Romania

Fiscal Council

Annual Report

Macroeconomic and fiscal developments

March 2011

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Summary

The Fiscal Council is an independent authority established by the Fiscal Responsibility Law, which aims to support the Government and the Parliament in designing and implementing the fiscal policy and to promote the transparency and sustainability of public finance.

According to the Fiscal Responsibility Law, the Fiscal Council has among its prerogatives to issue an annual report to analyze the conduct of fiscal policy during the previous year benchmarked against the framework set out in the Fiscal Strategy and Annual Budget, to assess the macroeconomic and fiscal developments as well as the objectives, targets and indicators included in the Fiscal Strategy and Annual Budget.

Even though a review of the economic and budgetary developments in 2010 against the Fiscal Strategy is not possible due to the delayed approval of the latter, the report of the Fiscal Council highlights the main macroeconomic developments, focusing on the analysis of the budget execution against the approved budget as well as on the main risks to fiscal sustainability over the medium term.

Following a difficult year of fiscal adjustment, the Romanian economy has stabilized and a gradual recovery is expected in 2011. Recent data signal a positive growth in the last quarter of 2010, while the gross domestic product has contracted in 2010 less than previously anticipated (-1.3 per cent compared to official forecasts of -1.9 per cent), supported by the strong growth of exports and industrial production.

The economy failed to emerge from recession last year due to the necessary corrections of the major structural imbalances that occurred in the pre-crisis period as a result of many years of unsustainable fiscal policies.

In January 2010, the Parliament approved a budget targeting a fiscal deficit of 5.9 per cent of GDP, target subsequently revised to 6.8 per cent of GDP due to the deterioration of the macroeconomic framework.

To achieve this goal, the Government decided to implement an ambitious fiscal consolidation package, based on the temporary cut of public sector wages by 25% together with the reduction of social outlays by 15 per cent. After the Constitutional Court has ruled out the pension cuts, the final consolidation package included the increase of the standard VAT rate by 5 percentage points (from 19 per cent to 24 per cent), effective July 2010.

The significant adjustment efforts proved to be effective in delivering the expected outcome, supported also by the over performance of the budget revenues. The 2010 deficit target was

achieved by a comfortable margin, the preliminary end year data showing a fiscal outturn of 6.5 per cent of GDP in cash terms.

According to the European Commission estimates, the structural deficit (determined by ESA95 standards) declined by 3 percentage points by end 2010 from close to 9% of GDP in 2008, and the fiscal consolidation path seems to be consistent with the authorities commitment of eliminating the excessive deficit by 2012 (effective budget deficit less than 3 per cent of GDP).

In the Fiscal Council's opinion, the risks to macroeconomic outlook are broadly balanced, while the risks to the conduct of fiscal policy are tilted on the upside (a higher effective deficit, especially in the election year 2012).

The higher domestic risks could materialize if the authorities' commitment for the fiscal consolidation process weakens due to potential political turmoil anticipating the 2012 elections. The potential slippages from a restrictive fiscal policy (e.g. reversing some of the already implemented austerity measures) could lead to a higher than targeted fiscal deficit in 2011 and 2012 and consequently, an increased risk aversion for the Romanian economy.

On the positive side, a better absorption of EU funds and improved confidence may lead to higher than expected economic performance, supported also by higher foreign direct investments driven by a more rapid pace of structural reforms.

In the Fiscal Council's opinion, the current fiscal policy is adequate to put the budget deficit target for 2011 within reach, based on the full year effects of the consolidation policies already enacted in 2010. However, the 3% of GDP deficit target for 2012, (both cash and accrual based), seems ambitious and may require additional measures to restrain public expenditure and improve tax collection, even though economic activity is projected to accelerate in 2012.

Despite the progress achieved, significant deficiencies still persist that can endanger the sustainability of public finances on the medium and long run.

The elimination of payment arrears still remains a challenge

Payment arrears were a recurrent problem in the past two years and all the targets agreed within the program with the international financial institutions were missed.

Although the outstanding payments of the central government had significantly declined by end 2010 as a result of the authorities' efforts, there are still pressures stemming from the local budgets, whose arrears continued to increase by the third quarter of 2010, amounting to 0.2 per cent of GDP.

The accumulation of losses and arrears in state owned enterprises is a risk to the sustainability of public finances over the medium term

A potential risk to fiscal sustainability over the medium term is the accumulation of losses and arrears in the public enterprises sector.

As of end 2009, the 722 SOEs have contributed to the overall economy turnover by only 6 per cent, while their accumulated arrears accounted for 27.1 per cent of total arrears in the economy.

The stock of arrears of the largest 150 companies increased constantly in the past years, accounting for 4.2 per cent of GDP in 2010. In June 2010, the arrears of all 722 enterprises represented about 4.8 per cent of GDP.

The subchapter V.5 of the report presents a detailed analysis of the state owned enterprises in terms of solvability and their ability to generate positive cash-flows. The data show that around 28 per cent of the employees and 18 per cent of the total turnover of SOEs are recorded in companies with negative solvability. The same companies are responsible for approximately 67 per cent of total SOEs arrears, benefit from more than 37 per cent of total subsidies and account for more than 66% of total losses in the public enterprise sector.

The efficiency of tax collection remains low

The fiscal consolidation package relied significantly on the increase of VAT standard rate, while the tax collection efficiency remains low.

The tax collection efficiency index for VAT and social contributions- computed as a ratio between the implicit and legal tax rate- is among the lowest in new member states, respectively 58% in the case of VAT (compared with 90% in Estonia and 71 % in Bulgaria) and 64 % for social contributions.
In this context, supplementary budgetary revenues can be attained by reducing tax evasion. An estimate is presented in subchapter VI.3 of this report.

The efficiency of public expenditures must be improved, in particular by setting priorities for public investments and multiannual budgeting

On the expenditures side, the coming years should focus on improving the efficiency of public spending, in particular by setting priorities for public investment and multiannual budgeting as well as restructuring budgetary expenditures in order to increase their sustainability.

The financial position of the public pension system is weak

Currently, the financial position of the pension system is very weak, the pensions expenditures being unsustainable with respect to the revenues raised from contributions. Increasing the number of contributors, the retirement age or other policy measures are absolutely necessary for ensuring the long term sustainability. The new pension law broadly addresses these issues, but over the short and medium term the financial situation of the pension system will continue to represent a major challenge.

II. Macroeconomic framework in 2010

The previous year marked the second consecutive year of contraction for the Romanian economy, the gross domestic product declining by 1.3 per cent. However, the amplitude of the contraction was smaller than envisaged by the official forecasts.

The economic recovery was delayed by the implementation of the decisive measures needed to correct the major structural imbalances that existed prior to the economic crisis. The last quarters marked a return on a growth path in all new member states, except for Romania which recorded only a marginal increase of 0.1% in the Q4 2010, as growth of exports remained strong and the decline in domestic demand was lower as compared to the previous quarters. This development can be partially explained by the amplitude of the imbalances accumulated in Romania prior to the economic crisis, but also reflects the impact of the austerity measures implemented in Q3 2010 on domestic demand.

The decline in the gross domestic product can be explained by the contraction in final consumption by 2.1 per cent, positive contributions coming from the change in inventories and net exports (RON -27.7 billion compared to -30.3 billion in 2009), the growth rate of the exports in real terms (+14.3 per cent) exceeding the one of the imports (+12.4 per cent). On the supply side, growth was recorded in industry (+5.1 per cent) and financial activities, real estate, rental and services for enterprises (+0.8 per cent), while negative evolutions were recorded in agriculture, forestry and hunting (-0.8 per cent), constructions (-10.7 per cent), wholesale and retail, repair of motor vehicles and of individual and household appliances; hotels and restaurants ; transport and communications (-4 per cent) and other services (-2.8 per cent).

The industrial production was severely affected by the global economic crisis but by Q4 2009, positive year-on-year growth of industrial output resumed, driven by higher exports. In 2010, the industrial production was 1.1% lower in real terms compared to 2008, but 5.6 per cent higher than 2009.

The resumption of economic growth was delayed by the decline in final consumption in the context of austerity measures implemented in Q3 2010 which lead to a sharp decrease in real disposable income together with worsened expectations on future economic developments.

