



GOVERNMENT OF ROMANIA

CONVERGENCE PROGRAMME

2014-2017

- April 2014 -

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INTRODUCTION

The updated version of the 2014 - 2017 Convergence Programme has been 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 the strengthening of 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 coming into effect on December 13 2011), the macroeconomic imbalance procedure, as well as the Euro Plus Pact.

The Convergence Programme illustrates Romania’s capacity to comply from 2015 with the medium term budgetary objective (MTO) representing a structural deficit of 1.0% of GDP¹, which is in line with the provisions included in the Treaty on Stability, Coordination and Governance of the Economic and Monetary Union.

The continuation of the reform process, particularly the fiscal consolidation process, based on the preventive financing agreement concluded with the EU, IMF and the WB can bring coherence to the macroeconomic and financial policies, thus adding to the consolidation of investors’ confidence and preserving the macroeconomic and fiscal stability.

In the medium run, the specific objective of the budgetary policy is to further adjust the budget deficit, with the planned targets situated at 2.2% of GDP in 2014 and below 2% of GDP for the interval 2015-2017 (according to ESA).

The Convergence Programme’s macroeconomic framework takes into account the prospects of the international environment and the European economy as per the European Commission’s forecasts. In addition, the macroeconomic scenario proposed for the interval 2014-2017 is convergent with the EC estimations in respect of the Romanian economy developments.

Romania has taken the actions 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 2013 and the outlook of preserving this trend in the upcoming years

¹Does not include the adjustor in cofinancing EU-funded projects with long term positive effect on the economic growth potential and it does not include the situations provisioned in the Treaty for Stability, coordination and governance within the EMU, art. 3, paragraphs 1(c) and 3(b).

allow an average time needed to meet the nominal convergence criteria and draw near to the real convergence.

In this context, the commitment that the Government of Romania made to join the European currency on January 1, 2019 will become achievable and necessary.

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 last couple of years, and is now at about 54% from the EU-28 average, compared to 52.9% in 2012 and 51.2% in 2011.

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 – 2013 (%)

	EU28	Romania
Real growth	-0.3	-0.3
Deflator	1.1	4.4
Nominal growth	0.8	4.1
GDP per capita growth of PPS (purchasing power standards)	0.5	2.6

Source: Eurostat and the National Prognosis Commission

The experience of new Member States which joined the Euro currency teaches us 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 70% of the European average.

Table 2 - Prospects of GDP per capita in PPS

	2012	2018	2020
GDP per capita in PPS	13500	18200	20250
- % of theEU-28 average	52.9	64.2	69.5

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 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 cut curb the budget deficit and improve public finance standing.

In 2012-2013, 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 3.2 percentage points in 2011-2013, i. e. from 5.5% in 2011 to 3% of GDP in 2012 and further to 2.3% of GDP in 2013, 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 2012 budget deficit accounts for 3% of GDP, which is below the average in the Eurozone, i.e. 3.7% of GDP, and EU28, i.e. 3.9% of GDP.
- The structural deficit went significantly down, reflecting a budget deficit without the effects of the business cycle. According to estimates, the cyclically adjusted budget deficit went down from 3.8% of GDP in 2011 to 1.8% of GDP in 2013, which is 2 percentage points over a period of two years.

In 2014, the budget policy confirms once again the commitment to continue the sustainable process of fiscal consolidation and support of reforms on the supply as well as the demand side, through investments in priority sectors such as infrastructure, education, power,

research etc., by providing business support and set up a fiscal and budgetary framework to sustain economic growth.

In the course of 2013, Romania made important progress with structural reforms, which helps meeting real convergence criteria. These reforms include the privatization and the measures aimed at boosting SOEs performance, the reform of public investments, the payment of arrears and the improved EU funds management system. These reforms underpin fiscal consolidation, involving nominal convergence as well. In parallel, the structural reforms required the restructuring and improvement of debt management.

The fiscal rules required by the Treaty on stability, coordination and governance within the economic and monetary union signed on March 2, 2012 were introduced in the Romanian legislation by means of the revised Fiscal and Budgetary Responsibility Law 69/2010. The revision of law 69/2010 was approved in the revision law 377/2013 published in the Official Gazette of Romania 826 of December 23, 2013. The newly introduced fiscal rules according to the Law 377/2013 apply as of January 1, 2014.

1.2 MONETARY AND EXCHANGE RATE POLICIES

In compliance with its Statute², 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 the 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 is and will continue to be firmly geared towards attaining the flat inflation target of 2.5 percent ± 1 percentage point and hence towards preserving price stability over the medium term, as well as towards bringing down and consolidating the inflation rate, in the longer run, at levels compatible with the ECB's quantitative definition of price stability.

The NBR shifted to a multiannual flat inflation target of 2.5 percent ± 1 percentage point in 2013, thus ending the stage of gradually decreasing³ annual inflation targets set and announced for two-year horizons – a typical feature of the inflation targeting strategy up to that point. This switch implies a monetary policy commitment to a single objective, deemed consistent with the medium-term price stability definition for the Romanian economy. The change was decided and announced by the central bank in late 2010 and was warranted, on one hand, by the flat target's enhanced capability of anchoring and stabilising inflation expectations – which is essential for reaching, within a relatively short time span, an inflation rate compatible with the inflation criterion laid down in the Maastricht Treaty and, in the longer run, with the ECB's quantitative definition of price stability – and, on the other hand, by expectations on an overall completion in 2012 of the disinflation that had started in 2000. This outlook did not, however, rule out the possibility of temporary inflation rate fluctuations in the periods ahead, owing to potential/foreseeable renewed adverse supply-side shocks⁴ and to the still high sensitivity⁵ of the consumer price index to these shocks.

The macroeconomic and financial environment of 2013, together with the shift to a flat inflation target, called for the maintenance of a prudent monetary policy stance throughout the year. In the first part of 2013, this approach was warranted primarily by risks to inflation expectations stemming from the renewed inflation bout in January, which, adding to that recorded in 2012 H2⁶, caused the annual inflation rate to deviate increasingly from the

2 Law 312 of 2004.

3 Annual inflation targets were 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 were left unchanged from a year earlier, i.e. 3.5 percent ± 1 percentage point and 3 percent ± 1 percentage point respectively.

4 That are mostly beyond the central bank's scope.

5 Deriving largely from the CPI basket composition.

6 The annual inflation rate climbed to 4.95 percent in December 2012, after having fallen in the lower half of the variation band of the 3 percent ± 1 percentage point target in the first part of the year, reaching a 23-year low of 1.79 percent in May 2012.

upper bound of the variation band of the flat target, and that deviation to remain significant until June⁷. However, both episodes of rekindled inflation were anticipated to be temporary, being generated exclusively by adverse supply-side shocks manifest in the latter part of 2012⁸ and, to a smaller extent, in early 2013⁹. In fact, the medium-term macroeconomic forecasts updated in 2013 H1 (see the February and May 2013 Inflation Reports) revealed and then reconfirmed the prospects of disinflation resuming in July and subsequently gaining momentum, amid the gradual fading out of the impact of supply-side shocks and the anticipated persistence of a wide negative output gap and of the ensuing strong disinflationary pressures.

Against this background, during the four meetings on monetary policy issues held January through May 2013, the NBR Board decided to leave the policy rate unchanged at 5.25 percent and to maintain the existing levels of minimum reserve requirement ratios on both RON and foreign currency-denominated liabilities of credit institutions. Given the emerging signs in early 2013 of more balanced risks to the inflation outlook, the monetary authority resumed though the adequate management of liquidity in the banking system and in its May 2013 meeting, the NBR Board decided to narrow the symmetrical corridor defined by interest rates on the NBR's standing facilities¹⁰ around the monetary policy rate to ± 3 percentage points from ± 4 percentage points. The latter decision was aimed at moderating interbank rate volatility and strengthening the transmission of the policy rate signal. Such calibration of the monetary policy sought to firmly anchor medium-term inflation expectations and to consolidate the prospects for the annual inflation rate to return onto a path compatible with the flat target, while avoiding additional contractionary effects on economic activity.

In the second part of the year under review, the adequately prudent monetary policy was pursued by capping at 0.25 percentage points each successive policy rate cut that the NBR Board resorted to starting July 2013. The only exception was the August decision, when the monetary policy rate was lowered by 0.50 percentage points. At the same time, the NBR extended the status-quo of the minimum reserve requirement ratios on both leu- and foreign currency-denominated liabilities of credit institutions and continued the adequate management of liquidity in the banking system.

The NBR resumed the monetary policy rate cutting cycle in July 2013 and extended it over the following months, prompted by the impending significant deceleration of inflation anticipated for 2013 Q3 and by the subsequent materialisation of this expectation, amid the fading out of the effects of adverse supply-side shocks – rendering more visible the disinflationary impact of the persistent negative output gap – and the ongoing improvement in inflation expectations. The downward correction of the annual inflation rate was even

⁷ The annual inflation rate came in at 5.97 percent in January 2013 and 5.37 percent in June 2013.

⁸ In 2012 they included: the sizeable decline in domestic agricultural output owing to the persistence of adverse weather conditions, higher global agri-food commodity prices, along with relatively heightened volatility of the leu exchange rate, mainly in relation to the USD, as well as increases in electricity prices.

⁹ Further hikes in the electricity price and in some excise duties, especially on tobacco products.

¹⁰ The interest rate on the lending facility was lowered to 8.25 percent from 9.25 percent, while the deposit facility rate was raised to 2.25 percent from 1.25 percent previously.

more sizeable than initially projected and the short-term inflation outlook was subject to successive downward revisions¹¹, given that starting September to the impact of fundamentals added the transitory disinflationary effects exerted by the 2013 bumper crop and by the considerable pass-through of the lower VAT rate on some bakery products¹². Symmetrically, the expected upward correction of the annual inflation rate following the dissipation of these effects was more pronounced, although the projected values of annual CPI inflation were seen remaining inside the variation band of the target (i.e. in its upper half) throughout the projection horizon, amid the protracted disinflationary impact anticipated to be exerted over the medium term by the negative output gap and by inflation expectations remaining at levels compatible with the flat target.

Against this background, the gradual adjustment of the monetary policy stance was aimed at ensuring the firm anchoring of medium-term inflation expectations, while paving the way for the revival of lending. This approach also sought to prevent a too sudden drop in bank deposit rates, to enhance the impact on longer-term interest rates, while relatively synchronising the NBR monetary policy cycle with those of other central banks in the region and in advanced economies.

In view of the annual inflation rate falling to 1.55 percent at end-2013 and the broad reconfirmation of the medium-term inflation forecast coordinates described in the previous projection exercise¹³, the NBR extended the rate-cutting cycle into January and February 2014, bringing the monetary policy rate at 3.5 percent. Moreover, in order to support the sustainable rebound in lending and to continue to bring the minimum reserve requirements mechanism into line with ECB standards in the field, the NBR Board decided in its January meeting to lower the minimum reserve requirement ratios on credit institutions' leu- and foreign-currency denominated liabilities to 12 percent and 18 percent respectively (from 15 percent and 20 percent respectively) starting with the 24 January-23 February 2014 maintenance period.

Looking ahead, especially over the medium-term horizon, that is throughout the period 2015-2017, the key challenge of monetary policy remains the solid anchoring of inflation expectations and the durable achievement of the 2.5 percent ± 1 percentage point target, while supporting the revival of lending and restoring confidence, which should pave the way for the recovery of the domestic economy. This challenge is expected to arise mainly from the inflationary impact exerted by the liberalisation of electricity and natural gas prices¹⁴, as well as by other potential supply-side shocks, which will coexist in the medium run with

11 According to the November 2013 Inflation Report, the updated forecast of medium-term developments showed the annual inflation rate remaining below the midpoint of the flat target in the following four quarters and even falling below the lower bound of the variation band of the target in the first part of 2014.

12 The VAT rate applied to some bakery products was cut to 9 percent from 24 percent as of 1 September 2013.

13 The baseline scenario of the projection published in the February 2014 Inflation Report placed the annual CPI inflation rate at 3.5 percent at end-2014 and at 3.2 percent at end-2015.

14 According to the calendar approved by the authorities in 2012, in line with the arrangements with the EU, IMF and the World Bank.

disinflationary pressures (anticipated however to abate gradually) stemming from the negative output gap.

Both in the short run and over the longer horizon, the pace and magnitude of future adjustments in the monetary policy toolkit, in the context of ensuring adequate real broad monetary conditions, will further be tailored primarily to the intensity of the disinflationary pressures of the negative output gap and to the behaviour of medium term inflation expectations and its related risks. In addition, a paramount role in substantiating monetary policy decisions will continue to play the balance of risks to the inflation forecast and the likelihood of their materialisation, on one hand, and the features of the monetary policy transmission mechanism (and hence of lending to the private sector) and of economic agents' saving/investment behaviour, on the other hand.

The viability and effectiveness of such a monetary policy configuration are further conditional upon the steadfast pursuit and the achievement of the objectives agreed with the EU, the IMF and the World Bank in the areas of fiscal consolidation, structural reforms and raising EU funds, ensuring the consistency of macroeconomic policy mix being of the essence in lowering the sovereign risk premium and hence in fulfilling the medium-term price stability objective, seen as a prerequisite for attaining lasting and sustainable economic growth.

2. ECONOMIC OUTLOOK

2.1. GLOBAL ECONOMY / TECHNICAL ASSUMPTIONS

The EC winter forecast announced the continuation of economic recovery in most Member States and in general in the European Union. After the end of recession in the spring of 2013 and after three quarters in a row of slight recovery, the outlook shows a moderate increase of economic growth. Hence, after in 2014 the real GDP went up by 1.5 % in EU and by 1.2 % in the Eurozone, the activity is expected to intensify in 2015 and reach 2.0 % in EU and 1.8% in the Eurozone. These numbers reveal an upward adjustment of 0.1 percentage points compared to the 2013 autumn forecast. In addition, the 2014 winter forecast prepared by the European Commission for 2014-2015 expects an overall growth lower by 0.4 percentage points, and by 0.5 percentage points respectively compared to the 2013 autumn forecast.

Predictions continue to start from the assumption that the policy measures agreed at EU and MS level support an improvement of both the confidence climate and the financial circumstances, and promote the necessary economic adjustment of Member States, by boosting their growth potential. The accumulated macroeconomic imbalances are trending down and lead to a moderate intensification of growth rates in 2014 and 2015. In the upcoming period, the domestic demand will increasingly become the main driver of economic growth in Europe.

While labor market shows a slow stabilization of employment, the unemployment is still high, as there is an usual lag of 6 months or more before the effects on the labor market reflect the moves of GDP. Thus, we expect a modest increase of the employment rate as of

this year and a decrease of the unemployment rate to 10.4 % in EU and close to 11.7 % in the Eurozone until 2015, with still very high variations among countries.

In addition, the low inflation of consumer prices is expected to prevail in the EU and the Eurozone in 2014, reaching 1.2 % and 1.0 % respectively, before slightly raising by around 0.3 percentage points in 2015, a year in which the growth is expected to gain momentum.

The current account balances of vulnerable member states improved in the recent years, following repeated price competitiveness gains and the consolidation of export sectors. Many of these economies are expected to see a current account surplus in 2014 - 2015.

The decrease of general public deficits is expected to continue in the upcoming period. Hence, these deficits are expected to go down to 2.7% of GDP in EU and 2.6% in the Eurozone, with the debt share to GDP reaching as high as 90% in EU and 96% in the Eurozone. The consolidation pace with respect to structural budget balance sheets shows a rather neutral fiscal orientation.

Against the background of a stabilized world economy, the 2014 EC winter projections forecast an increase of the export markets outside EU of around 5.6% in 2014 and 6% in 2015.

