

1) the influence of economic growth, the domestic currency depreciation and fiscal slippages [25] on the government debt; and

2) the impact of domestic currency depreciation and interest rates changes on interest payments.

Chart 6 – Factors which impact the government debt



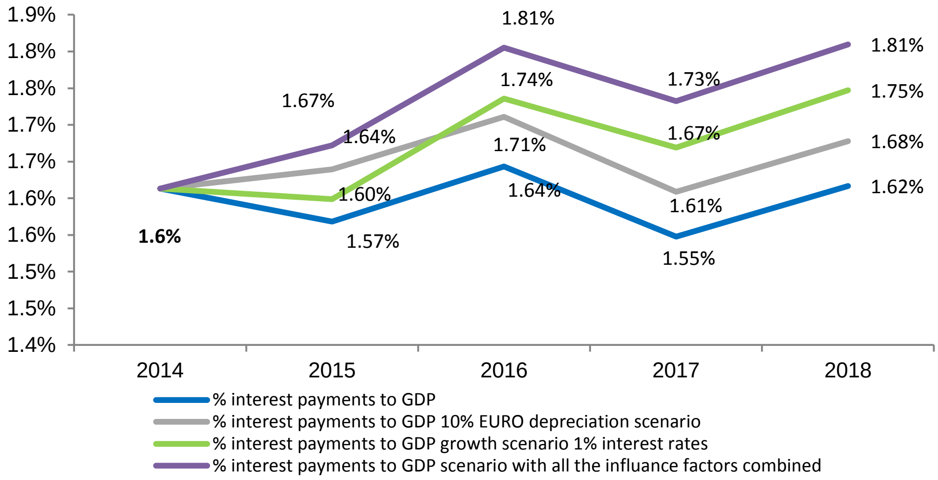
Source: Ministry of Public Finance

In Chart 6 we can see that the influence of an economic decline by 1% of GDP would have a

[24] All indicators in this section are in line with EU methodology.
[25] Cash deficit to cover of 2% of GDP.

negative impact on the indebtedness level, which will go up by 1.5% of GDP in the year 2018, and the depreciation of the domestic currency against the Euro by 10%, as Euro is the main currenncy of the foreign currency debt denomination, would trigger, in 2018, an increase of the debt share to GDP of up to 1.8% of GDP. A fiscal slippage translated into a cash deficit to be financed of 2% of GDP in 2015 – 2018, would lead to a higher indebtedness by up to 3.3% of GDP in 2018, while the combined influence of all these factors on the government debt share to GDP would trigger an increase of the indicator by 6.8% of GDP in 2018.

Chart 7 – Factors which influence the interest payments



Source: Ministry of Public Finance

Chart 7 shows that the depreciation of the domestic currency against the Euro[26] would have a low negative impact on the interest payments, which will go up by up to 0.06% of GDP in 2018, while the interest rates raising by 1% would result in a higher increase of interest payments share by up to 0.13% in 2018. The combined impact of these factors on the payments would trigger a raise of interest payments by 0.19% of GDP in 2018.

4.3. COMPARISON WITH THE PREVIOUS VERSION OF THE CONVERGENCE PROGRAMME

The macroeconomic scenario of medium term development described herein is not substantially different, in terms of GDP performance, from the previous programme edition of April 2014. The differences between the two programme versions come, in principal, from the revised statistical data in 1995-2013 and the provisional data published for 2014, according to ESA 2010, as well as the base effect of the resulting structural changes.

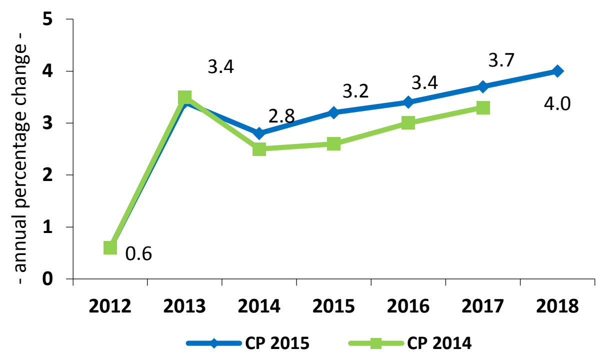
Hence, the GDP was projected to grow by 2.5% in 2014, according to the previous version of the Convergence Programme. The economic results obtained in the economic sectors, namely industry ad services, showed an increase of the gross domestic product by 2.8%.

For the year 2015 and the upcoming years, the forecast took into account the impact of the application of GEO nr. 6/2015 on the reduced VAT rates. As a consequence, it is provided for that in 2015 GDP will go up by 3.2% compared to the 2.6% forecast in the previous edition, mainly on the back of the domestic demand. The forecast for 2016-2018 provides for an

[26] The other currencies of debt denomination are trending up as well.

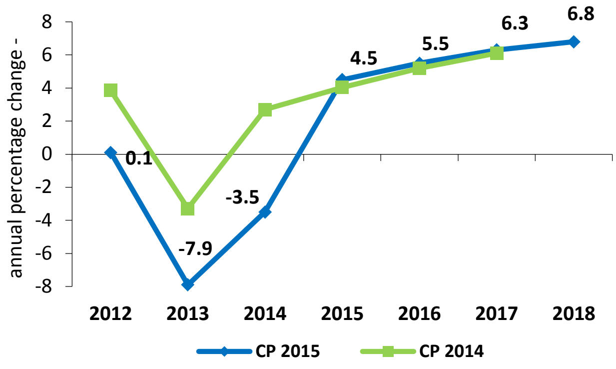
accelerated economic activity, with a growth rate higher than the one foreseen by the previous programme, namely 3.4% in 2016, 3.7% in 2017 and 4.0% in 2018, with the domestic demand, in particular the gross fixed capital formation, being the growth driver.

