ROMANIA'S GOVERNMENT

CONVERGENCE PROGRAMME

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1. INTRODUCTION

The coordination of the economic and budgetary surveillance policies is one of the European Commission's permanent concerns, as it represents a requirement for increasing the interdependence generated by the completion of the Internal Market and the Economic and Monetary Union. Moreover, according to the provisions stipulated in articles 99 and 104 of the EC's Stability and Growth Pact (the Council Regulation (EC)1466/97, amended by Regulation No. 1055/2005 and, respectively, Regulation No. 1467/1997, amended by Regulation No. 1056/2005), budgetary assistance in the EU is based on the in-depth and correlated analysis of the Stability or Convergence Programmes (developed by the Member States that did not yet adopt the Euro currency).

Romania is required to draft and send the first edition of the Convergence Programme to the European Commission in January, to allow its evaluation simultaneously with the other Member States' Programmes.

The European Commission, namely the General Directorate for Economic and Financial Affairs (DG ECFIN) sent the methodology on the Convergence Programmes' content and format in order to help the drafting process of the first edition according to a unitary concept, making easier their comparative analysis.

For Romania, the completion of a seven-year interval of preparations (2000-2006) for the EU accession and the start of another interval of preparations (2007-2013) for the adoption of the euro currency, which has approximately the same duration, is a significant opportunity to continue the reforms and to reduce regional economic disparities. Improvements concerning real convergence must be made in such a manner not to affect the nominal convergence criteria, that is by maintaining macroeconomic equilibrium.

For these reasons this edition of the Convergence Programme is of particular importance for Romania, being the first Programme to evaluate the possibilities for sustainable economic development, while promoting policies aimed at reaching convergence and improving the sustainability of public finances.

The timetable for adopting the euro is essentially a problem of temporal optimization, where the speed is dictated by a cost - benefit analysis, subject to the following constraints:

(i) fulfill on a sustainable basis the nominal convergence criteria;
(ii) attain a satisfactory level of the real convergence criteria;
(iii) reduce ERM2 participation to the mandatory minimum of two years.

Although it is stipulated that after joining the European Union, the monetary and exchange rate policies of each state become the object of common concern, it is also clear that the choices of the monetary and exchange rate strategy after EU accession represents, primarily, a responsibility and a prerogative of the member state.

The calendar proposed by the Romanian authorities for entering the exchange rate mechanism ERM 2 and, eventually, for euro adoption, has to fulfill the following conditions:

– to allow a sufficient time interval to fulfill constraints (i) and (ii);

– to be ambitious enough in order to focus the political will on the continuation of reforms.

All the institutions involved in producing the Convergence Programme (Ministry of Labour, Social Solidarity and Family, National Bank of Romania, National Commission for Economic Forecasting, National Institute of Statistics etc.) joined their efforts under the coordination of the Ministry of Public Finance to supply data and information as detailed and significant as possible, in accordance with the European Commission's requirements, which will substantiate and highlight the quality and consistency of the macroeconomic policies for economic growth and budgetary stability, as well as the prospects for real and nominal convergence of the Romanian economy.

Moreover, the experience from other member states was considered in the process of designing the Convergence program, together with the content of the programming documents issued by Romania, namely: the National Strategic Reference Framework and the National Reform Program.

The preparation of the Convergence Programme benefited from assistance on behalf of the European Commission granted by the Phare RO 2003/005-551.02.03 project, developed through the Romanian Center for Economic Policies (CEROPE).

Considering the fact that this programme represents a broad and extremely important document from the perspective of benefitting of the advantages offered by the accession to the European Union, entailing consequences for the entire society, various non-governmental organizations were consulted during its preparation (including public seminars and debates), alongside trade unions and employers' associations, as well as some scientific personalities. The Convergence Programme was also submitted to the Romanian Parliament for consultation and information, being endorsed by the government, and thus representing a commitment that transcends the electoral cycle.

2. OVERALL POLICY FRAMEWORK AND OBJECTIVES

2.1 Government Objectives and Priorities

The fundamental objective of the Government's economic policy is to promote sustainable economic growth, in conditions of competitiveness, which will in turn ensure nominal and real convergence with the European Union. To guarantee the success of this strategy the Government will give top priority to investing in human capital and in infrastructure.

The most important prerequisite for meeting the fundamental objective is the implementation of the right mix of macroeconomic policies to ensure the continuation of the disinflation process and to preserve the external sustainability.

As key elements comprised in the Government' medium-term economic strategy we highlight the following objectives, consistent with the goals of the European Community as set out in the re-launched Lisbon Strategy, the Broad Economic Policy Guidelines, and the EU Stability and Growth Pact:

- maintaining macroeconomic stability, continuing the disinflation process and containing the current account deficit;
- improving the medium term predictability and performance of the fiscal policy, including effective utilization of EU funds;
- continuing and deepening the structural reforms and delivering improved public services in health, education and professional formation, research and development and transportation as well as implementing the necessary reforms to enhance accountability and efficiency;
- ensuring the long term sustainability of the public finances;
- improving the business environment, promoting entrepreneurial culture, increasing labor market participation and flexibility and a harmonious regional development;
- public administration reform.

2.2 Monetary and Exchange Rate Policy

The new monetary policy framework increased the credibility of the process of designing and implementing the macroeconomic policy, facilitating the continuation of the disinflation process at a sustainable pace while maintaining consistent economic growth. Starting with August 2005, the monetary policy has been conducted within the framework of direct inflation targeting regime, based on transparency of NBR activities as well as clearly formulated inflation targets that made it possible the assessment of the effectiveness of the activities carried out by the monetary authorities. The performance of the macroeconomic policy mix promoted in 2006 led to the attainement of the inflation target defined as 5% dec/dec[*]. The monetary policy rate together with the policy of market liquidity control and the additional measures aimed at slowing down the pace of non-government credit growth are expected to be the main pillars of controlling the aggregate demand. The public announcement of inflation targets will remain the most efficient mean of anchoring inflationary expectations, their effectiveness being correlated with the overall credibility of

[*] Accordingly to the statistical data, in 2006 CPI dec-on-dec attained 4.87%.

the macroeconomic policy mix. The role of the interest rate policy will strengthen, enhancing the anchoring of inflation expectations trough its signal effect. At the same time, this variable can be calibrated so as to continue the disinflation path in a sustainable manner, by maintaining adequate credit growth and by stimulating the saving process.

For 2007, the inflation target was set at 4% dec.-on-dec. with a tolerance band of one percentage point in either direction; for 2008, the central target will become 3.8 % dec.-on-dec., with the same margin of tolerance, and, over the medium term, the inflation targets will be set in accordance with the path necessary for maintaining the disinflation process consistent with the convergence criteria.

The managed float exchange rate system is consistent with choosing the inflation as a nominal anchor and allows responding in a flexible way to unexpected shocks that may occur.

Considering the need to implement additional structural reforms that will increase the Romanian economy's capacity and flexibility to face asymmetric shocks, Romania will not be able to join the exchange rate mechanism (ERM 2) sooner than 2012.
Joining ERM 2, expected in 2012, will represent an important stage on the convergence path.

A higher degree of exchange rate stability can be ensured by increasing the credibility of the convergence process and through the stabilization of the long-term exchange rate expectations. In light of the expected productivity growth and the inflow of foreign direct investments, a gradual appreciation of the RON versus the European currency is likely to continue, this adjustment supporting the nominal and real convergence of the Romanian economy.

2.3 Fiscal Policy

The Government' fiscal policy is designed to support the convergence objectives, by maintaining the budgetary deficit at a prudent level, by stimulating improved collection rates, and by promoting measures for enlarging the tax base with a view to consolidate public revenues on a sustainable basis. Consolidating the quality of public finance is the Government's top objective, and its success is the main prerequisite for attaining the medium term budget objective and for promoting the efficient functioning of the automatic stabilizers.

Regarding the specific medium-term objective, we assume that the structural deficit will be 0.9% of GDP by 2011. This level provides a satisfactory safety margin to prevent breaching the budget deficit ceiling of 3% of GDP in the presence of possible future adverse shocks to the rate of economic growth.

The Government's efforts over the medium-term are directed towards the creation of adequate conditions for maintaining the long-term sustainability of public finance, including the costs of launching the second pension pillar, which primarily means adjusting public budgets to the consequences of population ageing.

The Government's goal is set to deliver improved public services, including high quality education and professional training, a modern and reliable transport network, and a responsive health service, through sustained increases in the net public sector investment, including effective utilization of EU funds.

Managing financial resources efficiently and effectively is central to this objective, with a view to allow sustained improvements of the fiscal policy performance in the long term. In this respect, the introduction of programme budgeting, increasing the expenditure flexibility and the consolidation of the three year budgeting in government financial planning will ensure the expected efficiency gains in public sector spending.

2.4 Structural policies

In addition to the fiscal consolidation trough improved efficiency and accountability in the spending of public resources, one of the main current challenges in the area of economic policy is the need to create adequate conditions for the functioning of the **labour market** and stimulate entrepreneurship. These areas are crucial for sustaining a rapid real convergence process and enhancing the competitiveness of the economy. Labour market flexibility is central to improving the companies' performance in the context of increased markets dynamics and globalization. Thus, development of a more flexible and competitive labour market may lead to declining unbalances thus contributing to macroeconomic stability. There are proposed in the National Reform Program, a series of actions and measures to initiate, continue and deepen structural reforms in key areas of the Re-launched Lisbon Strategy, with a view to ensure economic stability and public finance sustainability, improve competitiveness and productivity as well as enhace labor market functioning.

2.4.1. Labour market

The labour market in Romania is characterized by a relatively low activity rate from a comparative perspective, high unemployment rates for the age categories of 15-19 years and 20-24 years, a high percentage of early retirement from the formal labour market and significant employment in the agriculture sector with work relationships that are not subject to taxation.

Current Situation of the Labour Market

After 1990, the employed population declined continuosly. The activity and the employment rates for the working age population had sinuous evolutions reaching, in 2005, the level of 62.4%, and 57.7% respectively, lower than the EU 25 average by 9.2 and 7.7 percentage points, respectively.

The restructuring and the privatization process led to a migration of the urban population made redundant from the restructured sectors towards the rural area for subsistence agriculture. The agriculture became the last resort employer, determining the surpassing of the employment rate in the urban area by the rural one. The development of a competitive agriculture focused on medium-sized farms is expected to lead to the orientation of the active population of the rural area towards the agriculture services sector. Moreover, the consolidation of economic performance in industry and services will represent an additional incentive for the population segment employed in the subsistence agriculture towards the non-agricultural activity area.

Thus, it is estimated that in 2009, against the backdrop of the total employed population, the weight of population employed in the agricultural sector will decrease to 26.3%, 5.8 percentage points lower than in 2005.

At the same time, both the activity and the employment rates are expected to increase, reaching approximately 63,3% and, respectively, 59% in 2009.

The government aims at increasing the annual average participation rate for the active population aged between 15-64 years by 0.3 percentage points. In turn, achieving the objective of an employment rate of 59% and an ILO unemployment rate of 6.5% by 2009, requires further reform of the labour market with a view to enhance competitiveness.

The government will concentrate its efforts on the three priorities laid down in the re-launched Lisbon Agenda: attracting and upholding more people in the labour market, improving the adaptability and boosting the investments in the human capital, correlated with the demographic problem and migration, social exclusion, and with associated elements such as the population's health and the sensitive aspects of poverty.

A series of measures regarding the flexibility of the labour market in Romania were already adopted by the revision of the Labour Code (EGO no. 55/2006 for the revision of Law no. 53/2003), aiming at reducing the employment barriers through: loosening the restrictions on the use of term individual labour contracts to facilitate the taxation of labour from the informal area of the economy; promoting new types of employment through work contracts with part-time work and home work; simplifying the procedures for recording employees by introducing the general employees registry. In 2006, the provisions of the Labour Code regarding the flexibility of the collective lay-offs have been expanded, allowing the companies to swiftly resize their activity in line with their needs, ensuring, at the same time, protection of the workers going to be made redundant.

A number of programmes are expected to further contribute to the flexibility of the labour market:

- supporting training and obtaining management qualifications intended to make the entrepreneurship a career option, programme supported by grants from the European Social Fund;
- individually tailored assistance services for the unemployed, especially for the long-term unemployed, youth and vulnerable social groups;
- offering incentives for the employees to develop companies and careers, also aimed at enhancing the awareness of employers and employees as to the necessity of the long-life learning.

Fiscal incentives for employment

The introduction of the flat income tax in 2005 was intended to spur investments and create new employment opportunities on the one hand, and on the other hand to reduce the number of workers in the informal economy (it is estimated that this measure has so far clarified the situation of about 150,000 workers) and to trim down the burden associated to the tax administration. The government intends to continue the reduction of the labour burden by diminishing gradually the social security rates. Supplementary measures are envisaging the reduction of the contribution to the unemployment fund granted for certain time intervals to defined target groups: young graduates, workers aged over 45 years, single workers who support their families, disabled persons.

A guaranteed minimum income programme was implemented closely linked to the social security system, aiming at promoting employment and at alleviating poverty. The programme provides minimum income for households and also stimulates work, as the employment of a household family member leads to the increase by 15% of the social aid entitlement. Moreover, granting the guaranteed minimum income represents a complementary measure to the allocation of other benefits such as: medical insurance, emergency aid, heating aid.

In the context of the ongoing adjustment of the labour market, the government focuses to ensure equal access and reinsertion for the youths, women, elderly people and the persons considered disadvantaged. Thus, special attention will be paid to the consolidation of the institutional capacity, especially at local level, with a view to efficiently use the programmes financed under the European Social Fund. The objectives set by the government regard the decline in the long-term unemployment rate from 4.0% in 2005 to 3.5% in 2009, the ILO unemployment rate from 7.2% in 2005 to 6.5% in 2009 and the increase in the elderly employment rate from 39.4% in 2005 to 42.8% in 2009.

Quality training, acquirement of new skills by the work force facilitate the improved competitiveness of the labour market and to that extent becomes increasingly important in a knowledge-based economy and a global marketplace. As a significant requirement in developing the knowledge-based society is represented by adjusting the initial education and lifelong learning system, the government will give priority to the modernization of the national education system and the public service for employment. In this respect, through the National Reform Programme, a complex set of objectives will be set, regarding the stimulation of developing skills for digital economy and employment mobility, participation in initial and lifelong education, as well as the overall education reform.

Regarding life-long learning and vocational education, Romania registers a very low rate of participation to education and training among the population in the 25-64 age group (1.1% - 2001, 1.1% - 2002, 1.3% - 2003, 1.6% - 2005). The low number and the inconsistent geographical coverage of training providers for adults, the entrepreneurs/ enterprises low interest for the investment in developing human resources, as well as the training supply which focused more on programmes for general skills (computer usage, foreign languages, accountancy, etc.) and less on specific skills determined a low rate of participation to these programmes.

For the year 2010, it is estimated an increase by more than 7% of the participation rate to education and professional training for the 25 - 64 age group, representing an increase of 5.4 percentage points compared to 2005.

An important requirement in developing the knowledge-based society is represented by adjusting the education and vocational training systems in order to meet the market requirements. This implies upgrading the educational system regarding the initial and lifelong education and vocational training and updating the education curriculum and continuous teacher training.

Hence, regarding the education of young people as participants to the knowledge-based economy with a view to stimulate the development of digital economy skills, there are programmes for supplying IT systems for the schools in rural areas and the introduction of the digital literacy concept starting with the elementary school level. To reduce the gaps between schools in rural and urban areas, investments will be promoted to generalize the endowment of IT infrastructure of the rural schools by setting up an informational centre in each of the 2,884 settlements.

With a view to alleviate early school leaving, *Early Education Reform* has been promoted with dedicated components for the disadvantaged categories, focusing on Roma children, on children from special schools integrated in mainstream schools, and on children from social-economic disadvantaged groups. In addition to this, with a view to attract school age youths in the educational system, there are provided transportation services to schools for the students in isolated areas. Within the context of reforming the educational system, it is envisaged a concentration of the educational services supply (facilities related to a complex educational process, adequate material resources, diversified on education profiles, facilities related to leisure activities, etc.) in a "Community resources centre", the project aiming to the *enhancement of education quality and compatibility to the European educational system*, within the programme for building school campuses.

Romania recorded a significant dynamic in the labor market regarding the domestic geographic and occupational mobility. Within the context of diversification in the labor market, it is necessary to continue the process of adapting training services to the employers' needs and the development of perspectives for new occupations, so that capable individuals can easily switch jobs through acquiring of new competences. In this vein, it is envisaged a competences and partial qualifications certification system, allowing to practice one or more occupations and acquiring full qualifications, including the development of individuals' ability to employ independent activities. With a view to enhance the domestic geographical mobility and close the labor market deficit in certain local and regional markets, it is sought to increase the visibility of openings as well as of the facilities promoted by employers, so that workers would be provided incentives to change their jobs.

Regarding the external dimension of geographic mobility, adequate management of the economic migration will be required with a view to offset labor force deficit in certain sectors. Special programmes for the admission of foreign workforce will be drawn up depending on the Romanian labor market demands. At the same time, incentives will be provided for attracting highly skilled foreign personnel required especially in R&D and management fields.

2.4.2. Improving the Business Environment

A key issue for the investment decision is represented by the existence of a clear, stable and predictable business environment. In order to accomplish this objective it is necessary, on one hand, to have better regulations, and on the other hand, to set the ways of supporting the entrepreneurial initiative. In this respect, The Action Plan for the Removal of Administrative Barriers in Business Environment was set up, and its implementation has simplified the legislative and administrative procedures related to business start-up and development on a competitive basis with direct impact on increasing the efficiency of the licensing and approvals system.

World Bank -Doing Business 2007: How to Reform ranked **Romania** on the top place in the region and ranked it the second out of a number of 175 economies, in relation with its performance on reforming the business environment, due to more simplified procedures for issuing constructions licenses and to the establishment of the one stop office for processing applications. The reforms of labour laws allowed term contracts to be extended to 24 months, encouraging initial hiring. New customs procedures cut to half the time to satisfy regulatory requirements for foreign trade. Romania has also significantly improved the quality of the information made available to potential investors and cut down the interval necessary for carrying out bankruptcy procedures.

To improve the business environment, the government is implementing a wide range of measures, some of which as follows:

- continue the transposition of the Internal Market Directives and the promotion of legislative simplification in over regulated fields – the elaboration of impact assessments and cost-benefit analysis for the adoption of new legislation;
- implement the objectives provided for in the document for „Policy in the field of State Aid (2006-2013)'';
- reduce the level of state aids and focusing them to support horizontal objectives and to diminish the economic and social disparities between the Romanian regions;
- update the procedures and the legislation regarding intellectual rights;
- improve at the business level the knowledge and practice regarding intellectual protection rights;
- implement the newly adopted legal framework regarding bankruptcy, with a view to enforce fiscal discipline and promote competitiveness;
- develop the administrative capacity required for the consistent and homogeneous implementation of the legal provisions accross the local level;
- improve communication with the business environment and develop administrative capacity on regulatory provisions impact assessment;
- publish on a web site all the information regarding licenses, permits, authorizations required to the businesses;
- generalization of the on-line system for submitting requests regarding licenses, permits, authorizations;
- extend sole administrative offices for realizing different formalities;
- continue the internalization efforts for documents within public administration;
- improve the IT infrastructure of the public administration with a view to reduce the compliance costs of the business environment (including the ones related to fiscal and employment matters);
- develop business and technology incubators and other business infrastructure (business development and technology transfer centers) to promote and facilitate the market entry for new businesses, as well as integrate companies in industry and technology clusters and in supply chains;
- implement environment and quality management systems and certification of products under an adequate certification infrastructure;
- develop portals with a view to facilitate e-commerce and business networks and support electronic commerce as a key element in business development;
- develop a set of mechanisms to support the internationalization of some products and the realization of Romanian investments in EU member states and worldwide;
- improve public transparency and communication, including via internet.