Figure 1: 2010 Q4 GDP compared to pre-crisis level (maximum pre-crisis =100)

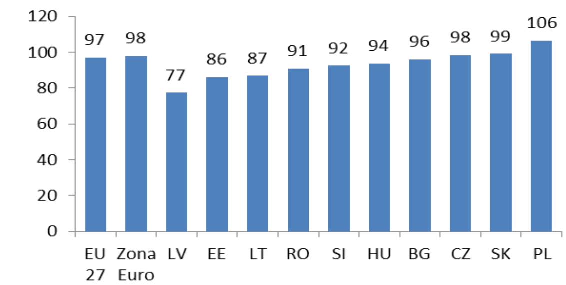
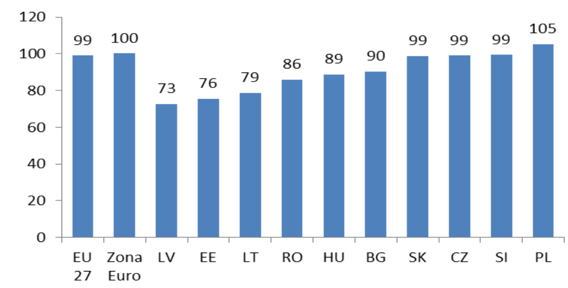
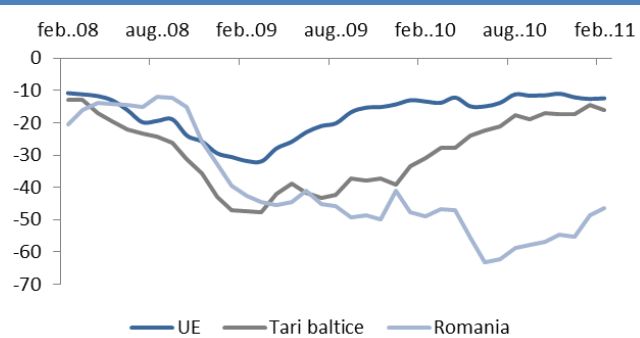


Figure 2: 2010 Q4 Consumption compared to pre-crisis level (maximum pre-crisis =100)

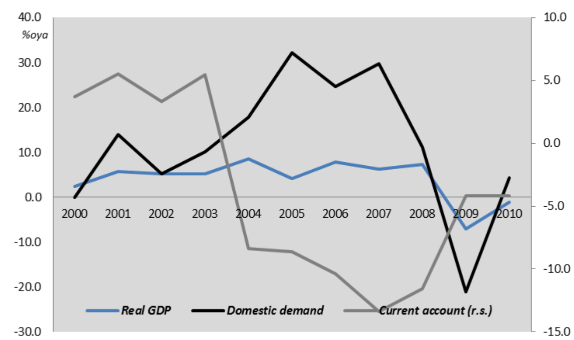


Source: Eurostat, Fiscal Council

Figure 3: Consumer confidence Index 2008-2010



Graficul 4: Real GDP 2000-2010



Source: Eurostat

Romania's external position continues to strengthen. The current account deficit was reduced from 13.5 per cent of GDP in 2007, to 4.2 per cent in 2010, as a result of the sharp decline in the trade balance deficit.

In 2010, the current account deficit was covered in proportion of 50.3 per cent by foreign direct investments of non-residents of EUR 2.596 billion, down by 25.6 per cent compared to 2009.

Remittances from abroad decreased from EUR 6.6 billion in 2008 to EUR 4.4 billion in 2009 and only EUR 3.8 billion in 2010.

Gross fixed capital formation declined 13.1 per cent in 2010 compared to 2009.

Figure 5: 2010 Q4 Investment compared to pre-crisis level (maximum pre-crisis =100)

Figure 6: 2010 Q4 Total Exports compared to pre-crisis level (maximum pre-crisis =100)

Source: Eurostat, Fiscal Council

Romania's external debt increased by 11.8 per cent in 2010 relative to 2009, reaching EUR 90.76 billion. At the end of 2010, the medium and long term external debt represented 79.3 per cent of total external debt, respectively EUR 72.019 billion, 9.5 per cent higher relative to December 2009. The short term external debt increased by 21.6 per cent, to EUR 18.476 billion (20.7 per cent of total external debt).

Based on the downward trend in inflation in the first half of 2010, the central bank lowered the monetary policy rate from 8 per cent at the beginning of the year to 6.25 per cent.

In the second half of the year, inflation rate increased sharply to a level of 7.96 per cent in December 2010, as a result of raising the standard VAT rate.

The average employment in 2010 was 4,238,130 persons, 7.8 per cent lower than 2009, due to the economic decline and personnel cuts in the public sector.

In 2010, the average gross wage was RON 1,397, 2.5 per cent higher than in the previous year, while the net wage reached RON 1,407, 1.8 higher than 2009. With an average inflation rate of 6.1 per cent, the real wage declined by 2.6 per cent.

Table 1: Macroeconomic indicators (differences from the forecasts)		
	2010 Forecast	2010
		%yoy
GDP		
GDP (RON million)	511,582	513,641
Real GDP	-1.9	-1.3
GDP components		
Final consumption	-3.3	-2.1
Household consumption	-3.4	-2.0
Government consumption	-2.5	-3.2
Gross capital formation	-11.0	-13.1
Exports (volume)	15.0	13.1
Imports (volume)	10.6	11.6
Inflation rate		
End of period	8.1	7.96
Annual average	6.2	6.09
Labor market		
Unemployment rate at the end of period	8.0	6.9
Average number of employees[1]	-3.7	-7.76
Gross average wage	3.5	2.5

Source: NIS, National Commission of Prognosis

III The fiscal policy in 2010

III. 1 Assessment of objectives, targets and budgetary indicators

The original budget projection for 2010 envisaged a 1.3 per cent growth of real GDP while the total revenues of the general consolidated budget were expected to reach RON 168.8 billion, out of which RON 7 billion represented EU funds. The fiscal deficit target was initially set to RON 31.9 billion (5.9 per cent of the initial estimated GDP).

[1] *Differences from NFC forecasts and the level effectively reported are also due to different methodologies: while the NFC forecast uses the labor force balance as a reference, the effective figures come from the NIS monthly bulletin which only considers enterprises with more than 5 employees.*

In the view of worsening economic conditions, the fiscal situation has deteriorated and the quarterly deficit target was missed in Q1 2010, mostly because of revenues falling short of the programmed levels.

In this context, without additional corrective measures, the full year budget deficit would have reached 9.1 percent of GDP. To accommodate the cyclical deterioration of the economy, the deficit target for 2010 was revised upwards to 6.8 percent of GDP.

To achieve the new deficit target, the Government proposed a package of measures involving a cut of the fiscal deficit by 2.3% of GDP (compared with the new baseline scenario), mainly through a 25% temporary cut in public sector wages and a 15% reduction in social spending. After the Constitutional Court has ruled out the pension cuts, the final consolidation package included the increase of the standard VAT rate by 5 percentage points (from 19 per cent to 24 per cent), effective last July.

Following the stronger than expected performance of VAT and excise duties in August and September, the general consolidated budget was revised for the second time keeping the deficit target of 6.8% of GDP.

The evolution of the main budget aggregates during 2010 is presented in *Table 2*.

Table 2: The evolution of the main budget aggregates during 2010

	Initial budget	First rectification	Second rectification	Actual
Revenues	**168.8**	**165.4**	**166.8**	**168.6**
Fiscal revenues	94.0	90.7	92.6	93.0
Social contributions	49.8	46.1	45.2	45.7
EU funds	7.0	7.5	8.9	9.4
Expenditure	**200.7**	**200.0**	**201.4**	**201.9**
Current expenditure	180.2	180.6	181.6	183.0
Capital expenditure	20.4	19.5	19.6	19.4
Budget deficit	**-31.9**	**-34.6**	**-34.6**	**-33.3**

The fiscal measures adopted in July 2010 delivered the envisaged adjustment, supported by the recovery in fiscal revenues beginning with Q3 2010. Consequently, the preliminary data for 2010 show a cash fiscal deficit of 6.5% of GDP, comfortably below the target of 6.8% of GDP.

The ESA 95 government deficit notified to Eurostat in October 2010 under the EDP procedure was estimated at 7.2% of GDP, a level close to the European Commission's estimate in the autumn forecast (7.3% of GDP). Considering the better than expected 2010 outcome and the revenues performance in January 2011[2], it is very likely that the fiscal deficit defined according to the European methodology to be lower than the initial estimates.