Oil price went up in Q3 2013, but decreased in January 2014 to 107 USD/barrel. Under these circumstances, in line with the EC winter forecast, the Brent oil prices are expected to reach, in average, 104.1 USD/ barrel in 2014 and 99.6 USD/ barrel in 2015. This corresponds to a price of 76.5 EUR/ barrel in 2014 and 73.2 EUR/ barrel in 2015.

While economic growth at global level is significant, a return of oil prices is highly unlikely, as possibly escalating geopolitical tensions in MENA region remain a risk factor.

Higher seafood and meat prices caused the food prices to go slightly up in 2013, with decreasing prices for the main grains such as corn, rice and wheat. In 2014, considering a better supply of food products, the food prices are expected to decline. The prices of metals and raw material trended down in 2013, as a result of the rich supply and weak demand. A modest price recovery is expected in 2014 -2015, supported by the increase of demand in both advanced and developing countries.

Economic and financial risks are more balanced now compared to last autumn. The higher risk to growth would be a worsening confidence, which could be caused by a stagnation of reforms at national or European level. This would translate in a high probability of an extended period of weak growth in Europe, with a negative impact on the economic activity over the interval under review. A very low inflation persisting in the Eurozone would bring risks to the process of restoring the balance of the economy. However, considering the increasingly firm recovery and the improved climate of confidence, the likelihood of shocks strong enough to impair the inflation expectations and cause a process of deflation at EU level is only marginal.

Alternatively, there is this potentially better opportunity of seeing a recovery stronger than expected, which is possible if bold structural reforms are implemented. This would support a

chain of positive reactions between the climate of confidence, economic growth, especially investment increase, on one hand, and the lending capacity of the banking sector, on the other hand.

2.2. CYCLICAL DEVELOPMENTS AND CURRENT PERSPECTIVES
CURRENT PERSPECTIVES

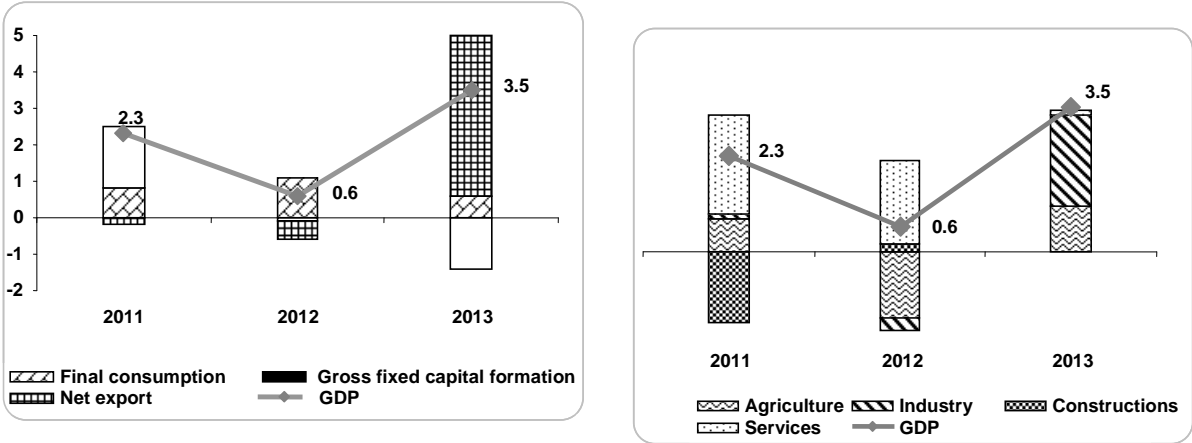
In 2013, GDP in Romania went up by 3.5%; this was the third consecutive year of economic growth (2.3% in 2011 and 0.6% in 2012), which consolidates the trend of recovery from the economic and financial crisis which hit Romania too, in 2009 and 2010. The growth in 2013 was mainly driven by the positive input of net exports, with the domestic demand trending down as a consequence of the lower gross fixed capital formation.

The net export contribution was 4.4 percent owing to the high foreign demand which triggered an increase of exported goods and services, in real terms, by 13.5%, with imports of goods and services increased by 2.4%.

The final consumption went up by 0.7% as a result of a higher private consumption by 1.3% and a decline by 1.8% of government consumption. Household consumption accelerated in H2 2013, against the background of a lower inflation and high crops, which encouraged the private farmers’ market and self-consumption, a important component of households consumption in Romania.

Investments remained far below expectations, with the gross fixed capital formation trending down by 3.3%, after signs of recovery in 2011 and 2012. This was caused by the high investor uncertainty, in particular foreign investors, and a low contribution of government investments.

Chart 1–Contributions to real GDP growth



Source: National Prognosis Commission

On the domestic supply side, one can notice the increase of the gross value added in agriculture (23.4%) and industry (8.0%), with the constructions sector going up by a trivial 0.4%. The services remained, in real terms, at the level of year 2012.

The annual inflation rate reached its historical minimum since 1990 at the end of 2013, i.e. 1.55%, which is by 3.4 percentage points below the end of 2012. As annual average, the inflation was by 0.65 percentage points above the previous year's average, i.e. 3.98%.

The considerable disinflation process came from a persisting demand gap and pressures from the agro-food prices. The lower VAT rate for some bakery products and the relatively stable exchange rate added to the consumer price decrease.

Administered prices trended opposite, with important hikes seen in water sewerage, sanitation (12.07%); natural gas (9.25%); and electricity (7.90%), compared to end of 2012.

Consumer prices in March 2014 compared to December 2013 went up by 1.21%, as a result of a 1.32% increase in non-food goods prices.

The annual inflation in March 2014 reached to 1.04%, trending down by 4.21 percentage points compared to March 2013.

In 2014, the inflation is expected to remain low and reach to 3.5% at year-end, with an annual average of 2.2%. The estimation is based on a positive impact in the course of 2014 of aggregate demand on the inflation rate, which is expected to remain at low levels, as well as on a normal year in agriculture.

In 2013, the **employment** according to the National Accounts declined by a petty 0.1% due to an employment rate in agriculture lower by 1.8% and constructions by 0.1%, with relatively the same level in industry compared to 2012 and the service sector growing by 1%. However, the number of employees in the economy went up by 0.8%, as a consequence of the higher number in the services sector by 1.7%, with all other sectors trending down.

The **unemployment rate** according to AMIGO went up from 7.0% in 2012 to 7.3%.

Cyclical developments

After a sharp decline of 7.6 percent in 2009-2010, the gross domestic product resumed its growth, though significantly slowly compared to pre-crisis times. The same observation goes for the potential GDP. Therefore, due to lower investments in particular (especially equipments which went down in nominal terms by a cumulated 40.5% in 2009-2010) both capital and total factor productivity (TFP) had a lower contribution to the formation of potential GDP, which has led to average growth rates below half of the pre-crisis levels.

Following the structural measures envisaged in 2014 and the upcoming period, as described herein, the gross fixed capital formation will go back to trending positive, after the 3.3% decline in 2013, and will have a positive impact on the potential GDP as early as 2014. As a result, the situation of the employment market will improve slightly, with the raise of employment rates and the number of hours worked making up for the negative demographic developments thus leading to a positive contribution of the labor factor to the growth of potential GDP. In addition, total factor productivity will have a positive and growing contribution. Thus, the potential GDP growth will speed up in the medium run.

The output-gap will continue to decline as the domestic demand recovers. The gap between the actual GDP and potential GDP is expected to close in 2018.

Table3–Factor contribution to potential GDP growth

	Contributions- % -				
	GDP	Capital	Labor	TFP	Output Gap
2013	2.0	1.1	0.1	0.7	-1.6
2014	2.2	1.2	0.2	0.9	-1.4
2015	2.4	1.2	0.2	1.0	-1.2
2016	2.6	1.3	0.2	1.1	-0.8
2017	2.7	1.4	0.1	1.2	-0.2

Source: National Prognosis Commission

2.3. MEDIUM-TERM SCENARIO

In line with EC winter forecast, which sees the EU economy taking on at a higher pace, we expect for 2014 – 2017 an improvement in the global performance of the Romanian economy, allowing the recovery from the contraction of the recession times (2009 – 2010).

In 2014 the gross domestic product will go up by 2.5% as a result of the positive contribution of both the domestic demand and the net export. In the upcoming years, we expect a gradual acceleration of GDP growth rate reaching 3.3% in 2017.

The economic growth in 2013 has not been sufficiently supported by domestic demand and investment demand in particular. The positive 4.4 percent contribution of net export made up for the 0.8 percent decline of domestic demand. The domestic demand went down mainly due to the savings of the private sector. The current account deficit was adjusted from a GDP share of 4.4% in 2012 to 1.1% in 2013, with the general government deficit consolidated from 3.0% in 2012 to 2.3% in 2013, which reveals a positive balance of the private sector accounting for 1.2% of GDP.

Under these circumstances, in order to encourage the private sector and implicitly the domestic demand contribution to growth, the private sector and household consumption will be prioritized.

Fiscal and budgetary measures with a multiplication effect were considered to stimulate investments: the government guarantee scheme for SME working capital¹⁵, improve EU funds absorption, exempt reinvested profits for tax purposes, cut social contribution rates on the employer side.

In terms of consumption, the measures expected to have an important effect on the disposable income are as follows: the increase of minimum wage, which will continue in 2015 and 2016, to reach RON 1200 in 2016; escalation of pensions to reflect inflation and actual performance of salary income; provision of the minimum insertion income;

¹⁵According to GEO 92/2013.

application of the unitary pay law provisions in the sense of raising the wages of low-income young employees; other measures aimed at the low and medium-income households.

Private consumption growth is expected to accelerate too, from 2.0 % in 2014 to 3.3% in 2017. Government consumption will be driven by budget policies focused on employment stabilization in the public sector and streamlining expenditures with goods and services.

If we consider as one-off the performance of the gross fixed capital formation in 2013, we expect an increase in 2014 – 2017 which may be supported by more substantial inflows of EU funds. Hence, the increase will speed up annually, reaching 6.1% in 2017 from 2.7% in 2014.

The contribution of net export to real GDP growth will decline compared to 2013, and will be slightly positive in 2014, to become negative in the following years due to raising imports of goods and services higher than exports, due to increasing investments.

Table 4–GDP components

	- annual, % -				
	2013	2014	2015	2016	2017
Real GDP	3.5	2.5	2.6	3.0	3.3
Private consumption expenditures	1.3	2.0	2.9	3.2	3.3
Public consumption expenditures	-1.8	1.8	1.7	2.5	1.7
Gross Fixed Capital Formation	-3.3	2.7	4.0	5.2	6.1
Exports of goods and services	13.5	6.6	4.7	4.5	5.0
Imports of goods and services	2.4	5.6	5.5	5.8	6.1

Source: Eurostat and National Prognosis Commission

The economic growth on medium term will create the circumstances for improving the employment, in particular the number of employees. Thus, the **employed population** is expected to grow, in average, by 0.3%, with the number of employees rising by 0.7%, annually.

The AMIGO **unemployment rate** will drop from 7.3% to 6.7% in 2017.

In 2015 – 2017, the **inflation** will continue to trend down in terms of annual inflation and annual average. The process will be supported by a continuation of the firm conduct of the monetary policy, as well as of the other components of the economic policy mix (fiscal, revenues). Estimates took into account the normal agricultural years and a low volatility of international oil price.

In addition, the gradual reduction of excise duty rate increase, the cautious wage policy and the continued structural reforms will keep the disinflation process on a sustainable track. Thus, the inflation rate will drop to 2.5% in 2017, with an annual average of 2.7%. In addition, the continued disinflation process will help inflation expectations to further decline. One other effective way to anchor inflation expectations will be the resumption of

the raising trend, in real terms, of the domestic currency to the Euro. This is possible if we take into account a possibly accelerated output growth in the Romanian economy, compared to its main trading partners. The impact of the exchange rate will be modest, and it will support the disinflation process.

2.4. SECTORAL BALANCES

In 2013, the exports raised by 10.0% compared to 2012, and imports by only 1.0%. Under the circumstances, the FOB-FOB trade deficit went down by 53.6% compared to 2012.

In the first 2 months of 2014 the exports in Romania raised by 9.2%, with imports increasing by 9.4%, compared to the same interval of 2013. Hence, the (FOB-FOB) commercial deficit saw a deficit of 201.5 million Euros during this time interval, raising by 15.8% compared to the same period of 2013.

As in the previous year, the exports in 2014 will remain a component of the demand, supporting economic growth in Romania. We expect the exports performance, compared to the previous year, to continue to be above imports in 2014. Thus, we estimate for 2014 an increase in the export of goods by 7.3%, while the import of goods is expected to raise by only 6.6%.

Overall, the 2014 forecast shows that the trade deficit, as value, will amount to 3.3 billion Euros, with a GDP share of 2.2%.

The intra-Community exports slowed down over the recent years, from 19.1% in 2011 to 8.8% in 2013, even decreasing by 1.4% in 2012. This trend will continue in 2014 too, with the intra-Community exports growing by 6.1%. In this context, the pace of exports outside the Community will be higher than the intra-Community exports rate by 4 percentage points, reaching 10.1%. The intra-Community imports growth pace will go up to 9.4% this year, while the imports outside the Community will continue to trend down and will drop by 2.0%. Considering the expected performance of imports and exports, the intra-Community area will see a deficit of 9.1 billion Euros, with a surplus of 3.4 billion Euros outside the Community area.

Taking into account the world's economy performance in the upcoming period, for the interval 2015-2017 the exported goods are expected to see an annual average increase of 7.3%, with imports of goods expected to raise by 7.5%. Following a decrease in 2013, the FOB-FOB commercial deficit share to GDP will trend up, and reach 2.5% in 2017. Exports to EU are projected to see an annual average pace of 5.9%, with intra-Community imports growing annually by an average 8.5%. Exports and imports outside the Community are estimated to grow in average by 10.3% and 3.7%, respectively.

In 2013, the balance of payments current account run a deficit lower by around 74% compared to 2012, reaching a share to GDP of only 1.1%. The current account deficit was

covered entirely from foreign direct investments. FDIs amounted to 2.7 billion Euros and exceeded by around 27% the level of 2012, i.e. 2.1 billion Euros.

In the first 2 months of 2014, the balance of payments current account ran a deficit of 102 million Euros, compared to a surplus of 177 million Euros in the same interval of 2013, against the background of an increasing deficit of the revenues and trade balance, and the decrease of the surplus in the current transfer balance.

In 2014, the current account deficit of the foreign balance of payments is expected to remain at approximately the same level as in 2013, i.e. 1.5 billion Euros, which accounts for 1% of GDP. FDIs will amount to 3.6 billion Euros, fully covering the current account deficit.

In the medium run, the current account deficit will remain within the range of 2.4 – 3.5 billion Euros, with a share to GDP of 1.5% in 2015 and 2.0% in 2017. In 2015-2017, the share to GDP of the net balance with the rest of the world, the capital account considered, will become positive and trending slightly up due to a higher contribution of the capital account. It is worth noticing that the capital account share to GDP will go up from 2.2% in 2015 to 2.8% in 2017. During this interval, FDIs are projected to increase from 4.0 billion Euros to 5.3 billion Euros, the share of foreign direct investments to GDP going up from 2.6% to 3.0%.

3. GENERAL GOVERNMENT AND DEBT BALANCE

3.1. POLICY STRATEGY

The economic and financial crisis has had a negative impact on the national economy and has contributed to a worsening of Romania's consolidated budgetary position. According to the ESA 95 methodology, the budget deficit has increased from 5.7% of the GDP in 2008 to 9.0% of the GDP in 2009.

As a result of the pro-cyclical nature of the budget policy until 2009, Romania had to approach the economic crisis through a double budgetary effort, namely by reducing the deficit to sustainable values, on the one hand, and, on the other hand, by creating fiscal space for investment expenditure meant to stimulate the economy.