2.4.3. Regional Development

One of the major goals of the government's policy of economic and social cohesion is the balanced development of Romania's regions', which implies facilitating the economic growth in the less developed regions, so that the real convergence process with the European economy is felt across the territorial level.

The economic growth rate at national level was high over the past years and the inflation rate had a continuous downward trend. However, the degree of economic polarization , measured through the dispersion of the distribution of Gross Domestic Product per capita, in the eight regions related to the average value of the country, has registered an upward trend. At present, the ratio between the maximum (West region) and minimum (North-East region) values of the Gross Domestic Product per capita is approximately 1.7 (Bucharest region, whose GDP per capita is very high, was taken out of the comparison), namely higher than the level of 1.56 registered in 2003.

Table 2.1: Regional Disparity Indicators*

	2003	2004	2006	2009
GDP/per capita				
N-E Region	0.723	0.692	0.675	0.676
S-E Region	0.857	0.907	0.845	0.841
South Muntenia Region	0.812	0.834	0.822	0.822
S-W Region	0.847	0.833	0.843	0.840
W Region	1.129	1.147	1.149	1.140
N-W Region	0.966	0.972	0.920	0.915
Centre Region	1.072	1.042	1.087	1.084
Bucharest-Ilfov Region	1.940	1.915	2.044	2.067

Source: 2003 and 2004 NIS; 2006 and 2009, NCEF forecasts.

Usually, a country's economic development is led by several development poles (the respective country's capital city is among them in most cases), accumulating competitive advantages in attracting investments both domestic and foreign and developing faster than the national average, pulling the other less developed regions through a spill-over effect. Among the factors that offer competitive advantages, we can enumerate the development degree of the small and medium enterprises, together with their density, the existence of some higher education centers and of an qualified work force, available for employment, the structure of productive activities (the more developed the services and the lower percentage of farming activities in the value of the region's gross added value, the higher gross domestic product per capita), and the transportation, as well as recreational and entertainment, infrastructure.

Against this background, the regional and territorial planning policy becomes a priority, based on the development of polycentric urban areas. This implies complementary and correlated development of urban and rural localities, by identifying, in each area, the "development poles," namely those cities that can become centers for the propagation of

* Calculated as ratio between the GDP per capita at region level and the national average

development to the adjacent rural localities. Additionally, the development of polycentric urban areas is one of the important goals of the territorial planning policy, established through the Government Programme.

The flexibility of the labour market and an increased labour force mobility are key factors in helping the harmonius development of the country. An important role has also the transportation infrastructure needed for an expedient movement of the workforce and the education process in order to adapt the structure of the skills to the market requirements.

After accession, Romania will benefit from important funds to support the country's development and to diminish the disparities compared to other EU Member States.

The priorities established in the Regional Operational Programme for 2007-2013, namely; supporting sustainable urban development, aimed at reviving the urban centers with growth potential, the consolidation of the regional business environment, tourism development and infrastructure improvement, answer the general goal of complementary and correlated development of the urban and rural localities and will ensure the future reduction in regional discrepancies.

Although the reduction in economic disparities is a long time process, there is the prospect that simultaneously with increased regional development based on the structural funds, the regional discrepancies will register a slight decrease in the medium run.

2.4.4. Public Administration Reform

The incumbent government re-launched the public administration's reform through ambitious, updated strategies, aiming at the acceleration of its modernization process.

The reform's foremost objective is to modernize the public administration aiming at intensifying its contribution to a sustainable economic growth and an efficient use of the public funds, including an adequate absorption of the UE funds.

Among the priorities identified for the upcoming interval, we may list:
- consolidation of the ministries and public institutions' administrative capacity;
- modernization of the human resources management in public administration;
- public services decentralization and strengthening the local authorities' financial autonomy;
- drafting and adopting the public services Charter, which will include quality norms and principles on the suppliers of public services;
- promoting actions to advertise the best practices in the public administration reform area from the Eurpean Union
- improving the quality of the regulation process.

Strengthening the administrative capacity of the ministries and public institutions implies focusing the efforts towards the following actions:
- introducing and generalizing the performance based public management, oriented to objectives and achieving results;
- developing an institutional framework using at each level the strategic planning procedures and tools;

- extending and improving the budgeting process on a programme based manner, in a multiannual framework, at both central and local levels;
- widen and generalize the procedures and standards referring to the public policies' drafting, planning and coordination;
- consolidating the link between regulating and drafting, planning and coordination of the public policies.

A series of programmes financed by EU are implemented in support of the the government's actions regarding public organizations, aiming at modernization of their programmes, processes, and information management, human resources training, and development of inter-institutional network.

The reform of the services and of public utilities mainly focuses on the organization of public services and utilities in line with the citizens' requirements, the competent public authority introducing quality standards, being possible to monitor and assess the public service quality and the civil servants' activity, together with the continuation of the decentralization of the basic public services: education, health, social assistance, and public order.

The decentralization process will be developed along three main directions: strengthening of the local autonomy, administrative and fiscal decentralization, based on an action plan to be implemented in several steps, allowing for the assessment of efficiency of the decentralization steps. According to the principles of the European Charter of local self-governance, Government intervention is intended to be limited to only those cases where certain public services, programmes or projects cannot be provided by the local authorities.

With a view to improve the process of drafting, planning and coordination of the public policies, minimal standards were adopted regarding the assessment of the new regulation's impact. The Government endorsed the amendments to the Law regarding the methodology for drafting normative acts, thus correlating the regulatory process to the public policies grounding and substantiation. In order to implement and generalize the preliminary impact assessment, a series of handbooks were launched for drafting public policies proposals and methodologies employed in planning public policies and impact's assessment.

The quality of the regulatory process will improve by means of:

- a systematic assessment of the proposals related to the regulatory proposals, first at central level, followed by the local administration;
- regular consultative meetings with all social partners;
- introducing and extending the final and intermediate assessment of the public policies and regulations;
- simplifying the current regulations, including evaluation and setting up specific objectives related to reduction in administrative costs;
- an inter-institutional cooperation aiming at improving the quality of regulations.

The public administration's reform and the careful sizing of the human resources in relation with the real needs required for supplying adequate quality services is essential from the standpoint of promoting and supporting an efficient labour market and in order to avoid blocking the resources potentially available on the labour market in conflict with the private sector's development. The government committs to support and accelerate the process of the public administration's reform, in order to improve the public services' quality, increase responsiveness to citizen and improve the institutional accountability mechanisms.

3. Macroeconomic Scenario

3.1 Assumptions on the International Economic Environment

As an open economy firmly integrated in the economy of the European Union, Romania is sensitive to changes in the external environment, especially to economic developments in the largest countries of the EU, which are our trade partners. Hence, the macroeconomic scenario takes into consideration for the external environment mainly the forecasts of the European Commission, comprised in the 2006 ″Autumn Forecast″, showing a strong economic growth for the forecasting horizon, although a relative slowdown is expected compared to 2006. EU countries' economic growth is and will continue to be determined by the significant increase in internal demand, representing a favorable factor for the future economic development of Romania.

For 2007 and 2008 the EU economy is expected to grow close to its potential. The European Commission's Autumn Forecast estimates that in 2006 – the best economic year since 2000 – the economic growth will reach 2.8% for the whole EU (2.6% for the euro zone), followed by a small decline to 2.4% in 2007 and 2008 (approximately 2.2% in the euro zone). These assessments are based on a positive outlook for the global economy, even if the US growth is expected to slowdown (from 3.4% this year to 2.3% in 2007 and 2.8% in 2008).

Table 3.1: Assumptions on the external environment

	2004	2005	2006	2007	2008
GDP – global economy	5.3	4.9	5.1	4.6	4.7
GDP EU – 25, out of which:	2.4	1.7	2.8	2.4	2.4
• consumption	2.0	1.5	2.2	1.9	2.3
• investment	3.1	3.0	4.9	3.6	3.3
GDP euro zone	2.0	1.4	2.6	2.1	2.2
GDP Germany	1.2	0.9	2.4	1.2	2.0
GDP Italy	1.1	0.0	1.7	1.4	1.4
Inflation	2.1	2.1	2.3	2.3	2.0

Source: European Commission – The Autumn Forecast 2006

Another element, considered for the macroeconomic scenario, is the expected negative impact on growth of the Germany's VAT standard rate increase in 2007. This factor was taken into account especially as Germany is the second economic partner (after Italy), registering a share of 15% of Romania's total exports (intra and extra EU). In the case of Italy, which accounts for a share of almost 20% of Romania's exports, the economic growth is expected to stabilize at an annual rate of 1.4% for the next two years.

However, according to the recent forecasts of some international specialized institutions, the prospects of economic growth in the main partner countries and even in the entire euro zone are better than initially expected for 2007. Thus, the "Consensus Forecasts" publication has revised upwards its GDP growth forecast for the euro zone, from 2.5% in September 2006 to 2.7% in December (Italy from 1.6% to 1.7%; Germany from 2.2% to 2.5%, Austria from 2.8% to 3.1%; France is the exception, with the forecast revised downwards from 2.3% to 2.1%).

The fact that the European economy is led by domestic demand will be an important support for the robust development of the Romanian economy. The yearly growth in investment remains well above the one observed in the previous cycles. Moreover, the conditions for investment growth are favorable: significant marginal profits are posted and the capacity utilization rates are improving. Investments are expected to further expand by 3.6% in 2007 and by 3.3% in 2008 in the overall EU region.

At the same time, the consumers' confidence remains high, leading to an estimated yearly growth in consumption of more than 2% for the following years.

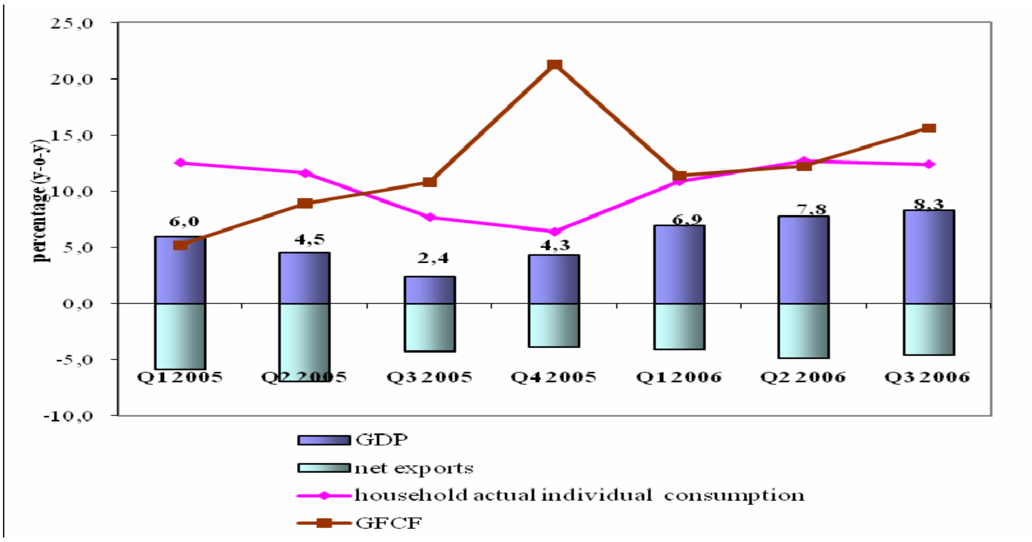
Alongside the robust growth of the European economy, the estimates in the macroeconomic scenario are based on the favorable economic and financial global conditions, such as: the stability of the international commodity prices, the moderate increase in the oil price (averaging 1% in 2007 and 2.5% in 2008) and the incremental improvement in the labour market (lower unit real labour costs and unemployment rate), and lower budgetary deficits.

3.2 Recent Macroeconomic Developments

Following a slowdown in the pace of economic growth, against the background of extremely difficult domestic and external conditions, to 4.1% in 2005, Romania returned this year to above potential GDP growth. The growth rate of the gross domestic product, of 7.8% in the first nine months of 2006, is the highest level registered along the last years.

An important characteristic of the economic growth in the first nine months of 2006 is the balanced contribution of the aggregate demand components, noting the acceleration of the gross fixed capital formation and the rapid increase of the exports of goods and services as compared with 2005.

Figure 3.1: GDP and its components evolution



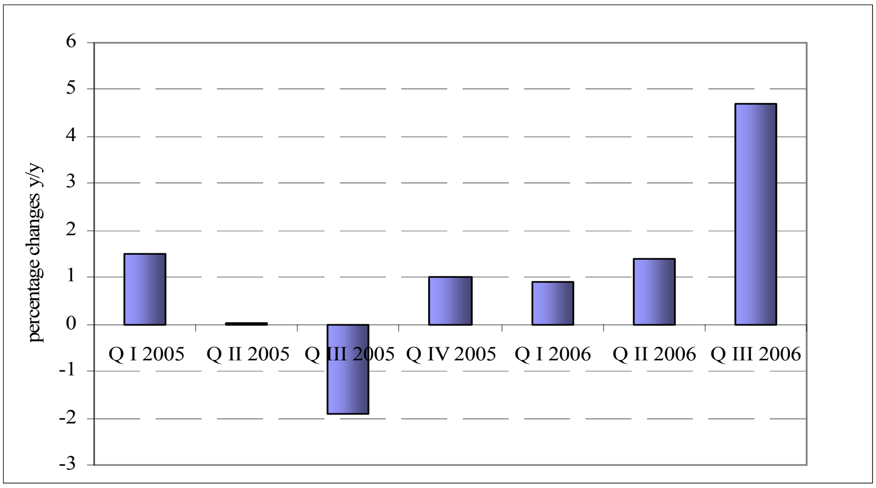
Source: National Institute for Statistics

The GDP evolution followed in the first three quarters of 2006 the pattern set out in Q4 2005, increasing as a result of a higher dynamics registered by the gross fixed capital formation and the reduction in the negative contribution of net exports, due to the acceleration in exports of goods and services. These evolutions led to an increase in gross fixed capital formation of 13.7% over the first nine months of 2006, compared to 9.4% over the first nine months of 2005, and to a decrease in the contribution of the net exports to the real increase of the gross domestic product, from 5.7% over the first nine months of 2005 to 4.6% over the first nine months of 2006.

Over the first 11 months of 2006, current account deficit increased by 44.8% compared to the similar period of 2005, mainly as a result of the expansion with 48,1% of the trade balance deficit, due to the speeding up of the investments and associated increased capital imports. This deficit was almost fully covered through foreign direct investments (with a share of 93.4% for January-November), accounting for EUR 8.3 billion, as compared to EUR 4.5 billion in the same period of 2005.

The positive impact of the economic growth, particularly due to the investment boost, was reflected both in an improved occupational structure by economic activity branches and in the raise of the employment by 2.4%[1)] in the first three quarters of 2006 compared to the same period of the previous year. The most important increases were registered in construction and services areas. Moreover, the weight of agriculture employment was reduced to 30,8% of the total employment.

Figure 3.2: Evolution of employment



Source: National Institute for Statistics

The employment rate at working age (15-64 years old) followed an upward trend starting 2005, reaching 59.3% in the first three quarters of 2006, greater by 1.5 percentage points compared to the similar period of 2005.

The ILO unemployment rate, measured quarterly, had a diminishing trend, reaching 7,0% at the end of the third quarter of 2006.

Although relatively modest from a comparative perspective, the Romanian performance and track-record regarding the reduction of the inflation rate, improved in the last several years-especially after 2000.

[1)] The data concerning employment are according to AMIGO methodology.

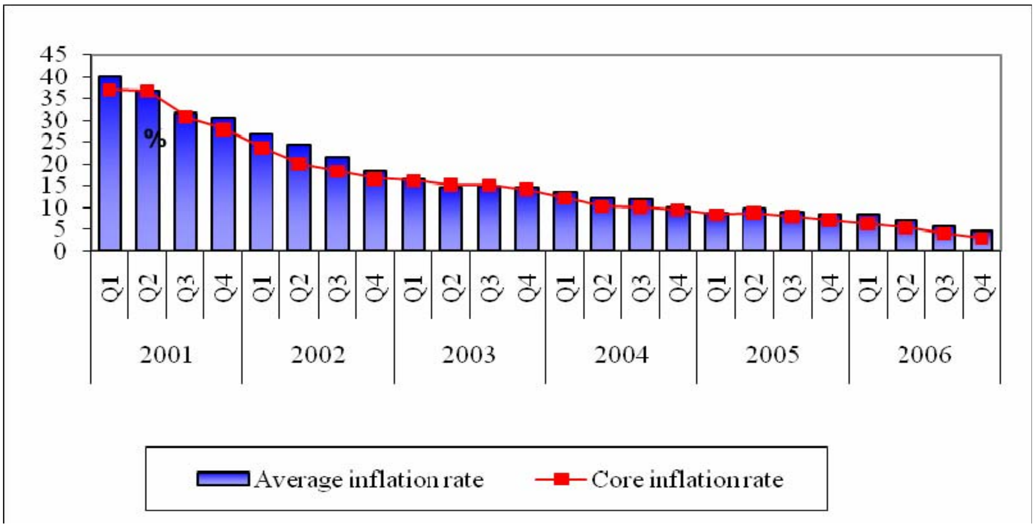
Table 3.2: Inflation rate (CPI)

	2001	2002	2003	2004	2005	2006
Annual average	34.5	22.5	15.3	11.9	9.0	6.6
At the end of the period	30.3	17.8	14.1	9.3	8.6	4.87

Source: National Institute for Statistics

The annual average inflation rate, considered also by the European Commission, reached for the first time over the transition period a one-digit level in 2005, namely 9%.

Figure 3.3: Inflation rate evolution (quarterly average)



Source: National Institute for Statistics

At the end of 2006, the year on year inflation rate declined to a historical minimum level of 4.87%, whit a more obvious deceleration in April, due to a base effect, and also in July and September, when quarterly changes in core1 inflation highlighted a clear slowdown in the pace of price increases. The more intense disinflation process was the result of an appropriate monetary and fiscal policy mix, improved market expectations regarding the sustainability of the disinflation process and increased competition in the retail sector.

Moreover, the adjustment of administered prices was relatively slower, and the volatile agricultural prices provided additional help by causing deflation in food prices. In fact, for the first time after 1990, in August 2006 monthly inflation registered a 0.07% decrease. Compared to the 2005 average, consumption prices increased by 6.56%, 2.44 percentage points below last year's level.

Regarding demand, the inflationary potential entailed by increased consumption, due to the credit expansion rather than gains in the wage income, was tempered by the favorable evolution of import prices as a result of the continuous appreciation of the national currency.

3.3 Medium Term Development Scenario and Cyclical Fluctuations

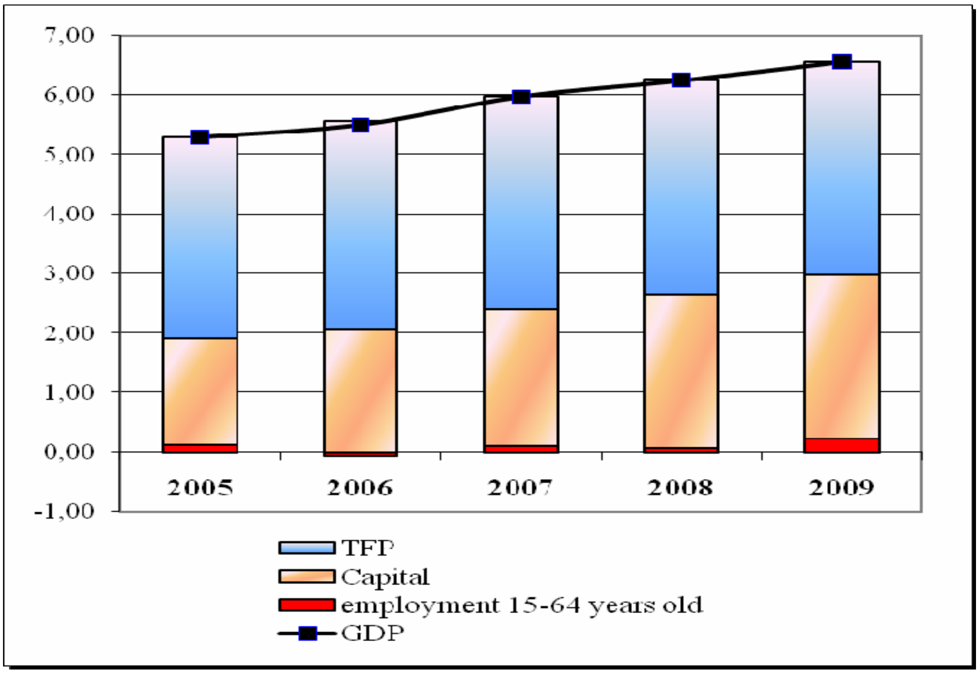
3.3.1 Cyclical Fluctuations

According to estimations based on the Cobb-Douglas production function, the potential GDP average growth rate is 6.08% for the period 2006-2009. Due to significant growth in investment, the capital stock will increase on average by 2.4% per annum, considering a depreciation rate of 5%. This evolution will determine a higher contribution of capital to potential GDP growth.