The fiscal performance showed signs of improvement starting August, when the effects of fiscal consolidation package started to be incorporated. The fiscal deficit decelerated steadily for five consecutive months. Between August and December, the budget deficit narrowed by 12% below the level recorded in the previous year, while in the first half of 2010 the fiscal gap increased by 25.6% year-on-year.

The total revenues increased by 7.2% yoy, reaching 168.6 billion RON (32.8% of GDP[3]) supported by the over performance of indirect taxes. VAT revenues (up 14.3% yoy) and excises (up 11.5% yoy) were the main factors that helped increasing the overall revenues. This performance is largely explained by the hike in the VAT rate, but also reflects the Government's efforts to fight tax evasion. It is worth noting that VAT and excise duties revenues were also 0.5% higher than the programmed levels.

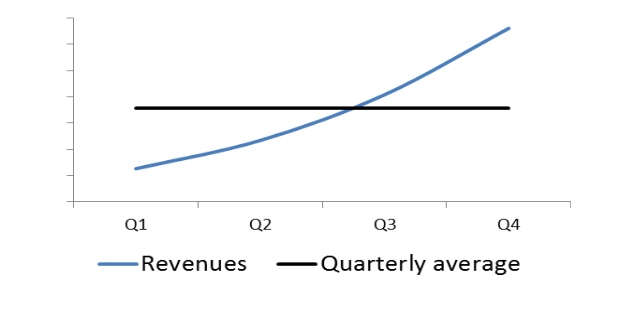
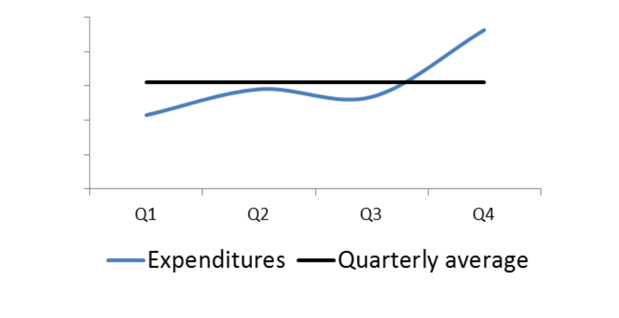
Non-tax revenues increased by 18.5% y-o-y, due to the one-off measures adopted in 2010 (such as the extraordinary transfers from several state owned companies and recording certain amounts that were previously treated as extra-budgetary).

The EU post-accession funds reached lei 5.4 billion, 182% higher than in the previous year, and remarkably, 9% higher than the programmed level.

In contrast, the receipts from direct taxes continued the downward trend. Profit tax revenues declined by 4.9% yoy, and receipts from income tax were 3.2% lower than the level recorded in 2009, due to public wages cuts. The revenues from social contributions declined by 4.5% yoy, reflecting the weak conditions on the labor market.

[2] *According to ESA95 methodology, budgetary revenue and expenditure are registered on accruals basis, therefore part of revenues of January in the year n+1 are allocated in the year n while revenue in January of the year n are registered in the year n-1.*

[3] *Actual GDP of 2010 has been used, higher than estimates used in reporting by Ministry of Public Finance*

Figure 7: Quarterly revenues of GCB (mil. RON)	Figure 8: Quarterly expenditures of GCB (mil. RON)
	

Source: Ministry of Finance, Fiscal Council

On the expenditure side, the total spending recorded a marginal increase (+4.2% yoy), reaching 201.9 billion RON, mainly due to the decline of personnel spending (-8.6% yoy) and investment expenditure (-5% yoy). In contrast, social security expenditures increased by 7.3% compared to the level recorded in 2009.

However, the quarterly path of the general consolidated budget expenditures still indicates a spending acceleration in the last quarter of the year. Specifically, total spending in Q4 2010 reached 58.2 billion RON, 20% higher than the previous quarter, and 11% higher than Q4 2009. More than half of the spending hike in Q4 2010 was caused by capital spending (up by 97% compared to the previous quarter).

There are also systematic and large gaps between planned and actual expenditure, indicating persistent weaknesses in the budget programming process. The charts below compare the actual spending relative to the initial budget plans by main economic category. In particular, it can be remarked a systematic understating of social assistance spending, that was revised upwards during both budgetary revisions (+3.6 billion RON), to finally exceed even the last approved program by RON 100 million. The excess spending was recorded at the state budget level.

Despite the authorities' plan to bring down the expenditure on goods and services by 10% relative to 2009, these increased by 5.2% yoy, exceeding the last budgeted level by RON 800 million, while the budgetary allocations for goods and services have been constantly supplemented throughout 2010.

However, the higher spending on goods and services may be partially explained by the authorities' efforts to clear the arrears in the public sector. In this context, the first budgetary revision allocated an additional amount of RON 1.9 billion to pay for arrears accumulated in the health sector, and similarly, the budget reserve fund was supplemented by RON 1.6 billion during the second budgetary revision, partially for arrears reduction.

Figure 9: Social Assistance 2010 (billion RON)

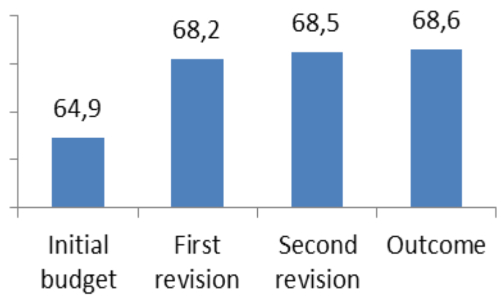
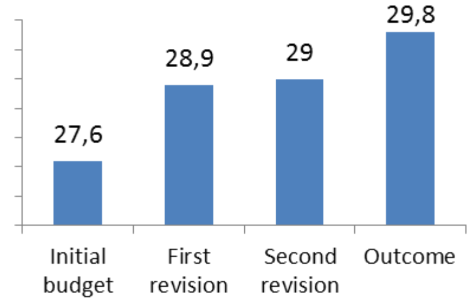


Figure 10: Goods and services 2010 (billion RON)



Regarding the expenditure items revised downwards, interest payments appears to be constantly overestimated, being reduced from 9.2 billion RON in the initial budget to 7.8 billion RON in the second budget revision, while the final outcome reached 7.3 billion RON.

Although payroll expenditures declined by 8.6% yoy, the personnel spending allocation was overshot by approximately 800 million RON as compared to the last rectified budget that was approved in mid-November. This overshooting appears to come from the local budgets that exceeded the estimated personnel spending by 1.3 billion RON (only partially explained by the transfer of some hospitals under local authority). This issue is of particular concern, since the assumed wage bill was constantly exceeded in the past due to the lack of control at the local level and could lead to the non-observance of the assumed wage bill ceiling for 2011.

Figure 11: Investment expenditure in 2010 (billion RON)

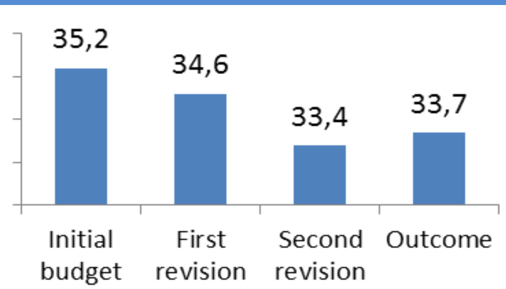
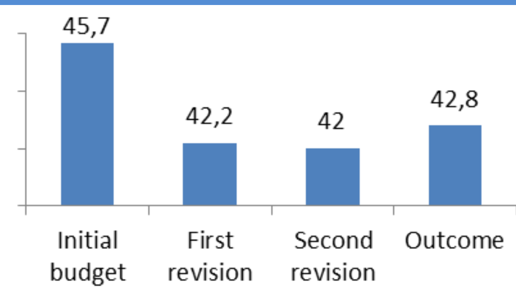


Figure 12: Personnel expenditure in 2010 (billion RON)



Investment spending that includes capital expenditures and transfers for investment reached 33.7 billion RON in 2010, 5% lower relative to the previous year. Additionally, there is still a pattern of cutting back investment spending to accommodate higher current spending throughout budget execution, as observed in the previous years.

In 2010, the Fiscal Council recommended further clarification on the utilization of the budgetary reserve fund, particularly specifying the amount to be used for arrears payment (possibly a breakdown by ministries/authorities). In the lack of such clarifications, this report tries to show the utilization of this fund in the last year, based on the Government decisions published in the Official Gazette of Romania.