Chart 8- A comparative review of GDP growth forecasts



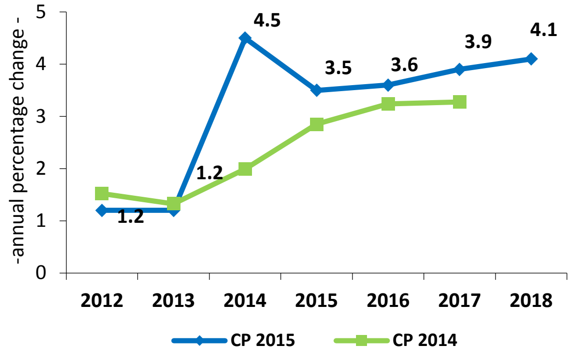
Source: The National Prognosis Commission

Chart 9- A comparative review of GFCF growth forecasts



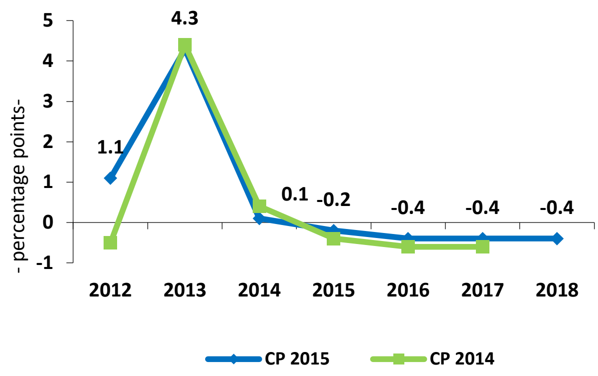
Source: The National Prognosis Commission

Chart 10 - A comparative review of private consumption growth forecasts



Source: The National Prognosis Commission

Chart 11- A comparative review of net export contribution to GDP growth



Source: The National Prognosis Commission

5. LONG TERM SUSTAINABILITY OF PUBLIC FINANCE

The public finance viability for the EU Member States is reviewed once in three years. The 2015 reporting exercise revealed, in the case of Romania, no-sustainability related short term risks, a low level of these risks on the medium term and a moderate level of these risks over the interval of the forecast, namely the year 2060. According to the updated projections for the purpose of the new exercise, the share of pensions expenditures is expected to remain, until the end of the forecast interval, below the EU average. Risks would increase if the primary structural balance went back to the levels of 1998-2012. The public debt level is expected to remain substantially below the 60% of GDP baseline value, but certain consolidation measures may be considered to cap the increase of costs associated to ageing population (mainly pensions).

One should note the positive assessment of the sustainability, compared to the 2009 Report, when sustainability-related risks for Romania was high on a long term, following the budgetary impact of expenditures generated by the population ageing process, which were far above the EU average. In this sense, the improvement of projections according to the 2012 Report is also confirmed by the 2015 exercise.

At EU level, the projected growth of budget expenditures was revised slightly downward, compared to the 2012 exercise. In 26 of the 28 MS, the total variation of population ageing-related budgetary costs trended down during the interval between the two Reports. They continue trending down now, with the adjustments and reforms in the pension, health and social security sectors initiated by the Member States.

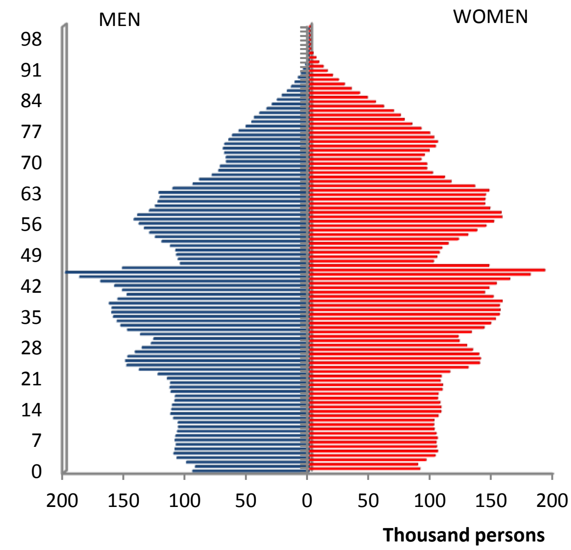
The updated projection of population ageing-related expenditure increase indicates, for Romania, a raise of 5.8 pp of GDP in 2013-2060 (4.4 pp in 2010-2060, with the European average at 1.8 pp). The breakdown on the main expenditure components is as follows:

- 0.1 pp of GDP is the increase in pension expenditures (European average is 0.2 pp)
- 1.9 pp of GDP is the increase of healthcare and long term care expenditures (European average is 2.0 pp).
- 0.4 pp of GDP is the increase of education expedinture (European average is 0.0 pp).

If we compare with other European states, the growth rate of ageing-related expenditures in Romania reflects the sharply reversed age pyramid. It is worth mentioning that the forecast did not include the EC recommendation to even out at 65 the retirement ages for men and women.

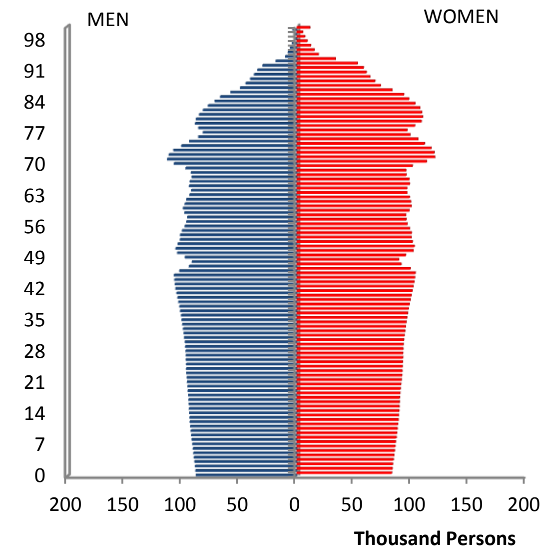
Chart 12 – Structure of the population: 2013–2060