The working age employment (15-64 years old) will register a slight increase, by an yearly average of 0.1%. It is noteworthy to mention the expectation of a trend reversal in he employment starting with 2007, resulting in a positive contribution to the potential GDP growth.

Total factor productivity (TFP) will continue to have a significant contribution, due to gains associated to the higher productivity technologies as a result of constant foreign direct investments inflows and an improved business environment.

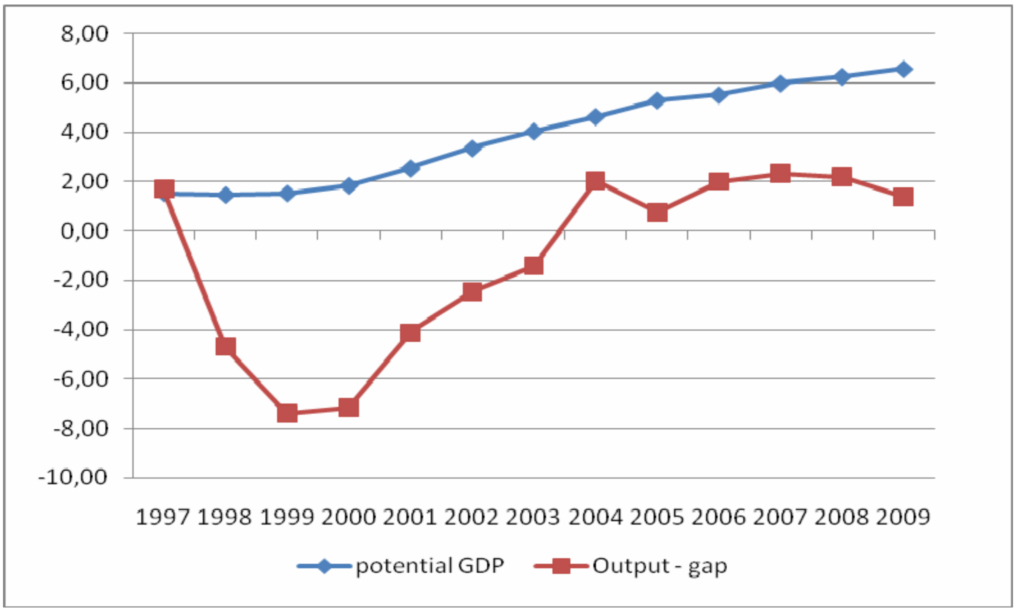
Figure 3.4: Factors contribution to potential GDP increase



Source: Ministry of Public Finance, DOFIN, National Commission for Economic Forecasting

For the next period, the output-gap will remain positive, but declining, leading us to the expectation of decreased inflationary pressures, sustaining ongoing disinflation. The output gap will decrease by 0.66 percentage points as compared to 2006, reaching 1.33% of the potential GDP in 2009.
Accordingly to our projections, we expect that the output-gap will be closed in 2011.

Figure 3.5: Output gap



Source: Ministry of Public Finance, DOFIN, National Commission for Economic Forecasting

The economic growth forecasted for the 2006-2009 interval is in average close to the potential GDP growth. The future evolution of potential GDP underlies our expectations regarding faster real convergence towards the economic development level of the European Union's member states.

3.3.2 Medium Term Development Scenario

According to the projected development scenario, average real GDP growth will be 6.4% per annum, with a gradual reduction of the negative contribution of the net exports.

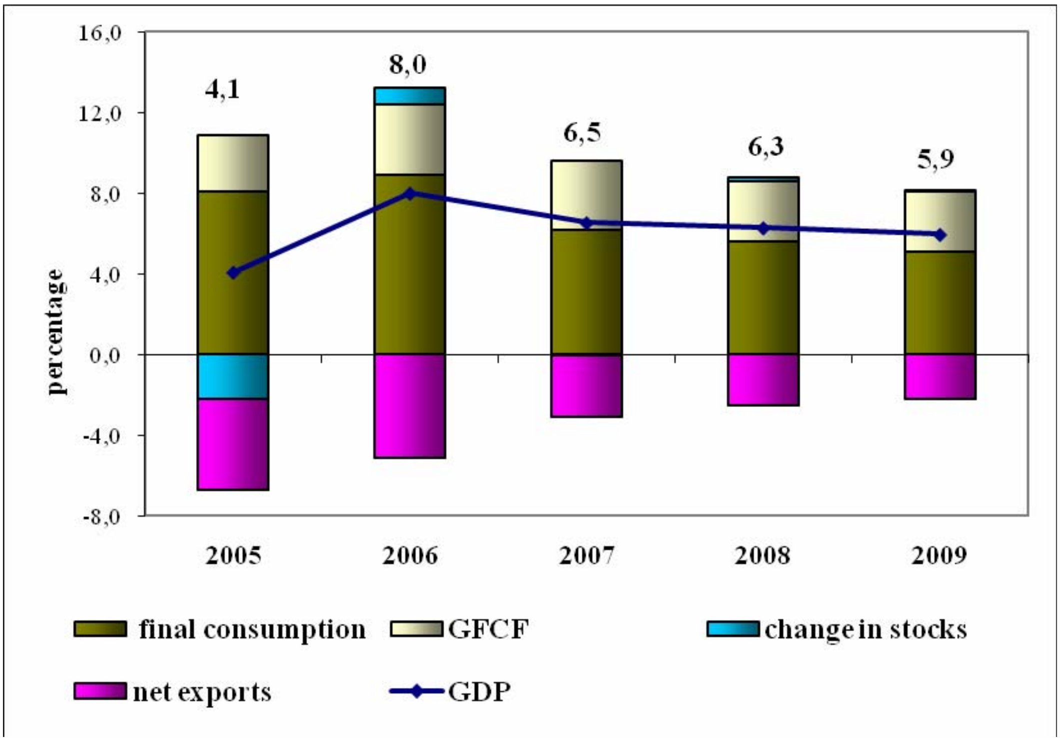
Table 3.3: Economic growth

	2005*	2006	2007	2008	2009
Annual percentage changes					
Real GDP	4.1	8.0	6.5	6.3	5.9
Nominal GDP	16.9	18.6	13.8	11.6	10.1
Real GDP components					
Private consumption expenditures	9.6	11.8	8.1	7.2	6.7
Government consumption expenditures	9	3.7	3.4	3.8	3.1
Gross fixed capital formation	12.6	15.0	14.0	11.5	11.0
Goods and services exports	8.1	11.8	10.9	7.6	7.3
Goods and services imports	16.6	20.8	15.0	11.2	11.2
Contribution to GDP growth (percentage)					
Final domestic demand	10.8	12.3	9.6	8.6	8.0
Changes in stocks and net acquisitions	-2.2	0.8	0.0	0.2	0.1
Net exports	-4.5	-5.1	-3.1	-2.5	-2.2

Source: National Commission for Economic Forecasting

* provisional data

Figure 3.6: Contribution of the utilization side components to the real GDP increase



Source: National Commission for Economic Forecasting

Following the large increase in household consumption (including NPISH*) of 10.2% in 2006, as a result of the expansion of retail credit, starting with 2007 we expect a significant slowdown in growth, as a result of the implementation of measures to limit the credit expansion by promoting higher real interest rates and by maintaining a prudent wage policy in the public sector. The lower increase in nominal unit labour cost compared to the GDP deflator will foster production growth in an environment characterized by low inflationary pressures, leading to an increase of the companies' profitability.

Continuing its 2005 acceleration, the gross fixed capital formation will register significant growth, based on the announced public investments and on substantial inflows of private investments, both domestic and foreign, boosted by improved perceptions regarding the business environment as a result of the country's EU accession.

The share of gross fixed capital formation in GDP will increase by 3.5 percentage points over 2007-2009, with a significant increase in the public sector (2.6 pp). The share of the private sector might decrease as a percent of GDP in the first part of the interval, but will recover afterwards. The below table highlights poorer savings in the private sector, requiring foreign financing needs ranging from 7.6% to 7.9% of the GDP. It is important to note that a large part of this amount will be covered by foreign direct investments, estimated to reach an average of 5.3% of GDP.

* Non-profit institutions serving households

Table 3.4 Savings – Investments Balance

% of the GDP	2005*	2006	2007	2008	2009
Domestic saving	12.4	13.1	14.6	16.0	17.1
National saving	14.0	14.5	16.0	17.3	18.6
- private sector	11.7	10.7	9.0	10.6	11.9
- government sector	2.3	3.8	7.0	6.7	6.7
Gross capital formation	22.7	25.0	26.4	27.6	28.5
- private sector	18.9	18.9	16.87	18.3	19.8
- government sector	3.8	6.1	9.7	9.3	8.7
Savings-Investments balance	-8.7	-10.4	-10.3	-10.2	-9.9
-private sector	-7.2	-8.1	-7.6	-7.6	-7.9
- government sector	-1.5	-2.3	-2.7	-2.6	-2.0

Source: National Commission for Economic Forecasting

Domestic saving will cover to a larger extent the planned investments (gross capital formation), namely 52.6% in 2006 and 59.9% in 2009. Moreover, there will be an increase of the level of investment financed through capital transfers from abroad, leading to the decrease in the external financing requirement by 1.4 to 2.1 percentage points.

From economic development point of view, Romania still lags far behind most European countries. The gross domestic product per capita, expressed in standard purchasing power (SPP), was in 2005 just one third of the EU 25 average and only 50% of the new EU member states average. The gross domestic product per capita in SPP is expected to reach approximately 40% of the EU 27 average in 2009.

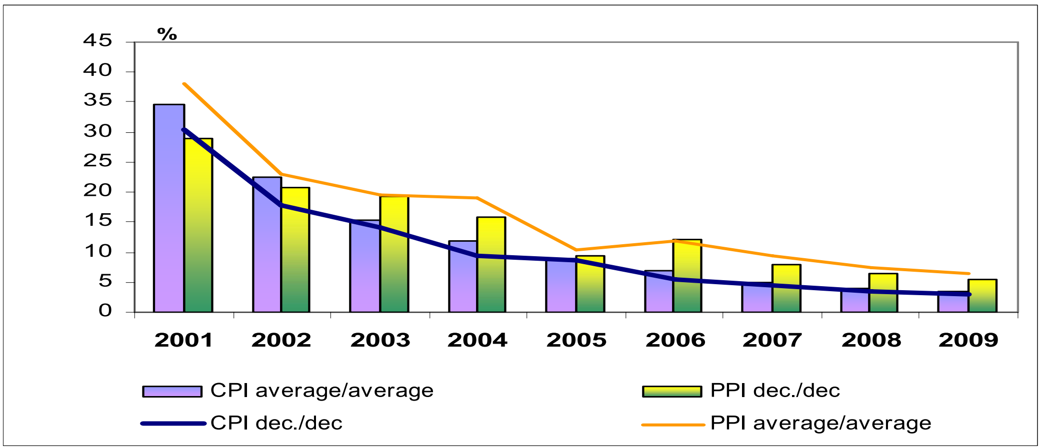
In the medium term, over 2007-2009, the disinflation process is estimated to continue as a result of the implementation of a firm monetary policy stance characterized by positive real rates of interest. Additionally, the gradual reduction of adjustements in administered prices, a prudent wage policy and the continuation of structural reforms will maintain the disinflation process on a sustainable path.

At the same time, the acceleration of the disinflation process will help to decrease inflation expectations. Moreover, another efficient mean for anchoring these expectations will be the preservation of the real appreciation trend of the domestic currency against euro. This scenario is possible taking into account the prospect of faster labor productivity growth in the Romanian economy compared with its main external partners.

The industrial production prices will continue their downward trend, compared to the consumption prices, nevertheless maintaining higher values. The gap between the two categories of prices will decrease significantly over the forecast horizon.

* semi-definitive data

Figure 3.7: Growth in consumption and industrial product prices



Source: National Institute for Statistics, National Commission for Economic Forecasting

We foresee that the main factors influencing the inflation developments in 2007, will be represented by the administered prices and the timetable of increases in excises agreed with the EU.

Although the GDP deflator will undergo a strong decrease, will remain higher than the consumer prices index.

Table 3.5: GDP and GDP components deflators
-annual percentage changes -

	2005	2006	2007	2008	2009
GDP deflator	12.2	9.8	6.8	5.0	3.9
CPI -average	9.0	6.6	4.5	4.3	3.2
Private consumption deflator	7.1	5.9	4.3	3.1	2.5
Public consumption deflator	20.9	10.2	4.9	3.0	2.3
Investment deflator	9.7	9.5	6.0	4.0	3.0

Source: National Commission for Economic Forecasting

The benefits of the high rates of economic growth registered in the last years, are felt at the real economy's level, in an improved **employment** rate, by increasing the active working age population (15-64 years old) by approximately 125 thousand persons and the employed working age population by another 180 thousand persons.

Both activity and employment rates will slightly recover after 2005. Between 2006 and 2009 we expect a growth of the activity rate by 0.9 percentage points, mainly due to higher FDI inflows, a rise in competitiveness and last, but not least, to a rise in wages. The working age population's employment rate will increase by 1.3 percentage points during 2006-2009 due to fiscal policies, long-lasting and performing job creation and to the balance between job flexibility and security.

According to the trend registered over the past years, the unemployment rate's decrease will continue, reaching a value of approximately 6.5% in 2009, as a result of a more effective implementation of the active employment policies.

Table 3.6: Labour force evolution*

	2005	2006	2007	2008	2009
annual percentage changes					
Total population	0.2	0.0	-0.1	-0.1	-0.1
Active working age population	-1.1	0.3	0.3	0.4	0.3
Working age employment	-0.1	0.7	0.5	0.5	0.5
ILO unemployment	-12.0	-4.8	-1.5	-0.8	-1.5
- % -					
Activity rate	62.4	62.5	62.8	63.0	63.3
Employment rate	57.7	58.1	58.4	58.7	59.0
ILO unemployment rate	7.2	6.8	6.7	6.6	6.5

Source: National Commission for Economic Forecasting

We also expect a high level of the **external deficit** in the following years, mainly due to the intense investment process and the associated imports, required for modernizing the productive capacities and for developing infrastructure.

We also forecast higher exports as a consequence of investments made in the previous years and of the positive prospects of the external environment, outpacing the increase in the imports and interrupting the increasing trade deficit trend, expected to stabilize at 12% of GDP over the next three years. Along with the larger exports value, the improvement of the export structure is expected to continue, with the share of highly-processed and value added goods increasing further. For the first time in 2006, the share of the equipment in total exports was larger than the share registered by the light industry. Still the trade balance deficit is expected to remain the main contributor to the current account deficit.

We also foresee an increase of the revenues deficit, as a natural consequence of growing profits due to the expansion of the FDI stock, mainly repatriated flows and reinvested profits by the foreign investors. The current transfers balance will experience a moderate rise in nominal terms, and will contribute to the alleviation of the commercial deficits and of the revenues.

Table 3.7: External-financing needs

in % of GDP

	2005**	2006	2007	2008	2009
Current account deficit	8.7	10.4	10.3	10.2	9.9
Capital account	0.8	0.2	1.4	1.9	2.1
External financing needs	7.9	10.2	8.9	8.3	7.8
Financing by credits	0.3	1.0	2.0	2.4	2.4
Financing by foreign investments:	7.6	9.2	6.9	5.9	5.4
out of which, net FDI	6.6	8.9	6.2	5.1	4.5

Source: National Commission for Economic Forecasting

* Working age population (15-64 years old)

** semi-definitive data

Due to the increasing contribution of the capital account, the external financing needs will decrease at a faster pace than the reduction of the current account deficit.

The annual external financing needs will register a diminishing trend up to 7.8% of GDP in 2009, after reaching 10.2% in 2006.

The foreign deficit financing will be mainly accomplished based on autonomous sources, without generating foreign debt, nevertheless registering a downward trend, as a result of the ending of the privatization process in the economy.

Over 2007-2009, simultaneously with the stabilization of the foreign direct investments' level, the forecasts outline a diminishing trend in the coverage ratio of the current account deficit, from 60.2% in 2007 to 45.8% in 2009. At the same time, there is estimated a significant increase of the coverage of the current account deficit by capital transfers, to a large extent determined by the EU funds absorbtion, estimated to expand their contribution from 13.8% of the current account deficit estimated for 2007, to 21.2% in 2009.

In conclusion, the prospects of economic growth for the next three years underlined in this scenario have a high degree of predictability, being in accordance with the Romanian economy's potential and correlated with the available financing resources. The foreign investments flows, planned to be attracted, are below the record levels accomplished in 2005 and 2006, and the forecast regarding the EU grants inflows is taking into account the absorbtion capacity of the Romanian economy. Hence, the aggregate demand remains at a high level, and the domestic supply – following the improved utilization of the production factors – can cover to a greater extent this demand. We can say that the economic risks associated to a possible deceleration of the economic growth, are much lower.

However, some risks remain present and are mainly associated to the factors that can affect the domestic supply's response to the demand, namely:

- a decrease in the competitiveness of certain activities, leading to a market loss for some products - both on the domestic and export markets;
- delayed restructuring or investments due to the requirements to observe quality standards (for example in the food industry), affecting some capacities;
- uncertainty related to the climate changes with impact on the agriculture output;
- a more rapid outsourcing of the lohn activitities especially in the light industry, postponing the overall branch's revival.

At the same time, the risks related to the foreign economic environment continue to be present, namely:

- an unexpected negative evolution of international prices, including the energy
- a significantly lower economic growth in the European Union compared to the baseline scenario considered in the official projections
- increased competition as a result of the cheaper products from Asia (mainly in the textiles and footwear sectors).

To the extent these risks will become obvious, the external deficits will increase and could become unsustainable (evident in a lower coverage ratio from autonomous financing sources, namely transfers of capital and foreign investments).

It is estimated that such factors can trigger negative influences and may lead to the slowdown of the economic growth, on the average, by approximately 1 percentage point per year, due to the lower exports dynamics and an increased current account deficit, on the average, by approximately 1.5 percentage points of GDP per year.

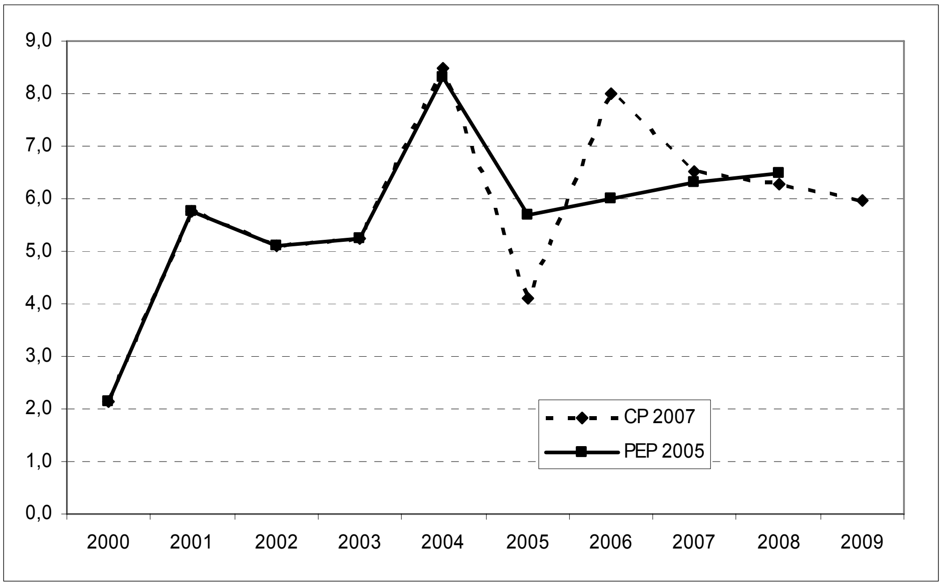
The lower activity and turnover will lead to a decrease in competitiveness and higher unemployment rate compared to the baseline scenario.