Hence, approximately 2.58 billion RON have been distributed from the budgetary reserve fund in 2010, out of which 1.9 billion RON were allocated to the central administration and around 660 million to the local level. Within the overall amounts allocated at the central level, only approximately 900 million RON were destined for arrears payment, mainly to the Ministry of Transport and the Ministry of Economy.

A detailed list of the Government decisions allocating amounts from the budgetary reserve fund by beneficiaries and destinations is presented in Annex 1 to this report.

The public debt as a share of GDP increased significantly in 2010, to 37.75% from 30% at end 2009, in the context of persistent economic contraction and a budget deficit of 6.5% of GDP. The public debt recorded an accelerated dynamics, increasing by 16.42 of GDP since end 2008.

Government public debt represents 94.03% of total debt compared with 92.65% in 2009, while the share of local public debt is 5.97%, down from 7.35% in the previous year.

State loans hold the highest share in total public debt, cumulating 40.39% of the total, followed by government bonds with 18.66%, treasury bills with 17.91%, while Eurobonds represent 5.76%.

The structure of newly issued government securities by initial maturity shows the prevalence of short-term financing. Thus, treasury bills with maturities of up to one year, totals 74.6% of new government loans. Longer term financing is relatively small, 3-year bonds cumulating only 16% of new loans while bonds with a maturity of five to ten years totals 6.15% and 3.28% of total.

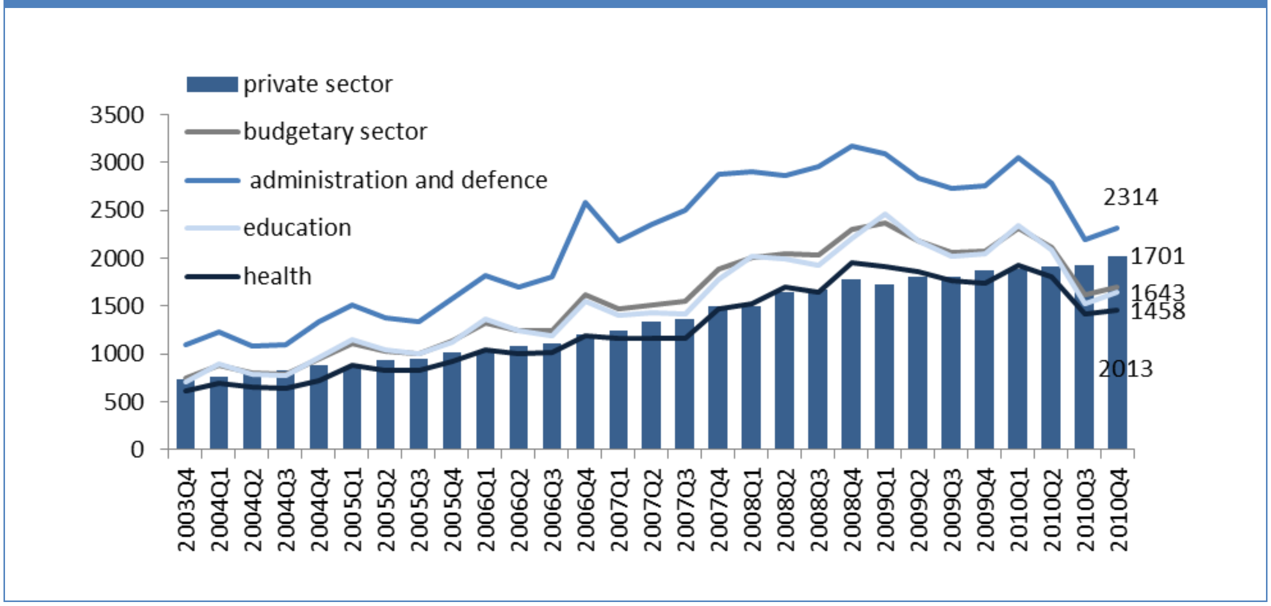
The cost of attracting new resources recorded a positive trend, the government securities yield falling below 7% at end 2010, compared to 10% last year, due to Romania’s improved risk perception and excess liquidity in the banking system.

III.2 Public sector wage policy

Personnel expenditure has increased substantially between 2005 and 2008, the public sector wage bill increasing by 1.5 percentage points of GDP. The average wage in the public sector grew cumulatively by 63% throughout this period, further increasing disparities in average compensation in the public and private sector. (*Figure 13*)

Until 2010, the public average wage has been higher than in private sector, but the 25% wage cut has reduced the average public wage to less than the average in the private sector. As of December 2010, the average public wage fell from 2,108 RON in Q2 2010, to 1,701 RON in the Q4 2010, below the private sector average of 2,013 RON.

Figure 13: Average gross gain in the private and public sector (RON / month 2003-2010)



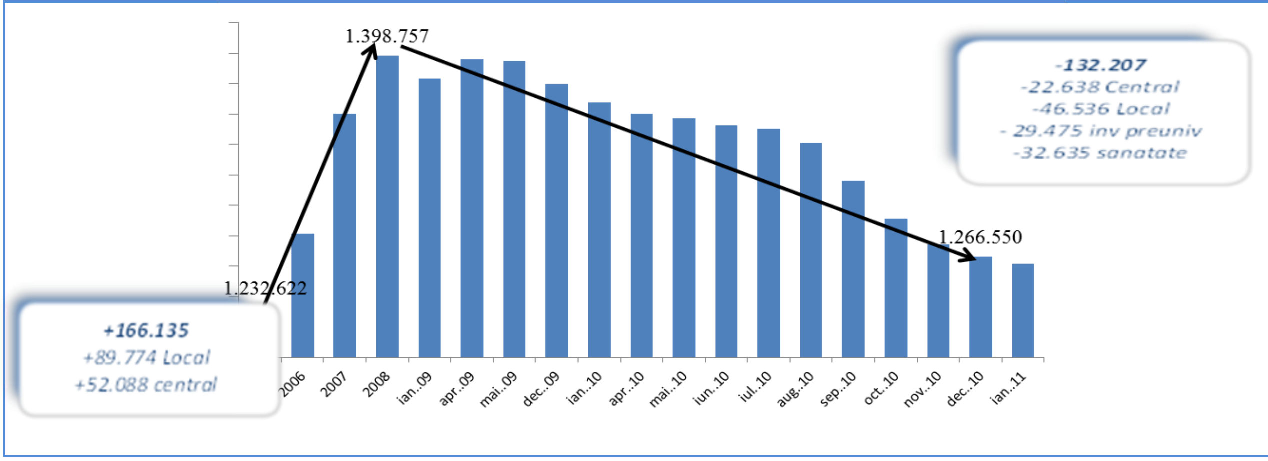
Source: National Institute of Statistics, Fiscal Council calculations

Public employment increased by about 170,000 from end-2005, to about 1.4 million people at end-2008. The largest increases in employment occurred in local governments (approximately 90,000), with the central administration adding about 50,000 employees.

As part of the authorities' fiscal adjustment efforts, public employment has declined since end-2008, mainly due imposing a freeze on employment (effective since May 2009) and replacing only 1 of 7 departed employees.

As a result, the total number of employees in the general government declined by 132,000 (to 1.26 million employees) between end 2008 and December 2010 (*Figure 14*). More than 50% of the departing employees were at the local level (about 76,000), out of which 29,000 secondary education staff. There was also a sharp decline in the health sector personnel (approximately 33,000).

Figure 14: Evolution of public sector employment 2005-2010



Source: Ministry of Public Finance

The general government employment is split approximately equal among central administration and self-financed institutions and local administrations.

Total general government employment was about 1.26 million as of December 2010. The institutions financed from the state budget employs approximately 350,000 people, with the majority of personnel in the Ministry of Administration and Interior and the Ministry of Defense (*Table 3*). Self-financed institutions, mostly hospitals and universities, have about 380,000 employees. These institutions are largely financed by direct transfers from the central government budget. The rest of the 600,000 are employed by local governments.