As of 2009, once we entered the excessive deficit procedure, the central objective of the fiscal and budgetary policy has been to decrease the budget deficit to values that comply with the provisions of *Protocol no. 12 on the procedure applicable to excessive deficits*¹⁶.

The fiscal consolidation policy in Romania has been supported through financing agreements with the EU and the IMF, and has managed to correct the budgetary imbalance (in ESA terms) by over 6 percentage points in only three years and to exit, as of 2013, the excessive deficit procedure of the European Union (the ESA deficit of 2012 was below the limit of 3% of the GDP).

At the same time, medium term budgetary planning observes the new rule related to budget deficit provided by the *Treaty on Stability, Coordination and Governance in the Economic and*

¹⁶Appendix to the Treaties of the European Union, 3% of the GDP according to the ESA 95 methodology.

Monetary Union, and has scheduled to achieve the budget objective on medium term (1% of the GDP in structural terms) in 2015.

Table 5 – Budget deficits

- % of the GDP -

Budget deficits	2008	2009	2010	2011	2012*)	2013*)	2014*)	2015**)
ESA deficit	-5.7	-9.0	-6.8	-5.5	-3.0	-2.3	-2.2	-1.4
Structural deficit	-8.3	-9.6	-6.1	-3.8	-2.5	-1.8	-1.7	-1.0

*) estimates

**) Does not include the adjustor in cofinancing EU-funded projects with long term positive effect on the economic growth potential and it does not include the situations provisioned in the Treaty for Stability, coordination and governance within the EMU, art. 3, par. 1(c) and 3(b).

The reduction of the budget deficit after 2008 was necessary, but the means chosen in 2010-2011 implied significant social costs and had a negative influence on Romania's economic growth potential.

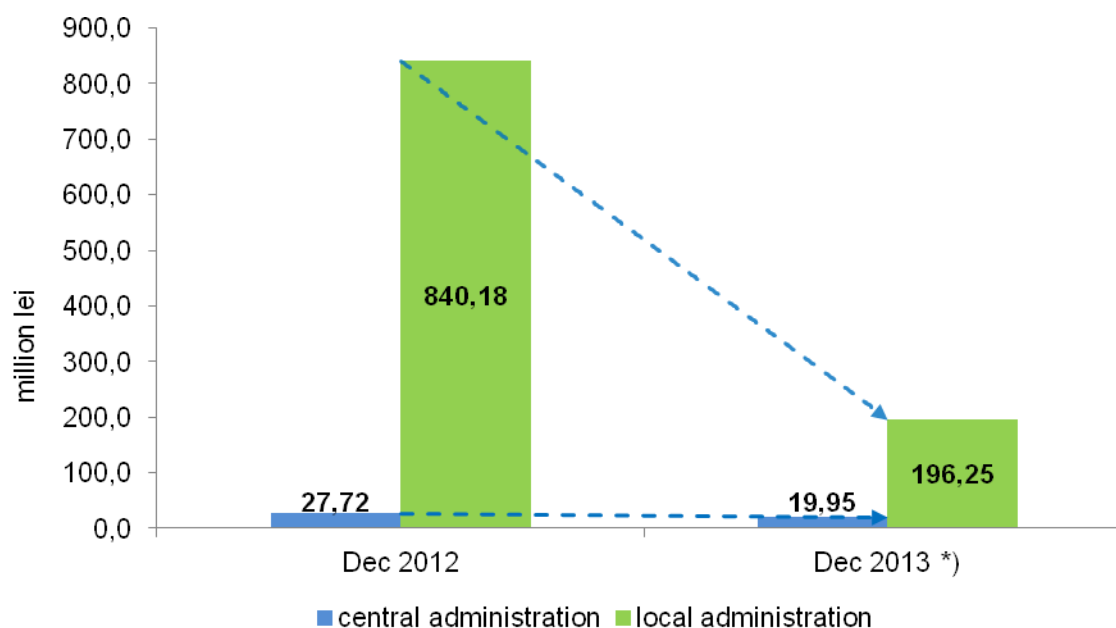
As of 2013, a new vision of continued fiscal consolidation has been applied, which would stimulate economic growth, distribute in an equitable manner the burden of adjustments and eliminate the increase of disparities and social tensions.

The budgetary consolidation corresponding to 2013 was achieved through a decrease of the deficit and a decrease of the arrears of State-owned companies, as well as of those of the local and central public administration, and through the implementation of structural reforms, like:

- **Strengthening budget discipline by reducing waste in the spending of the central apparatus and by paying the arrears in the fields of health, transportation infrastructure, and those of the local administration and the State-owned companies.**

The payment of arrears is a measure that contributes both to the reformation of the management of both investments and public institutions, by acting both in the real economy and at the level of targeting budget deficit. With respect to budget deficit, in 2013 the significant decrease of these arrears led to its decrease by 0.4pp of the GDP. This was also reflected in the fact that, for the first time in Romania's history, in 2013 the ESA deficit (2.3% of the GDP) was lower than the cash deficit (2.5% of the GDP). The situation of the arrears is presented in the graph below.

Chart 2 -Arrears of the central and local government



* Note: The total amounts were reduced by 360 million lei according to point 5, bullet two of Annex 1 Memorandum of Economic and Financial Policies representing amounts disputed after verification by NAFA for one of the following reasons: failure to comply with relevant laws or regulations; billing or purchasing inadequate or lack of evidence on the performance of the work invoiced.

Source: Ministry of Public Finance

A series of measures have been taken, among which a system of control of commitments that is to operate in 2014 as a pilot project. With respect to legislation, a series of legislative acts have been adopted/amended, which support the payment of arrears of the State-owned enterprises and the local or central public authorities, among which we mention:

- *Emergency Ordinance no. 3/2013 on the regulation of certain measures to decrease certain arrears in the economy, other financial measures, as well as on the amendment of legislative acts*, which provides that the credit authorities of the local budgets of the administrative-territorial units/subdivisions and of the locally subordinated public institutions that register arrears on January 31, 2013 are bound to reduce their level by at least 85% by March 31, 2013.
- *Government Emergency Ordinance no. 46/2013 on the financial crisis and the insolvency of administrative-territorial units*, through which the central authorities will ensure a stricter control of the total expenditure of local authorities.
- *Law no. 72/2013*, which transposes into the national legislation the provisions of Directive 2011/7 on fighting late payments;
- *The Law on Fiscal Responsibility no.69/2010*, which was amended through the Law no. 377/2013, in accordance with the provisions of the EU on fiscal governance with the purpose of integrating structural fiscal targets and corrective measures in case of deviations;

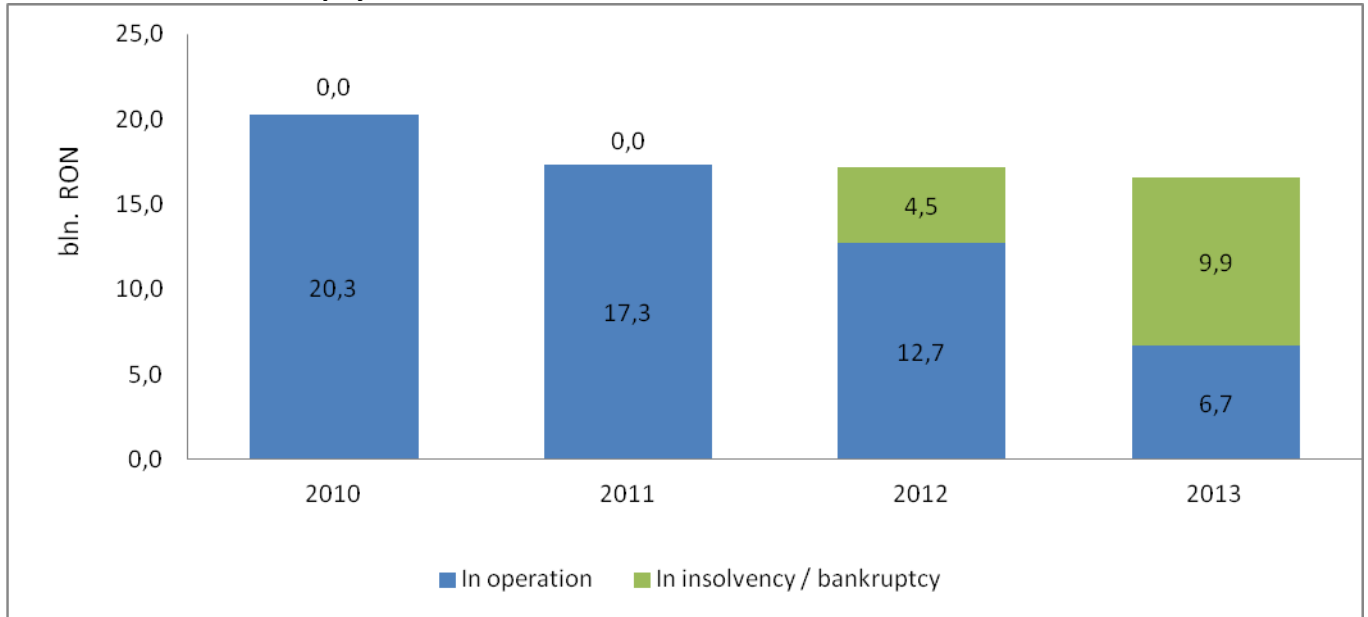
The impact of this legislative framework is currently evaluated as being a positive one, considering that after the major payments made on account of the arrears, the arrears have not increased anymore.

- **Structural reforms of public sector enterprises**

- In the course of 2013, important progress was made with the implementation of the **privatization agenda**, which consisted of:
 - The sale of 15% of the share capital of “Transgaz” National Natural Gas Transport Company – around 72 million Euros collected;
 - The sale of 15% of the share capital of “Romgaz” SA, the National Natural Gas Company - around 390 million Euros collected. As part of this offer, the Global Depository Receipts were issued for the first time, together with a public offer on the Bucharest Stock Exchange;
 - The sale of a new package resulted from a 10-percent share capital raise of the “Nuclearelectrica” SA National Company – around 70 million Euros collected.
- In the course of 2013, consideration was given to **improving financial performance of public sector enterprises**, by cutting operational losses and reducing the debts. These actions required:
 - *The restructuring of some state owned enterprises* (some were liquidated when necessary): two SOEs were put under insolvency procedure as a move to ease the reorganization process and start improving the efficiency of the company business;
 - The approval of a *Memorandum on the government shareholding* and the government oversight of SOEs, as a measure aimed at improving the management of the national portfolio of state-owned companies. This Memorandum includes the clear responsibilities of line ministries and of the MoPF with respect to the corporate governance, financial reporting, accountability and transparency, monitoring and evaluation of SOEs management. In addition, the documents promotes good practices, including the adoption of IFRS;
 - The approval of the corporate governance law for the state-owned companies, pursuant to the provisions of GEO 109/2011 and follow-up on the implementation of the law.

As a consequence of the abovementioned reforms, the debts of public enterprises included in the central government which were active in 2012 and monitored by the Ministry of Public Finance, went down by RON 6 billion at end-2013 compared to 2012, (from RON 12.7 billion to RON 6.7 billion, as shown in the chart below.

Chart 3 – SOEs overdue payments in 2010-2013



Source: Ministry of Public Finance

Public investments reform through a substantial increase of the co-funding allocation for European projects and the prioritization of significant public investments.

Investment expenditures in 2014 account for RON 39.8 billion, which is an amount higher by RON 3.6 billion compared to 2013, accounting for 6% of GDP, and a share in total budget expenditures of 17.2%, more by 0.9 percentage points compared to 2013. Given the high importance of public investments, including as a driver of the economic recovery, and the need to improve the public investment management, Romanian started to implement, as of 2013, a set of public investment management reforms. This approach differs from the previous years, as it relies on the below principles:

- Prioritize public investments;
- Limit financing from the state budget;
- Target the projects implemented under EU-funded programs, and projects funded from loans for which audits are conducted and there is a prospect of multiplication of public investment funds.

The reform of public investment, initiated in 2013, required the following actions:

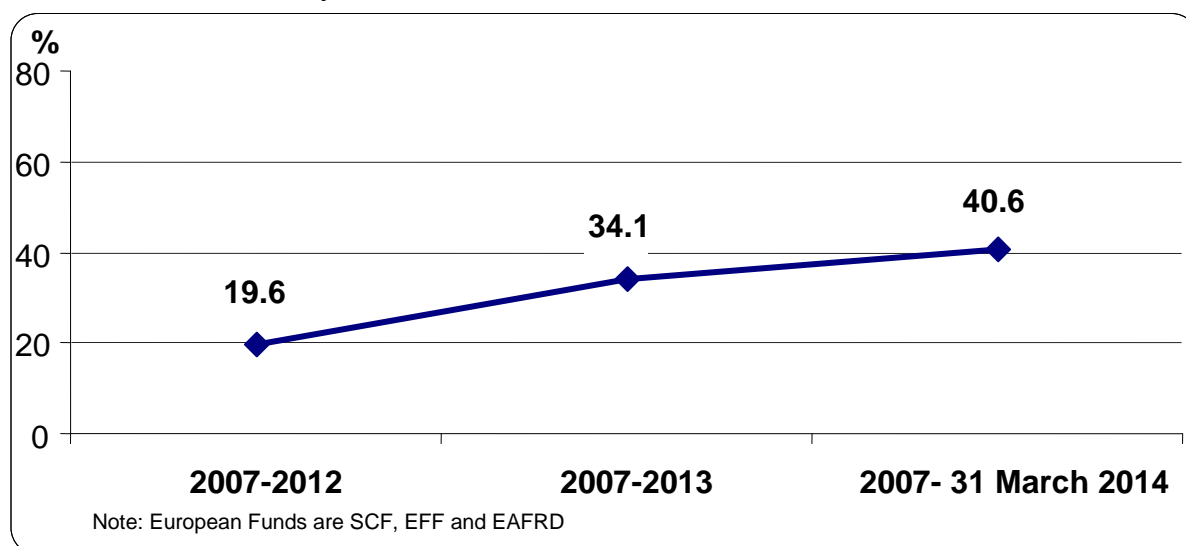
- Set up institutional mechanisms to prioritize significant public projects (over RON 100 million), as a move to help completing the investments by channeling investments to selected investments, and increase the transparency of the decision-making in the allocation of investment spending, as well the transparency in monitoring the implementation of investments. The mechanism allows the removal of non-performing projects or projects which do not meet the current development criteria anymore;

- Introduce the obligation to report, on a monthly basis, with respect to the progress made in the execution of projects, in units of measurement, as a move to improve the quality of budget execution reviews;
- Set up a Public Investment Evaluation and Monitoring Unit within the Ministry of Public Finance. The Unit will help strengthen the quality control in the preparation, prioritization and management of new significant public investment projects financed by the central government;
- Approve the legal framework required to implement the above-actions.

As a consequence, the EU project co-financing expenditures went substantially up, by RON 2.2 billion, which is by 12.7% more compared to 2012, i.e. from 2.9% of GDP in 2012 to 3.1% of GDP in 2013. In addition, temporary borrowings from the Treasury amounting to over RON 8.8 billion in 2013 were used to pay the beneficiaries of projects financed with European funds awaiting EU reimbursements.