4. COMPARISON WITH THE PEP'S LATEST EDITION AND THE MACROECONOMIC SENSITIVITY ANALYSIS

4.1. Comparison of the Macroeconomic Framework

The medium term development macroeconomic scenario, presented in this programme does not significantly differ from the one included in the last version of the Pre-Accession Economic Programme. If we consider that the projection regarding the rate of economic growth is firstly based on the development´s potential, the forecast of this indicator remains slightly higher than 6%. This projection is backed not only by recent achievements, but also by the assumptions on the foreign environment and, most of all, by the growth prospects as reflected in the European Commission's Autumn Forecast.

Figure 4.1: Comparison between forecasted GDP growth rates



Source: National Commission for Economic Forecasting

CP 2007 = Convergence Programme, 2007 edition
PEP 2005 = Pre-Accession Economic Programme, 2005 edition

Conversely, changes appear in relation with the provisions in the last version of the Pre-Accession Economic Programme, on the domestic demand's structure and the response of the domestic supply.

The differences emerge, on the one hand, due to the trends highlighted by the recent developments and by the statistical updates and, on the other hand, due to the changes in the economic and budgetary policies.

In the first case, the domestic need for goods in 2006, mainly of capital and intermediary goods (power and raw materials), corresponding to higher than initially forecasted foreign investments, was reflected to a greater extent in the increase of the foreign deficits. At the same time, the domestic demand – both consumption and investments – witnessed growth rates above the forecasted ones. In fact, these developments were evident since 2003 and were highlighted by the updates of the National Institute of Statistics.

Figure 4.2 : Comparison between forecasted growth rates of private consumption expenditures

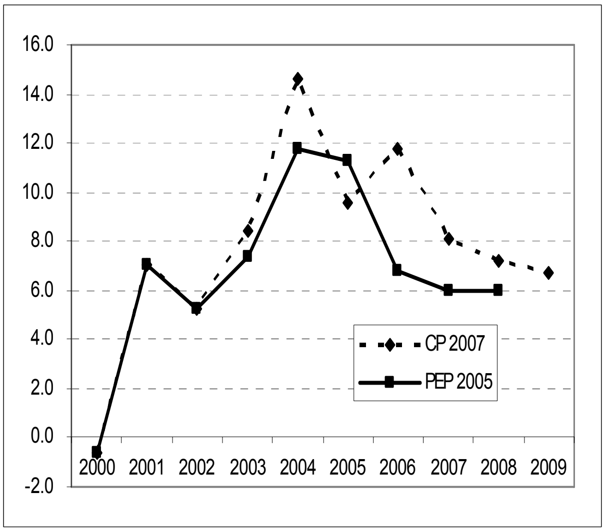
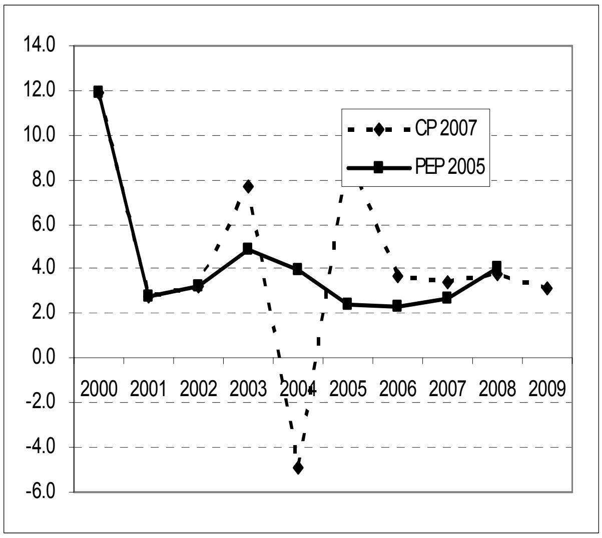


Figure 4.3 : Comparison between forecasted growth rates of public consumption expenditures

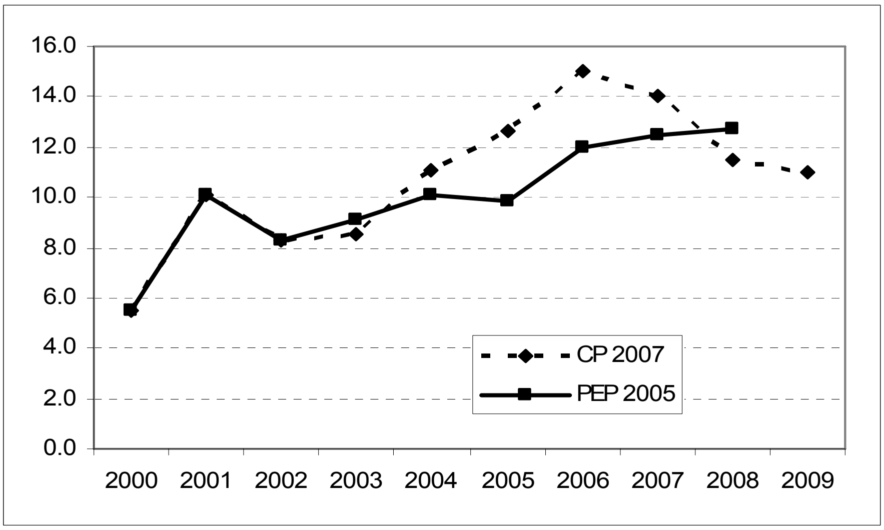


Source: National Commission for Economic Forecasting

In the second case – of shift in policies – the main change is represented by the new structure of the budgetary expenditures stipulated by the recent law of the state budget for the year 2007. As a result of the increase of both budgetary revenues and deficit level, additional funds were allocated for the public investments, meaning almost a doubling of the percentage share of the capital expenditures in the total budgetary expenditures.

Consequently, the dynamics of the gross fixed capital formation (GFCF) forecasted for 2007, was increased with the corresponding trend update for the following years.

Figure 4.4: Comparison between forecasted GFCF growth rates

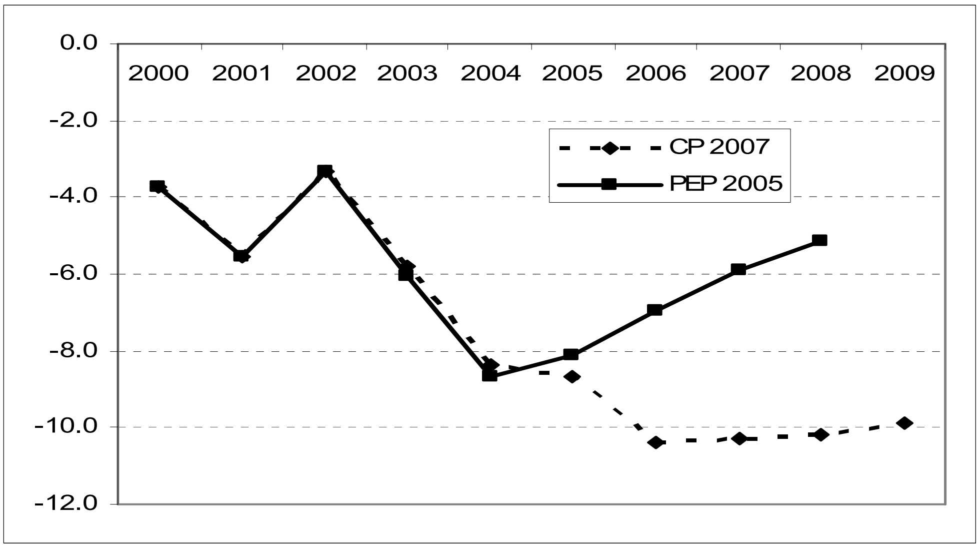


Source: National Commission for Economic Forecasting

Ultimately, given a more moderate, than initially envisaged, capacity of the domestic supply to satisfy the additional demand, the foreign deficits are estimated at a higher level in the Convergence Programme, compared to the Pre-Accession Economic Programme.

That is why, the current account deficit is forecasted at more than 9% of GDP and is relatively stable over the entire interval.

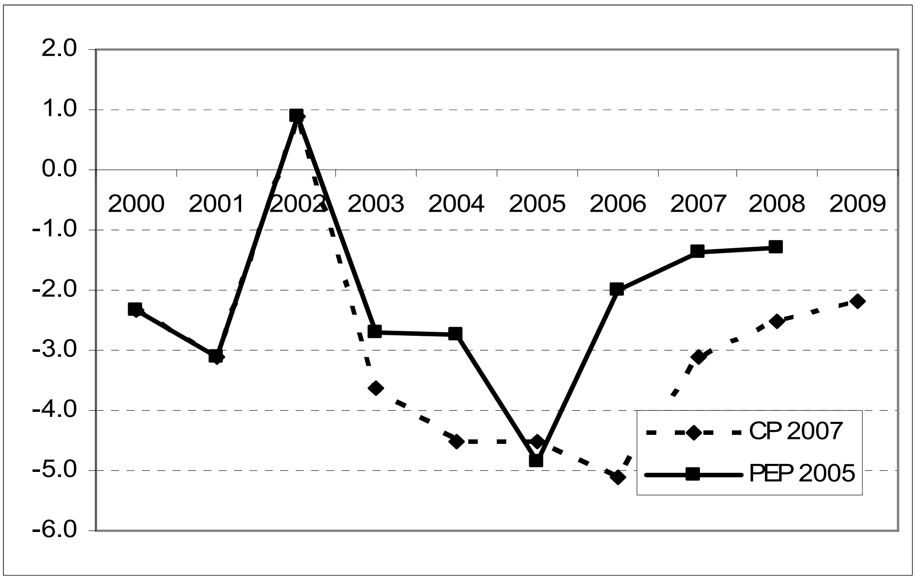
Figure 4.5: Comparison between forecasted current account deficit shares in GDP



Source: National Commission for Economic Forecasting

As a consequence, the higher external deficits, though sustainable, are reflected in the actual development scenario as a greater negative contribution of net exports to the GDP growth, from 1.4% in the latest edition of the Pre-accession Economic Program to over 2% in the Convergence Program.

Figure 4.6: Comparison between net export's contributions



Source: National Commission for Economic Forecasting

4.2. Comparison of the budgetary deficits

The differences from the projections presented in the Pre-Accession Economic Programme are presented in the following table:

Table 4.1: Comparison of the budgetary deficits (% of GDP)

	2005	2006	2007	2008
1. PEP edition 2005	0,4	0,7	1,0	1,5
2. PC edition 2007	1,5	2,3	2,7	2,6
3. diferences (1-2)	-1,1	-1,6	-1,7	-1,1

Source:Ministry of Public Finance

Regarding the fiscal targets for the year 2005, even if the budgetary deficit was higher than initially estimated, registered a low level. The control of the deficit was the result of the tight expenditures management, implemented in an environment characterized by far-reaching reforms on the tax side.

In 2006, the deficit target, was changed significantly, the initial programm approved by the Parliament being often revised during the year, reaching 2.3% of GDP, from an initial 0.5% of GDP. These modifications were aiming at ensuring the necessary funding of the start-up of infrastructure projects in top priority areas: transportation, environment, education, sanitation, for the preparation of public projects to be continued with financing from structural funds for the 2007-2013 period. This fact triggered also the modification of the budgetary deficit targets for the following years.

4.3 Macroeconomic Sensitivity Analysis

Three different scenarios will be considered for the macroeconomic sensitivity analysis: the impact of the nominal increase of the wages, decreased agricultural production's impact, and the impact of the exchange rate depreciation. One could argue that other types of shocks exist too, which can have both a significant effect on the Romanian economy and also a certain materialization probability. For example, if we take into account the high percentage of the trade with the EU countries in the total trade, a negative impact on the economic growth in the European Union's area could become relevant for the national economy. However, if we consider the significant share of the import of intermediary goods in the Romanian exports and the persistence of the growth rate of exports, evident in previous years (despite the significant appreciation of the exchange rate), the impact of such a shock is difficult to be evaluated ex-ante. Similarly, the oil price's impact is lower than the one estimated based on the percentage of the energy imports in the total imports, taking into account the significant exports of oil products by Romania.

4.3.1 Nominal Wage Impact

In Romania, the nominal wage growth was rapid over the past years. It represents a positive evolution to the extent this dynamic is supported by an increased productivity, encouraging on the same time a higher participation on the labour market. However, high growth rates amplify the risks of macroeconomic imbalances. This scenario reflects the estimated impact of a higher growth of the average wage, compared to the basic macroeconomic scenario. The impact of the public sector's wage fund is not taken into account in relation with the budgetary expenditures, but only the macroeconomic effect of the additional stimulus on the aggregate demand. A 5% increase of the nominal wage in 2007, compared to the baseline scenario that already includes relatively consistent wage increases, leads to a poorer performance in curbing inflation (by 0.6 percentage points Dec/Dec) and to an increased current account deficit each year over the analysed interval (due to the higher pace of increasing consumption), the biggest impact being of 0.6 percentage points in 2008. This estimation takes into account the answer of the monetary policy (a more restrictive monetary policy compared to the one projected in the basic scenario in 2007) and keeping the fiscal policy constant compared to the baseline scenario.

4.3.2 Agricultural Production's Impact

The agricultural sector is an important source of volatility for the Romanian economy, due to some reasons that are related both to the climatic conditions and to the failure of accomplishing some investments, which would have decreased this sector's vulnerability related to the adverse weather evolutions. The agricultural production's negative impact is easy to note in the figures on the evolution of inflation and economic growth, lower by 0.5 percentage points in 2007. The goods produced in agriculture have a higher percentage (7%) in the consumption prices indicator; hence a negative impact on the supply's side entails a significant effect on the CPI. In the given situation, in the absence of some corrective monetary and fiscal policies (taking into account the fact that a lower economic growth implies a lower output gap) the December/December inflation is by 0.6 and 0.4 percentage points higher in 2007 and in 2008 respectively, compared to the baseline scenario. The impact on the budgetary deficit is negligible, as long as the consumption from the agricultural production is non-taxable to a greater extent.

4.3.3 Exchange Rate Depreciation's Impact

The evolution of the exchange rate over the past years has played an important role in supporting the disinflation process and the consumption's positive trend, due to considerable increases in purchasing power. This scenario evaluates the probable effects of a 5 percentage points nominal depreciation of the exchange rate in 2007, compared to the baseline scenario. The most visible effect is the one on inflation, by missing the target set for 2007 by more than 1 percentage point compared to its maximum limit of the tolerance band and a similar performance in 2008. The budgetary deficit will be marginally lower, due to a higher gross domestic product. This type of shock entails a positive effect on the commercial balance, which will place itself at a lower level each year of the projection interval (compared to the baseline scenario), while keeping its upward trend on the medium and long run.

5. GENERAL GOVERNMENT FINANCES – DEFICIT AND DEBT

5.1 Budgetary Policy Objectives and Strategy

As noted in the introductory chapter, the Romanian Government sets itself the fundamental goal of providing macroeconomic stability by promoting a successful mix of coherent macroeconomic policies, by maintaining a conservative fiscal stance and by promoting cautious wage policies, to support the disinflation process and to limit external imbalances, which in turn will facilitate sustainable economic growth and real convergence. This policy is also complemented by structural reforms supported by budgetary programmes– in education, sanitation, research and development and pensions to spur the potential growth. The private sector represents the main engine of growth and convergence and promoting a favourable business environment and a flexible labour market will stimulate both domestic and foreign direct investments, and thus consistent gains in employment, productivity and competitiveness.

The goal of the government's fiscal policy is to sustain the real and nominal convergence process while ensuring the long term sustainability of public finances by promoting key structural reforms in education, health and pension areas. The objective of the fiscal policy is the consolidation of public finances with a view to increase its stabilizing role by reducing the structural deficits and by improving the conditions for the symmetrical functioning of the automatic stabilizers. The structural budget deficit will reach a level of 0.9 percent of GDP in 2011, complying with the stipulations of the revised Stability and Growth Pact, and ensuring an adequate safety margin in order to avoid the overshooting of the 3 percent of GDP budget deficit ceiling.

The tax policy will be oriented towards ensuring a stimulating and non-discriminatory environment, while focusing on measures to consolidate its simplicity, transparency and predictability. Further reductions in the social security contribution rates is justified by the intent to diminish the economic players' propensity of maintaining their activities in the grey economy, in order to give a positive impulse to labour market developments while contributing to the achievement of the goals of the relaunched Lisbon strategy.

One of the key budgetary challenges on the medium and long term is the necessity to close the structural gaps identified in infrastructure, sanitation, education and R&D areas, while keeping at the same time the budgetary stance characterized by cautious levels of the budgetary deficit.

The Government will sustain this balance by improving the administration of revenues and by increasing the efficiency of budgetary expenditures. Substantial measures related to the improvement of the collection process were already implemented by accelerating the forced collection process, speeding up by the bankruptcy procedures and by the strengthening of the budget constraints both for the public and private enterprises. We will continue this process in parallel with additional measures aimed at enlarging the tax base in fields such as the environment, state-owned enterprises and agriculture.

Although the level of the government expenditure will grow on medium term, drastic improvements are needed for the efficient manner of public funds spending, mostly by setting clear priorities, especially for the investment projects, through horizontal coordination of the economic policies, continuous improvement of the medium term budget programming and by increasing the transparency of this process.

The implementation of the aforementioned structural reforms is crucial for increasing efficiency and accountability, also including the increased share of the prophylactic and medical care in total sector spending, the consolidation of the decentralization process in the education area by defining and implementing the cost per capita financing, the promotion of long-life learning schemes and professional training, and improving the link between the R&D and the corporate sector, especially the relationship with small and medium sized enterprises.

5.2 Public Finances Evolution over 2005 and 2006

In January 2005 Romania has launched a fundamental tax reform. The profit tax was cut from 25 percent to 16 percent and a single personal income tax rate of 16 percent replaced a progressive five-bracket scale with rates between 18 and 40 %. At the same time, the taxation of other income sources was raised and aligned at the single rate of 16% (for dividends, interest and capital revenues), and some other exemptions were eliminated in order to increase the tax base. The main aim of the reform was to simplify the tax system, increase predictability and to improve incentives for work and business. The reform was accompanied by consistent measures to improve the tax collection. The introduction of the flat tax for income and the fiscal relaxation represented important steps forward, moving the spotlight from the issue of taxation level to more sensitive issues like tax compliance costs, administrative burden and to those associated to regulatory measures and to corruption.

In 2006, the fiscal-budgetary policy faced two major challenges: maintaining a prudent approach with a view to ensure external sustainability and continuing the disinflation process, and, concurrently, ensuring and consolidating the financing sources needed to support the commitments deriving from the EU accession and building up momentum for the Lisbon agenda.

The budgetary policy gave impetus to the tax reform with the following main coordinates:

- maintaining a low and prudent level of the budget deficit;
- strengthening tax administration and revenue collection consolidation;
- continuing cuts of the social security rate with a view to reduce labour costs;
- improving transparency and effective public funds utilization;
- creating the conditions for a better prioritization of the public policies.