Table 3 Public employment by line ministries	December 2008	December 2010	Differences
Total employment	1,398,757	1,266,550	-132,207
A. Central administration	694,995	639,722	-55,273
1. State budget	338,727	334,533	-4,194
Ministry of Administration	146,955	147,822	867
Ministry of Defense	79,666	79,210	-456
Ministry of Finance	33,716	31,210	-2,506
Ministry of Justice	13,558	15,053	1,495
Other ministries	64,832	61,238	-3,594
2. Self-financed institutions	304,132	260,001	-44,131
Hospitals[4]	209,273	176,638	-32,635
Universities	68,095	68,229	134
3. Institutions financed from the Social Security's Budget	52,136	45,188	-6,948
B. Local authorities	703,762	626,828	-76,934
Pre-university education	332,952	303,477	-29,475
Local executive authorities	310,912	264,382	-46,530

Source: Ministry of Finance

[4] *For comparability, we included all medical units in central administration, although some of them have been transferred during 2010 under local authority*

III.3. Absorption of EU funds

During 2007- 2013, Romania will be granted 19.2 billion euro of EU structural and cohesion funds. Coordinated by the EU cohesion policy, these funds are designed to support the convergence of member countries, increasing competitiveness and employment.

Table 4: Structural funds absorption by operational programs						
	Total allocations 2007-2013	Payments December 2010			Absorption rate	Absorption excl. pre-financing
		Total o/w:	**Pre-financing**	**EU Refunds**		
Regional Development	3.726	554,9	381,4	173,5	14,9%	4,7%
Environment	4.512	318,5	266,2	52,3	7,1%	1,2%
Transport	4.565	47,2	0,0	47,2	1,0%	1,0%
Competitiveness	2.554	251,2	106,3	144,8	9,8%	5,7%
Human Resources	3.476	464,2	416,6	47,6	13,4%	1,4%
Administrative Capacity Development	208	10,2	4,1	6,1	4,9%	2,9%
Technical Assistance	170	9,0	1,2	7,8	5,3%	4,6%
Total	**19.211**	**1.655,3**	**1.175,8**	**479,5**	**8,6%**	**2,5%**

Source: ACIS, Fiscal Council calculations.

With an absorption rate of only 8.6% of the total allocation (the highest rate of 15% for Regional Development OP and the lowest of 1% for the Transport OP), Romania is facing serious challenges and risks to lose these opportunities.

Transport OP is the least efficient operational program, with only 47 million euro paid until end 2010 (about 1% of the available budget for 2007-2013).

In contrast, as of December 2010, Bulgaria absorbed 5.81% of its total available budget for transport infrastructure (about 94 million euro) and has a contract ratio of 30%.

At the other end, the Regional OP and Human Resources OP are the best performing programs in terms of absorption of structural funds. These programs had an absorption rate of 14.9% and 13.4%, with paid grants of 555 million euro and 464 million euro respectively.

It's true than in many new member states, EU funds absorption after ascension was quite slow, so in this respect, Romania is not atypical. Nevertheless, Romania is now in its fifth year as an EU member state, and available funds have a time limit, they must be used by 2013.

Table 5: Absorption of structural funds - comparison with other EU Member States					
	Total allocations 2007-2013 billion Euro	**Payments December 2010 billion Euro**	**Absorption rate**	**Total allocations per capita Euro**	**Total payments per capita Euro**
Estonia	3,5	0,9	26,0%	2.692	700
Latvia	4,6	1,3	29,0%	1.917	556
Poland	67,3	13,7	20,4%	1.917	391
Czech Republic	26,7	3,3	12,4%	2.567	318
Bulgaria	6,9	0,7	10,2%	908	93
Romania	19,2	1,65	8,6%	916	79

Source: European Commission

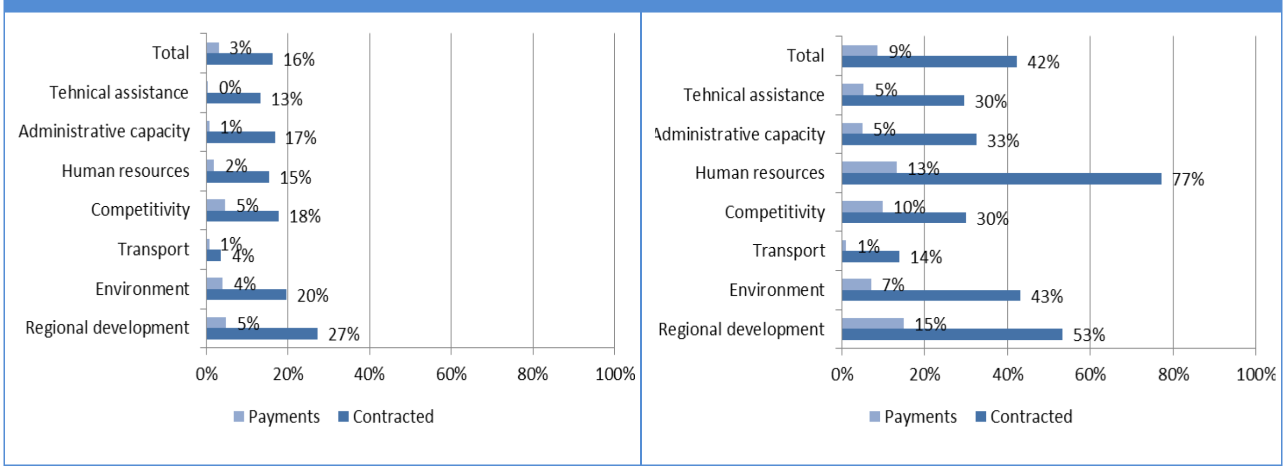
Benchmarked against other new member states, the low absorption rate in Romania is even more obvious. The average rate of absorption after four years of membership is far below the average of countries in the sample below (8.6% vs. 17%).

As of end 2010, Latvia paid over 1.3 billion euro in EU grants, meaning 29% of the available budget for 2007-2013. Similarly, Estonia and Poland succeeded until now to use 26% (about 900 million euro) and 20.4% (about 13 billion euro) of the allocated funds. Czech Republic has also managed to absorb 3.3 billion euro, an absorption ratio of 12.44%, as of December last year.

The amount of EU funds absorbed of Romania divided by the population is also the lowest in the EU, 79 euro per capita against 700 euro in Estonia or 93 euro in Bulgaria.

Figure 15: Absorption of funds: payments and contracting

2009 **2010**



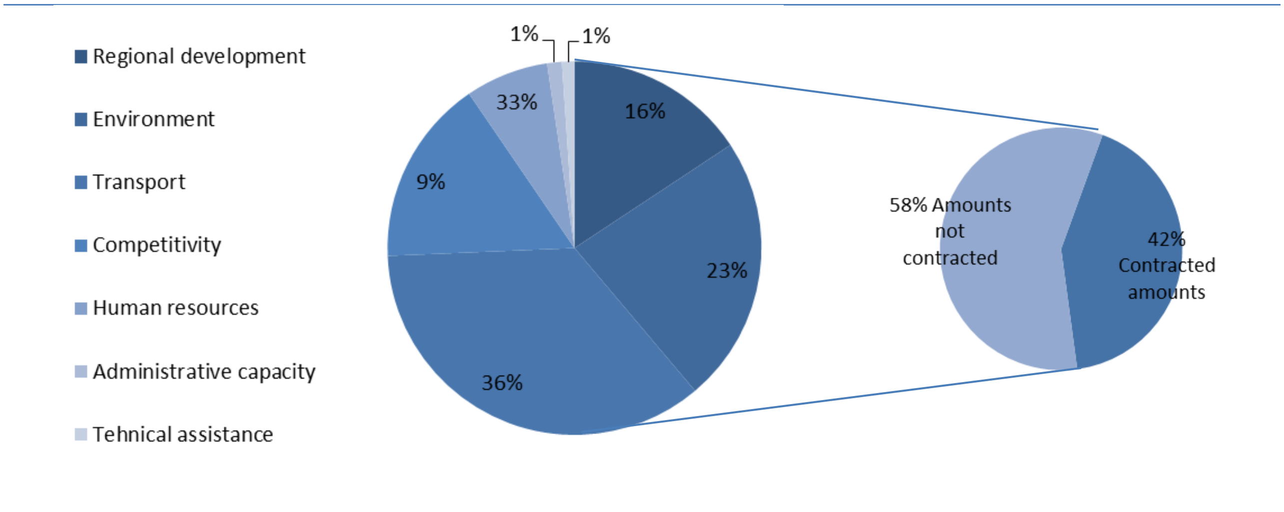
On the positive side, the process of contracting the structural and cohesion funds improved in 2010, with a contracted ratio of 42%, up from 16% in 2009.

Nevertheless, there are significant discrepancies between the seven operational programs, Human Resources OP being the best performer with a contracted ratio of 77% and the Regional Development OP with 53%.

At the other end of the spectrum, are the Transport OP with a contracted ratio of only 14%, and the Competitiveness OP and Technical Assistance OP with a contracting rate of 30%.