Structure of Romania's population in 2013



Source: Eurostat-EUROPOP 2013

Structure of Romania's population in 2060

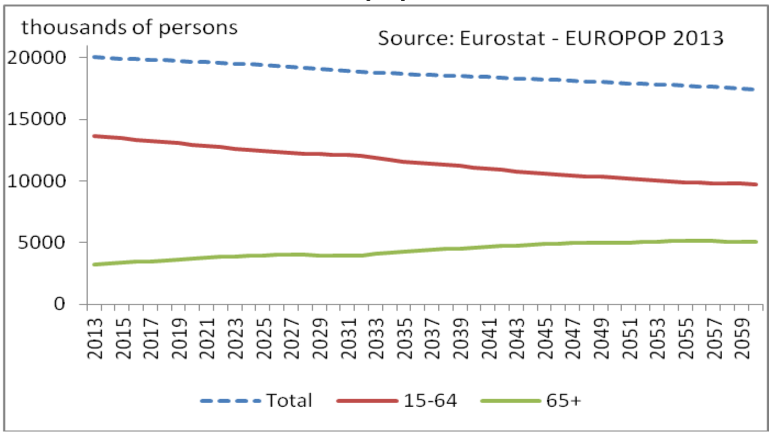


Source: Eurostat-EUROPOP 2013

Demographic changes will affect the composition of population in Romania. The magnitude and speed of the ageing process are related to the life expectancy, fertility and migration trends.

The rapid ageing will change the ratio between the population at retirement age and the active population, triggering major changes in the age structure and negative consequences on the labor market. The ratio between people over 65 and people at working age (15 to 64) will raise considerably, which means that in the upcoming years the public pension system will have substantially less resources compared to its expenditures.

Chart 13 – Evolution of the population



The age composition of the population will be deeply affected in 2013-2060: the share of the population at working age (15 to 64) will substantially drop by 12.1 pp in the time interval under review, with the share of population over 65 raising in the same time interval by 12.5pp.

The ageing process is considered a consequence of low fertility: in 2012, the fertility rate was 1.53 children per woman, below the optimal level of reproduction, and will raise, according to Eurostat estimates, to 1.83 in 2060.

The results of demographic forecast provided by Eurostat for Romania[27], indicates a substantial decline in the number of population, namely by 2.6 million persons less in 2060 compared to 2013. While the young population is trending down as a result of increasingly less women at fertility age, there are some positive signs from the increase in fertility rate.

Table 14 – Demographic indicators

	2013	2020	2030	2040	2050	2060
Fertility rate	1.65	1.73	1.79	1.81	1.82	1.83
Population Total millions	20.02	19.69	19.00	18.46	17.97	17.44
of which:						
Men	9.76	9.59	9.26	9.02	8.81	8.57
Women	10.26	10.10	9.74	9.44	9.16	8.87
Life expectation at birth						
Men	70.8	72.8	75.4	77.8	80.0	82.0
Women	77.9	79.5	81.6	83.5	85.1	86.7
Life expectation at 65						
Men	14.5	15.5	16.9	18.3	19,6	20.8
Women	17.8	18.8	20.1	21.4	22.7	23.9

Source: Eurostat-EUROPOP 2013

[27] Eurostat – EUROPOP 2013

In Romania, the life expectancy for men is projected to grow by around 11.2 years over the time interval under review, from 70.8 in 2013 to 82.0 in 2060. The life expectancy at birth is expected to raise by 8.9 years for women, i.e. from 77.9 in 2013 to 86.7 in 2060, which shows a slight convergence of life expectancy for men and women.

In the medium and long run, the performance of the pension sector is strongly influenced by the demographic outlook, which is given by the birth rate and the life expectancy, alongside the inevitable ageing of the population.

Table 15 – Long term forecast of pension expenditures

	2013	2014	2020	2030	2040	2050	2060
Pension Pillar 1	8.2	8.2	8.1	8.1	8.4	8.4	8.1
Pension Pillar 2	-	-	-	0.1	0.4	0.7	0.8

Source: National Prognosis Commission

The estimates of the pension model indicate an increase of pension expenditures share under Pillar 1, from 8.2% of GDP in 2013 to around 8.4% of GDP at the beginning of the 2040-50 decade, followed by a gradual decrease towards the end of the forecasting interval, until below the share of the baseline year.

The Pension Pillar 2 will have an increasingly substantial share in the total pension expenditures, and is expected to amount to around 0.8% of GDP at the end of the forecasting interval.

6. THE QUALITY OF PUBLIC FINANCE

The improvement of the public finance quality is needed to provide a sustainable economic growth. In this sense, it is a Government priority to continue ensuring a fiscal and budgetary framework which helps the development of the economic environment. Anti-cyclical fiscal policy measures, adopted after the crisis to counteract the effects of the economic recession, brought positive results, with signs of visible recovery visible since 2013, when Romania had the highest GDP growth rate of the period after 2008. In addition, the level of balance-related macroeconomic indicators (including fiscal indicators such as the budget deficit) show a situation of stability.

While there are all these positive aspects helping improve the investor feeling (business environment), there is also a constant need for the authorities to step up in particular in fighting tax evasion and improving efficiency, transparency and accountability in using the public resources (features of the public finance quality which require firm action from the fiscal policy decision-makers).

6.1. BUDGET REVENUES

The main objectives set to improve the efficiency (quality) of budget revenues are related to the simplification of the system of taxes, reducing the fiscal burden and the tax evasion, increase the tax collection rates.

The simplification of the system of taxes and the reduction of bureaucracy happen gradually. The number of payments that a company has to make in one year in Romania to pay its charges and duties went down from 113 in 2007 to 39 in 2012 and further to 14 in 2013. In addition, the number of hours needed to pay the tax obligations of one fiscal year dropped to 159 in 2013 from 200 hours in 2012. When the Register of non-fiscal duties and tariffs was set up in 2009, a number of 491 non-fiscal duties and tariffs were counted. As a result of the Government's policy reducing their numbers, because of the fact that the management costs were higher than the duty amount or the tariff itself, the numbers dropped substantially from 491 to 170 as currently. Out of these, 91 are licensing fees and charges.