5.3 Medium Term Budgetary Expenditure Framework

The formulation of the budget policy is interrelated with the other macroeconomic policies (wage and income policies) and with the anticipated progress in structural economic reforms, which will allow flexible adjustment in relation to the short term economic conditions and the preservation of stability and growth in the long term.

Romania has a level of public expenditures of approximately 32-33% of the GDP, one of the lowest from a comparative point of view. The Romanian economy grows at an average pace of 6% per year. This process in itself leads to additional fiscal space due to the resources created in the economy.

However, taking into account the significant investment needs and the big disparities existing between the rural and urban areas, Romania considers taking a pro-active attitude, namely of increasing the public expenditures, not only in real terms but also as percentage of GDP, to be able to increase its competitiveness in attracting foreign capital and in keeping the national investments under increased international mobility of the production factors. Reaching this goal and covering the additional expenditures related to the EU accession process would mean an increase of the budgetary expenditures' percentage from approximately 33% of the GDP in 2005, up to 39% of GDP in 2009, rates higher than those of Ireland and Lithuania, but lower than of all other 24 European countries.

The main coordinates underlying the fiscal-budgetary policy in 2007 are:

- further fiscal relaxation in the area of social security, tax base broadening, revenue collection improvement
- improvement of the public expenditure by a better prioritization and promoting restructuring efforts continuously in key sectors in order to enhance the correlation between sectoral policies, measurable outcomes and budgetary resources
- improving the framework for the effective utilization of the structural instruments.

The 2007 budget act combines, in a comprehensive national economic policy framework, regional development policies with strategic European objectives and conditions related to access EU funds.

Budget revenues are envisaged to continue the upward trend set in 2006, explained both by the favourable cyclical position of the economy as well as by the additional improvement of the tax administration process. The consolidation of revenues base is seen as the cornerstone for ensuring the resources necessary to fulfill Romania's obligations derived from its status as an EU Member State.

The budgetary revenues will reach 36.5 % of GDP in 2007, including grants, representing an increase of 2.6 percentage points against the level registered in 2006. The revenues from direct taxes shall increase by 0.9 percentage points, from 6.3 percent of the GDP in 2006 to 7.2 percent of GDP in 2007, as a result of the increase in income tax revenues, supported by the planned wage increase of 12.4% and by the 1.8% enlargement in the employees number. In addition, at the profit tax, we anticipate an increase of revenues of 0.2 percentual points following the improved companies profitability expectations, while improved collection performance, broadened tax base and further consumption expansion will bring the revenues from VAT to a level of 9.3 % of GDP. The social security contributions will register a slight decrease as a result of the envisaged measures for reducing their taxation level.

The budgetary policy framework in 2007 will remain prudent on the expenditure side, targeting a balance between supporting the macroeconomic framework through the continuation of the disinflation process and keeping the current account deficit within sustainable limits, and by promoting priority investment projects. The key objectives of the budgetary policy are reasserting the public policies in the areas related to the human capital, as education, research and development, health and social cohesion, while financing the national contribution to investment programmes eligible for EU funds and sustaining the payment of the national contribution to the EU budget.

The Ministry of Finance will target a level of 39.2% of GDP for the consolidated budget expenditures in 2007 (higher by 3.0 percentage points compared to the previous year). The main fields that will be financed in 2007 will be education (at 5.2% of the GDP, registering a significant increase in 2007 compared to the previous years), the healthcare system (with an allocation of 4% of GDP), research and development (with an allocation of 0.5% of the GDP compared to 0.4% in 2006) and infrastructure.

The subsidies will follow a decreasing trend towards 1.0% of GDP in 2007 from 1.5% of GDP in 2006, following the decline of state intervention, respectively the consolidation of market mechanisms. Collective consumption and social transfers will register a slight increase of 0.5 and 0.3 percentage points respectively.

The medium-term fiscal framework reflects the necessity to consolidate the revenues by improving tax collection and by broadening the tax base, with a view to accommodate the increased government spending commitments. Further revenue consolidation and increasing public spending in key areas such as education, R&D, transport and environment infrastructure becomes compulsory in the light of the economic competitiveness needs of the Romanian economy. The actual medium term expenditure framework creates sufficient fiscal space to accommodate accession related costs (including our contribution to the EU budget) and to sustain our commitments from the perspective of the EU Lisbon agenda.

Table 5.1: Selected components of expenditure

	ESA Code	2005	2005	2006	2007	2008	2009
		Level	% of GDP				
1. Collective consumption	P32	25,382.3	8.8	8.3	8.8	8.3	8.6
2. Total social transfers	D62+D63	28,744.2	10.0	9.6	9.9	10.3	9.6
3. Interest expenditure	D41	3,281.1	1.1	1.1	1.1	1.1	1.0
4. Subsidies	D3	4,820.6	1.7	1.5	1.0	0.9	0.9
5. Gross fixed capital formation	P51	10,984.0	3.8	6.1	9.7	9.3	8.7
6. Other expenditure		23,290.8	8.1	9.6	8.7	9.8	11.0
Total expenditure	TE	96,503.0	33.6	36.2	39.2	39.6	39.8

Source: Ministry of Public Finance

The interest expenditures are relatively stable in the medium term, as a consequence of the reduced budget deficits, a low public debt level, extended maturities, and lower interest and inflation rates.

The wage expenditures were set at 6.3 % of GDP for 2007 and will be maintained constant as a share in GDP on the medium term.

The investment expenditures are forecasted to grow from 4.1% of GDP in 2006 to 6.3% in 2009. The main areas which will benefit of an increased budgetary allocation for investments are education, housing, public development and transportation.

Table 5.2: Evolution of the investment expenditures

	% in GDP				
	2005 Achievments	**2006** Programme	**2007** Programme	**2008** Estimate	**2009** Estimate
Total	2.6	4.1	6.6	6.3	6.3
Out of which:					
National defence	0.3	0.4	0.4	0.2	0.2
Public order and national safety	0.2	0.4	0.3	0.4	0.3
Education	0.2	1.0	1.3	1.4	1.8
Sanitation	0.1	0.1	0.3	0.3	0.2
Housing, services and public development	0.4	0.5	0.7	0.9	0.9
Environment protection	0.1	0.1	0.1	0.1	0.1
Transportation	0.8	1.1	4.1	3.4	2.3

Source: Ministry of Public Finance

The implementation of the envisaged institutional reform measures, including the efforts to extend program budgeting and fostering multi-annual investment projects, will lead to improvement in domestic and EU fund absorption capacity.

The budget deficit will be gradually reduced to 2 percent of GDP in 2009 (from 2.7 percent of GDP in 2007) in order to contain the excessive aggregate demand, maintain the disinflation process and preserve the current account deficit within sustainable limits.

5.4 The Impact of EU Accession on Public Finance

Starting with 2007, the financial budget-related flows between Romania and the European Union will significantly increase both in diversity and volume. In its capacity as a member state, Romania will receive, as early as the first year after admission, important financial resources from the EU budget, through Structural Funds, Cohesion Funds, and Agricultural Policy funds.

For the next financial perspective (2007 – 2009) Romania aims at reaching a budgetary position of net recipient of EU funds. Starting with the moment of EU accession, Romania will have to make some mandatory expenditures, as follows:

- its own contribution to the EU budget;
- co-financing programs of agriculture and rural development;
- co-financing of projects financed through structural and cohesion funds;
- continuation of the co-financing for ISPA projects (transportation and environment) programs started in the previous years;
- continuation of the co-financing for PHARE programs started in the previous years.

Romania will also have to provide its own contribution to the EU budget, broken down on the traditional sources (customs duties, sugar etc), VAT and gross national product quota.

The table below shows the net balance between the Romanian budget contribution to the EU own resources pool and the pre- accession and post- accession fund allocation for 2007 - 2009.

Table 5.3: Net budget position against the EU budget

Share in GDP, %	2007	2008	2009
Total EU funds	2.07	2.55	3.17
Romania contribution to EU budget	1.04	0.99	0.89
Balance	1.03	1.56	2.28

Source: Ministry of Public Finance

The European Union accession is expected to have a positive impact on the public budget and the economic development of the country, with the net benefit increasing from EUR 1.114 million in 2007 to EUR 1.887 million in 2008 and EUR 3.058 million in 2009.

As share in GDP, due to the payment of the national contribution to the EU budget, Romania will have to increase the expenditure to 1.04 % of GDP in 2007 to 0.99% of GDP in 2008 and 0.89% of GDP in 2009.

The structural and cohesion funds will include, after 2007, the regional development funds, and also the internal policy funds, including institutional development.

According to the assessment made on the basis of HEROM model (HERMIN type model) presented in the National Strategic Framework of Reference, the effect of the total EU funds absorption would generate a supplemental GDP growth of 15% until 2015, as compared to a scenario in where Romania would not benefit of these funds.

5.5 Computation of Structural and Cyclic Deficit

In order to estimate taxes and expenditures elasticities, we applied the OECD and EC's methodology, as described by Giorno et al (1995) and van den Noord (2000). This methodology is based on the decomposition of each elasticity into a number of components that can be estimated by using available data and specific econometric techniques.

Table 5.4: The elasticity of budget revenues and expenditures as against GDP

Year	Revenues				Expenditures
	Elasticity of income tax	Elasticity of social security contributions	Elasticity of profit tax	Elasticity of indirect taxes	Elasticity of primary expenditures
2005	1,2320	0,700	1,2455	1,000	-0,0825

Source: Ministry of Public Finance; NationalForecasting Commission and DOFIN

Forecast of the budget's structural components

The budget's structural components are obtained by subtracting the cyclical component from the current budget component, by using the specific formula below:

$$CAB_t = B_t - B_t^C = B_t - \sum_j B_{t\ j}^C$$

The cyclical component of each category of revenues and expenditures ($B_{t\ j}^C$) is calculated by using the output gap and the estimated elasticity as against the gross domestic product (α_j^{GDP}). The formula used to calculate the cyclical component is as follows:

$$B_{t\ j}^C = B_{t\,j} \times \alpha_j^{GDP} \times output\_gap_t$$

The structural deficit had a decreasing trend from 2000 on, reaching the lowest level of -1.7 percent of GDP in 2005.

Table 5.5: The evolution of the annual structural and cyclical budget components

Year	Current budget deficit (% of GDP)	Cyclical deficit (% of GDP)	Structural deficit (% of GDP)
2000	-4.4	-2,16	-2,24
2001	-3.5	-1,14	-2,36
2002	-2.0	-0,68	-1,32
2003	-1.5	-0,39	-1,11
2004	-1.5	0,53	-2,03
2005	-1.5	0,20	-1,70

Source: Ministry of Public Finance

The calculation for the 2005-2009 interval is based on the assumptions regarding the potential output and the output gap. Taking into account these hypotheses, the structural deficit increases from 1.7% of GDP in 2005 to 3.39 % in 2007 and declines at 2.4% of GDP in 2009.

Table 5.6: Cyclical and structural deficit

% in GDP	2005	2006	2007	2008	2009
1. GDP growth in constant prices	4.1	8.0	6.5	6.3	5.9
2. Current balance	-1.5	-2.3	-2.7	-2.6	-2.0
3. Net interest payment	1.1	1.1	1.1	1.1	1.0
4. Output gap	0.73	1.99	2.31	2.17	1.33
5. Cyclical budget component	0.20	0.57	0.69	0.65	0.41
6. Adjusted cyclical balance (2-5)	-1.7	-2.86	-3.39	-3.25	-2.41
7. Adjusted primary balance (6-3)	-0.6	-1.76	-2.29	-2.15	-1.41

Source: Ministry of Public Finance, National Forecasting Commission and DOFIN

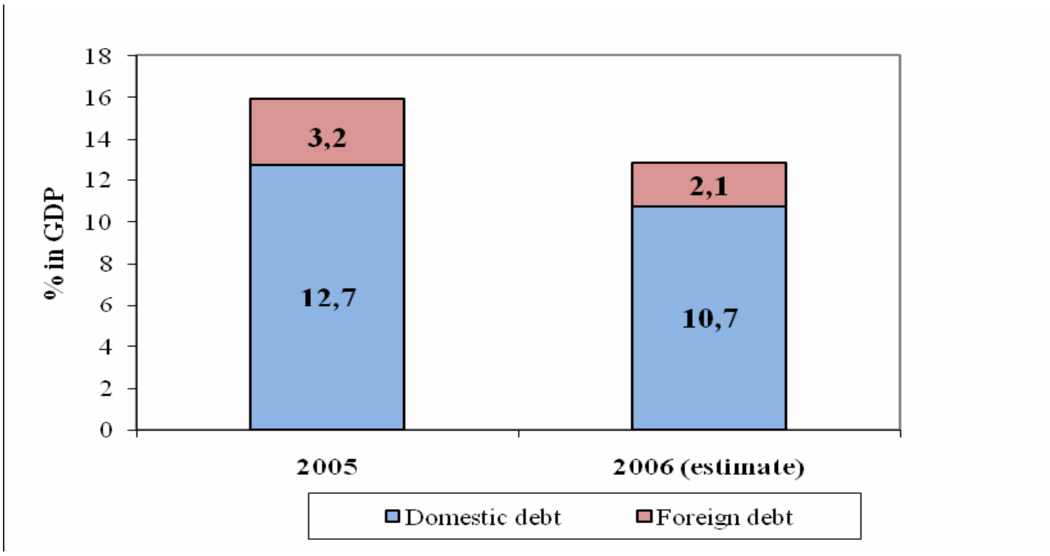
5.6 Public Debt and Debt Strategy

5.6.1 Government Debt Management and Budgetary Deficit Financing

Starting with 2005 the legal framework relevant for public debt management is represented by the Public debt law no. 313/2004. According to this law, the Ministry of Public Finance has the responsibility of contracting and managing the government debt.

The public debt ratio of Romania is below 20% of GDP, much lower than the threshold of 60% of GDP set by the Maastricht Treaty. At the end of 2005, the government debt, calculated in accordance with the EU methodology (ESA95), represented 15.9% of GDP, out of which the domestic debt was 3.2% and the foreign debt was 12.7%. For the end of 2006 the level of this indicator is estimated at 12.8% of GDP.

Figure 5.1: Public debt structure



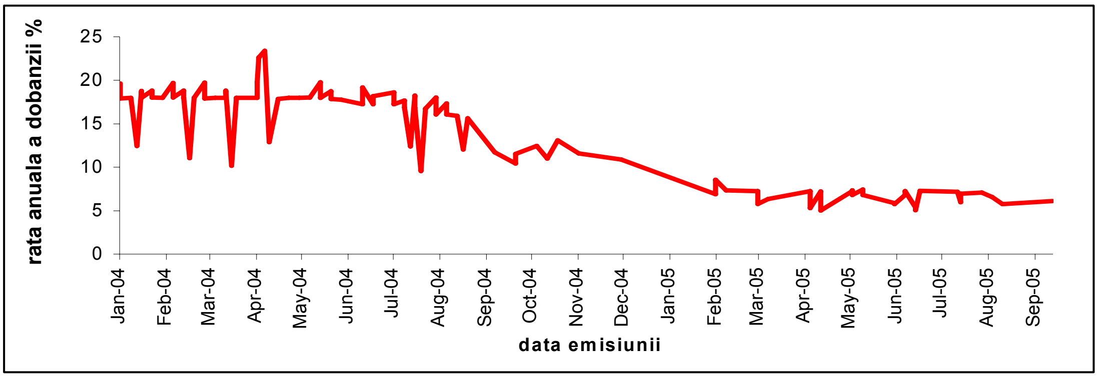
Source: Ministry of Public Finance

At the end of 2005, the government debt broke down by types of instruments shows that government securities represented 31.2% of the total debt, the rest being loans.
Regarding the initial maturity of government debt, 6.4% is short-term debt, while 93.6% is medium and long term, the average maturity being 5.6 years. It has to be mentioned that the government debt broken down by type of interest rate shows a floating rate debt of 39.2% out of total government debt. The local currency debt represented 19.1% of the total debt, and the government debt denominated in euro was 51.5% out of total hard currency debt.

5.6.2 Government Securities Market

Regular meetings were organized, starting with 2005, between the Ministry of Public Finance and primary dealers and investors to discuss market developments and expectations as well as investment requirements.

Figure 5.2: Government Securities Market



Source: Ministry of Public Finance

A government securities calendar published for the entire year was issued for the first time in 2006. According to the schedule, 3, 5 and 10 year government bonds and 6 and 12 month T-bills were planned to be issued during the year. However, all the scheduled auctions were cancelled due to the lower than expected expenditures and to the constant surplus noticed during the budget execution. Practically, the financing from domestic sources was reduced to short term borrowing from the available liquidity in the current account of the state treasury, and especially from the surpluses recorded in the local and other budgets (social securities budget or unemployment budget).

The implementation of the new legal framework in the public debt area eliminated the possibility for the line ministries to borrow by using state guarantees issued by the Ministry of Finance. It is important to mention that the granting of state guarantees was limited only to top priority projects after their endorsement by the Competition Council.

Table 5.7: The value of the state guarantees issued for external loans

-million euro-	**2004**	**2005**	**2006**
Total, out of which:	2,040.0	410.5	7.2
- contracted by ministries	1,177.2	0.0	0.0
- contracted by local public authorities	86.3	20.0	7.2
- contracted by companies	776.5	390.5	0.0

Source: Ministry of Public Finance

In 2005, the budget deficit was financed in a fairly balanced way between internal and external market (56% from external sources and the rest from internal sources), while in 2006 the majority of the financing will be provided by domestic sources.

5.6.3 Objectives of Government Debt Management for 2007-2009

The main objective from the standpoint of public debt management is to keep the government debt level within sustainable limits and ensuring the necessary sources for financing the budget deficits at a minimal cost and by assuming a reasonable risk level.

In this view, in 2007 will be published a debt management strategy covering the period of 2007-2009, presenting the objectives of the Ministry of Public Finance relevant to public debt management and the instruments intended to be used for reaching these goals.

For ensuring the financing of the budget deficit and the refinancing of the public debt the government will have in view mainly internal sources, aiming to reduce the internal debt costs and reducing the associated currency risk for the government debt portfolio.

Another objective in attracting financing from the internal market is the development of the government bonds' market, the launching of medium and long term benchmark securities, having the reopening possibility with the aim of raising their liquidity. The development of the secondary market by creating references (benchmark type) is essential from the point of view of diminishing the financing costs for the state and for the issuance of municipal and corporate bonds.

The development of the public bonds market takes into account the significant demand increase, that followed the full liberalization of the capital account and the emergence of the private pensions funds following the implementation of the pensions reform in 2007.

At the same time, periodical meetings with the representatives of the National Bank Of Romania will be organized, for improving the coordination of the fiscal and monetary policies, and with primary dealers and investors, for discussing the evolutions and the specific investment requirements of the internal financial market.

One of the key objectives in managing government debt is represented by the gradual reduction of project financing (due especially to the contracting of loans from international financial institutions), and increasing the share of negotiable debt, contracted by issuing government securities mainly on the internal market; but also by accessing the international capital markets so as to maintain a constant presence of Romania in the context of the continuous improvements of the sovereign ratings.

Regarding the financing in foreign currency, the Government intends to consolidate the euro denominated exposure, aiming to reduce the currency risk in view of the perspective of adopting the single European currency and encouraging the issuance of long-term and fixed rate debt.

Institutionally speaking, the Ministry of Public Finance intends to improve the internal infrastructure by implementing a government debt management system, with risk management capabilities of the government debt portfolio, and an electronic auction system for the issuance of government securities. Also, we intend to improve the public debt management legal framework, the most important aspects regarding the elimination of the prospect for Ministry of Public Finance to borrow and subsequently on lend to line ministries, while sovereign guarantees issuance and on lending by Ministry of Public Finance to different companies will be limited to financing major projects endorsed by law. Moreover, the government adopted the EGO no.113/2006, stipulating the use of the privatization proceeds (amounting to EUR 3.0 billion), for the establishment of the National Development Fund. According to the ordinance, National Development Fund is set up within the state budget at the Government disposal and it is earmarked for financing infrastructure investment projects, real estate compensations and pre-financing/co-financing projects benefiting from EU funds.