Regarding the breakdown by operational programs of EU funds to be contracted, (*Figure 16*), Transport OP has the largest amount (approximately 4 billion euro and 36% of the total amounts not contracted), followed by Environment OP (2.5 billion euro and 23% of total).

Figure 16: Amounts not contracted by Operational Programs



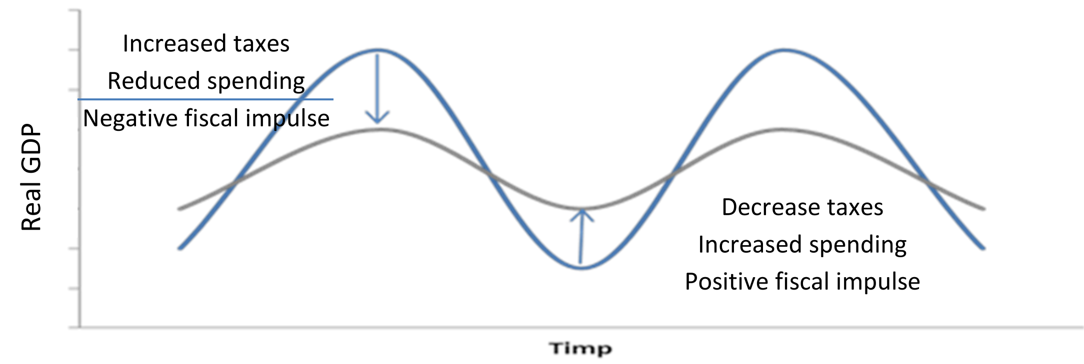
Source: Authority of Structural Instruments Coordination, Fiscal Council calculations

IV. Structural fiscal position

Fiscal and budgetary policy is one of the main instruments governments use to influence the economy, through changes in taxation levels and budgetary expenditures. Through fiscal and budgetary policies, authorities can impact macroeconomic variables such as aggregate demand, disposable income and the overall economic activity. In this approach, fiscal and budgetary policies play a key role to mitigate business cycle fluctuations.

A counter-cyclical fiscal policy, which acts to mitigate the amplitude of business cycle fluctuations, involves a more lax conduct in times of recession and a more restrictive conduct in times of economic "boom". *(Figure 17)*

Figure 17: The stabilizing role of fiscal policy (Counter-cyclical fiscal policy)



This is necessary particularly where automatic stabilizers are too weak and insufficient to stabilize the economy; the issue is especially relevant in emerging economies facing high tax evasion and a high share of shadow economy, and / or a low level of unemployment benefits.

The consolidated budget deficit does not represent a proper indicator for the assessment of fiscal policy because it reflects the influence of both permanent and transitory factors. Permanent factors influencing budget deficit refer to stable elements of public revenue and expenditure. Stable revenue and expenditure flows are those prevailing under normal conditions, in the absence of external shocks, when the economy is operating at its potential level, compatible with a low and stable inflation. By contrast, transitory factors are influenced by the business cycle. Tax revenues tend to decline during periods of recession and grow rapidly during periods of expansion. On the expenditure side, the effect is reversed. For example, social transfers, namely expenditure with unemployment benefits, tend to rise in times of recession and decrease during periods of sustained economic growth.

A measure of assessing how the fiscal policy fulfills its role of macroeconomic stabilizer is represented by the change in the structural budget balance. Structural balance can be defined as the level of budget balance recorded when real GDP equals potential GDP.

Structural budget balance = Actual balance - Cyclical component

Cyclical component = Excess demand/Demand deficit X budget parameters sensitivity to the excess demand/demand deficit

Excess demand / demand deficit is the difference between actual GDP and potential GDP

In this case, the structural budget balance can be used to identify how much of the change in the fiscal position (taxes, transfers, spending) is due to economic conditions and how much is attributable to fiscal policy decisions.

In addition, the structural balance is useful in assessing the sustainability of fiscal policy, indicating the extent to which the current fiscal policy is sustainable (the budget deficit will adjust itself) or involves the need for major adjustments in the future.

Also, the structural balance allows assessing the impact of fiscal policy on aggregate demand - respectively to quantify the so-called fiscal impulse that reflects the variation (with reversed sign) in the structural balance. In this respect, an increase in the structural deficit is considered to be expansionary (positive fiscal impulse), and a reduction - contractionary (negative fiscal impulse). Analyzed together with the economy's cyclical position, the fiscal impulse allows assessing the extent to which fiscal policy is acting like a macroeconomic stabilizer - acting in the sense of decreasing aggregate demand pressures in times of economic boom or for the purpose of stimulating aggregate demand during recession.

Table 6: The evolution of structural balance and fiscal impulse 2005-2012

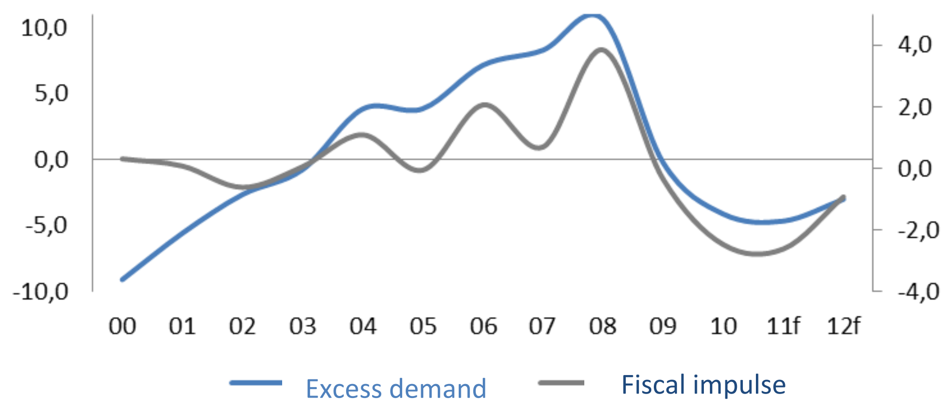
	2005	2006	2007	2008	2009	2010e	2011e	2012e
Excess / Deficit demand	3,9	7,1	8,3	10,6	-0,2	-4,1	-4,6	-3,0
Budgetary balance (ESA95)	-1,2	-2,2	-2,6	-5,7	-8,6	-7,3	-4,9	-3,5
Primary budget balance [5]	0,1	-1,4	-1,8	-5,0	-7,1	-5,4	-2,9	-1,6
Structural balance	-2,3	-4,4	-5,1	-8,9	-8,6	-6,1	-3,5	-2,6
Fiscal impulse	-0,1	2,1	0,7	3,8	-0,3	-2,5	-2,6	-0,9
Primary fiscal impulse	0,2	2,5	0,8	3,8	-1,2	-2,8	-2,7	-0,8

Source: European Commission, Fiscal Council calculations

In the case of Romania, the fiscal impulse was positive during the period of rapid growth before the financial crisis, contributing to the overheating of the economy and fueling the imbalances accumulated in the economy (*Figure 18*). Moreover, the pro-cyclicality of the fiscal policy during the pre-crisis period exhausted the fiscal space needed to stimulate the economy in recession, leading to the need to reduce the budget deficit during the crisis (primarily due to financing constraints) and to perpetuating the pro-cyclicality of fiscal policy.

[5] *Excluding interest expenditures*

Figure 18: Romania - Fiscal impulse and excess demand



V. Sustainability of public finances

V.1 Sustainability indicators

In the autumn of 2009 the European Commission published a report assessing the sustainability of public finances in EU countries. The report includes several indicators of sustainability, importance being given to the so-called S1 and S2 indicators. Sustainability indicators quantify the gap needed to be covered to ensure the sustainability of public finances.

The S1 indicator shows the adjustment to the current primary balance required to reach a target for the government gross debt of 60% of GDP in 2060, including paying for any additional expenditure arising from an ageing population.

The S2 indicator shows the adjustment to the current primary balance required to fulfill the infinite horizon inter-temporal budget constraint - equality between discounted income and expenditure - including paying for any additional expenditure arising from an ageing population.