In the course of 2014, a number of legal measures were implemented within the taxation system, as a move to facilitate the business operations, encourage investments and innovation and boost the corporate taxpayer voluntary compliance.

Hence, to improve company liquidity, new VAT refunding rules were introduced since March 1, 2014. The new measure provides for the increase of the threshold amount (from 10000 lei to 45000 lei) in respect of the amounts that the taxpayers are requesting, depending on which the fiscal inspection is conducted afterwards. For the authorities, this is a way to handle the work more efficiently.

Starting on January 1, 2014, the VAT paid when the invoice was collected in the case of companies with sales below 500,000 Euros, which allowed them to pay the VAT due to the State Budget only after they collected the amount invoiced, became optional. Giving up the choice of paying VAT at the time the invoice is collect would in exchange allow the deduction (and payment) at the time of invoicing.

In order to encourage investments and innovation, the companies which reinvest their profits in technological equipment manufactured and/or purchased after July 1, 2014 and commissioned until December 31, 2016, are exempt from the corporate income tax obligation since July 1, 2014.

A priority to the Government is reducing the employers' fiscal burden. To this purpose, since October 1, 2014, the social security contribution share on the employers' side was cut by 5%. This measure procures additional sources for investments impacting the economic growth, reducing the labor cost per unit and encouraging the creation of jobs.

At the beginning of 2015, new measures aimed at reducing the fiscal burden and encourage the business environment were implemented, by reducing the tax on constructions by 0.5% and the VAT rate to 9% for all inclusive services.

Additional fiscal relaxation measures (most important the VAT cut as of this year, a new decrease of the social security contribution rate as of 2018 and the reduction of the personal income tax) and re-writing Fiscal and Fiscal Procedure Codes were approved by the Government in March 2015 and have been forwarded to the Parliament for adoption.

In April 2013, the „Revenue Administration Modernization Project" was started; the project is managed by the National Agency for Fiscal Administration (NAFA) in partnership with the World Bank, and its objectives are to improve the efficiency and efficacy in the process of collecting taxes and social contributions, improve the voluntary compliance and reduce the fiscal burden of taxpayers. In the course of 2014, NAFA implemented a number of programs, pilot projects and tax inspections which resulted in an improved voluntary compliance (both for filing and payment) and a reduced underground economy. For a proper collection of budget revenues, NAFA expanded the scope of taxpayer assistance by including the assistance over the phone, internet, email, as a move to better inform the taxpayers, and improved the administrative procedures and the automation of the institution.

With regard to the collection of revenues, the rate of collection in Romania is low taking into account the high taxation rate for the budget revenues with a higher GDP share (particularly VAT). In this context, and to reduce the tax evasion, the Government contemplates new measures, such as the receipts lottery started in 2015. This measure is aimed at encouraging people to request the receipts which allow them to win some money by participating to the lottery.

On the other hand, the 2014-2020 Romania Partnership Agreement, an agreement which is requested by the EC from each Member State, sets the financing priorities of Romania, to help reaching the objectives provided for in the Europe 2020 Strategy. The goals we will follow will be to improve the efficiency of the implementation and reduce the administrative burden, with the fund allocation oriented towards investments with a significant impact and continue the sustainable interventions in the current programming period.

6.2. BUDGET EXPENDITURES

The budget expenditures control is a crucial element in the Government's commitment to reduce the budget deficit. Key objectives on the medium term are as follows:

- Increase the fiscal room for investments;
- Improve medium and long term sustainability;
- Improve the capacity of absorbing EU funds;
- Improve the predictability of the medium term budget policy.

In order to provide the necessary budget resources to support investments and economic sectors, the Government plans a substantial consolidation of budget policies through the following measures:

- Strengthen budgetary discipline by paying the central government arrears, the local governments' arrears and the arrears of state-owned companies and take measures to prevent new arrears;
- Improve the efficiency of budget allocations through the reform of public investments, direct substantial funds to cofinance European projects and use mostly own financing resources;
- Consolidate national budget frameworks, and fiscal institutions in line with the commitments made under the Fiscal Pact;
- Provide transparency in using public funds and best practices in budget reporting.

7. INSTITUTIONAL FEATURES OF PUBLIC FINANCE

7.1. FISCAL RULES

The Fiscal and Budgetary Responsibility Law 69/2010 introduced new fiscal rules to strengthen the fiscal and budgetary discipline in Romania. The law has been revised since its approval due to domestic or foreign factors, which also required the adjustment of budgetary discipline rules, the numerical fiscal rules and the implementation of new elements in the overall management of the budget process.
The provisions of Directive 85/2011 and the Treaty on the stability, coordination and governance within the Economic and Monetary Union were implemented in the national legislation through the Law 377/2013 which revised the Fiscal Responsibility Law 69/2010.

The fiscal and budgetary responsibility law has as main objectives:

- provide predictability and stability to the budget policy by adopting the key elements of the medium term fiscal and budgetary strategy;
- provide and preserve the fiscal and budgetary discipline on a medium term;
- improve transparency and sustainability of public finance, on a medium and long term.

The principles of the fiscal and budgetary responsibility law are essentially the following:

- the budget planning of the MoPF is based on macroeconomic and budgetary projections.
- macroeconomic and budgetary projections are compared with the most recent forecasts of the European Commission and, as applicable, of other international independent institutions.
- any substantial deviation from the EC forecast must be described and motivated, in particular where the level of increase in the variables contained in the external assumptions are substantially far from the values mentioned in the EC forecast.
- the macroeconomic and budgetary projections used in the budget planning process are subject to regular reviews, which must be impartial and comprehensive, based on objective criteria, and to an ex-post evaluation, conducted by the Fiscal Council /the bodies which are competent to conduct this evaluation.
- the Fiscal Council /the bodies which are competent to conduct the ex-post evaluation publish the results of the evaluation on the institution’s website.
- the results of the evaluation are taken into consideration by the future macroeconomic and budgetary forecast.