5.7 Sensitivity Analysis

5.7.1 Budget

The profile of the general consolidated budget is mainly determined by the state of the economy, depicted by macroeconomic factors such as inflation, interest rates, foreign exchange rates, GDP growth rate, wage level and employment. On the other hand, the structure and level of the general government revenues and expenditure are contributing to the performance of the economy. A significant part of the expenditure is directly influenced by the inflation level (pensions and social security benefits), while the debt servicing costs are influenced by the interest rate and foreign exchange rates.

On the revenues side, the collection of taxes and levies is obviously influenced by the nominal consumption and the wage fund. Against the macroeconomic baseline scenario, we have assessed for 2007 the influence of the lower average growth in the gross economy wide wage of 11.4 compared to 12.4 percent, a lower growth in employment of 1 compared to 2 percent, a further appreciation of the real exchange rate from 5% to 6% and a marginal decline in the social security contributions rate.

Table 5.8: Sensitivity of the general consolidated budget revenues against changes in macroeconomic variables

Tax category (revenue share in GDP)	Macroeconomic base	Change in macroeconomic base (percentage points)	Change in general government revenues (% GDP)
1. Personal Income Tax (3.4%)	average gross wage	lower by 1	-0,009
	Employment	lower by 1	-0,006
	real exchange rate (RON/EUR)	appreciation by 1	0,0004
2. Social security Contributions (9.5%)	tax rate	lower by 1	-0,074
	average gross wage	lower by 1	-0,048
	Employment	lower by 1	-0,049
3. Corporate Income Tax (2.7%)	average gross wage	lower by 1	0,025
	Employment	lower by 1	0,031
	social security tax rate	lower by 1	0,021
4. Value added tax (9.3%)	average gross wage	lower by 1	-0,01
	Employment	lower by 1	-0,011
5. Customs	real exchange rate (RON/EUR)	appreciation by 1	-0,0044
Total	**average gross wage**	**lower by 1**	**-0,042**
	Employment	**lower by 1**	**-0,035**
	social security tax rate	**lower by 1**	**-0,053**

Source: Ministry of Public Finance

The above table describes the impact triggered by the changes in the macroeconomic variables on the general government revenues. As expected, the impact is negative, and particularly so in the case of the social security contributions, as a marginal drop in the tax rate yields a decline of revenues by 0.053 % of GDP whereas a lower growth in employment and of the average gross wage results in a decline by 0.035 % of GDP and 0.042 % of GDP respectively.

5.7.2 Public Debt

The main factors considered for the sensitivity analysis are: the economic growth rate, currency depreciation and the interest rate.

1) Economic growth rate

According to the baseline scenario (based on the macroeconomic indicators provided by the National Commission of Forecast) used for the medium term budget projections, the share of the public debt in GDP will decrease by 4.2 percent in 2009 compared to 2005 (from 15.9 percent of GDP in 2005 to 11.7 percent of GDP). In the alternative scenario, characterized by a GDP growth rate one percentage point lower compared to the baseline scenario, the share of the public debt will decrease by 4.3 percent of GDP (from 15.9 percent of GDP to 11.6 percent in 2009).

2) Exchange rate depreciation

According to the baseline scenario, the share of interest expenditures in GDP will decline from 1.15 percent in 2005 to 1.06 percent in 2009 while in the alternative scenario built on the assumption of a 1% depreciation rate, the interest expenditures will be reduced to 1.07% over the same interval.

3) Interest rate

The interest expenditures will decrease from 1.15% of GDP in 2005 to 1.06 % of GDP in 2009 in the baseline scenario, while in the alternative scenario, built on the assumption of a 1 percentage point increase of interest rates (Euribor and Libor), the share of interest rate expenditures will decline to 1.09% of GDP in 2009.

5.8 Budgetary Consequences of Important Structural Reforms

Romania has recently adopted a number of laws that fundamentally renew the philosophy of the public expenditures. The long term impact of these reforms should reduce the level of public spending and should increase the efficiency in terms of public service delivery.

Pension system

The second component of the pension system is the private and mandatory pillar, which will be implemented starting with January 1, 2008, as part of the Social Security System. A percentage from the contributions to the redistributive pillar will be compulsorily directed towards privately managed pension funds (up to 2% of wages in the first year and increasing gradually by 0.5 percentage point every year until reaching a contribution rate of 6% in 2016). Although in the long term this measure has a positive impact on the sustainability of the system, it entails short term costs which have to be assessed from a budgetary perspective.

For assessing the budgetary impact of the contributions to the second pension pillar we assumed the following hypotheses:

1). the first evaluation year is 2008
2). 50% of the eligible persons with an age between 35-45 will express their option to contribute to the system
3). the revenues from each category of contributors were assessed taking into account the average wage, adjusted with the difference between the actual income of the respective population segment and the national average
4). the average total employee number and the respective age distribution was projected by the National Forecasting Commission and the National Statistics Institute taking into account the demographic prospects
5). the allocation of the assets of the pension funds in different investment vehicles was determined based on an international comparative study, the shares in the overall portfolio being as follows: 70% in government bonds, 15% in equity and 15% in deposits.

Table 5.9: Contributions value to the second pension pillar

	2008	**2009**	**2010**
1. Gross wage income	690	1,017	1,433
2. Unemployment benefit	15	22	32
3. Gross revenue of the self-insured	6	10	14
Total contributions - million RON	711	1,049	1,479
- million Euro	203	300	423

Source: Ministry of Public Finance

The results show that the budgetary impact of the implementation of the second pillar is not significant. The value of the contributions will be around 0.17% of GDP in 2008, increasing gradually to 0.3% of GDP in 2010 and reaching 1% of GDP in 2016 when the value of the tax quota redirected from the pay-as-you go system reaches its maximum level of 6 %.

The government intends to finance the emerging deficit through the domestic issuance of long term government bonds in order to:
- consolidate the yield curve of government securities;
- deepen the domestic market development;
- create transparent benchmarks to help the issuance activity in the private sector.

6. QUALITY OF PUBLIC FINANCES

6.1 General Framework of Public Finances Policy/Fiscal Policy Strategy

In 2005 the government set out on an overall reform of public finances, aimed at spurring economic growth, supporting nominal and real convergence, and also at improving the quality of public finances.

Although there is no clear international evidence on the manner in which the level of public spending affects economic growth, it is certain that the quality of spending does. The main priority for the next period is represented by the consolidation of the quality of public finances by improving the efficiency, transparency, and accountability in the use of public resources. Consistent reform measures will be promoted in order to speed up the decentralization process and to increase the efficiency and sustainability in the fields of pensions, healthcare, education, and research and development. The overall budgetary process will be subject to in-depth reforms, through the expansion of the inclusion degree of the budgetary programmes and by increasing the focus placed on the medium term framework, in order to increase the predictability and transparency of the manner in which public resources are being spent. If, so far, the expenditures were usually carried out by allocating incremental increases over the entire range of fields, with the budget departments playing an accounting rather than strategic allocation function, the process of setting long-term objectives provides an important opportunity for a more fundamental review of the balance and pattern of expenditure across sectors. Over the past years, the process of planning the general consolidated budget has been constantly amended, in order to shift the focus from the cost-oriented budgeting process to the implementation of the performance-based budgeting, to constructing goal oriented budgets and on correlating them with the performance indicators. The 2007 budget was largely prepared in a programme-based structure (out of state budget expenditures, 64% were allocatted subject to programmes), while for the following years, the programme structure will be used as a primary tool for the allocation of budgetary expenditures. We must also note that the budget for 2007 and the associated medium term budgetary framework represents an important progress including a limited number of priorities, formulated in a clear and transparent manner, adequately provided for from a financing point of view.

The programme budgeting will probably need a longer time to demonstrate its benefits, as it requires long term efforts in improving analytical, managerial and implementation capacities across all government structures. In order to strengthen the medium-term public finance programming capacity, the Ministry of Public Finances intends to improve the system of economic modelling, providing reliable and substantiated estimates of future economic developments, and implement a methodology for multi-annual budgeting, including a transparent mechanism for the decision making process of the government regarding future activities and associated expenditures.

The budgetary revenues will have an upward trend, following the implementation of consistent steps regarding the tax administration reform and for improving the collection and enlarging the tax base in the fields of environment, agriculture, and state-owned companies. A comprehensive review of the extrabudgetary taxes and revenues will be realized in the following period in order to judge their economic opportunity and to asses the impact on the corporate balance sheet. The profit, income, and VAT tax rate levels will not be modified during the forecast horizon.

The implementation of the mentioned structural reforms in education, health, pension and the public investments' prioritization, will improve the public finances' sustainability, will strengthen the accountability and efficiency in delivering public services and will create the conditions for increasing the potential growth rate , implicitly speeding up the real convergence process.

6.2 Budgetary Revenues

In January 2005 Romania launched a fundamental tax reform. The profit tax was cut from 25 percent to 16 percent and a single personal income tax rate of 16 percent replaced a progressive five-bracket scale with rates between 18 and 40 percent.

Basically, the reform aimed at removing the various exemptions and discretionary special regimes, which contributed in the past to the building up of tax arrears both by public and private companies. Regarding the enlargement of the tax base, many of the exemptions and deductions granted by the previous legislation were eliminated, including the possibility to deduct the amortization expenditures up to 20 percent from the value of the fixed asset, the deductibility of the private health insurances and the deductibility of the positive value of the participation shares. Moreover, the statutory tax rates on the dividends, interest and capital gains were increased toward the flat tax level of 16 percent, thus contributing to an increased transparency and to the creation of a non-discriminatory business environment.

The new Fiscal Code, which came into force on 1 January 2007 by the adoption of Law nr 343/2006, introduces new regulations in the fiscal field, in order to accomplish harmonization with the EU rules and directives, which will generate higher revenues to the state budget.

6.2.1 Main new measures in the 2007 Fiscal Code

Tax on profit

The tax base was enlarged, the tax system was simplified and the EU provisions were adopted by: eliminating the categories of deductible reserves for the taxable profit of the banking and insurance companies, by eliminating the specific categories that cannot be found to the other taxpayers categories; elimination of fiscal facilities granted for the agricultural cooperatives and for the investments in the mountain areas, which are regulated by special laws not respecting the EU principles; introduction of the advance payments system starting with 2008, with the exception of the banking and insurance sectors starting by 2007; endorsement of the provisions related to the common fiscal regime applicable to the parent companies and to the field branches from various EU Member States regarding the distribution of dividends according to the provisions stipulated in the Directive 90/435/EEC, together with the applicable regime for mergers, splits, partial splits, transfers of assets and share exchanges in which various Member States companies are involved, according to the Directive 90/434/EEC.

Micro-enterprise´s Taxation

The new tax rates that will be implemented in the upcoming years are the following:
- 2% on the turnover for 2007;
- 2.5% on the turnover for 2008;
- 3% on the turnover for 2009.

The micro-enterprises or taxable legal persons whose turnover within a fiscal year is higher than 100,000 euro or the cumulated management and consultancy fees exceed 50 percent of their income, will pay tax on profit according to EGO no. 110/2006.

Tax on Personal Income

The main provisions in the new Fiscal Code, applicable from 2007 onwards are the following:

- standardizing the single 16% flat rate tax for all types of incomes, with the exception of the gambling games and the transfer of real estate properties;
- changing the methodology for calculating and administrating the tax on gains from transactions with movables;
- modification of the methodology for calculating the income tax obtained from transactions with immovable goods;
- elimination of tax exemptions for the gains obtained from the transfer of real estate property, obtained either through exchange or by inheritance;
- implementation of the EU Directives 48/2003, 49/2003, and 77/1999 related to the taxation of the non-residents and to the exchange of information.

VAT

The tax base for VAT will be increased by eliminating all remaining exemptions not observing the EU legislation (research and development, television and radio stations, cultural shows, and spa treatments).

Another important measure, negotiated with the European Commission, is represented by the downward revision of the VAT turnover ceiling level to 35,000 euro (from 57,000 euroin 2006, leading to the expansion of the tax base.

Excise duties

Regarding excise duties, the government is committed to continue the harmonization process with the EU directives and their progressive increase, according to the schedule included in Chapter 10 – Taxation. At the same time, the excise will be eliminated for certain non-harmonized items (for cars, microwave ovens, yachts, and other personal sailing ships). The non-harmonized excise duties that will be maintained refer to the following articles: perfumes, hunting guns, gold and platinum jewels, and crystal-made objects.

Local Taxes and Duties

As regards the local taxes and duties, the following measures are planned:

- for buildings used as residences, with an area exceeding 150 sqm, the building tax is increased, by 5% for each additional 50-sq m, or fraction of it;
- the tax on transportation means will be increased due to the changed methodology, based on the cylindrical capacity, by multiplying each 200 cm3 group or a fraction of it, by a sum ranging from 7 to 120 RON;
- the tax on sport and recreational ships is fixed between 0 and 800 RON/year;
- restaurants and bars – will be compelled to pay a tax to the local budget, amounting to 3,000 RON for the issuance/renewal of the annual license that authorizes the respective company to carry out these types of activities.

6.2.2 Other fiscal measures

In the field of **customs duties,** starting with 2007, Romania will adopt the EU customs tariffs and code. Under these circumstances, the customs duties collected on Romania's territory will become revenues of the community budget.

Regarding the **social security contributions**, their total rate (including pensions, unemployment, and healthcare contributions, cumulated both for employer and employee), was 48.24% in 2006 and the government is implementing a progressive reduction of an approximately 2pp per year over 2007-2009 interval. The first cut was introduced in January 2006, when the social security share paid by employers was decreased to 31.24% from 33.24% of the gross wages, out of which 19.75% was collected for the pensions fund, 7,75% for the healthcare fund, and 2,5% for the unemployment and labour accidents fund. The social contributions paid by employers remained unchanged at 17%, corresponding to 9.5 percentage points to the pensions fund, 1 percentage point to the unemployment fund, and approximately 6.5 percentage points to the healthcare fund.

Approximately 90% of the budgetary revenues are collected from the following sources: profit tax, social security contributions, and VAT. Excises and VAT contributes by 35 percent to the total revenues. Social security contributions have the largest share (approx. 30% of the revenues). In 2006, the income and profit taxes contributed each approximately with 10 % of the general government revenues.

Besides revenues from taxes, the budgetary revenues are made up of: revenues due to the state budget, income from other economic activities carried out by state-owned companies, revenues from the sale of assets of the companies with majority state capital, income from fines. In 2006, non-tax revenues contributed with about 7 % to the general government budget, being the second most important source of income after the aforementioned sources. Foreign assistance funds, allocated by the European Union, will contribute to increase of the share of non-tax revenues to the total budgetary revenues, reducing the share of tax revenues.

The acceleration of economic growth, improvement in the tax collection, and the tax reform implemented over the last two years, triggered a significant increase of the budgetary revenues, above the value set out in the budgetary plan. In 2006, the ratio of the general government revenues to GDP increased sharply, exceeding the level of 33% of GDP. The performance of the budgetary revenues improved: the collection of the profit tax increased by 8.12 percent in real terms in the first 9 months of 2006 while the collection of the income tax registered a 31.35% increase compared to the same period of the previous year.

Moreover, the collections of the VAT and excises increased by 18.10 and 5 percent respectively.

The tax reform implemented in the taxation field had a positive impact on the business environment by increasing the transparency and reducing administrative burden. The promoted tax changes diminished the share of direct taxes and raised the importance of indirect taxes. They redirected the burden of taxation from labour force and profit toward consumption taxation. This process will continue in the coming years, given the commitment to gradually reduce the social security taxes and to increase excises.

The revenues will register an upward trend as a result of the implementation of several consistent measures aimed at improving tax collection and administration and at enlarging the tax base in key areas as real estate market, agriculture, environment and state-owned enterprises.

6.3 Budgetary Expenditures

Key structural reforms will be implemented in the field of public expenditures in order to create an outcome and efficiency based system and to increase accountability of public spending. The fiscal framework considered increased public expenditures needed both to pay Romania's contribution to the EU budget and for allocatting additional resources in key areas set out in the Lisbon agenda: education, research and development, environment, and transportation. Fiscal consolidation has an important qualitative component and aims at increasing the efficiency of spending public resources in the fields of education, research and development, healthcare, and transportation, and controlling the growth rate of the wage bill.

6.3.1 Public Education expenditures

The public spending earmarked for education targets the highest level since December 1989, being almost 4.5% of GDP in 2006 and aiming to reach 5.3% of GDP in 2010. It will be channelled toward the implementation of the public policies aimed at accomplishing the following goals:

- non-discriminatory access to education during lifetime through: ensuring the logistics and school equipment – computers/educational computation systems, as well as the financial aid that will encourage the acquisition of computers and the educational system's reform;
- ensuring a high quality educational system, through: implementation of the program for ensuring and assessing the educational system's quality, facilitating the access to education and to extra curricular activities;
- educational autonomy in order to efficiently use the school resources through improving the financial and administrative management in a decentralized environment;
- increasing the Education and Research Ministry's capacity in the fields of policy development and implementation, of project management, and of establishing public spending priorities.

6.3.2 Public R&D expenditures

Research will benefit from a higher budgetary allocation, in order to diminish the disparities that are inconsistent with provisions of the Re-launched Lisbon strategy. Thus, 0.5% of GDP will be allocated to R&D in 2007 and increasing up to 1% of GDP in 2009. The level of spending (including both private and public) will be around 3% of GDP at the end of the forecasting horizon. In this respect, support will be granted to technological progress based on industrial and pre-competitive research aimed at obtaining and testing new products, technologies, and services. The improved cooperation in the R&D field between universities, companies, and the R&D institutions will be promoted as a basis for the future development of the companies' competitiveness.

In the same manner, the budget will support projects meant to increase the research and development activities' efficiency carried out by universities and by the research institutes, by providing the latter with last generation equipment, instruments and software, which are expected to complete the existing R&D structure or to develop new infrastructure (laboratories, centres of excellence), to develop the international partnership in research-development activities, and to develop the technological fields with economic potential of interest in Romania.

The companies' access, mainly of small and medium-sized companies, to R&D activities and to innovation will be supported based on projects, to ensure the transfer of know-how and technology and to help small companies start new business activities.

6.3.3 Infrastructure Expenditures

In the field of **transport infrastructure and public housing**, the following policies will be financed:

- harmonization of the transport system with the European system;
- rural infrastructure development/rehabilitation: roads, water supply systems, and sewerage systems;
- consolidation and rehabilitation of the buildings' heating systems;
- implementation of the specific information system in the field of real estate properties and of urban planning and the implementation of the urban databases;
- making the "urban and territorial planning" concept fall in line with the sustainable development requirements.

It is not enough to acknowledge the need to allocate additional resources. In order to improve the public sector's performance, the Government implements a wide reform programme aimed to increase the quality standards for public services, eliminate inbalances in their supply and increase the citizens' satisfaction degree. The decentralization process is one of the major current priorities in this regard. Through the transfer of the spending, the government intends to improve the quality of services and to increase the degree of the local governments' responsiveness and accountability toward their own communities' needs.

A new decentralization framework was introduced by Law 195/2006, including an integrated and transparent set of norms that must be observed when new responsibilities are transferred at local level. The main elements of this legislative package are the following:

- a complete and transparent set of general and specific principles for guiding the process of transferring additional tasks at local level;
- the setting up of the Inter-ministerial Committee for Technical Decentralization, with the role to coordinate the development and implementation of the decentralization sectoral strategies accomplished by various working groups in each ministry;
- an overall review on how responsibilities are shared by each segment of the government and their classification according to three categories: exclusive, common, and delegated.

The government endorsed a strategy for **decentralizing the pre-university education** in the second half of 2005. The strategy stipulates the transfer of the majority school management functions towards local governments (including the nomination and firing of the school principal and the optimization of the schools network), or even at the school's level (hiring and firing teachers, acquisition of textbooks, etc.). Regarding the financing, the strategy stipulates the introduction of the per capita formula to cover school's current expenditures. The current fragmented system used for school financing will be reviewed in order to ensure the consolidation process of the standard expenditures. According to this strategy, the envisaged timeframe to implement the above reforms is 2007-2010.