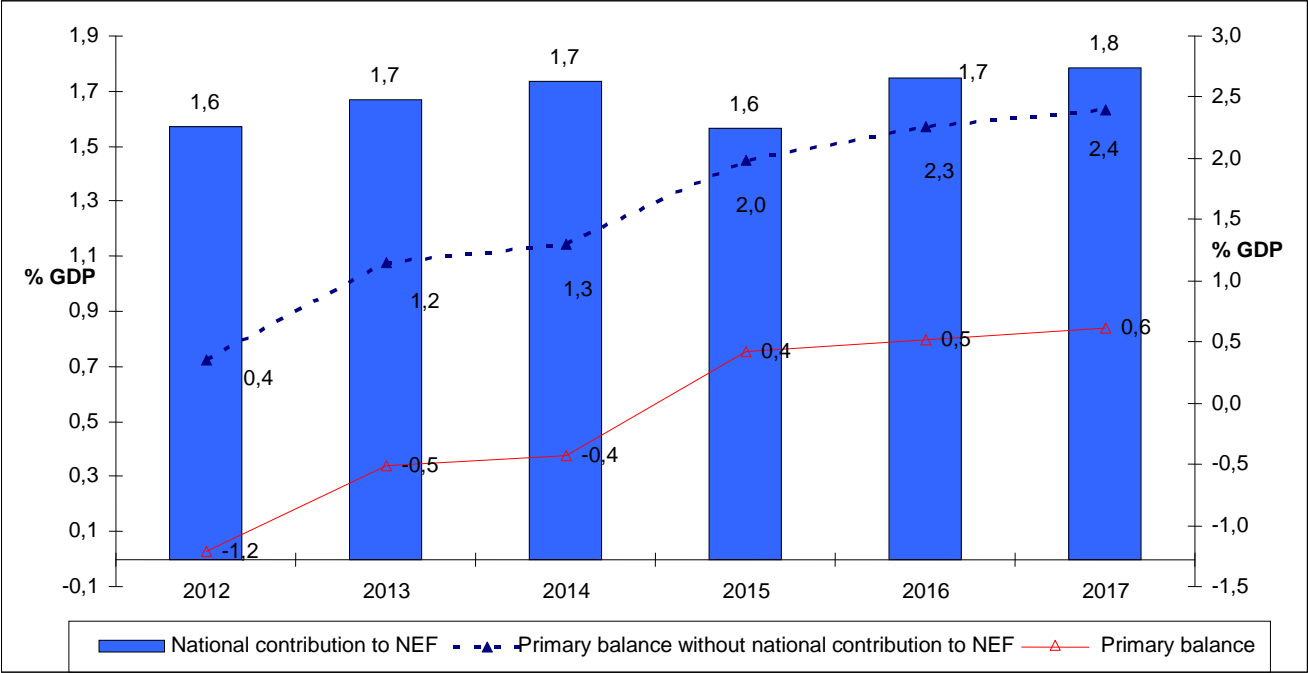
Hence, the absorption rate went up to 40.6 % at the end of March 2014.

Chart 4– EU funds absorption rate



Source: Ministry of Public Finance

Chart 5– Impact of domestic contribution to projects funded from nonrefundable external funds (NEF) compared to the primary balance in 2012-2017



Source: Ministry of Public Finance

The domestic contribution share to the projects financed from foreign grants is expected to account for around 1.6% of GDP in 2015. In addition, in 2015 the domestic support will be required for European financial frameworks, namely 2007-2013 and 2014-2020. If this co-financing is removed from the 2015 primary balance (0.4% of GDP), the balance would reach a positive 2.0% of GDP.

I. The fiscal and budgetary policy in 2014¹⁷

1. **Continued fiscal consolidation** through decreasing the ESA deficit from 2.3% of the GDP in 2013 to 2.2% of the GDP in 2014, and of the cash deficit from 2.5% of the GDP in 2013 to 2.2% of the GDP in 2014. These targets include an adjustment for investments of 0.2% of the GDP compared to the Fiscal and budgetary strategy of 2013-2015 for the purpose of creating fiscal space to stimulate investments.

On the part of revenues a series of measures have been implemented with regard to profit tax (RON -20 mil.), the tax on the income of microenterprises (RON 49.8 mil.), the income tax (RON 44 mil.), excises and other special duties (RON 2959.5 mil.), mandatory social contributions (RON 349.8 mil.), the tax on constructions value, other than buildings (RON 488 mil.), mining royalties (RON 50 mil.).

On the expenditure part, for 2014 it was considered to maintain the salary rights at the level of December 2013. By way of exception from this rule, as of January 2014, the basic salaries of the teaching staff with a seniority of up to 6 years have been increased by up to 10%, without exceeding the basic salary established through the Framework-law no. 284/2010 on unitary salaries for the staff paid from public funds, as subsequently amended.

The staff expenditure corresponding to the general consolidated budget of 2014 include an amount of RON 2.0 billion which represents the installment of 25% of the writs of execution obtained by the staff in the budgetary sector with regard to salary rights.

At the same time, for 2014 it was considered a maximum number of positions in the budgetary sector of 1,185,000.

Also, the enforcement of the measures related to not granting prizes, holiday premiums, holiday vouchers, meal vouchers (with the exception of the staff from public institutions financed entirely from own income) is continued in 2014, as well as those of compensation of overtime only by free time.

2. **Stimulating economic growth** through:

a. Stimulating investments

- Increasing public investments, especially increasing co-financing for the absorption of European funds by 0.5 percentage points in order to compensate the investments in the private sector;
- Increasing the financing of investment programs of the local authorities from RON 14.6 billion in 2013 to RON 18.4 billion in 2014, i.e. an increase of 26%. According to the Treaty of accession to the European Union, Romania has committed itself (by 2015 for the water supply systems and by 2018 for the

¹⁷If it not specified otherwise, the figures presented in this section correspond to the cash methodology.

sewerage and water treatment systems) to ensure compliance of the localities with the environmental legislation through the development of water and wastewater infrastructure, since otherwise the infringement procedure could be started;

- Supporting agricultural producers by allocating from the State budget through the budget of the Ministry of Agriculture and Rural Development the amount of RON 2.1 billion, i.e. RON 1.5 billion in subsidies supporting agricultural producers and RON 0.6 billion in complementary national direct payments in the vegetable sector.
- Stimulating the business environment through State securities and State aid plans, especially through the new plan of guarantees for the SMEs amounting to RON 2 billion;
- An exemption from the payment of tax on the profit reinvested in technological equipment, i.e. work machines and installations used to generate taxable income¹⁸ - the enforcement period is between July 1, 2014 and December 31, 2016. The investments remain amortizable from a fiscal perspective, through the use of linear or decreasing amortization for a term equal to at least half of their normal operation period, but not more than 5 years.

b. Stimulating consumption, at the same time with ensuring social protection for the categories of population with low income

- Indexation of pensions by 3.75%;
- Increasing the minimum guaranteed national gross basic salary by 12.5%;
- Increasing the minimum guaranteed income by 4.5%.
- Applying the law on unitary salaries in the sense of increasing the salaries of young employees with lower income,
- Directing the salary increases in the budgetary sector to young graduates from the fields of health and education who stay in the system (resident physicians; junior teachers in the pre-university education; tutors and lecturers in the university education), in order to facilitate investments in health and education;
- In order to stimulate the business environment and reduce labor taxation, a major objective of the Government is to reduce the rate of social contributions; this reduction will be made in a budget neutral manner. In this respect, it will be attempted in the second half of 2014 to reduce this rate significantly. For this purpose, a feasibility study will be performed and it will

¹⁸- such as provided in subgroup 2.1 in the Catalogue on the classification and normal operation periods of fixed assets.

be discussed with all those involved, and the conclusions of said study will be agreed upon with the EC, the IMF and the World Bank.

- Other measures of increase of available income for low and medium income households.

3. Continued process of prioritization of public investments, through:

- Approving and publishing the list of priority public investments (among the significant investments, over RON 100 million).
- Introducing the mandatory monthly reporting on the physical execution in measurement units in order to increase the quality of the budget execution analysis.

II. NAFA supports the achievement of fiscal and budgetary policy objectives and economic policy objectives through its objectives set for 2014, as follows:

a. Firmly fight tax evasion, with the following priority actions:

- Improve and update the special case fiscal databases;
- Optimize VAT refund procedures based on risk assessments, as a move to reduce tax audit times in this area and the time to settle refund cases until the month of June 2014;
- 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;
- Fight VAT frauds, in particular intra-Community fraud, through partial fiscal inspections (on economic operators involved in imports, acquisitions, delivery, manufacturing of excisable goods, which have the obligation to pay excise duties) following referrals by taskforce operations and the management of specific risk profiles and an efficient exchange of risk-related information;
- Strengthen customs control:
 - Develop the IT security policy;
 - Boost the efficiency of mobile teams, by making these teams more active in the field and by conducting traffic controls;
 - Continue to manage the specific actions aimed at the implementation of the Schengen Convention;
 - Protect the national and Community customs territory by fighting the smuggling of illicit drugs and precursors, counterfeit goods, mobile cultural assets, wild species of plants and animals, precious metals and stones and alloys thereof, as well as the traffic of commodities with a high risk to

consumers' health and safety, and by controlling cash movements at the Community border;

- Improve the coverage of monitoring and control in respect of production, acquisition and import of energy products, alcoholic products and alcohol. In this area, NAFA intends to introduce the permanent oversight based on risk analysis;
- Strengthen controls at EU foreign border to fight the smuggling of cigarettes and other processed tobacco products.

b. Improve voluntary compliance, with the following priority actions:

- Continue to apply the stable installment arrangements for the obligations of taxpayers in difficulty as a result of a temporary lack of funds;
- Simplify taxpayers' access to their tax files;
- Continue to simplify tax forms and develop electronic filing;
- Create technical and procedural conditions to allow the use of all bank instruments to pay tax obligations;
- Continue to implement high quality standards for the services provided and streamline business processes;
- Develop taxpayer services provided, for instance, via the NAFA portal (seen as a one-stop-shop) until June 30, 2014, also by providing an interpretation free of ambiguities of the tax legislation, through the means of a procedure issued jointly with MoPF and establish one single channel responsible for answering to all questions related to tax law interpretations until December 31, 2014;
- Develop electronic channels of interaction with the taxpayers.

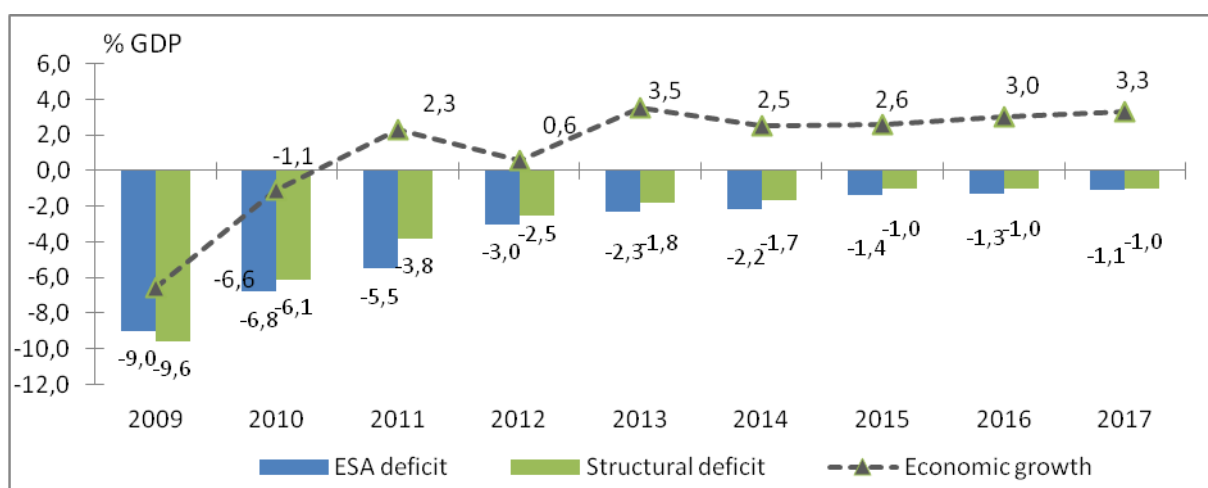
3.2. MEDIUM TERM BUDGETARY OUTLOOK

While the structural deficit¹⁹ is being revised regularly, including for the past years' levels, one can notice that Romania saw the largest cuts of this deficit after the European rules were introduced in this respect.

Starting with 2011 –the year in which the regulations requiring the annual cut of structural deficit by minimum 0.5 percentage points became effective – Romania's deficit went down by 4.3 percentage points, namely from 6.1% of GDP in 2010 to 1.8% of GDP in 2013.

In average, the annual cut was 1.4 percentage points. As a consequence, Romania, alongside Denmark, was the only country in the non-Eurozone which joined the MTO monitoring mechanism, like the Eurozone states.

Chart 6 – Budget deficit and economic growth in 2009-2017



Source: Ministry of Public Finance

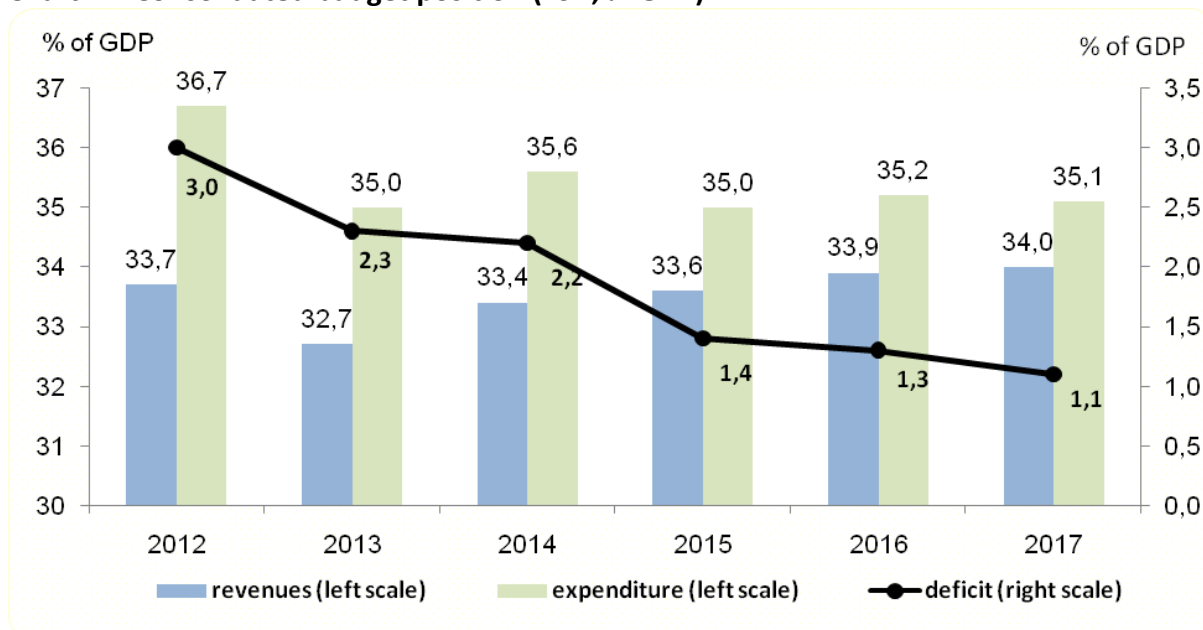
For 2014, the budget deficit takes into account an adjustor for the cofinancing of EU-funded projects, approximately 0.2 pp of GDP.

The general objective is to reach MTO in 2015, namely a structural deficit of 1% of GDP, after the end of the excessive deficit procedure in 2013 was confirmed (ESA deficit below 3% of GDP).

In order to reach MTO in 2015, the revenues, expenditures and deficit of the government in ESA terms are estimated as percentage of GDP as in the chart below.

¹⁹ Macroeconomic indicator determined through an econometric method.