Table 7: Sustainability Indicators					
	Required adjustment given the initial budgetary position		**Required adjustment to reach debt to GDP ratio of 60% in 2060**		**Necessary adjustment costs due to ageing**
S1 =	Gap to the debt-stabilizing primary balance	+	Additional adjustment required to reach a debt target of 60% of GDP in 2060	+	Additional adjustment required to finance the increase in public expenditure due to ageing up to 2060
S2 =	Gap to the debt-stabilizing primary balance	+	0	+	Additional adjustment required to finance the increase in public expenditure due to ageing over an infinite horizon

Source: European Commission, Sustainability Report 2009

The higher the value of the indicators, the greater the effort required to adjust the primary balance. A negative value of S2 indicates the fulfillment of the inter-temporal budget constraint - even with progressive deterioration of the primary balance under the impact of demographic factors the public finance sustainability would be assured.

The Sustainability Report 2009 divides EU countries into three risk groups, according to the calculated values of sustainability indicators.

Countries with a low risk rating in terms of fiscal sustainability are Bulgaria, Denmark, Estonia, Finland and Sweden. Medium risk category countries are Belgium, Germany, France, Italy, Luxembourg, Hungary, Austria, Poland and Portugal.

Romania is located in the category of high-risk countries in terms of fiscal sustainability, with the Czech Republic, Ireland, Spain, Greece, Cyprus, Latvia, Lithuania, Malta, Netherlands, Slovenia, Slovakia and United Kingdom.

For Romania, the S1 indicator is 6.9% of GDP and the S2 indicator is 9.1% of GDP, both hovering above the EU 27 average of 5.4% of GDP for S1 and 6.5% for S2. This means that, to put public finances on a sustainable path, Romania should improve in a sustainable way the primary budget balance by 9.1% of GDP over the time horizon considered. This adjustment could be achieved by a combination of increasing revenue and reducing spending and by reforming the pension system, social security and health system, in order to decelerate the growth rate of age-related expenditure.

In this context, it should be mentioned that the recently approved legislation reforming the public pension system is an important step towards improving the sustainability of public finance position in the long run.

V.2 Challenges to public finances sustainability

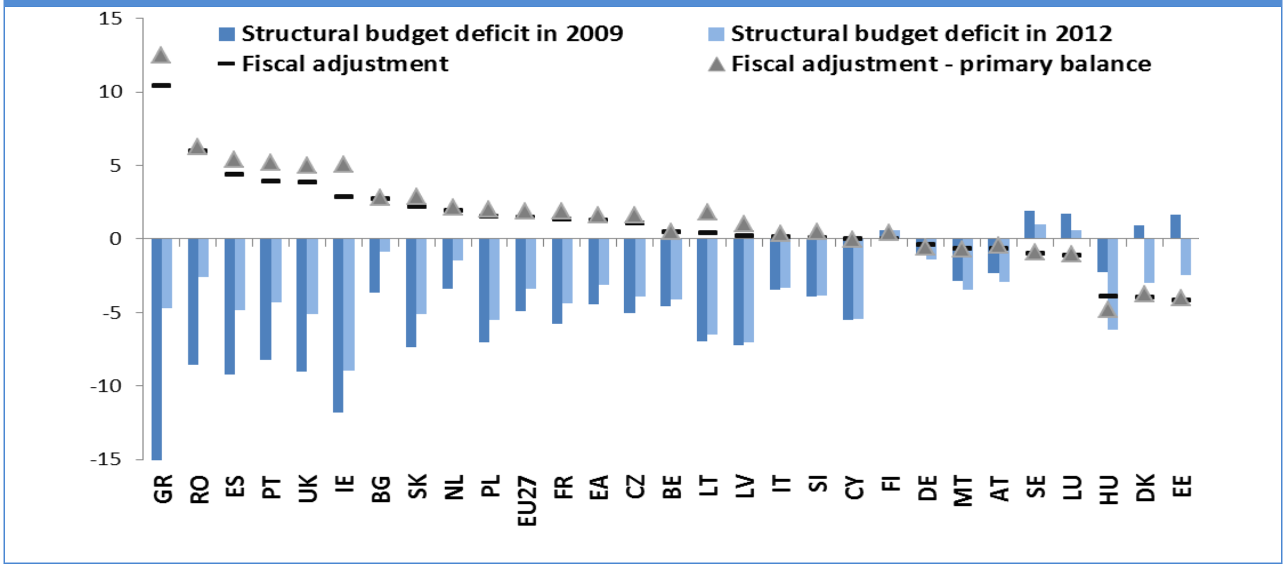
The main challenge for fiscal policy in Romania in the coming years is to reduce the structural deficit while creating fiscal space for public investment expenditures (especially infrastructure), addressing the structural problems hampering the economic growth and ensuring long term sustainability of public finances in the light of the inevitable ageing process.

Particularly, the main challenges to the sustainability of public finances consist of:

- Poor collection of public revenues (including increased tax evasion)
- Scarce resources of the public pension system
- High losses of state owned companies
- Weak financial discipline of local governments
- Low efficiency of public spending
- Very poor financial state of the health system, leading to chronic accumulation of arrears
- Necessity to strictly control the level of social spending
- Setting a list of priorities for public investment and their multi-annual budgeting (that should exceed the political cycle).

At end-2008, the structural deficit reached 8.9% of GDP, thus depleting the operating space for a fiscal loosening in the recession that followed. Furthermore, the excessive deficit procedure has been initiated in Romania's case under Article 104 (6) of the European Community Treaty, the deadline for its correction being set for 2012. Compliance with this deadline, namely reducing the consolidated budget deficit to a level below 3 percent of GDP in 2012, involves an average annual effort to adjust the structural deficit of about 1.75 percentage points of GDP in 2010-2011, according to the European Commission calculations. The necessary fiscal consolidation path is one of the most ambitious in the European Union (*Figure 19*).

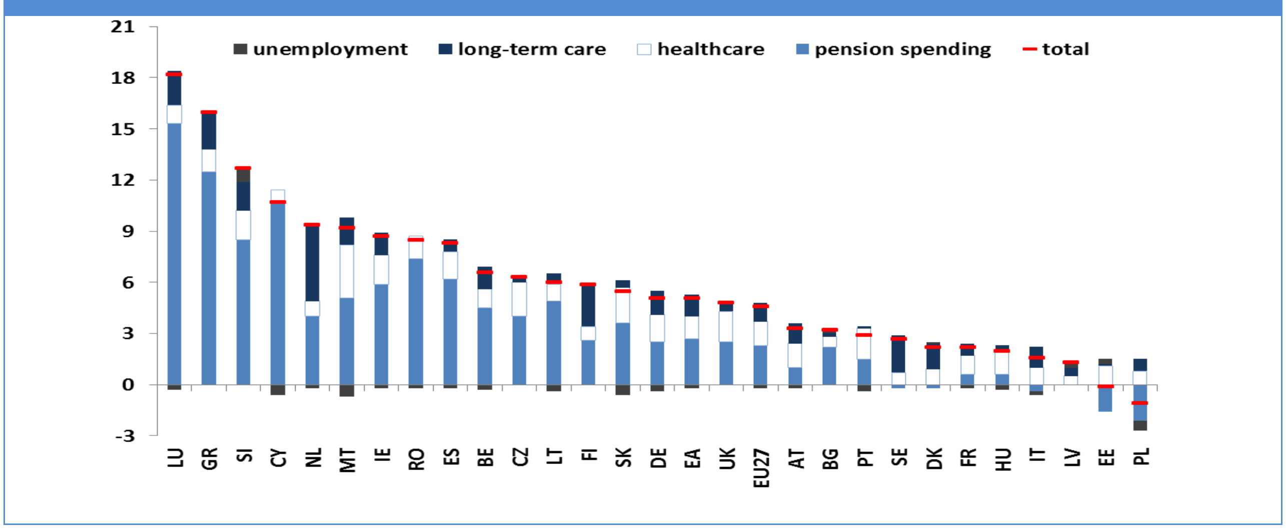
Figure 19: Fiscal consolidation in EU



Source: European Commission

In these circumstances, the fiscal policy had to remain pro-cyclical also during the crisis period. However, fiscal consolidation is needed not only in the context of high deficits recorded and the related difficulties/costs of financing, but also in terms of sustainability of public finances, given the long-term impact of ageing on budgetary expenditure, that would generate additional spending estimated at 8.5% of GDP in 2060 relative to 2010 (one of the highest in the European Union - *Figure 20*).