Also, the Ministry of Public Health elaborated the sectoral strategy of the **decentralization of the sanitation program** for the 2007-2009 interval. The general objective was increasing the life quality by promoting the following measures:

1) delimitation of the competences between the central public administration and the local one for a more efficient management of the sanitation system and the transfer of competences from the Ministry of Public Health towards the regional authorities and the local public administration;
2) the increase of the public administration role in developing and implementing the programs of public sanitation, in order to better respond to the specific needs of the communities;
3) redefining the role for the structures of the Ministry of Public Health in the elaboration and implementation of the public sanitation policies;
4) enhancement of the audit capacity of the Ministry of Public Health through the establishment of the State Sanitation Inspectorate and of 8 regional Sanitation Inspectorates;
5) raising the responsibility for the citizens of the local public administration by transferring under the management of local authorities (as a form of property, medical and financial management) of a two thirds of the number of hospitals from the network of the Ministry of Public Health (town or communal hospitals, health centers and municipal hospitals).

These hospitals will be financed from own revenues and local budget resources while the Ministry of Public Health will contribute by the National Investment Programs. Specifically, the local authority will support a part of the expenses associated for the investments in the maintenance and the construction of new hospitals, the consolidation and the rehabilitation of the existent ones, the acquisition of new medical equipments and all the other necessary goods for the medical activity.

A new legislative framework was endorsed and will be implemented, starting with January 2007, in **the fiscal decentralization field**. The major improvements deal with the equalization system, introduction of the conditional allocation notion and of the provisions on the local governments' insolvency and bankruptcy. More specifically, the equalization fund will be distributed by the Ministry of Public Finances decentralized services, according to a national formula that takes into account the fiscal capacity and the expenditure needs. It is envisaged that the equalization formula will also include a measure of the local fiscal effort by 2009.

Other projects going to be implemented on medium term by the government refer to a national monitoring framework for the supply of local services and the design of a standard reference system, the development of an ad-valorem properties taxation at local level and the setting up of an evaluation system for the administrative capacity in order to consider possible solutions for asymmetric decentralization.

The government's investments will continue to increase, in order to curb the structural differences between Romania and the other EU Member States. To support these priorities, significant resources from the structural and cohesion funds will be attracted, too.

The interest-related expenditures will know a medium-term stabilization, due to an increased level of the budgetary deficits. At the same time, the subsidies granted to companies will register a downward trend, following the consolidation of the progress registered during the structural reforms process.

The aforementioned measures will entail a positive impact on the quality of the public spending – increasing the efficiency of the public sector, raising the value-added of the public investments projects and improving sustainability of the public finances.

7. LONG–TERM SUSTAINABILITY OF PUBLIC FINANCES

7.1 Recent evolutions

A significant part of the public spending is based on programmes, and therefore needs a long term perspective. Current decisions on these programmes affect the dynamics of public spending not only in the near future but also after several decades. In this respect, it becomes a must to study the consequences of the respective decisions on the future developments in the sustainability of the public finances.

The demographic evolution (fertility and mortality rates) and the labour market participation are the main objective factors, exerting a direct impact on the public finances' sustainability.

7.1.1 Fertility Indicators Evolution

Currently, the fertility rate is very low from an international comparative perspective – only 1.26 children per woman, much below the optimal reproduction level. An improvment is expected in the future – firstly, at a lower pace (reaching 1.36 children per woman in 2015) and at a speeder pace afterwards (reaching 1.93 children per woman in 2030); during the second interval of the forecasting period, the pace is expected to slow down again, tending towards the reproduction level at the end of the period.

7.1.2 Mortality Rates Evolution

The mortality rate is expected to decline for both genders, the life expectancy at birth being expected to go upward by the end of the forecasting period with 6.7 years for men and 6.4 years for women.

Table 7.1: Life expectancy
(average number of years expected at a certain age)

	2005	2010	2020	2030	2040	2050
Men						
Life expectancy at:						
Birth	68,2	69	70.3	71.8	73.4	74.9
Age of 20	50,1	52	51.8	53.1	54.5	55.9
Age of 60	16,4	16,9	16.7	17.7	18.7	19.7
Age of 65	13.3	13.6	13.4	14.2	15.1	16.0
Retirement age	13.8	13.9	13.4	14.2	15.1	16.0
Women						
Life expectancy at:						
Birth	75,5	75,7	77.8	79.1	80.6	81.9
Age of 20	57,1	57,8	58.9	60	61.3	62.5
Age of 60	20,1	20,9	21.4	22.4	23.4	24.4
Age of 65	16,1	16.5	17.4	18.2	19.2	20.1
Retirement age	20.9	21,4	21.4	22.4	23.4	24.4

Source:World Bank and Ministry of Labour, Social Solidarity and Family

Total population will register a downward trend from 21.6 million at July 1, 2006 to approximately 18 million in 2050. The main explanation is the low level of fertility which, even if improving, will remain below the optimal reproduction level over the entire forecasting period.

Table 7.2: Projection of the population number and the rate of dependence

	2005	2010	2020	2030	2040	2050
Total population (thousands people)	21,624	21,207	20,402	19,704	18,392	18,018
percentage (%), of which:						
0-14 years old	15.6%	15%	14.3%	14.4%	15.1%	15.2%
+15 up to retirement age	65.3%	66.4%	65.2%	62.7%	57.3%	53%
>retirement age	19.1%	18.6%	20.5%	22.9%	27.6%	31.8%
Dependency rate (%)	29.2	28	31.4	36.6	48.2	59.9

Source:World Bank and Ministry of Labour, Social Solidarity and Family

The number of contributors to the pension system is expected to decline to about 4 million towards the end of the forecasting period (from approximately 5.9 million currently), due to the diminishing trend of the total population. Similarly, the number of pensioners benefitting from age limit pensions is expected to go down from a current number of 3.2 million people to about 2.8 million in 2050. Thus, the number of pensioners is forecasted to gradually increase until 2037 when it reaches approximately 4.2 million, and then to constantly go down until the end of the forecasting interval.

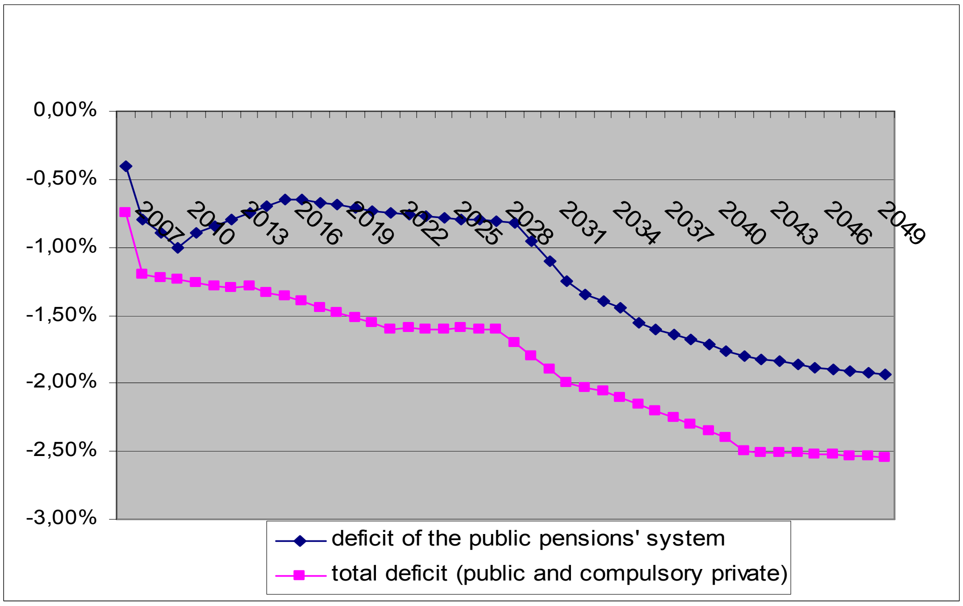
7.1.3 Evolutions of the Labour Participation Rates

The demographic challenges are amplified by the employment level of age limit employees. In 2005, the employment rate for the population recording an age between 15 and 64 was 57.7%, as against the EU average of 63.8%, requiring consistent additional efforts to reach the target set by the Revised Lisbon Strategy - 70% by 2010. The employment rate for the population recording an age between 55 and 64 was 39.4% in 2005, below the EU average of 43% registered in EU and the 50% target set in the Lisbon Strategy.

7.1.4 Pension System's Evolution

In order to evaluate the dynamics of the pension system, we assumed an indexation of the pensions' benefits of 150% multiplied by the inflation level. This assumption is a realistic one, considering both the recent pattern of the indexations in the public pension system and the government's goal of increasing these benefits in order to ensure a moderate rise of the replacement ratio, calculated on the basis of the average wage. The table below shows that the system registers a permanent deficit between 0.4 and 2% of GDP. The deficit will further deteriorate when part of the contributions to the public pension system will be re-directed towards the private one.

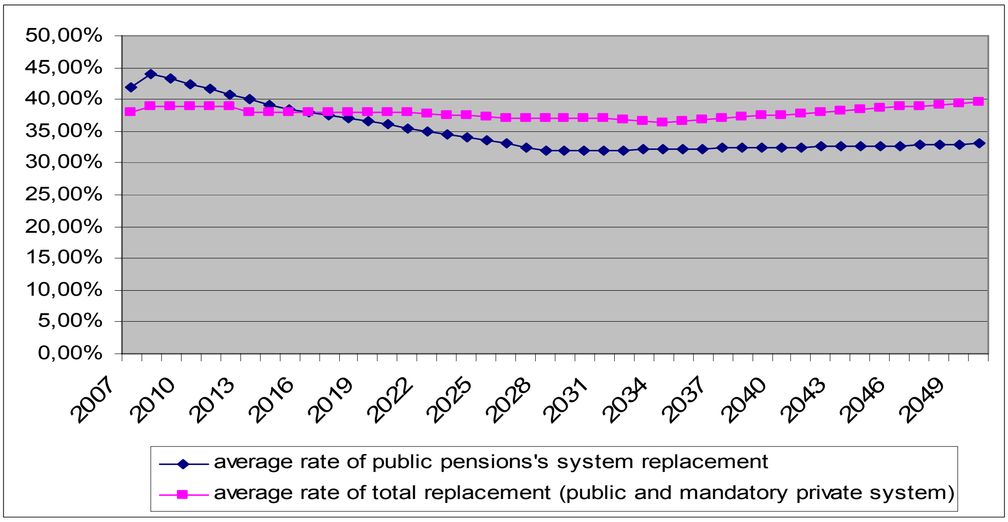
Figure 7.1: Evolution of the Pensions' System Deficit



Source: World Bank and Ministry of Labour, Social Solidarity and Family

Replacement rates (calculated on the basis of gross average wage) show an improvement after the implementation of the pension system reform. The replacement rate is expected to reach 40% at the end of the forecasting period in the case of the implementation of the compulsory contributions, as compared to only 33% in the case of the actual public system.

Figure 7.2: Evolution of the average rate for Pensions' Replacement



Source: World Bank and Ministry of Labour, Social Solidarity and Family

7.1.5 Health System's Evolutions

Population's health indicators improved during the last five years, after a deterioration period evident during the mid 90's. However, they are still lagging from a comparative perspective with the EU member states. As observed in the below table, several indicators - male life expectancy and standardized death rates (SDRs) - worsened in the mid-1990s, while others continued to improve. Maternal and infant mortality are currently at their lowest levels since 70's.

Table 7.3: Selected Health Indicators

	1970	1980	1990	1995	2000	2004
Female life expectancy at birth	70	72	73	74	75	75,4
Male life expectancy at birth	66	67	67	66	68	68,2
SDR ischemic heart disease 0-64 per 100,000 males	26	42	55	72	63	62
SDR all causes and ages	1,236	1,284	1,169	1,224	1,098	1,076
Infant mortality rate (per 1,000 live births)	49	29	27	21	19	17
Maternal mortality (per 100,000 live births)	116	132	83	48	33	24

Source: WHO HFADB and MoH Statistical Annual Book.

The infant mortality rates in Romania are below the average of countries with similar income levels, while maternal mortality is slightly above average. However, these rates are higher than every other country in the European Union.

Furthermore, the deterioration trend of some other health indicators was not yet reversed. For instance, the incidence of tuberculosis is increasing and there has been little progress in reducing the number of cardiovascular diseases. At the same time, the evolution of standardized death rates for all ages and causes shows that the diseases of the circulatory system represent one of the leading causes of death in Romania. The decrease of these rates is very modest and their levels are still well above those registered in the European Union**.**

The main institutions implied in the health system are:

- The Ministry of Public Health: elaborates the health strategy and policies, financing by health programs, the acquisitions of medical equipment and some other activities of strategic importance for the public sanitation system;
- The National Health House: manages the health contributions system with the aim of implementing the Government policies and programs in the health area;
- The Physician´s College and other professional organizations: exerting a supervisory role in the practice of the medical profession and the quality of the medical services;
- The suppliers of sanitation services from the different levels of the medical system (primary assistance, ambulatory, hospitals, etc.)

International benchmarking confirms that while public spending on health as a share of GDP is in line with the level registered in other countries with the same level of development, it is lower than in most of the EU countries. Spending has increased in real terms, fluctuating between 3.4 and 4 percent of GDP. However, a number of factors hinder the satisfactory functioning of the system and creates pressure for increasing the level of the resources, mainly:

-the higher share of approximately 60-70% of the resources from the health budget absorbed by the hospital system (compared with an average level of 35-40% in the EU member states);
-the technological and therapeuticall progress registered in the medical field, triggering higher costs;
-the increasing expectations of the population
-the lack of a sufficient financial discipline in the system.

7.2 Measures to Improve Public Finances' Sustainability

7.2.1 Pensions Sector

The first step in the pension's reform was implemented in 2001 by the enactment of the Law no 19/2000 regarding the public pension system.

At this stage, the law provided for measures aiming to decrease the long-term fiscal inbalances of the social security budget, such as:

- rising the standard retirement age from 57 to 60 years for women and from 62 to 65 years for men, in a gradual approach until 2014;
- granting additional pension points in order to stimulate participation in the labour market even after meeting the cumulative criteria for retirement,
- increasing the minimum contribution period for both genders from 10 to 15 years until 2014;
- introducing a new formula for computing pensions, thus improving the correlation between the contributions to the system and the level of benefits, based on a points system that takes into account the incomes obtained throughout the career period, with strong redistributive elements considered in the calculation.

The second stage of the reform, initiated in 2005, consisted of a coherent set of measures aimed at reforming the system by creating a multi-pillar framework, while continuing the consolidation of the public pension pillar.

A key element in consolidating the public pension system (first pillar) was the externalization of the non-contributive services. In this respect, a number of benefits were excluded from the social security budget, such as:

- the payment of the farmers' pensions was transferred to the state budget, starting with 2005;
- the payment of the child-raising allowances and medical allowances were transferred to the state budget, respectively to the health social insurance fund, starting with 2006.

The multi-pillar framework represents one of the main solutions of the Romanian Government in order to consolidate and increase the long-term sustainability of the pension's system. Moreover, there are also currently designed additional measures to restrict early retirement by limiting eligibility criteria.

The second pillar - the private-managed compulsory pensions - will be implemented starting January 1, 2008 (according to Law 411/2004). The main consequence of the framework is represented by the redirection of a certain part of the contribution from the main pillar (up to 2% of the wage fund for the first year with the share gradually increasing during the next eight years, up to 6% at the end of the period). The contribution to these private funds will be mandatory for the entire population under 35 years and voluntary for those aged between 36 and 45. Each pension fund should assist minimum 50,000 participants and will function under the supervision of a newly established body named the Pension Funds Supervisory Commission (established by Law no 313/2005). The persons who will not succeed in choosing a certain fund will be directed ex officio towards a fund administrator.

The third pillar – private-managed voluntary pensions schemes - will be implemented starting with 2007 (Law 204/2006 regarding voluntary pensions). There are expected to join the scheme around 300,000 participants in the first year and another 200,000 in 2008. Total contributions will be around 100 million euro at the end of the second implementation year.

7.2.2 Health Sector

In order to increase the access of the population to medical services, improving the quality and the efficiency of the health services, Ministry of Public Health established through its own strategy, the following priorities:

- the development and enhancement of the primary and ambulatory medical assistance;
- the development of new services: home medical assistance, and the day-light hospitalization;
- the diminish of the share of hospital assistance from 60-70% of the total resources to around 40%, while implementing consistent restructuring measures aimed at downsizing the hospitals;
- rehabilitation of the infrastructure of the sanitation system;
- the development and reorganization of the emergency services network;
- increasing the share of the preventive measures, compared to the curative one;
- improving the IT network;
- decentralization of the sanitation services;
- improving and raising the level of the financial flows to the system by:
    - the establishment of the development fund for investments in hospitals;
    - introduction of the payment based on diagnostic related groups;
    - raising the level of the resources by increasing the number of contributors to the system;
    - attracting financial resources from the private sector;
    - regulating the private insurance health system (complementary system) for diversifying the resource base, raising the level of the competition in the system with positive consequences evident on a better cost control and the provision of services with improved quality;
    - introducing and finalizing the concept of co-payment and of minimal health services package.

In 2006, a comprehensive law package **(**Law number 95/2006 and the associated secondary legislation **)** was approved by Parliament, aimed at improving accountability and efficiency in the hospital sector by introducing a more professional management, increasing the decisional transparency, ameliorating the allocation of the resources and implementing more strict and specific provisions regarding the conflict of interests.

The government is fully committed to implement this package and to deepen the overall reform process in order to improve the public finance sustainability within the sector. A further involvement of the private sector in supplying medical assistance is essential for reducing the pressure exerted on public resources and improving the quality of the medical services.

7.2.3 Measures to Enhance Fertility Rates

In this respect, the Government adopted the Law 396/2006, granting a financial support of 200 euro per family, with the condition that both partners are at the first marriage. In addition, striving for boosting the birth rate, the government adopted the Emergency Decision no 148/2005, stipulating the child care holiday right (up to 2 years for normal childs and up to 3 years for handicapped persons) for the people having realized professional revenues for at least 12 month. Moreover, these persons are benefiting of an monthly indemnity of RON 600 and an additional RON 100 incentive, starting by January 1, 2007.

From the same date, the amount of the child allowance will be of RON 200 for each child with an age below 2 years (3 years respectively for the handicapped childrens).

8. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

8.1 Institutions Involved in Drafting the Budget Law

The budgetary process consists of five main stages:

- drafting the budget,
- discussion of the draft budget and endorsement at legislative level
- budget execution
- implementation monitoring
- endorsement of the general execution account.

The process of budget formulation, execution and monitoring is governed by the Law of Public Finances as well as by other legislative acts (Government regulations, instructions, methodologies etc.). The Ministry of Public Finance has the main responsibility of preparing the drafts of the annual budgetary laws, of the rectification laws, as well as of the laws on the endorsement of the annual execution account. These drafts are presented by the minister of public finances in the Government's meetings and assumed by the Cabinet, in order to be submitted to the Parliament for approval.

The Law of Public Finances approved in 2002, stipulates that the Parliament adopts the annual budgetary laws and the rectification laws, elaborated by the Government in the context of the assumed macroeconomic strategy. According to the provisions in this Law, the Parliament cannot approve amendments to the budget, which would lead to an increase of the budgetary deficit, the Government being empowered to establish the maximum level of this indicator. If the budget law is not endorsed at least three days ahead the end of the budgetary exercise, the Government will fulfil its duties, as stipulated in the previous year's budget, and, as a general rule, the monthly limits for expenditures cannot be above 1/12 from the previous year budget.