Rules introduced by the new economic governance.

1. Introduce a numerical fiscal rule regarding the structural budget deficit; this rule is considered as being observed if one of the following requirements is met:

- The medium term budget objective does not go beyond a lower cap set for the public administration’s annual structural balance of -0.5% of the gross domestic product in market prices;
- When the ration between the public debt according to EU methodology and the gross domestic product, in current prices, is substantially below 60% and when the risks for the long term sustainability of public finances are low, the MTO lower cap cannot exceed an annual structural balance of maximum -1.0 % of GDP, in market

prices;

- The annual structural deficit of the general government is convergent with the medium term budget objective, in line with an adjustment calendar agreed with the EU pursuant to the EC Council Regulation nr.1466/1997 on strengthening the surveillance of budget positions and the surveillance and coordination of economic policies.

2. *Introduce a correction mechanism which is automatically triggered in case of deviation from the structural budgetary deficit rule:*

- This mechanism is activated when a deviation from MTO is found (the deviation is considered important if it is at least 0.5% of GDP in one year and minimum 0.25% of GDP in average per year, over two years in a row);
- The measures aimed at correcting the deviation are formulated in measurable terms, designed to cover several years and produce effects on the following budget year at the latest;
- Correction measures are proportional with the scale of the deviation;
- Correction measures will make sure that the implementation of recommendations that EU institutions made for Romania and a correction pace set in line with the Stability and Growth Pact;
- Correction measures shall be applied primarily to the general government's budgets or component entities which generated the deviation in the first place.

3. *Introduce an escape clause in case of extraordinary circumstances:*

- This clause allows the non-observance of the fiscal rule on the structural budget deficit, including the possibility not to use the correction mechanism;
- Extraordinary circumstances = an unusual event which is not under the control of the government and which has a major influence on the financial position of the general government or periods of severe economic recession, as defined in the revised SGP;
- The start and the end of extraordinary circumstances are the subject matter of an opinion issued by the Fiscal Council, and the Government is required to inform the Parliament and the European Commission.

4. *Introduce a numerical fiscal rule on the public debt:*

- The public debt according to EU methodology shall not exceed 60% of GDP;
- If the ratio between the public debt according to EU methodology and the GDP exceeds the baseline 60% of GDP, the public debt shall be cut by an average 5% per year, an annual average for a 3-year period.

5. *Introduce prudential interim thresholds for the public debt, including automatic measures in case those thresholds are exceeded:*

- If 45% of GDP<public debt < 50% of GDP
    - MoPF submits to the Government a report explaining the debt increase and makes suggestions to preserve a sustainable level of this indicator;

- If 50% of GDP<public debt < 55% of GDP
    - A program is proposed to reduce the debt share to GDP, including, without limitation, measures which cause the freezing of total wage expenditures of the public sector
- If 55% of GDP<public debt< 60% of GDP
    - in addition to the measures described at point 2 above, the Government initiates measures which cause the freezing of total social security expenditures of the public sector.
- If : public debt > 60% of GDP
    - In addition to the above measures, the Government initiates and applies a program to cut the public debt in accordance with the second rule at point 4.

6. *Introduce new quality standards for macroeconomic forecasts used in budget planning:*

- The macroeconomic framework on which the fiscal and budgetary strategy relies is using the most recent information and represents the most likely macro-fiscal scenario or a more careful scenario;
- The macroeconomic framework of the fiscal and budgetary strategy contains a statement which shows the consistency or the difference to the most recent forecasts of the European Commission. Should they be significant, the differences between the selected macro-budgetary scenario and the EC forecast shall be described and motivated, in particular when the level or the increase of variables used in the foreign assumptions deviate in a significant manner from the values included in the Commission projections.
- If the Fiscal Council sees persistent deviations of the same sign compared to actual data, appearing over a period of at least four years in a row, the Government shall take the necessary measures and make them available to the public.

Fiscal Institutions

In order to protect the objectives and principles mentioned above, the Fiscal Council, a self-standing authority established by the Fiscal-Budgetary Responsibility Law (Law 69/2010) set for itself the objective to support the Government and Parliament to prepare and implement the fiscal and budgetary policy and promote the transparency and sustainability of public finance.

In order to achieve this objective, the Fiscal Council has a large range of attributions, such as: evaluate macroeconomic projections used in supporting the forecast of general government revenues; estimate the impact of packages of measures which could influence the budget balance; analyse the budget execution and the extent to which this corresponds to proposed targets; monitor the compliance with fiscal rules; issue recommendations on the current and future fiscal policy.

Statistical Governance

In the recent years, Romania has progressed with the improvement of the fiscal forecasting and the budget formulation practices. To strengthen fiscal transparency and provide a better consistency with the European System of Accounts, a medium term action plan is currently under debate, aimed at improving the scope of fiscal and budgetary data, as well as macroeconomic data, the times and deadlines for reporting, at the same time with improving the quality and integrity of the respective data.