Chart 7 – Consolidated budget position (ESA, % GDP)²⁰



Source: Ministry of Public Finance

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

For revenues:

- Continue the implementation of measures aimed at boosting the tax system efficiency by redrafting the Fiscal Code and the Fiscal Procedure Code;
- Diversify tax ways by introducing the lump sum tax for various categories of legal entities;
- Reduce tax burden for low-income labor force;
- Implement a new system of mandatory social contributions, by enlarging the calculation base to include the income of self-employed, irrespective of any other incomes of these individuals, if any;
- In the medium run, revise the way that tax on buildings is calculated, in a move to start taxing property based on the purpose of that property (buildings used as homes or for other purposes) and not based on the legal status of the owner, according to the current legislation in force;
- In order to improve the autonomy at local level, contain the number of tax exemptions allowed by the law; the local authorities will be responsible for this, as they will have the power to decide whether to grant or remove exemptions for certain categories of taxpayers;

²⁰The relation revenues-expenditures=balance may show differences due to roundups to one decimal.

- Improve VAT legislation to counteract tax evasion;
- Consider the prospect to reduce the VAT standard rate for 2014-2016, as budget revenues collection improves;
- Continue to improve excise duty legislation to meet approximation criteria with the Community law, by introducing the EU Directives in the domestic legislation;
- Improve excise duty legislation to counteract tax evasion on this particular segment;
- Observe the Romania's commitments with IFIs, namely implement measures aimed at boosting revenues from excise duties, in particular by cutting evasion on the alcoholic beverage segment, along with better matching the excise duty rates with the alcoholic contents and the fabrication process;
- Other measures aimed at the low and medium-income households.

For expenditures:

- Provide a sustainable level to wages and pensions expenditures of the public sector;
- Channel available resources to public investments in infrastructure, agriculture and rural development, power and advanced technology;
- Boost EU funds absorption to reach an absorption rate of 50%-80% until December 31, 2015;
- Reconsider public procurement based on criteria of opportunity, priority and efficiency;
- Implement multi-annual project and program budgeting, which will allow important budget savings and a higher predictability and efficiency in public spending.

In 2013, Law 165/2013 was adopted to introduce the measures aimed at finalizing the process of restitution, in cash or equivalent, of property/buildings abusively confiscated by the communist regime in Romania.

The applications filed for restitution of land which may not be solved by restitution in kind shall be solved by the allocation of a number of points which count as compensation titles.

As of January 1, 2016, the points allocated given as compensation by means of a specific ruling may be used to tender for real estate included in the national fund of farming land and other real estate.

At the same time, article 41 of the Law requires that the cash amount representing damages in the files approved by the Central Damage Commission before the effective date of this law, as well as the amounts payable under court rulings final which are final

and non-revocable on the effective date of this law, shall be paid within five years, in equal annual installments, starting on January 1, 2014.

As a consequence, the National Authority for Property Restitution included in its 2013 balance sheet the compensation titles in amount of RON 2,059.9 million. This amount is included in the 2013 ESA deficit. The total value of the titles is expected to go up in the upcoming period, from RON 2,059 million to RON 4,500 million.

RON 500 million were included in the 2014 state budget to cover this type of damages.

II. NAFA objectives in 2015 – 2017; priority actions:

a. Firm fight against tax evasion

- Develop risk assessment for the whole tax administration activity, using the available tax data about taxpayers;
- Develop IT applications to analyze the outcome of fiscal inspections conducted as a result of risk assessments, as a move to confirm risk criteria and provide data for future risk assessments;
- Strengthen the electronic filing system for data, documents and procedures, to allow documents to circulate within NAFA without the need to print them over and over again;
- Improve and update databases to include any special cases identified;
- Develop and implement an automated review program for the information filed by taxpayers, in order to speed up desk checks as required by the Fiscal procedure Code. The documentary checks procedures will be applied.
- Fight VAT frauds, in particular intra-Community frauds, through partial tax inspections (on economic operators involved in imports, acquisitions, deliveries and manufacturing of excisable goods) following referrals from taskforce operations and by managing specific risk profiles and an efficient exchange of risk-related information;
- Develop e-commerce audits;
- Strengthen customs control:
 - Develop the IT security policy;
 - Boost the efficiency of mobile teams, by making these teams more active in the field and by conducting traffic controls;
 - Continue to manage the specific actions aimed at the implementation of the Schengen Convention;
 - Protect the national and Community customs territory by fighting the smuggling of illicit drugs and precursors, counterfeit goods, mobile cultural assets, wild species of plants and animals, precious metals and

stones and alloys thereof, as well as the traffic of commodities with a high risk to consumers' health and safety, and by controlling cash movements at the Community border;

- Improve the coverage of monitoring and control in respect of production, acquisition and import of energy products, alcoholic products and alcohol. In this area, NAFA intends to introduce the permanent oversight based on risk analysis;
- Strengthen controls at EU foreign border to fight the smuggling of cigarettes and other processed tobacco products.

b. Improve voluntary compliance

- Develop, in a joint effort with the Romanian Bank Association, an efficient electronic system of instituting/removing garnishments in respect of cash available in the debtors' bank accounts;
- Simplify taxpayers' access to their tax files;
- Continue simplification of tax forms and develop the e-filing process;
- Continue to implement quality standards for the services provided by the agency and streamline business processes;
- Develop the tax agency's call center by increasing the number of positions and create support services for phone operators involved in this activity; set up regional centers to speed up the process of providing answers to taxpayers' questions;
- Develop electronic information channels with the taxpayers.

c. Boost efficiency of revenue collection

- Strengthen the professional training component to develop and improve training activities, including by developing a training strategy, and to improve the skills of NAFA staff;
- Implement a unitary and integrated IT system offering value-for-money;
- Automate and improve efficiency of functional processes within NAFA, by using IT&C against the background of the agency's reorganization;
- Improve taxpayer services by using IT&C means.

3.3. IMPACT OF EU ACCESSION ON PUBLIC FINANCES

3.3.1. EU BUDGET ALLOCATION FOR ROMANIA – 2007-2013 MFF

The absorption of European funds is the Romanian Government's top priority. Romania must make the best use of the substantial EU allocation (around 34.6 billion Euros) under the current multi-annual financial framework (MFF), as this is a key development resource to the Romanian economy in the short, 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 reimbursable.

The following table shows the EU allocations to Romania under the **2007-2013 multiannual financial framework**:

Table 6 – 2007 - 2013 MFF

Total EU allocations to Romania under the 2007-2013 multiannual financial framework	
	million Euros
Instrument	
Structural and Cohesion Funds	19,668
European Agricultural Fund for Rural Development	8,124
European Fishery Fund	231
European Agricultural Guarantee Fund	6,580
Total	34,603

Source: Ministry of Public Finance

3.3.2. ROMANIA: NET FINANCIAL POSITION IN RESPECT OF EU BUDGET (2007-March2014)

In order to set their net positions in the relationship with the EU Budget, Member States use an instrument called „Net Financial Balance”. As early as the first year after accession, Romania was a net beneficiary in the financial relationship with EU, with a positive balance, as shown in the table below.

Table 7 – Romania: Net Financial Balance in 2007 – March 31, 2014

million Euros

Item	Achieved 2007	Achieved 2008	Achieved 2009	Achieved 2010	Achieved 2011	Achieved 2012	Achieved 2013	Achieved 31.03.2014	Achieved 2007-31.03.2014
A	1	2	3	4	5	6	7	8	9=1+...+8
I. AMOUNTS RECEIVED FROM EU BUDGET (A+B)	1599.71	2642.34	2930.24	2293.63	2621.59	3442.13	5556.65	2711.95	23798.25
<i>A. Pre-accession funds</i>	812.26	747.68	618.74	273.17	132.61	43.90	30.84	0.00	2659.20
<i>B. Post-accession funds, of which:</i>	787.45	1894.67	2311.50	2020.46	2488.98	3398.24	5525.81	2711.95	21139.05
B1. Structural and Cohesion Funds (SCF)	421.38	648.45	917.84	505.54	708.36	1170.92	2963.12	1427.88	8763.49
B2. Rural Development and Fishery Funds (EFF+EAFRD)	15.13	578.75	565.93	760.48	883.05	1090.05	1229.99	345.99	5469.36
B3. European Agricultural Guarantee Fund (EAGF)	6.89	461.87	575.93	663.78	768.95	991.27	1174.70	933.86	5577.27
B4. Other (post-accession)	344.05	205.60	251.80	90.65	128.62	146.00	158.00	4.22	1328.94
II. AMOUNTS PAID TO EU (C+D)	1150.89	1268.93	1364.43	1158.91	1296.24	1427.77	1534.77	642.90	9844.84
C. Romanian contribution to the EU Budget	1129.13	1246.78	1315.49	1109.25	1234.26	1405.57	1469.80	634.16	9544.43
D. Other contributions	21.77	22.15	48.94	49.66	61.98	22.20	64.96	8.74	300.40
III. Balance of flows = I - II	448.82	1373.41	1565.81	1134.72	1325.35	2014.36	4021.89	2069.05	13953.41

Source: Ministry of Public Finance

In 2013, the rate of EU funds absorption improved in Romania and became the highest absorption rate since the country's EU accession year.

Under the circumstances, 2014 becomes a key year, in which Romania has the mission to request from the European Commission a reimbursement as high as possible, in order to reduce the burden for 2015.

3.3.3. EU BUDGET ALLOCATIONS TO ROMANIA – 2014-2020 MFF

The year 2014 marks the beginning of a new 7-year multi-annual financial framework within the EU, ending in 2020. This new MFF (2014-2020) covers a different set of programmes compared to the previous one (2007-2013). MFF is a mechanism which provides the predictability of EU expenditures and requires, at the same time, a strict budgetary discipline.

The budget which has been allocated to Romania under the new 2014-2020 MFF amounts to 39.8 billion Euros, of which 21.82 billion Euros for the Cohesion Policy.

The EU allocation under this financial framework will continue to support economic growth in Romania. The current budget policy measures are aimed at boosting the absorption rate, in particular by raising the co-financing portion (which required the 0.2% adjustor for an additional absorption of EU funds).

3.4. DEBT LEVEL AND PERFORMANCE²¹

PUBLIC DEBT AND THE GOVERNMENT PUBLIC DEBT MANAGEMENT STRATEGY

The government debt according to EU methodology accounted at the end of 2013 for 38.4% of GDP, far below the 60% ceiling required by the Maastricht Treaty. While at end-2012 the government debt was 38.0% of GDP, the financing needs in 2013 and the consolidation of the foreign currency financial buffer of the Ministry of Public Finance, based on an economic growth of 3.5% of GDP, resulted in an increase of this indicator to 38.4% of GDP at end-2013. At the end of 2013, the general government domestic debt accounted for 17.5% of GDP and the general government external debt amounted to 20.9% of GDP, as the consequence of a financing process in 2011-2013 focused on a significant external funding component.

The objectives of the government public debt strategy for 2014-2016, recently approved by the Government, are as follows:

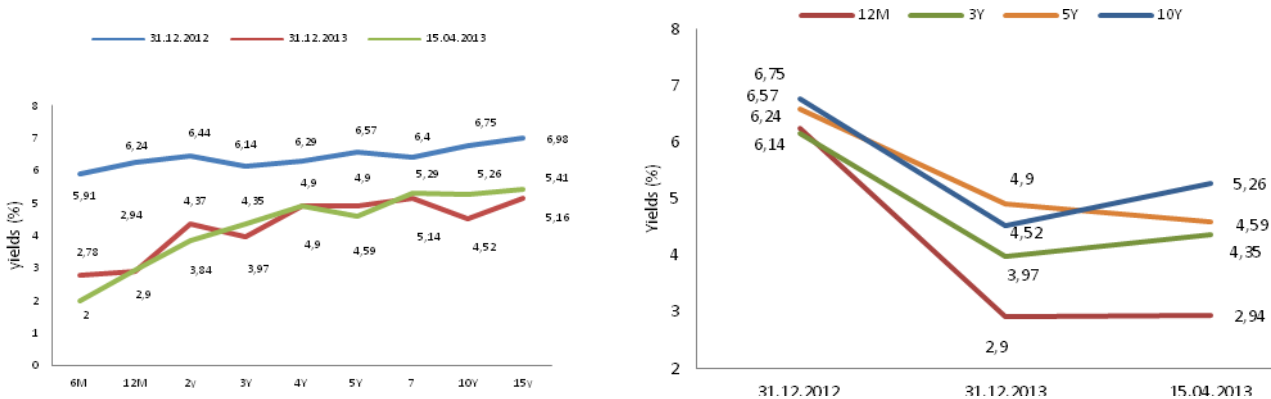
- Cover the government's financing needs and the payment obligations, while minimizing the costs on medium and long term;
- Limit the financial risks associated to the government public debt portfolio, in particular by extending the average remaining maturity of debt; and
- Develop the domestic market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

In 2014, the *budget deficit* will be covered, in a balanced manner, from both domestic and 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 50 billion, which is lower by RON 5 billion compared to the amount of issuances in 2013.

The financing strategy from domestic sources provides in principal for the use of T-Bills denominated in domestic currency, including with shorter maturities (3 months, initially) in addition to those on 6 and 12 months, and benchmark bonds on medium and long term depending on the market demand and the objective of building the yield curve in domestic currency. The yields of government securities followed a downward trend in the recent years, due to a prudential adjustment of the monetary policy conduct by the central bank (NBR), in conjunction with other factors, such as global liquidity and the non-resident investors interest in T-Bonds denominated in RON, after including some of Romanian bonds in the regional index of Barclays and JP Morgan GBI-EM, for emerging markets.

²¹All indicators used in this chapter are in line with the EU methodology.

Chart 8 – Yields of government securities on the primary market



Source: Ministry of Public Finance

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 (in equivalent amount of 1.5 - 2 billion Euros) along the length of the yield curve, simultaneously with a transparent policy of issuing the government securities. In addition to this policy, MoPF plans to eliminate the government securities denominated issued in Euros on domestic market, having in view that this is a non-typical instrument which leads to a fragmentation of government securities market.

Starting with 2015, after the implementation of the procedural and operational framework, MoPF intends to use liability management operations, such as buy backs and bond exchange, to accelerate the construction of liquid benchmark securities and facilitate the refinancing of benchmarks coming due..Similarly, MoPF plans to start using reverse repo operations for an effective management of the Ministry’s cash balances, based on prior consultations with the NBR, as a move to coordinate the policy for government financing and cash management with monetary policies.

Through a transparent policy of government securities and more liquid benchmarks, the secondary market should trend positive and consolidate faster. To further incentivize, the MoPF plans to introduce, until the end of 2014, an electronic trading platform (ETP). This should increase transparency while reducing the transaction costs for market participants.

External financing sources in the medium run will come in principal from Eurobonds issued on the external capital markets under the MTN Programme for the Eurobonds issuances on the external markets and in addition loans contracted with official creditors (international financial institutions and government agencies). MoPF intends to remain present in the international capital markets in Euros and access the USD market and other foreign currencies markets on an opportunistic basis, selecting the longest possible maturities in a

move to reduce refinancing risk, bearing in mind the cost of extending maturity.