Table 8.1: Budget preparation calendar

Due dates	Activities
31 March	The forecasts of the macroeconomic and social indicators for the budgetary year for which the draft of the budget is elaborated, as well as for the following 3 years, are elaborated by the authorized bodies. These indicators shall be updated throughout the carrying on of the budgetary process.
1 May	The Ministry of Public Finance submits to the Government, the objectives of the fiscal and budgetary policy for the budgetary year for which the draft of the budget is elaborated and for the following 3 years, together with the expenditure limits established for the main loan managers.
15 May	The Government informs the Parliament on the main directions of its macroeconomic and public finance policies.
1 June	The minister of public finance submits to the main loan managers, a frame-letter specifying the macroeconomic context of the budget, the methodologies used in its drafting, as well as the expenditure limits approved by the Government.
15 June	The modification of the expenditure limits shall be adjusted by the

Due dates	Activities
	Government, at the proposal of the Ministry of Public Finance, on the basis of the requests of the main loan managers.
15 July	The main loan managers have the obligation to submit to the Ministry of Public Finance the proposals for the next year draft budget, and the associated estimates for the following 3 years, complying with the expenditure limits
1 August	Submission of the draft budgets and final annexes to the Ministry of Public Finance
30 September	The Ministry of Public Finance, on the basis of the drafts of the budget of the main loan managers and of the own budget, elaborates the drafts of the budgetary laws and the drafts of the budgets. These drafts are submitted to the Government.
15 October	After the assumption of the drafts of the annual budgetary laws and the drafts of the budget, provided in paragraph (1), the Government shall submit them for Parliament adoption.
31 December	The Parliament adopts the budget draft.
1 January (next year)	Starting of the budget execution after the approval of the Parliament.

Source: Ministry of Public Finance

8.2 Institutional Framework for the Coordination, Implementation and Management of the EU Funds

Co-financing from the structural funds and the Cohesion Fund will become an important resource for the National Development Plan policies. The European Council decided that the funds allocation for Romania should reach up to 3,78% from the national GDP. These funds represents the co-financing needs of local governments and private bodies.

Increasing the absorption capacity of EU grants is a very important objective of the Government's macroeconomic policies. The Cabinet has settled the institutional framework for the management of EU grants, by adopting the Government Decision no. 497/2004. According to this decision, the Ministry of Public Finances was designated as management coordination authority for the programming and the implementation of the EU funds.

Another important step in the process of optimizing the administration of EU funds was the establishment in 2005 of the Payments and Certification Agency, under the Ministry of Public Finances' subordination, with the responsibility of certifying the expenditure incurred under different projects and sending the requests for funds to the European Union. This authority detains the national contribution and the structural and cohesion funds as a global position in the budget.

The budgetary policies will also facilitate the access to the structural and cohesion funds, by allocating important resources from the budget.

The Government is also preparing additional measures for maximizing the absorption of resources from the structural and cohesion funds, especially by increasing the absorption capacity of the public administration and the effective utilization of these resources, by:

- setting up specialized structures inside the competent bodies authorized with the allocation of budgetary funds;
- hire an adequate number of personnel;
- ensure the training of the personnel involved in the allocation of EU grants;
- define and implement specific procedures according to the communitty rules and principles.

Table 8.2: Institutional Framework

Operational programme	Management authority	Intermediary bodies	Fund
Convergence objective			
OP Economic Development and Competitiveness	Ministry of Economy and Trade	-National Agency for Small and Medium Sized Enterprises -Ministry of Education and Research -Ministry of Communications and Information Technology -Ministry of Economy and Trade – Department of Energy Policy -National Tourism Agency	ERDF
OP Transport infrastructure	Ministry of Transportation, Housing, and Tourism	-	ERDF+CF
OP Regional development	Ministry of European Integration	-the eight regional development agencies	ERDF
Environment infrastructure	Ministry of Environment, and Water Management	The 8 environment protection agencies	ERDF +CF
OP Human Resources Development	Ministry of Labour, Social Solidarity and Family	National Agency for Employment Ministry of Education and Research	ESF
OP Development of administrative capacity	Ministry of Administration and Interior	-	ESF
OP Technical assistance	Ministry of Public Finance	-	ERDF

Source: Ministry of Public Finance

ERDF - European Regional Development Fund
CF - Cohesion Fund
ESF - European Social Fund

8.3 Improving the Budget Planning in Medium-Term

Starting 2006 the Romanian government initiated a reform process by introducing a strategic planning system within the central administration. This system will be implemented in two stages: the first one will consist in drafting of the management component for the strategic plans and, respectively, the second stage is addressed to the budgetary programming component. In this respect, the Government General Secretariat issued the Methodology for the Strategic Planning System on Medium-Term for the Central Administration - First Stage, the Management Component.

The strategic planning system's objectives address topics such as: increase the predictability of the Government actions, promote a more efficient management of the public policies, creating appropriate links between public policies' planning and the budget drafting and also, increasing the coherence and efficiency in the process of spending the public funds.

Among the priorities of this system we mention the following:

a) improving drafting and grounding of the sectoral policies by enhancing the procedures, methodologies and standards used in public policies;
b) institutional efficiency and rationalization;
c) enhancing the coordination between the sectoral policies and the Governing Programme, with National Development Programme or other comprehensive strategies (Lisbon Strategy, for instance) and correlation with the existing resources within the consolidated budget;
d) spurring a better correlation between the sectoral policies/programmes and the medium term budget planning system;
e) focus on the quality of using the public funds by improving the program based budgets: defining the objectives in a SMART manner; establish the outcomes/effects that will be achieved; introduce a system and associated procedures for grounding and collecting the monitoring indicators.

In 2007 the Government General Secretariat will collaborate with the Ministry of Public Finance with the aim of detailing the instructions and the methodology of the 2008 budget drafting and granting assistance to the line ministries with the purpose of elaborating the Methodology for the Strategic Planning System – the programme-based budgeting Component and the Methodology for setting the performance indicators for the budgeting programmes.

8.4 Fiscal Administration Reform

Romanian government initiated the reform process of the revenues administration, aiming at increasing the efficiency of collection, reducing the burden associated to the voluntary compliance and improving the services granted to the taxpayers, including promoting integrity and transparency. Starting January 2005, the National Customs Authority and Financial Guard were transferred to the National Agency of Fiscal Administration, which became a central revenues´ collecting institution.

The major challenges that are facing the tax administration are related to the lack of a functional IT system and the slow speed of the information sharing in the field declarations, payments and forced execution. In addition, a major part of VAT statements are subject to a preventive audit while the selection is dominated by cases re-directed from other institutions (such as General Prosecutor´s Office), the situation being exacerbated by the major inbalances in the resource allocation between Bucharest and counties tax administration departments (and within the last ones).

The main actions envisaged to be implemented are:

- The additional development of the IT system allowing a real time cross-check of the payments' declarations, automatic transmission of the payment notification, and the initiation of the forced-execution process;
- delegate field audits´s responsibilities from the centre towards local departments and develope a national audit strategy;
- set up a risk-based analysis and indentification system in the field of taxpayers' audit, in order to save resources and enhance the efficiency of the forced-execution process;
- improve resource allocation on the basis of taxpayers' number, granting a maximum priority for Bucharest area;
- maintaining the momentum created in the forced execution process and speed up the tax arrears recovery process.

8.5 Institutional framework for local borrowing

According to the provisions of Public Debt Law no. 313/2004, starting with 2005, the local authorities may borrow or guarantee domestic or foreign loans on short, medium and long term, with a view to finance local public investment projects and to refinance local public debt, under the endorsement of the local borrowing authorization commission.

The experience accumulated so far in relation to the local authorities, led to the conclusion that a streamlining of the documentation processing is required.

By the recently adopted Government Decision no. 9 regarding the setting up and functioning of the local borrowing authorization commission, it has been provided for the:

1. simplification and standardization of the documentation required from the local authorities to be submitted to the local borrowing authorization commission;
2. monitoring framework of the local authorities regarding the obligations to be observed during the contracting/ guaranteing period of loans or other issued securities;
3. consultation with the associative local authorities structures, according to the provisions from the European Chart of local autonomy.

Total due repayment of the contracted loans, including principal, interest and fees cannot exceed 30 percent of the local authority own revenues during the repayment period.

8.6 Progress in harmonization of the public finance statistics

Starting with 2006, within the framework of the annual fiscal surveillance procedure, Romania has submitted twice the Fiscal Notification, on March 31 and September 30.

The data for 2002-2005 and estimates for 2006 have been reported based on last budget approved by the Parliament. The main improvements in the government financial statistics, regard: tax and social contributions assessement on an accrual basis; the insertion of amounts allocated from own revenues and recording the expenditures from privatization proceeds. It has been also updated the computation of public administration final consumption on sub-sectors.

Regarding the convergence to ESA 95, a EUROSTAT delegation conducted a study visit in Romania in June 2006, assessing the procedures and data sources used for tax notifications, specifically Table 2 regarding the budget deficit (Net lending/Net borrowing).

Ministry of Public Finance will continue the collaboration with the National Institute of Statistics in the area of public finance statistics, by focusing on data reporting according to COFOG level II and data source utilization.

ANNEXES

Table 1a. Macroeconomic projections

	ESA Code	2005	2005	2006	2007	2008	2009
		Level [1] billion RON	percentage modification,%				
1. Real GDP	B1*g	256,7	4,1	8,0	6,5	6,3	5,9
2. Nominal GDP	B1*g	288,0	16,9	18,6	13,8	11,6	10,1
Real GDP Components							
3. Private consumption expenditure	P3	186,8	9,6	11,8	8,1	7,2	6,7
4. Government consumption expenditure	P3	43,4	9,0	3,7	3,5	3,8	3,1
5. Gross fixed capital formation	P51	60,6	12,6	15,0	14,0	11,5	11,0
6. Changes in inventories and net acquisitions of valuables (% of GDP)	P52+ P53	-2,2					
7. Exports of goods and services	P6	95,7	8,1	11,8	10,9	7,6	7,3
8. Imports of goods and services	P7	129,3	16,6	20,8	15,0	11,2	10,3
Contributions to GDP increase							
14. Final domestic demand		-	10,8	12,3	9,6	8,6	8,0
15. Changes in inventories and net acquisitions of valuables	P52+ P53	-	-2,2	0,8	0,0	0,2	0,1
16. External balance of goods and services	B11	-	-4,5	-5,1	-3,1	-2,5	-2,2

[1] real GDP' and its components levels is in the previous year's prices.

Table 1b. Prices evolution

	Codul ESA	2005	2005	2006	2007	2008	2009
		Level	Percentage modification				
1. GDP deflator			12,2	9,8	6,8	5,0	3,9
2. Private consumption deflator			7,1	5,9	4,3	3,1	2,5
3. Harmonized indicator of the consumption prices			9,1	6,6	4,5	4,3	3,2
4. Public consumption deflator			20,9	10,2	4,9	3,0	2,3
5. Investments deflator			9,7	9,5	6,0	4,0	3,0
6. Export price deflator (goods and services)			-0,9	2,8	3,3	2,9	2,6
7. Import price deflator (goods and services)			-3,6	-0,8	-0,7	-0,8	-0,5

Table 1c. Labour market's evolution

	ESA Code	2005	2005	2006	2007	2008	2009
		Level thou people	**Percentage modification**				
1. Employed persons (according to the National Accounts definition) - thousands people		9147	-0,1	0,6	0,3	0,3	0,2
2. Unemployment rate (according to ILO definition) -%			7,2	6,8	6,7	6,6	6,5
3. Labour productivity per person (real GDP/ employed person)			4,2	7,4	6,2	6,0	5,7
4. Compensation of employees	D1		17,4	15,6	11,8	9,9	9,4

Table 1d. Sectoral balances

% of GDP	**ESA Code**	**2005**	**2006**	**2007**	**2008**	**2009**
Net lending/borrowing, vis-a-vis the rest of the world	B9	-7,9	-10,2	-8,9	-8,3	-7,8
from which:						
- balance of goods and services		-10,3	-11,8	-11,7	-11,5	-11,4
- balance of revenues and transfers		1,6	1,4	1,4	1,3	1,5
- capital account		0,8	0,2	1,4	1,9	2,1

Table 2. Consolidated budget projection

	ESA Code	2005	2005	2006	2007	2008	2009
		Level	% of GDP				
Net borrowing (EDP B.9) on sub-sectors							
1. General government	S13	-4.205,1	-1,5	-2,3	-2,7	-2,6	-2,0
2. Central government	S 1311	-4.262,1	-1,5	-3,0	-3,0	-3,0	-2,4
3. State government	S1312						
4. Local government n	S1313	-150,5	-0,1	0,2	0,1	0,1	0,04
5. Social security funds	S1314	207,5	0,1	0,5	0,2	0,4	0,3
General government (S.13)							
6. Total revenue	TR	92.297,5	32,1	33,9	36,5	37,1	37,8
7. Total expenditure	TE	96.503,0	33,6	36,2	39,2	39,6	39,8
8. Net lending/borrowing	EDP B9	-4.205,5	-1,5	-2,3	-2,7	-2,6	-2,0
9. Interest expenditure, incl. FISIM	EDP D41	3.281,1	1,1	1,1	1,1	1,1	1,0
10. Primary balance		-924,4	-0,4	-1,2	-1,6	-1,5	-1,0
Selected components of the revenues							
11. Total taxes		52.334,8	18,2	19,8	21,7	21,7	22,6
11a. Taxes on production and imports	D2	36.348,0	12,7	13,5	14,4	14,5	14,9
11b. Current taxes on income, wealth, etc.	D5	15.986,8	5,6	6,3	7,2	7,2	7,7
11c. Capital taxes	D91	0	0	0	0	0	0
12. Social contributions	D61	27.882,1	9,7	9,4	9,6	9,4	9,1
12. Poperty-generated income	D4	4.036,8	1,4	1,5	1,5	1,5	1,4
12. Other revenues		8.043,7	2,8	3,2	3,8	4,5	4,7
15=6. Total revenue	TR	92.297,5	32,1	33,9	36,5	37,1	37,8
Pm.: Tax burden (D2+D5+D61+D91-D995)[*)]		80.217,0	27,9	29,2	31,2	31,1	31,7
Selected components of the expenditures							
16. Collective consumption	**P32**	25.382,3	8,8	8,3	8,8	8,3	8,6
17. Total social transfers	**D62+D63**	28.744,2	10,0	9,6	9,9	10,3	9,6
18. Interest-related expenditure	**EDP41**	3.281,1	1,1	1,1	1,1	1,1	1,0
19. Subsidies	**D3**	4.820,6	1,7	1,5	1,0	0,9	0,9
20. Gross fixed capital formation	**P51**	10.984,0	3,8	6,1	9,7	9,3	8,7
21. Other expenditure		23.290,8	8,1	9,6	8,7	9,8	11,0
22=7. Total expenditure	TE	96.503,0	33,6	36,2	39,2	39,6	39,8

Note: The revenues and expenditures are calculated according to ESA. For the correct measurement of the revenues and expenditures of the consolidated budget, were eliminated trough the consolidation the flows within the each sector and between the different sub-sectors. For the year 2006, was used the last program approved, as well as some estimates for the transposition of data according to ESA methodology. According to the last forecast, the budget deficit for 2006 will be less than the target foreseen in the approved budget.

Table 4. General government debt developments

% of GDP	2005	2006	2007	2008	2009
1. Gross government debt (according to ESA)	15.9	12.8	13.5	12.6	11.7
2. Change in gross debt ratio	-2.9	-3.1	0.8	-0.9	-0.9
Contribution to the modification of gross debt					
3. Primary balance	-0.4	-1.2	-1.6	-1.5	-0.9
4. Interest expenditure (incl. FISIM)	1.1	1.1	1.1	1.1	1.0
5. Stock-flow adjustments	-3.6	-3.0	1.3	0.5	-1.0
From which: - Differences between cash and accrual	0.11	0.03	-0.02	-0.01	-0.02
- Net accumulation of financial assets from which: coming from privatization *)	0.15 0.08	2.68 2.68	0.31 0.26	0.09 0.09	0.08 0.08
- Valuation effects and others	-3.9	-5.7	1.0	-0.6	-1.1
p.m. implicit interest rate on debt	7.8	9.1	8.7	8.9	9.0
Other relevant variables					
6. Liquid financial assets **)	0.6	3.9	3.6	3.1	2.8
7. Net financial debt (7=1-6)	15.3	8.8	10.2	9.6	8.9

**) destination of sums that will be used from these availabilities will be set through a government decision, according to the provisions in the Government's Emergency Ordinance No. 111/2003.*

***) represents the availabilities in the MoPF's hard currency account and in the lei account from collections follwoing the turning to value of bank assets and of the privatization activity.*

Table 5. Cyclical developmentss

% of GDP	ESA Code	2005	2006	2007	2008	2009
1. Real GDP growth (%)		4.1	8.0	6.5	6.3	5.9
2. Net lending of general government	EDP B9	-1.5	-2.3	-2.7	-2.6	-2.0
3. Interest expenditures (including FISIM recorded as consumption)	EDP D41+SIFIM	1.1	1.1	1.1	1.1	1.0
4. Potential GDP growth (%)		5.29	5.51	5.98	6.25	6.6
contributions:						
- Labour		0.11	-0.07	0.1	0.07	0.26
- Capital		1.79	2.07	2.30	2.58	2.75
- Total factor productivity		3.39	3.51	3.58	3.60	3.59
5. Output gap		0.73	1.99	2.31	2.17	1.33
6. Cyclicall budgetary component		0.20	0.57	0.69	0.65	0.41
7. Cyclically adjusted balance (2-6)		-1.7	-2.86	-3.39	-3.25	-2.41
8. Cyclically adjusted primary balance (7-3)		-0.6	-1.76	-2.29	-2.15	-1.41

Table 6. Divergence from the previous variant

	ESA Code	2005	2006	2007	2008	2009
GDP growth (%)						
Previous update		5.7	6.0	6.3	6.5	
Current update		4.1	8.0	6.5	6.3	5.9
Difference		-1.6	2.0	0.2	-0.2	
General government net lending (% of GDP)						
Previous update		-0.4	-0.7	-1.0	-1.5	
Current update		-1.5	-2.3	-2.7	-2.6	-2.0
Difference		-1.1	-1.6	-1.7	-1.1	
General government gross public debt (% of GDP)						
Previous update		17.1	15.1	14.6	14.6	
Current update		15.9	12.8	13.5	12.6	11.7
Difference		-1.2	-2.3	-1.1	-2.0	

Table 7. Long -term sustainability of public finances

% din PIB	2004	2005	2010	2020	2030	2050
Total expenditures	33.4	33.6	39	39	38.4	37.9
Expenditures with pensions	6.7	6.7	7.3	7.3	7.8	7
Healthcare	3.2	3.5	3.7	3.7	3.6	3.5
Education-related expenditures	3.4	3.6	5.3	5.3	5.0	4.7
Total revenues	31.9	32.1	37.5	38	37.4	36.9
	- average growth rate -					
Labour productivity growth	9.3	4.2	6.1	5.4	4.6	3.7
GDP real growth	8.5	4.1	6.5	5.5	4.6	3.7
	- % -					
Participation rate among men *)	70.2	69.5	69.2	70.9	71.4	78.4
Participation rate among women *)	56.2	55.3	56.9	59.3	59.4	69.0
Total participation rate *)	63.2	62.4	63.0	65.1	65.4	73.7
Unemployment rate – BIM	8.0	7.2	6.4	5.5	5.2	5.0
Population aged 65 and over/ total population	14.5	14.7	15.6	16.5	17.5	21.0

*) *Data are provided in cash methodology*

Table 8. Assumptions

	2005	2006	2007	2008	2009
Lei/Euro exchange rate	3.62	3.52	3.45	3.38	3.32
World GDP increase, without EU	5.6	5.7	5.2	5.2	5.2
GDP growth in EU	1.7	2.8	2.4	2.4	2.4
Foreign market growth	5.5	8.5	6.5	6.4	6.3
World imports volume, without EU	7.3	8.8	8.2	7.7	6.9
Oil price (Brent, US dollars/barrel)	54.1	65.6	66.3	68.0	69.0