ANNEXES

Table no. 1 a – Macroeconomic prospects

	CODE ESA	2014	2014	2015	2016	2017	2018
		LEVEL [1)] BILLION RON	RATE OF CHANGE				
1. Real GDP	B1*g	655.2	2.8	3.2	3.4	3.7	4.0
2. Nominal GDP	B1*g	666.6	4.6	5.0	5.7	6.0	6.2
REAL GDP COMPONENTS							
3. Private consumption expenditures	P3	412.8	4.5	3.5	3.6	3.9	4.1
4. Government consumption expenditures	P3	95.3	5.3	1.0	2.0	1.6	1.5
5. Gross Fixed Capital Formation	P51	146.2	-3.5	4.5	5.5	6.3	6.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+ P53	4.5	0.0	0.0	0.0	0.0	0.0
7. Exports of goods and services	P6	273.9	8.1	6.1	5.8	6.2	6.3
8. Imports of goods and services	P7	277.5	7.7	6.5	6.8	7.2	7.2
CONTRIBUTIONS TO GDP GROWTH							
14. Final domestic demand			2.7	3.4	3.8	4.1	4.4
15. Changes in inventories and net acquisition of valuables	P52+ P53		0.0	0.0	0.0	0.0	0.0
16. Net export	B11		0.1	-0.2	-0.4	-0.4	-0.4

[1)] The actual level of GDP and its components are included in the previous year's prices.

Table no. 1 b – Price developments

	2014	2015	2016	2017	2018
	RATE OF CHANGE				
1. GDP deflator	1.8	1.8	2.3	2.3	2.2
2. Private consumption deflator	1.3	1.3	1.5	2.1	2.1
3. Harmonized consumer price index	1.4	0.2	2.0	2.7	2.5
4. Public consumption deflator	-0.8	3.2	3.0	2.7	2.2
5. Investments deflator	0.3	1.2	1.5	1.4	1.4
6. Export deflator (goods and services)	0.1	1.3	1.3	0.3	0.3
7. Import deflator (goods and services)	-1.4	1.0	0.2	-0.2	-0.1

Table no. 1 c - Labor market developments

	ESA Code	2014	2014	2015	2016	2017	2018
		LEVEL THOU. PERSONS	RATE OF CHANGE				
1. Employment [1]		8678.3	1.0	1.1	1.1	1.2	1.2
2. Employment thousand hours worked [2]		15766445	1.6	1.4	1.4	1.5	1.5
3. Unemployment rate -% [3]			6.8	6.7	6.6	6.5	6.4
4. Labor productivity[4]			1.7	2.0	2.2	2.4	2.7
5. Labor productivity, hours worked[5]			1.2	1.7	1.9	2.1	2.4
6. Compensation of employees – million lei	D1	208907	4.0	5.8	5.9	6.1	6.2
7. Compensation per employee - lei		34614	2.0	3.7	3.7	4.0	4.2

[1] Employment, the definition of the domestic concept in the national accounts
[2] The definition from the national accounts
[3] Definition harmonised with Eurostat (Labor Force Survey – AMIGO)
[4] Real GDP per employed person
[5] Real GDP per hour worked

Table no. 1 d – Sectoral Balances

% of GDP	ESA CODE	2014	2015	2016	2017	2018
1. Net lending/borrowing, vis-à-vis the rest of the world	B9	2.1	1.2	1.0	0.8	0.8
of which:						
- balance of goods and services		0.2	0.2	0.3	0.1	0.0
-balance of primary and secondary income		-0.7	-1.4	-1.7	-1.6	-1.4
- capital account		2.6	2.4	2.4	2.3	2.2
2. Net lending/borrowing of the private sector	B.9	3.6				
3. Net lending/borrowing of general government	EDP B.9	-1.5				
4. Statistical discrepancy						

Table Nr. 2 a – General Government budgetary prospects

	ESA CODE	2013	2013	2014	2015	2016	2017
		LEVEL MLN RON	% OF GDP				
Net Balance (EDP B9), by sub-sectors							
1. Consolidated Budget	S.13	-9920.8	-1.5	-1.45	-1.2	-1.0	-0.8
2. Central Administration	S.131	-14716.3	-2.2	-1.9	-1.4	-1.2	-1.0
3. State Administration	S.132	M	M	M	M	M	M
4. Local Administration	S.133	3563.6	0.5	0.3	0.2	0.1	0.1
5. Social Security Funds	S.134	1231.9	0.2	0.2	0.1	0.1	0.1
Consolidated Budget (S13)							
6. Total revenue	TR	222511.5	33.4	33.6	32.6	32.6	32.5
7. Total expenditures	TE[1]	232432.3	34.9	35.1	33.8	33.6	33.3
8. Net Balance	EDP B.9	-9920.8	-1.5	-1.5	-1.2	-1.0	-0.8
9. Interest expenditure	EDP D.41	10754.3	1.6	1.6	1.6	1.5	1.6
10. Primary Balance[2]		833.5	0.1	0.1	0.4	0.5	0.8
11. One-off and other provisional measures[3]		0.0	0.0	0.0	0.0	0.0	0.0
Selected Components of Revenue							
12. Total taxes (12=12a+12b+12c)		126619.1	19.0	19.1	19.4	19.7	19.8
12a. Taxes on production and imports	D.2	85276.1	12.8	12.9	13.0	13.2	13.3
12b. Current taxes on income, wealth, etc.	D.5	41343.0	6.2	6.1	6.4	6.5	6.5
12c. Capital taxes	D.91						
13. Social contributions	D.61	57370.2	8.6	8.3	8.1	8.2	8.3
14. Property income	D.4	5211.5	0.8	0.9	0.9	1.0	1.0
15. Other[4]		33310.7	5.0	5.3	4.2	3.7	3.3
16=6. Total Revenue	TR	222511.5	33.4	33.6	32.6	32.6	32.5
p.m.: fiscal burden (D.2+D.5+D.61+D.91-D.995)[5]							
Selected Components of Expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	85702.3	12.9	12.7	12.4	12.6	12.6
17a. Compensation of employees	D.1	51039.5	7.7	7.4	7.0	6.9	6.8
17b. Intermediate Consumption	P.2	34662.8	5.2	5.3	5.4	5.7	5.8
18. Social payments 18=18a+18b)		79094.3	11.9	12.1	12.0	11.9	11.8
of which, Unemployment benefits[6]		1122.5	0.2	0.2	0.2	0.2	0.2
18a. Social transfers in kind	D.6311, D.6312, D.63131	9184.2	1.4	1.4	1.4	1.4	1.4
18b. Social transfers other than in kind	D62	69910.1	10.5	10.7	10.6	10.5	10.4
19=9. Interest expenditure	EDP D.41	10754.3	1.6	1.6	1.6	1.5	1.6
20. Subsidies	D.3	3538.8	0.5	0.5	0.4	0.4	0.3
21. Gross Fixed Capital Formation	P.51	28340.0	4.3	4.4	4.3	4.4	4.5
22. Capital Transfers	D.9	5898.0	0.9	1.0	0.9	0.8	0.8
23. Other[7]		19104.6	2.9	2.9	2.2	2.0	1.7
24=7. Total Expenditures	TE1	232432.3	34.9	35.1	33.8	33.6	33.3