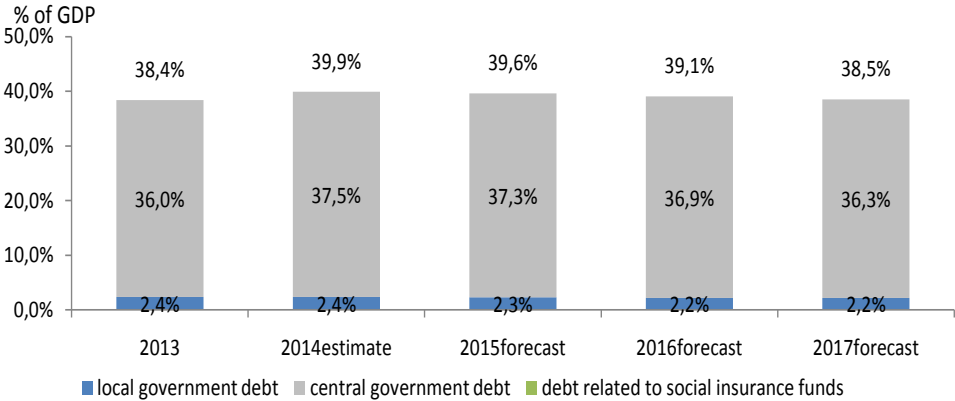
By using the opportunity window in January 2014 the Ministry of Public Finance issued, under the MTN Programme, two series of USD-denominated bonds with maturities of 10 and 30 years, in aggregate amount of 2 billion. Hence, Romania borrowed 1 billion USD for 10 years and a 4,875% coupon (trending down compared to the last year's issuance) and 1 billion USD for 30 years (the longest maturity ever of a government bond) and a 6,125% coupon. In addition, on April 15 2014, MoPF issued Eurobonds denominated in Euros with a 10-year maturity (for the first time since the financial crisis) and extended the yield curve in Euros and obtaining the lowest cost ever for Romania in issuing Eurobonds (yield: 3.701%; coupon 3.625%).

In addition, MoPF intends to continue the partnership with IFIs in order to benefit of the financial advantages coming from the products of these institutions. Hence, in 2014, the 300 million Euros remained in the BIRD DPL DDO loan will be committed, as well as the first IBRD development policies loan (DPL), in amount of up to 750 million Euros, of a series of 2 DPL loans, with the second loan to be contracted in the first half of the fiscal year 2015. These loans will be used to support the government objective of improving Romania's growth potential by improving the efficacy of interventions in the public sector and maximizing the functioning of capital, real estate and energy markets. These two IBRD loans will be followed during 2016 – 2017 by two more similar loans with the amount to be determined latter .

To these should be added, other new loans will be contracted with IFIs (EIB, BDCE) during 2014 – 2016, to finance the state budget deficit and refinance the government public debt, based on the realization of investments and/or other necessary actions in sectorial reforms. *The sources for debt refinancing* will come from the markets on which the debt is issued, and from the foreign currency buffer of the State Treasury. In order to improve debt management and avoid seasonal pressures in financing the budget deficit and refinancing the government debt, the State Treasury's financial buffer will be kept in amount equivalent to around 4 months of financing needs.

With an annual average economic growth of 2.8% of GDP and ESA deficits of up to 2.0 % of GDP during 2014 – 2017, we expect the gross general government debt share to remain below 40% of GDP, as shown in the chart below.

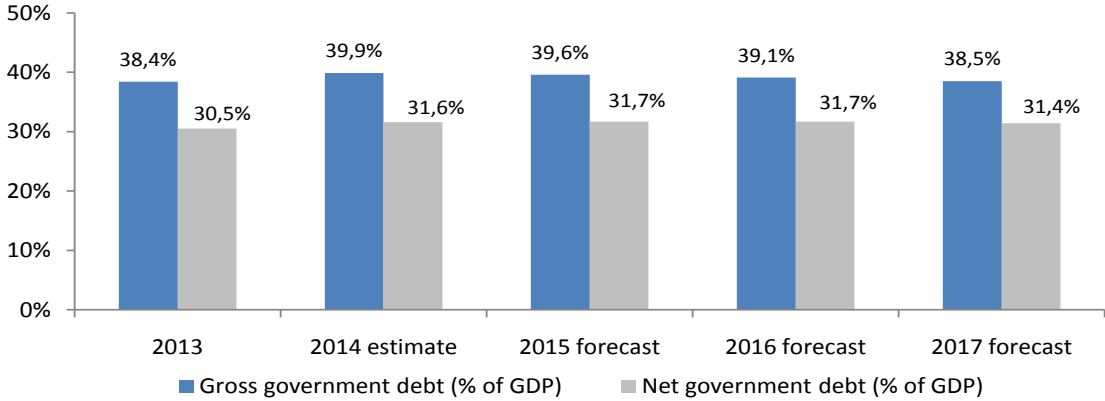
Chart 9 – Gross Government Debt according to EU methodology



Source: Ministry of Public Finance

If the liquid financial assets²² are considered, the net general government debt (gross debt minus liquid financial assets) in the interval under review will not exceed 32% of GDP.

Chart 10 – Government Debt according to EU methodology



Source: Ministry of Public Finance

The factors which influence the change of debt share to GDP in 2014-2017, including stocks—flows adjustments, are included in annex 4.

²² FA1, FA2, FA3 (consolidated at market value), FA5 (if quoted in stock exchange; including mutual fund shares).

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

4.1 RISKS

Risks which may affect the real economy and the growth objective are mainly foreign risks. The Romanian economy, as part of the European economy, is dependent on the foreign economic outlook.

The recent EC projections confirm the expectations of EU recovery which started in the second half of this year continuing and even accelerating in the upcoming year. Should this not happen, the declining demand in the EU, in particular in Romania's main commercial partners, will affect the GDP growth, through exports in principal, but also through investment flows. The foreign risks associated with macroeconomic outlook continue to include the fragility of financial markets, the uncertainty of the US fiscal policy and the geopolitical tensions which could lead to a higher increase of energy prices.

On the domestic side, risks are in general balanced in terms of impact on the domestic supply and demand. After a very good agricultural year in 2013, should the weather be bad for agriculture in 2014, the crops could drop significantly and directly affect the inflation and the economic growth.

While the monetary policy rate was relaxed, a risk which will impact all economic sectors, and in particular the SMEs, is the restraining lending policy of the banking sector. After the developments of the recent months, we expect a slight recovery of bank lending, but it would take a significant increase of lending to companies and households to achieve the 2014 growth objectives.

The dynamics of movements in the region show a number of elements which indicate a positive situation of Romania, compared to other countries.

First, in general terms, Romania is less dependent on the foreign energy resources, compared to other member states. In addition, imports of oil products and natural gas dropped significantly in 2013, due to a reduced consumption power in the economy, mostly generated by a decrease of the activity of energy-intensive consumers. The country became less dependent also due to increasing importance of the renewable resources, against the background of massive investments in the recent years, stimulated by the green certificates and the liberalization measures.

Second, about 70% of Romania's commercial flows are mostly oriented to EU countries. Third, the source of foreign direct investments in Romania, in 2012, comes mostly from the Netherlands, Austria, Germany, France and Italy.

In addition, the Romanian banking sector is formed of banks in which the biggest part of capital is European, which, in conjunction with other factors mentioned herein, puts Romania in a favorable situation in terms of geopolitical dynamics in the region.

4.2 SENSITIVITY OF BUDGET FORECASTS TO DIFFERENT SCENARIOS AND ASSUMPTIONS

Budget variables elasticity

Taking into consideration that the collections from fees and taxes are closely linked to the employment rate performance in the economy, the average income and the economic growth, the below table shows the impact on budget revenues of economic variables variation taken separately, with 2014 as baseline. Compared to the baseline scenario, considering the share in total budget revenues, the highest risk is associated to collections from social contributions and direct taxes (-0.08% of GDP, VAT in particular). Thus, the highest negative impact should the economic growth drop by 1pp (which involves a simultaneous decline of employment and wages) will be on social contributions performance (-0.17% of GDP). In this context, it is important to notice the government's decision to help the resilience of labor market and encourage employment through its recently approved measures.

Table 8 – Sensitivity of general government revenues to the changes in the macroeconomic variables

Category of taxes and charges (GDP share)	Macroeconomic Basis	Changes of the macroeconomic base (pp)	Changes in the revenues (% of GDP) 2014
1. Income tax (3.5%)	Gross average salary	Reduced by 1	-0.037
	Employment level	Reduced by 1	-0.028
	Gross domestic product	Reduced by 1	
2. Social security contributions (8.6%)	Gross average salary	Reduced by 1	-0.088
	Employment level	Reduced by 1	-0.077
	Gross domestic product	Reduced by 1	
3. Profits Tax (1.7%)	Gross average salary	Reduced by 1	0.021
	Employment level	Reduced by 1	0.021
	Gross domestic product	Reduced by 1	-0.016
4. VAT (8.2%)	Gross average salary	Reduced by 1	-
	Employment level	Reduced by 1	-
	Gross domestic product	Reduced by 1	-0.080
Total	Gross average salary	Reduced by 1	-0.104
	Employment level	Reduced by 1	-0.084
	Gross domestic product	Reduced by 1	-0.096

Source: Ministry of Public Finance

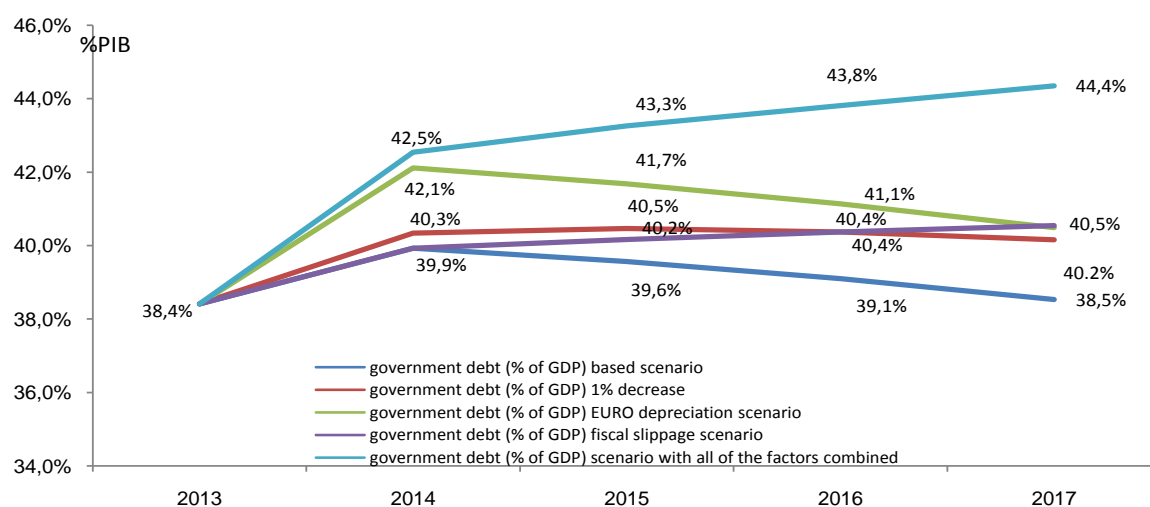
4.3. PUBLIC DEBT SENSITIVITY

Sensitivity analysis of public debt²³

1) the influence of economic growth, the domestic currency depreciation and fiscal slippages²⁴ on the government debt; and

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

Chart 11 – Factors which influence the government debt



Source: Ministry of Public Finance

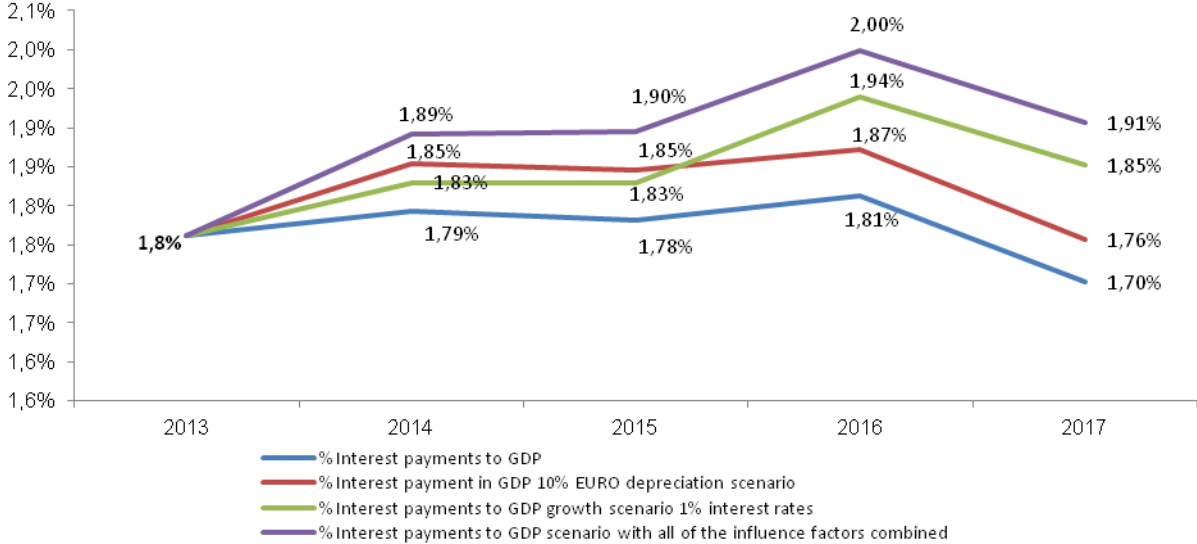
Chart 11 shows that a decrease of the projected economic growth by 1% of GDP would negatively impact the indebtedness level, which will go up by 1.7% of GDP in 2017, and the depreciation of the domestic currency by 10% compared to Euro²⁵, which is the main foreign currency in which is denominated the foreign government debt portfolio, would lead to an increase of government debt share to GDP of up to 2.0 % of GDP in 2017. A fiscal deviation translated in a cash deficit of around 2% of GDP during 2015 – 2017 would result in an increase of the indebtedness level of up to 2.0% of GDP in 2017, while the joint impact of these factors on the government debt share to GDP would push this indicator up by 5.9% of GDP in 2017.

²³ All indicators in this section are in line with EU methodology.

²⁴ Cash deficit to cover of 2% of GDP.

²⁵ The other currencies of debt denomination are trending up as well.

Chart 12 – Factors which influence the interest payments



Source: Ministry of Public Finance

Chart 12 shows that the depreciation of the domestic currency against the Euro²⁶ by 10% would have a low negative impact on the interest payments, which will go up by up to 0.06% of GDP in 2017, while the interest rates raising by 1% would result in a higher increase of interest payments share by up to 0.15% in 2017. The joint impact of these factors on the payments would trigger a raise of interest payments by 0.21% of GDP in 2017.

4.4. 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 2013. The differences between the two programme versions come, in principal, from the revised statistical data in 2010-2012 and the provisional data published for 2013, as well as the base effect of the resulting structural changes.

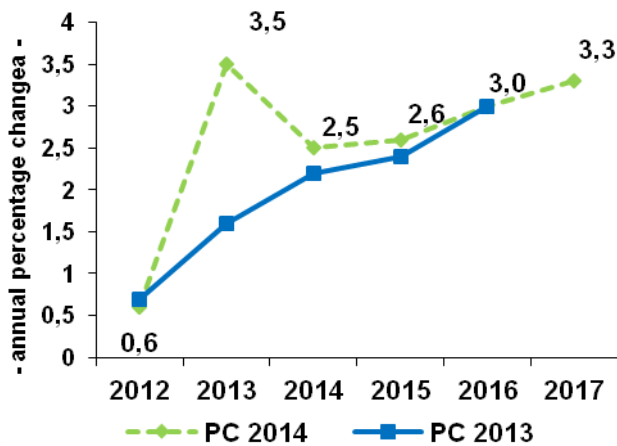
Hence, the GDP was projected to grow by 1.6% in 2013, according to the previous version of the convergence programme. Statistical achievements which included the strong export performance due to the industrial output and the exceptional crops, showed an increase of the gross domestic product by 3.5%.

As a result of this performance, GDP is expected to grow by 2.5% in 2014, compared to 2.2% projected in by the previous programme version, mainly on the back of domestic demand. The 2015-2017 forecast sees a higher pace of the economic activity, trending up in 2015 at a

²⁶ Idem 25.

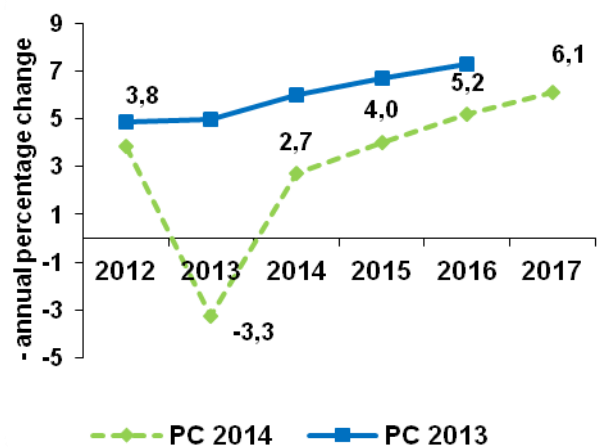
slightly higher rate compared to the previous programme edition, i.e. 2.6% compared to 2.4%, followed by 3% in 2016 and 3.3% in 2017, with the domestic demand and in particular the gross fixed capital formation as driver of growth.

Chart 13—A comparative review of GDP growth forecasts



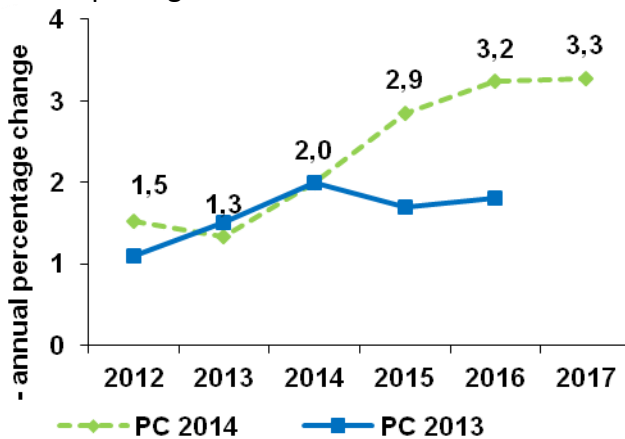
Source: National Prognosis Commission

Chart 14—A comparative review of GFCF growth forecasts



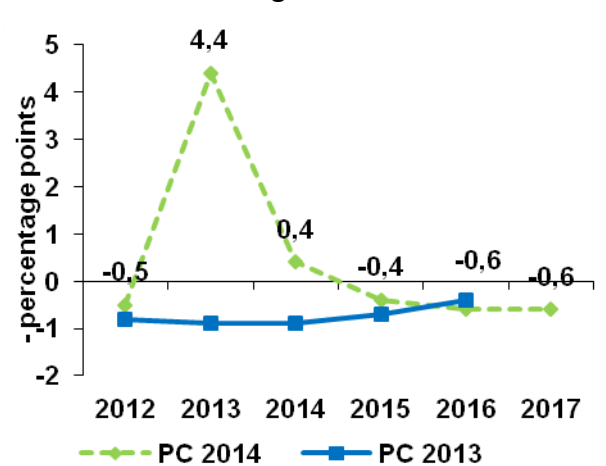
Source: National Prognosis Commission

Chart 15 - A comparative review of private consumption growth forecasts



Source: National Prognosis Commission

Chart 16 - A comparative review of net export contribution to GDP growth



Source: National Prognosis Commission

5. LONG TERM SUSTAINABILITY OF PUBLIC FINANCE

The last Report on Public Finance Sustainability, published in 2012, analyzes the viability of public finance in the EU Member States, taking into account the financial, economic and fiscal impact of the crisis which started in 2008 and the population ageing according to the Population Ageing Report. This Report is produced every three years. EU Member States are currently preparing a new set of projections regarding the public finance sustainability in the longer run, an exercise which starts in 2013 (instead of 2010) and has the same forecast time horizon, namely 2060.

In the case of Romania, the 2012 Report revealed no sustainability-related risks on the short term, with a low risk on the medium term and a moderate risk on the long term, namely in 2060. According to the updated projections, the share of pensions expenditures will drop by the end of the forecast interval under the EU average considered in the 2012 Report. Risks would increase if the primary structural balance goes 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 required to cap the increase of costs associated to ageing population (mainly pensions).

One should note the positive assessment compared to the 2009 Report when risks for Romania were seen as high in respect of long term sustainability, following the budgetary impact of expenditures generated by the population ageing process, which were far above the EU average.

At EU level, the projected growth of budget expenditures was revised downward, according to the 2012 Ageing Report, compared to the 2009 exercise. In 18 of the 27 MS, the total variation of budgetary costs saw a descending trend in the interval between the two Reports. This trend continues against the background of 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 according to the 2012 Ageing Report at 2.9 pp). The breakdown on the main expenditure components is as follows:

- 2.5 pp of GDP is the increase in pension expenditures (European average is 1.4 pp)
- 2.0 pp of GDP is the increase of healthcare and long term care expenditures (European average is 2.0 pp).

If we compare with other European states, the growth pace 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.

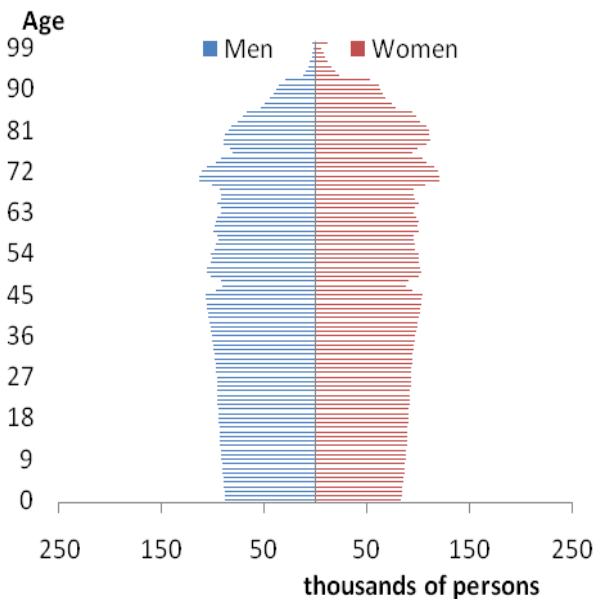
Chart 17 – Structure of the population: 2013–2060

Structure of Romania’s population in 2013



Source: Eurostat-EUROPOP 2013

Structure of Romania’s population in 2060

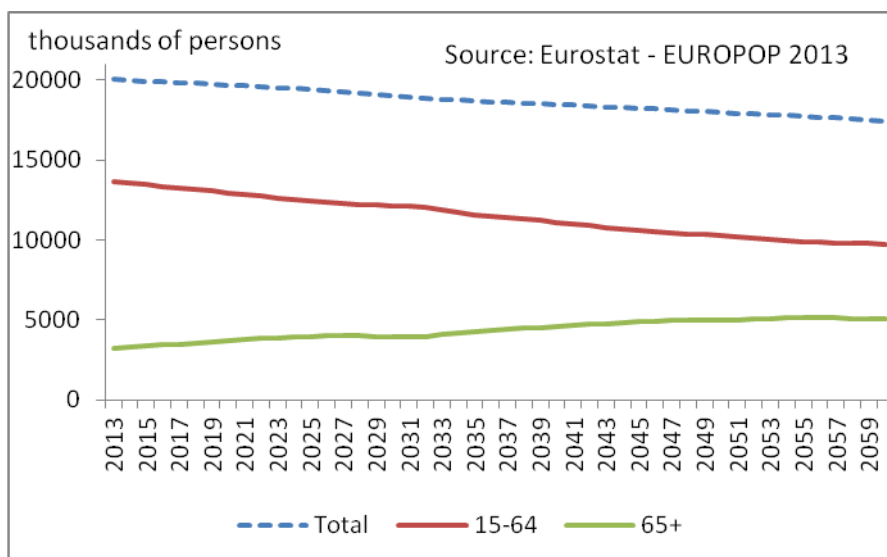


Source: Eurostat-EUROPOP 2013

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.

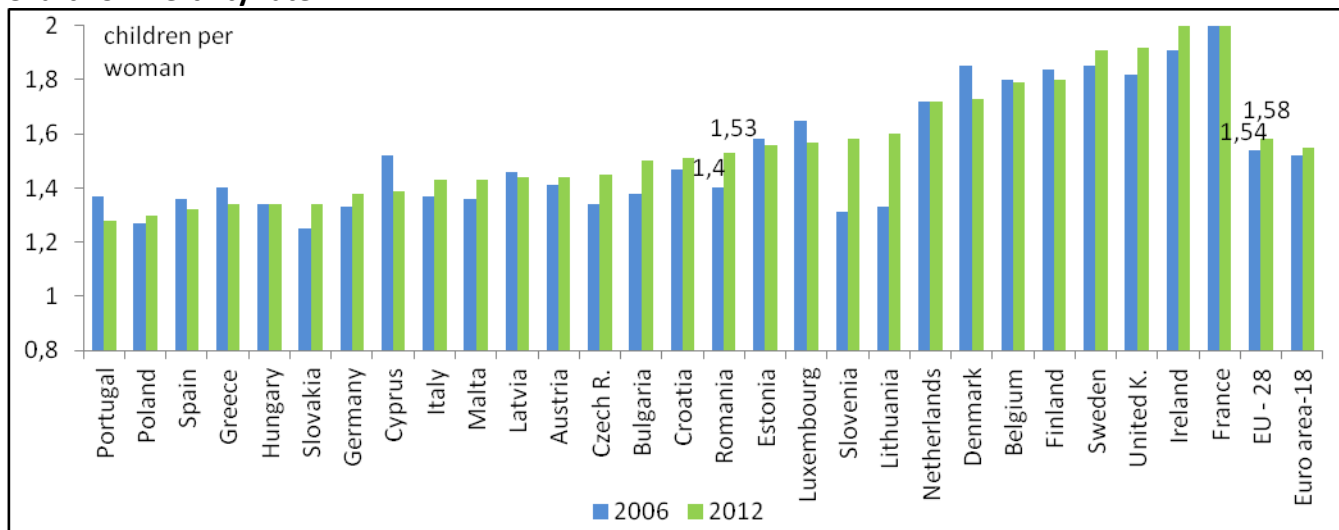
The rapid ageing will change the ratio between the population at retirement age and the active population, triggering major changes in the age structure and negative consequences on the labor market. The ratio between people over 65 and people at working age (15 to 65) will raise considerably, which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

Chart 18 – Evolution of the population



The age composition of the population will be deeply affected in 2013-2080: the share of the population at working age (15 to 64) will drop by 28.6% in the time interval under review, with the share of population over 65 raising in the same time interval by 54.9%.

Chart 19 – Fertility rate



Source: Eurostat

The ageing process is considered a consequence of low fertility in Romania: 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 Romania²⁷, indicate a substantial decline in the number of population, namely by 2.6 million persons less in 2060 compared to 2013.

While the young population trends down as a result of increasingly less women at fertility age, there are some positive signs from the increase in fertility rate.

Table 9 – 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

Source: Eurostat-EUROPOP 2013

	2013	2020	2030	2040	2050	2060
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	85.2	86.8
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: National Prognosis Commission

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 86.8 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 deeply influenced by the demographic perspectives, which are given by the birth rate and the life expectancy, alongside the inevitable ageing of the population.

Table 10 – Long term forecast of pension expenditures

	2010	2013	2020	2030	2040	2050	2060
Pension Pillar 1	9.4	8.1	8.6	9.3	10.5	11.5	11.9
Pension Pillar 2	-	-	0.1	0.5	1.2	1.5	1.1

Source: National Prognosis Commission

The estimates of the pension model indicate an increase of pensions share under Pillar 1, from 8.1% of GDP in 2013 to around 11.9% of GDP at the end of the forecasting interval.

The share of pensions under Pillar 2 to the total pension expenditures will gradually increase, and is expected to peak around the year 2050, with a share of 1.5% of GDP.

6. QUALITY OF PUBLIC FINANCE

One of the Romanian Government's priority in the following years is to continue consolidating the quality of public finance through improved efficiency, transparency and accountability in spending public resources. The Government of Romania is committed to continue the sustainable fiscal consolidation process and provide a fiscal and budgetary framework which fosters both private and public economic environments. In this respect, an important feature of the budget policy is the increase of budget appropriations aimed at creating room for priority sectors which have an impact on economic growth: infrastructure, education, research etc.

To strengthen public finance management, the Government continues the implementation of reforms aimed at improving the commitment control and fiscal reporting systems, preventing arrears and better managing fiscal risks. To this purpose, the arrears of local governments are published monthly, since the end of September 2013. Progress was made in implementing the commitment control system through the formulation of standard definitions for commitments, and consideration is being given to extending this type of control to entities.

6.1. BUDGET REVENUES

The Fiscal Code was designed so as to provide the predictability of the tax system. The purpose is to improve the fiscal competitiveness of the business environments by: a) broadening the tax base; b) simplifying the system of taxes; c) improving budget revenues collection; d) cutting tax evasion.

Hence, starting with 2009, the number of non-fiscal fees was reduced by 50%, i.e. from 491 in 2009 to 252 at the present time. Of these, 101 are licensing fees and tariffs.

When it comes to tax administration, the purpose is to boost the efficiency of collection and the efficacy in fighting fraud and tax evasion. Thus, an anti-fraud task force was established through the reorganization of the operative audit within the headquarters of the National Agency for Fiscal Administration; this is a control mechanism expected to remove overlaps and different fiscal treatments of the same economic operation and to be fully consistent with the our country's commitments to the international financial bodies.

The main objectives for improving tax administration are related to the firm fight against tax evasion, the improvement of voluntary compliance and the improved efficiency of revenue collection.

In order to improve the capacity of revenue collection, consideration is being given to using simple and modern procedures, like using the large scale internet, for instance, used for online filing of tax forms.

The fiscal reforms envisaged in upcoming period were designed in such way to prevent new pressures on the expenditures, improve the budget process and provide efficient revenue

collection and budget operations on a medium term. This requires public policies relying on the performance of financed activities and the allocation of funds based on efficiency.

With respect to fighting tax evasion, as priority axis of the tax administration activity, the relevant professional bodies intensified the inspection and audit activities²⁸. These resulted in additional tax amounts, referrals for criminal investigations, damages assessed.

In addition, the 2014-2020 Partnership Agreement for Romania (an agreement which is requested by the European Commission from all Member States) sets the country's funding priorities to achieve the objectives of the Europe 2020 Strategy. The purpose will be to improve the efficiency of implementation and lower the administrative burden, with funds allocation oriented towards obtaining a significant impact of investments, namely the continuity of sustainable interventions of 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, channel 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.

²⁸Higher by 20.7% in 2013 compared to 2012.

7. INSTITUTIONAL FEATURES OF PUBLIC FINANCE

7.1. FISCAL RULES

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, as follows:

1. Introduce a numerical fiscal rule regarding the structural budget deficit; this rule is 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 ratio 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.

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
 - Then: 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
 - Then: devise a program 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
 - Then: 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.

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 reveals 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, in the macroeconomic forecast, 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.

7. Strengthen the role of the Fiscal Council in monitoring the observance and implementation of fiscal rules:

- Regarding the action of monitoring how numerical fiscal rules are observed and applied, including those on the correction mechanism and extraordinary circumstances. Thus, The Fiscal Council issues opinions on:
 - the occurrence of extraordinary circumstances;
 - the measures correcting the deviation;
- The Government must explain the divergence of opinions with the Fiscal Council.

7.2. 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.

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 how fiscal rules are observed; issue recommendations on the current and future fiscal policy.

7.3. STATISTICAL GOVERNANCE

Over the recent years, Romania has made important progress in improving the fiscal forecast and the budget formulation practices. In order to strengthen fiscal transparency and to achieve a better consistency with the European System of Accounts (ESA), a medium term action plan is being discussed which is aimed at improving the coverage of macroeconomic and fiscal and budgetary data, the reporting periods and deadlines, simultaneously with boosting the quality and integrity of data reporting.