[1] Adjusted for the net flow of swap-related flows, i.e. TR-TE=EDP B9
[2] The primary balance is calculated as (EDP B9, point 8) plus (EDP D.41, point 9)
[3] A plus sign means deficit-reducing one-off measures
[4] P.11+P.12+P.131+D.39+D.7+D.9 (different from D.91)
[5] Including those collected by EU and including an adjustment for uncollected taxes and social contributions (D.995).
[6] Includes the benefits in cash (D.621 and D.624) and benefits in kind (D.631) related to unemployment aid
[7] D.29+D4 (different from D.41)+D.5+D.7+D.9+P.52+P.53+K.2+D.8

Table no. 2b – No-policy change projections[1]

	2014	2014	2015	2016	2017	2018
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenue at unchanged policies	222511.5	33.4	33.6	32.6	32.6	32.5
2. Total expenditure at unchanged policies	232432.3	34.9	35.1	33.8	33.6	33.3

1) The projections shall start at the time when the Stability or Convergence Programme is drafted and show revenue and expenditure trends under a 'no-policy change' assumption, as defined on p.15. Therefore, figures for X-1 should correspond to actual data for revenue and expenditure.

Table no.2c – Amounts to be excluded from the expenditure benchmark

	2014	2014	2015	2016	2017	2018
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	11099.7	1.7	2.7	1.8	1.9	1.9
2. Cyclical unemployment benefit expenditure [1]	-2.6	-0.0004 *)	0.0005	0.0015	0.0015	0.0006
3. Effect of discretionary revenue measures[2]	0	0	0.48	0.89	0	0
4. Revenue increase mandated by law	0	0	0	0.04	0	0

1) The methodology used to arrive to the cyclical component of the unemployment expenditures as defined by COFOG under code 10.5

The following formula was used:
$$E_t^{UC} = E_t^U \cdot \frac{u_t - NAWRU_t}{u_t}$$
where:

EtU – unemployment expenditures and EtUC – cyclical component of unemployment expenditures.

2) Revenue increase required by law should not be included in the impact of discretionary measures: the data in rows 3 and 4 must be mutually excluded.

*) In 2014 unemployment costs were 1.0 billion lei (0.15% of GDP) and are decreasing as a percentage of GDP for the period 2015-2018

Table no. 3– Central administration expenditures by functions

% of GDP

	COFOG CODE	2014*)	2017
1. General public services	1	4.8	n.a.
2. Defense	2	0.9	n.a.
3. Public order and safety	3	2.3	n.a.
4. Economic affairs	4	6.5	n.a.
5. Environment protection	5	0.7	n.a.
6. Housing and community amenities	6	0.9	n.a.
7. Health	7	4.0	n.a.
8. Recreation, culture and religion	8	0.9	n.a.
9. Education	9	2.7	n.a.
10. Social protection	10	11.2	n.a.
11. Total expenditures (=item 7=24 in Table 2a)	TE	34.9	33.6

*) 2014 semifinal data

Table no. 4 – General Government debt developments

	ESA CODE	2014	2015	2016	2017	2018
1. Gross government debt [1]		39.8	40.1	39.4	38.4	37.1
2. Change in government debt		1.8	0.3	-0.8	-0.9	-1.3
Contribution to changes in gross debt						
3. Primary balance[2]		0.1	0.1	0.4	0.5	0.8
4.Interest expenditure[3]	EDP D.41	1.6	1.6	1.6	1.5	1.6
5. Stock-flow adjustment		0.4	-1.2	-2.0	-2.0	-2.1
of which: - Differences between interest paid in cash and accruals[4]		-0.1	-0.1	-0.1	-0.1	-0.1
- Net accumulation of financial assets[5]		1.7	-0.9	-0.1	0.1	0.0
of which : - privatization proceeds		0.1	0.0	0.0	0.0	0.0
- Valuation effects and others [6]		-1.2	-0.2	-1.9	-2.0	-2.0
p.m. Implicit interest rate on debt [7]		4.4	4.1	4.3	4.2	4.5
Other relevant variables						
6. Liquid financial assets[8]	% to GDP	8.4	7.0	6.6	6.3	6.0
7. Net financial debt (7=1-6)	% to GDP	31.4	33.1	32.8	32.1	31.2
8. Debt amortization (existing obligations) since the end of the previous year [9]	% to GDP	7.8%	7.1%	5.5%	3.2%	3.2%
9. Percentage debt denominated in foreign currency	% to debt	57.0%	54.7%	50.9%	49.9%	49.0%
10. Average maturity [10]	years	5.3	5.5	-	-	-

[1] *As defined in Regulation 3605/93 (not an ESA concept)*
[2] *According to position 10 in Table 2a*
[3] *According to position 9 in Table 2a*
[4] *The differences in respect of interest expenditures, other expenditures and revenues may be distinguished when relevant or when the debt-to-GDP ratio is above the benchmark*
[5] *Liquid assets (foreign currency), government bonds, active in third countries, enterprises controlled by the state and the difference between listed and non-listed assets may be distinguished when relevant or when the debt-to-GDP ratio is above the benchmark*
[6] *The changes resulting from exchange rate variations and the operations on the secondary market may be distinguished when relevant or when the debt-to-GDP ratio is above the benchmark*
[7] *The associated proxy version is the ration between annual interest payments and the average debt stock from the previous year*
[8] *AF1, AF2, AF3 (consolidated at market value), AF5 (if listed on the stock exchange, including mutual funds' shares)*
[9] *Indicator calculated based on the debt at December 31, 2014.*
[10] *Average remaining maturity*