ANNEXES

Table no. 1 a – Macroeconomic prospects

	ESA CODE						
		2013	2013	2014	2015	2016	2017
		LEVEL ¹⁾	RATE OF CHANGE				
		BILLION RON					
1. Real GDP	B1*g	607.4	3.5	2.5	2.6	3.0	3.3
2. Nominal GDP	B1*g	628.6	7.1	5.4	5.5	5.5	5.6
REAL GDP COMPONENTS							
3. Private consumption expenditures	P3	377.8	1.3	2.0	2.9	3.2	3.3
4. Government consumption expenditure	P3	87.4	-1.8	1.8	1.7	2.5	1.7
5. Gross Fixed Capital Formation	P51	149.2	-3.3	2.7	4.0	5.2	6.1
6. Changes in inventories and net acquisition of valuables(% of GDP)	P52+ P53	-5.2	-0.9	-0.6	-0.3	0.1	0.1
7. Exports of goods and services	P6	270.7	13.5	6.6	4.7	4.5	5.0
8. Imports of goods and services	P7	272.6	2.4	5.6	5.5	5.8	6.1
CONTRIBUTIONS TO GDP GROWTH							
9. Final domestic demand			-0.3	2.1	3.0	3.6	3.9
10. Changes in inventories and net acquisition of valuables	P52+ P53		-0.6	0.0	0.0	0.0	0.0
11. Net export	B11		4.4	0.4	-0.4	-0.6	-0.6

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

Table no. 1 b – Price developments

	2013	2014	2015	2016	2017
	RATE OF CHANGE				
1. GDP deflator	3.5	2.8	2.8	2.4	2.3
2. Private consumption deflator	4.4	2.8	2.6	2.3	2.1
3. Harmonized consumer price index	3.2	2.5	3.3	3.0	2.7
4. Public consumption deflator	7.0	4.6	3.5	2.7	2.4
5. Investments deflator	-0.7	2.5	2.2	2.1	2.0
6. Export price deflator (goods and services)	-2.1	1.1	1.0	0.7	0.4
7. Import price deflator (goods and services)	-1.5	2.4	1.5	0.6	0.3

Table no. 1 c - Labor market developments

	ESA CODE	2013	2013	2014	2015	2016	2017
		LEVEL THOU. PERSONS	RATE OF CHANGE				
1. Employment ¹⁾		9189.7	-0.1	0.2	0.3	0.3	0.3
2. Employment thousand hours worked ²⁾		17265273	-0.5	0.3	0.4	0.5	0.5
3. Unemployment rate -% ³⁾		729.7	7.3	7.1	6.9	6.8	6.7
4. Labor productivity ⁴⁾			3.7	2.3	2.3	2.7	2.9
5. Labor productivity, hours worked ⁵⁾			4.0	2.2	2.2	2.5	2.7
6. Compensation of employees – million RON	D1	208411	6.5	6.2	5.6	5.7	5.7
7. Compensation per employee - RON		33261	5.7	5.6	4.9	5.0	5.0

¹⁾ Employment, the definition of the domestic concept in the national accounts

²⁾ The definition from the national accounts

³⁾ Definition approximated 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	2013	2014	2015	2016	2017
1. Net lending/borrowing, vis-à-vis the rest of the world	B9	1.1	1.2	0.7	0.9	0.8
of which:						
- balance of goods and services		-0.5	-0.6	-1.2	-1.7	-2.1
-balance of primary incomes and transfers		-0.6	-0.4	-0.3	0.2	0.1
- capital account		2.2	2.2	2.2	2.4	2.8
2. Net lending/borrowing of the private sector	B.9	3.4	3.4	2.1	2.2	1.9
3. Net lending/borrowing of general government	EDP B.9	-2.3	-2.2	-1.4	-1.3	-1.1
4. Statistical discrepancy		0.0	0.0	0.0	0.0	0.0

Table no. 2 a– General Government budgetary prospects

	ESA CODE	2013	2013	2014	2015	2016	2017
		LEVEL MILLION RON	% OF GDP				
Net Balance (EDP B9), by sub-sectors							
1. Consolidated Budget	S.13	-14308,2	-2,3	-2,2	-1,4	-1,3	-1,1
2. Central Administration	S.131	-18068,8	-2,9	-2,3	-1,4	-1,2	-1,0
3. State Administration	S.132	M	M	M	M	M	M
4. Local Administration	S.133	870,2	0,1	-0,1	-0,1	-0,1	-0,1
5. Social Security Funds	S.134	2890,4	0,5	0,2	0,1	0,0	0,0
Consolidated Budget (S13)							
6. Total revenue	TR	205503,0	32,7	33,4	33,6	33,9	34,0
7. Total expenditures	TE ¹⁾	219811,2	35,0	35,6	35,0	35,2	35,1
8. Net Balance	EDP B.9	-14308,2	-2,3	-2,2	-1,4	-1,3	-1,1
9. Interest expenditure	EDP D.41	11077,4	1,8	1,8	1,8	1,8	1,7
10. Primary Balance ²⁾		-3230,8	-0,5	-0,4	0,4	0,5	0,6
11. One-off and other provisional measures ³⁾							
Selected Components of Revenue							
12. Total taxes (12=12a+12b+12c)		117617.7	18.7	19.2	19.4	19.6	19.8
12a. Taxes on production and imports	D.2	80047.6	12.7	13.0	13.1	13.1	13.2
12b. Current taxes on income, wealth, etc.	D.5	37570.1	6.0	6.2	6.3	6.5	6.6
12c. Capital taxes	D.91						
13. Social contributions	D.61	55275.5	8.8	8.8	8.8	8.8	8.8
14. Property income	D.4	4911.3	0.8	0.9	0.9	0.9	0.9
15. Other ⁴⁾		27698.5	4.4	4.5	4.5	4.7	4.6
16=6. Total Revenue	TR	205503.0	32.7	33.4	33.6	33.9	34.0
Selected Components of Expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	84220.3	13.4	14.0	13.9	13.7	13.3
17a. Compensation of employees	D.1	51124.1	8.1	8.0	8.0	7.9	7.6
17b. Intermediate Consumption	P.2	33096.2	5.3	6.0	5.9	5.8	5.7
18. Social payments 18=18a+18b)		77619.6	12.3	12.0	11.7	11.5	11.4
of which, Unemployment benefits ⁶⁾							
18a. Social transfers in kind	D.6311, D.6312, D.63131	9545.6	1.5	1.3	1.2	1.1	1.1
18b. Social transfers other than in kind	D62	68074.0	10.8	10.7	10.5	10.4	10.3
19=9. Interest expenditure	EDP D.41	11077.4	1.8	1.8	1.8	1.8	1.7
20. Subsidies	D.3	2018.1	0.3	0.4	0.4	0.4	0.4
21. Gross Fixed Capital Formation	P.51	27992.7	4.5	4.8	4.6	5.1	5.6
22. Capital Transfers	D.9	5296.2	0.8	0.9	0.8	0.9	0.9
23. Other ⁷⁾		11586.9	1.8	1.8	1.8	1.8	1.8
24=7. Total Expenditures	TE1	219811.2	35.0	35.6	35.0	35.2	35.1

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), if appropriate.

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

	2013	2013	2014	2015	2016	2017
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenue at unchanged policies	205503.0	32.7	33.4	33.6	33.9	34.0
2. Total expenditure at unchanged policies	219811.2	35.0	35.6	35.0	35.2	35.1

1) The projections shall start at the time when the Stability or Convergence Programme is drafted (please indicate the cut-off date) 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

	2013	2013	2014	2015	2016	2017
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	8911.5	1.4	2.2	2.4	2.4	2.4
2. Cyclical unemployment benefit expenditure ¹	33.27	0.0053*)	0.0000	-0.0050	-0.0076	-0.0076
3. Effect of discretionary revenue measures ²	0	0	0.6 **)	0	0	0
4. Revenue increase mandated by law	0	0	0	0	0	0

¹) Please provide details on the method used to arrive to the cyclical component of the unemployment expenditures as defined by COFOG under code 10.5

$$E_t^{UC} = E_t^U \cdot \frac{u_t - NAWRU_t}{u_t}$$

The following formula was used: 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 2013 unemployment costs were 1.2 billion (0.2% of GDP) and are maintained as a percentage of GDP for the period 2015-2017

***) Represents revenue measures taken in 2014 (present at fiscal-budgetary policy in 2014 on page 20)

Table no. 3– Central administration expenditures by functions

% OF GDP	COFOG CODE	2013	2017
1. General public services	1	4.9	n/a
2. Defense	2	0.8	n/a
3. Public order and safety	3	2.3	n/a
4. Economic affairs	4	5.4	n/a
5. Environment protection	5	0.6	n/a
6. Housing and community amenities	6	1.2	n/a
7. Health	7	4.4	n/a
8. Recreation, culture and religion	8	0.9	n/a
9. Education	9	3.0	n/a
10. Social protection	10	11.5	n/a
11. Total expenditures (=item 7=24 in Table 2a)	TE	35.0	35.1

Table no. 4 – General Government debt developments

% OF GDP	ESA CODE	2013	2014	2015	2016	2017
1. Gross government debt ¹⁾		38.4	39.9	39.6	39.1	38.5
2. Change in gross government debt ratio		0.4	1.5	-0.3	-0.5	-0.6
Contribution to changes in gross debt						
3. Primary balance ²⁾		-0.5	-0.4	0.4	0.5	0.6
4. Interest expenditure ³⁾	EDP D.41	1.8	1.8	1.8	1.8	1.7
5. Stock-flow adjustment		-1.9	-0.7	-1.7	-1.8	-1.7
<i>of which:</i>						
- Differences between cash and accruals ⁴⁾		-0.1	-0.1	-0.1	-0.1	-0.1
- Net accumulation of financial assets ⁵⁾		1.3	0.8	0.0	0.0	0.1
<i>of which :</i>						
- privatization proceeds		0.3	0.0	0.0	0.0	0.0
- Valuation effects and others ⁶⁾		-3.1	-1.5	-1.7	-1.7	-1.7
p.m. Implicit interest rate on debt ⁷⁾		5.0	4.9	4.7	4.8	4.6
Other relevant variables						
6. Liquid financial assets ⁸⁾	% to GDP	7.9	8.3	7.9	7.4	7.1
7. Net financial debt (7=1-6)	% to GDP	30.5	31.6	31.7	31.7	31.4
8. Debt amortization (existing obligations) since the end of the previous year ⁹⁾	% to GDP	8.8	6.8	5.2	4.7	2.6
9. Percentage debt denominated in foreign currency	% to debt	61.5	60.2	57.2	53.4	52.1
10. Average maturity ¹⁰⁾	years	4.4	4.6	-	-	-

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, 2013.

¹⁰⁾ Average remaining maturity

Table no. 5 – Cyclical developments

% OF GDP	ESA CODE	2013	2014	2015	2016	2017
1. Real GDP growth (%)		3.5	2.5	2.6	3.0	3.3
2. Net lending of general government	EDP B.9	-2.3	-2.2	-1.4	-1.3	-1.1
3. Interest expenditures	EDP D.41	1.8	1.8	1.8	1.8	1.7
4. <i>One-off</i> and other temporary measures ¹⁾		0	0	0	0	0
5. Potential GDP growth (%)		2.0	2.3	2.4	2.6	2.7
Contribution:						
- Labour		0.1	0.2	0.2	0.2	0.1
- Capital		1.1	1.2	1.2	1.3	1.4
- Total factor productivity		0.7	0.9	1	1.1	1.2
6. Output gap		-1.6	-1.4	-1.2	-0.8	-0.2
7. Cyclical budgetary component		-0.5	-0.5	-0.4	-0.3	-0.1
8. Cyclically adjusted balance (2-7)		-1.8	-1.7	-1.0	-1.0	-1.0
9. Cyclically adjusted primary balance(8+3)		0	0.1	0.8	0.8	0.7
10. Structural balance (8-4)		-1.8	-1.7	-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 with long term positive effects on the economic growth potential and the situations foreseen in the Treaty on stability, coordination and governance within the economic and monetary union, article 3, paragraphs 1(c) and 3(b).

Table no. 6 – Divergence from previous update

	ESA CODE	2013	2014	2015	2016	2017
Real GDP growth (%)						
Previous edition		1.6	2.2	2.4	3.0	
Current edition		3.5	2.5	2.6	3.0	3.3
Difference		1.9	0.3	0.2	0.0	
General government net lending(% of GDP)						
Previous edition	EDP B.9	-2.4	-2.0	-1.8	-1.8	
Current edition	EDP B.9	-2.3	-2.2	-1.4	-1.3	-1.1
Difference		0.1	-0.2	0.4	0.5	
General Government Gross Debt (% of GDP)						
Previous edition		38.6	38.5	38.6	38.9	
Current edition		38.4	39.9	39.6	39.1	38.5
Difference		-0.2	1.4	1.0	0.2	

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

% OF GDP	2007	2010	2013	2020	2030	2040	2050	2060
Total Expenditures								
Of which: age-related expenditures	13,2	17,2	15,8	16,3	17,2	18,8	20,6	21,6
- Pensions expenditures	6,4	9,4	8,1	8,6	9,3	10,5	11,5	11,9
- Social security								
Full service and early pensions	5,3	7,8	6,9	7,2	7,7	8,9	10,1	10,6
Other pensions (disability, descendants)	0,8	1,6	1,2	1,4	1,6	1,5	1,4	1,3
Occupational pensions (if connected to the central administration)								
- Health care	3,5	3,7	3,7	3,7	3,9	4,2	4,5	4,6
- Long term care (previously counted in "Healthcare")	0,5	0,6	0,7	0,7	0,8	1,0	1,3	1,7
- Education expenditures	2,8	3,5	3,3	3,3	3,2	3,1	3,3	3,4
- Other age-related expenditures								
- Interest expenditures								
Total Revenues								
Of which: property income								
Of which: from pension contributions (or social contributions if appropriate)	6,6	7,0	7,2	8,1	9,7	11,1	11,9	12,2
Pension reserve fund assets	0	0	1,8	6,0	11,4	8,8	5,7	3,9
Of which: consolidated public pension fund assets (assets other than the central administration's liabilities)								
Systemic Pensions Reforms¹								
Social Contributions diverted to mandatory private scheme ²⁾	0	0,2	0,4	1,0	1,1	1,3	1,5	1,7
Pension expenditures paid by mandatory private scheme ³⁾	0	0	0	0,1	0,5	1,2	1,5	1,1
Assumptions								
	- average rates -							
Labor productivity growth (hourly rates)	5,9	0,5	2,0	2,5	2,1	2,3	2,1	1,7
Real GDP growth	6,3	-0,3	2,1	1,9	1,3	1,2	0,7	0,5
	- % -							
Participation rate male (aged 20 to 64)	71,0	77,0	77,2	78,1	75,6	73,4	72,9	73,8
Participation rate female (aged 20 to 64)	57,9	59,9	59,6	59,4	57,3	55,6	55,3	56,4
Total participation rate (aged 20 to 64)	64,4	68,8	68,3	68,8	66,5	64,5	64,1	65,2
Unemployment rate – ILO	6,8	6,6	6,9	6,9	6,7	6,7	6,7	6,7
Share of population at 65 and over 65 in total population	14,5	17,6	15,1	17,6	20,2	25,7	31,1	34,8

Average rates refer to the above-mentioned interval. For the forecast years the rates are calculated based on potential GDP estimated in the 2012 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 2012, 0.5 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 – Contingent liabilities

% of GDP	2013	2014
Public Guarantees*)	2.2%	2.9%
<i>Of which: linked to the financial sector</i>	0.03%	0.03%

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