Table no. 5 – Cyclical developments

% OF GDP	ESA CODE	2014	2015	2016	2017	2018
1. Real GDP growth (%)		2.8	3.2	3.4	3.7	4.0
2. Net lending of general government	EDP B.9	-1.5	-1.3[2)]	-1.2	-1.0	-0.8
3. Interest expenditures	EDP D.41	1.6	1.6	1.6	1.5	1.6
4.*One-off* and other temporary measures[1)]						
5. Potential GDP growth (%)		1.9	2.5	2.9	3.1	3.2
Contribution:						
- Labour		-0.3	0.1	0.3	0.3	0.2
- Capital		0.6	0.7	0.9	1.0	1.2
- Total factor productivity		1.5	1.6	1.7	1.8	1.8
6. Output gap		-1.6	-1.0	-0.6	-0.1	0.7
7. Cyclical budgetary component		-0.5	-0.3	-0.2	0.0	0.2
8. Cyclically adjusted balance (2-7)		-1.0	-1.0	-1.0	-1.0	-1.0
9. Cyclically adjusted primary balance(8+3)		0.6	0.6	0.6	0.5	0.6
10. Structural balance (8-4)		-1.0	-1.0	-1.0	-1.0	-1.0

[1)] A plus sign means deficit-reducing one-off measures
[*)] does not include the adjustor for cofinancing the EU funded projects

Table no. 6 – Differences from previous edition

	ESA CODE	2014	2015	2016	2017	2018
Real GDP growth (%)						
Previous edition		2.5	2.6	3.0	3.3	
Current edition		2.8	3.2	3.4	3.7	4.0
Difference		0.3	0.6	0.4	0.4	
General government net lending(% of GDP)						
Previous edition	EDP B.9	-2.2	-1.4	-1.3	-1.1	
Current edition	EDP B.9	-1.5	-1.45[*)]	-1.2	-1.0	-0.8
Difference		0.7	-0.05	0.1	0.1	
General Government Gross Debt (% of GDP)						
Previous edition		39.9	39.6	39.1	38.5	
Current edition		39.8	40.1	39.4	38.4	37.1
Difference		-0.1	0.5	0.3	-0.1	

*) Includes 0,25pp adjuster for co-financing the EU funded projects

Table no. 7 – Long-term sustainability of public finance

	2013	2014	2020	2030	2040	2050	2060
Total Expenditures							
of which: age-related expenditures	15.3	15.3	15.6	16.1	17.0	17.4	17.5
Pensions expenditures	8.2	8.2	8.1	8.1	8.4	8.4	8.1
Social security							
Full service and early pensions	7.0	7.0	7.0	6.9	7.2	7.2	7.0
Other pensions (disability. descendants)	1.2	1.2	1.1	1.3	1.2	1.2	1.1
Occupational pensions (if connected to the central administration)							
- Health care	3.8	3.8	4.1	4.3	4.6	4.7	4.8
- Long term care (previously counted in "Healthcare")	0.7	0.7	0.8	1.0	1.2	1.4	1.6
- Education expenditures	2.6	2.6	2.6	2.7	2.8	2.9	3.0
- Other age-related expenditures							
- Interest expenditures							
Total Revenues							
of which: property income							
of which: from pension contributions (or social contributions. as appropriate)	5.5	6.1	6.1	6.1	6.1	6.3	6.5
Pension reserve fund assets							
of which: consolidated public pension fund assets (assets other than the central administration's liabilities)							
Systemic pension reforms[1)]							
Social Contributions diverted to mandatory private scheme[2)]	0.7	1.0	1.5	2.1	2.4	2.5	2.7
Pension expenditures paid by mandatory private scheme [3)]	0	0	0	0.1	0.4	0.7	0.8
Assumptions							
	- average rates -						
Labor productivity growth (hourly rates)	1.5	1.7	2.5	2.7	2.3	2.2	1.8
Real GDP growth	3.4	2.8	3.3	1.8	1.4	1.5	1.3
Participation rate male (aged 20 to 64)	77.7	77.6	78.6	78.5	76.7	76.5	77.0
Participation rate female (aged 20 to 64)	60.2	59.8	60.1	59.5	57.5	57.4	58.0
Total participation rate (aged 20 to 64)	68.9	68.7	69.4	69.1	67.2	67.1	67.7
Unemployment rate – ILO	7.1	6.8	6.7	6.7	6.5	6.5	6.5
Share of population at 65 and over 65 in total population	16.4	16.7	18.0	20.4	23.1	26.9	28.8

Average rates refer to the above-mentioned interval. For the forecast interval the rates are calculated based on potential GDP estimated in the 2015 public finance sustainability assessment exercise.

[1)] *Systemic Pension Reforms refer to pension reforms introducing a multi-pillar system. including a mandatory pillar with a total own fund; in 2014, 1 percent of GDP was directed to the Pension Pillar 2*

[2)] *Social contributions or other revenues to the mandatory pillar with a total own fund. for covering the pension obligations attracted in accordance with the systemic reform*

[3)] *Expenditures with pensions or other social benefits paid by the mandatory pillar with total own fund in respect of pension obligations attracted in accordance with the systemic reform*

Table no. 7 a – Contingent liabilities

	2014	2015
Public Guarantees*)	2.3%	2.8%
Of which: linked to the financial sector	0.02%	0.02%

*) of the general government sector. excluding guarantees granted between units of the general government sector.