Figure 20: Increase in age-related public expenditures, 2010-2060, % of GDP

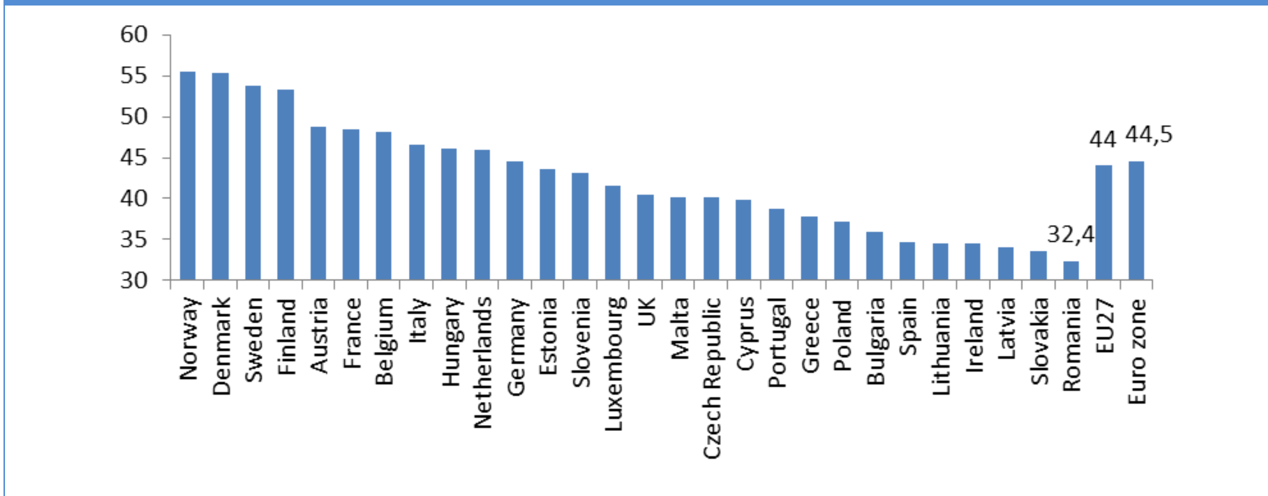


Source: European Commission, Sustainability Report 2009

V.3 Tax collection in Romania - international comparisons

Romania has the lowest share of overall government revenues to GDP in EU (tax and non-tax revenue), only 32.4% of GDP in 2009, and 11.6 percentage points of GDP lower than the EU average. Tax revenue to GDP (taxes and social contributions) in Romania was 27.1% in 2009, lower by 12 percentage points than the EU 27 average (38.8%). The share of tax revenue to GDP is the second to last in the EU and significantly lower than in Bulgaria (28.9%), Hungary (39.5%) and Slovakia (28.8%).

Figure 21: Budget revenues (% of GDP, ESA 95, 2009)



Source: EUROSTAT

The structure of tax revenue in Romania stands out because of the high share of revenues from indirect taxes supplying 41% of total tax revenue compared to the EU 27 average of 34%, while the share of revenue from social security contributions was 35% (EU 27 34%) and from direct taxes - only 24.0% (EU27 32%).

The tax system in Romania is characterized by weak tax collection, with inefficient administration and excessive bureaucracy[6], a relatively small tax base, with many legal exemptions and deductions and increased tax evasion.

Tax collection efficiency can be assessed by the ratio of implicit tax rate (ratio of the actual revenues collected for a particular type of tax and the tax base) and the statutory rate of taxation. This ratio is called collection efficiency index.

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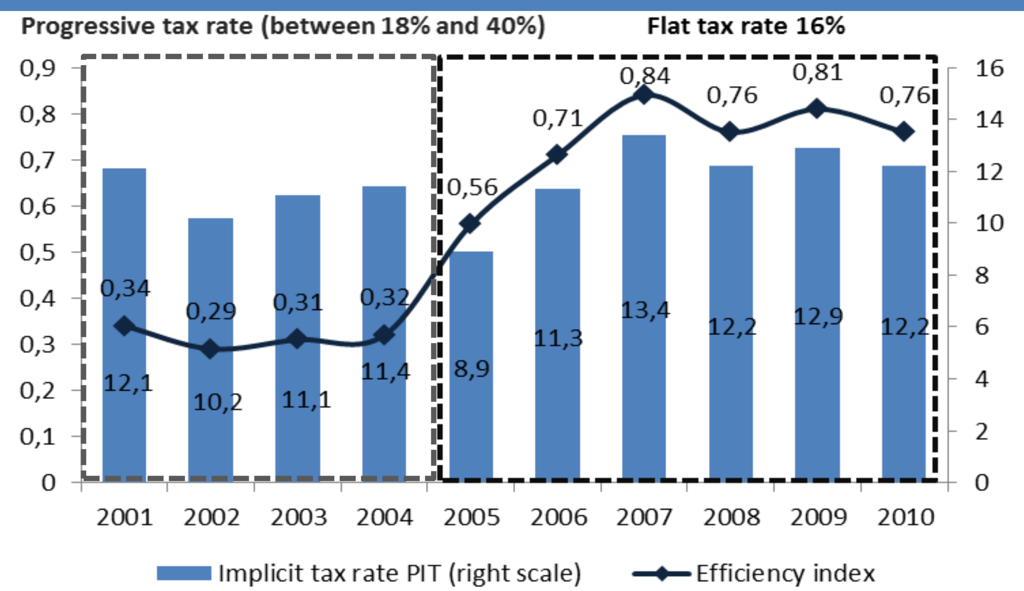
[6] *According to World Bank report - Doing Business 2011, Romania ranked 182 out of 183 countries worldwide with respect to the number of tax payments per year that a company should carry out.*

On personal income tax, the collection efficiency index in Romania increased significantly in 2005-2007, stalled since 2008 and slightly declined in 2010. Also, compared with the countries from Central and Eastern Europe, Romania ranks third in the sample in 2009, with an efficiency collection index of 81% and an implicit tax rate of 13% (calculated as the ratio of direct taxes paid by the population[7] and gross wages from the national accounts - including those of the unobserved economy, from which social security contributions paid by employees were deducted). However, there is a significant difference between Romania and the first ranked country, Bulgaria, whose degree of efficiency is very high.

Figure 22: Implicit tax rate and collection efficiency index for personal income tax in Romania



[7] *Also include other forms of taxes paid by the population (e.g., tax on capital gains), not only on wage income. Unfortunately, there is no detailed data available on the types of taxes paid by the population in order to take into account only wage income taxes. This is the explanation why the efficiency index might be greater than 1 (see Bulgaria).*

Table 8: Taxation efficiency index - Personal income tax							
Country	Legal personal income tax*		Implicit tax rate**		Taxation efficiency index***		Position
	2009	2010	2009	2010	2009	2010	2009
Bulgaria	10,0	10,0	10,7		1,07		1
Czech Republic	15,0	15,0	8,2		0,55		10
Estonia	21,0	21,0	15,1		0,72		4
Latvia	23,0	26,0	15,4		0,67		6
Lithuania	15,0	15,0	13,3		0,89		2
Hungary	24,5	24,5	16,8		0,69		5
Poland	29,5	25,0	18,7		0,63		7
Romania	16,0	16,0	13,0	12,2	0,81	0,76	3
Slovenia	27,0	27,0	16.6		0,62		8
Slovakia	19,0	19,0	11,2		0,59		9

Source: European Commission, Eurostat, Ministry of Finance, Fiscal Council

** Where the standard rates were changed during the year, standard rates weighted average was reported.*

*** Computed as the ratio between "revenues from direct tax paid by the population" and personal income tax base (gross wages from the national accounts from which social insurance contributions paid by employees were deducted). For Czech Republic and Hungary, the personal income tax base is the gross wage plus social security contributions paid by employers ("super gross").*

**** Calculated as a ratio between the implicit tax rate and the legal rate. For Romania, the data used are based on cash methodology.*

On corporate income tax, the collection efficiency index increased significantly in Romania in 2005-2006 but since 2007, it has been on a downward trend. Also, compared with the countries from Central and Eastern Europe, Romania ranks third in the sample in 2009, with an efficiency index of only 30% and an implicit tax rate of 4.8% (calculated as the ratio of direct taxes paid by enterprises[8] and gross operating surplus from national accounts, which includes unobserved economy, as a proxy for the profits of businesses). However, there is a significant difference between Romania and the first ranked country, Bulgaria, whose degree of efficiency is higher.

[8] They also include other forms of tax paid by enterprises, not just on profit. Unfortunately, there is no detailed data available on the types of taxes paid by enterprises in order to take into account only corporate income tax.

Figure 23: Implicit tax rate and collection efficiency index for corporate income tax in Romania

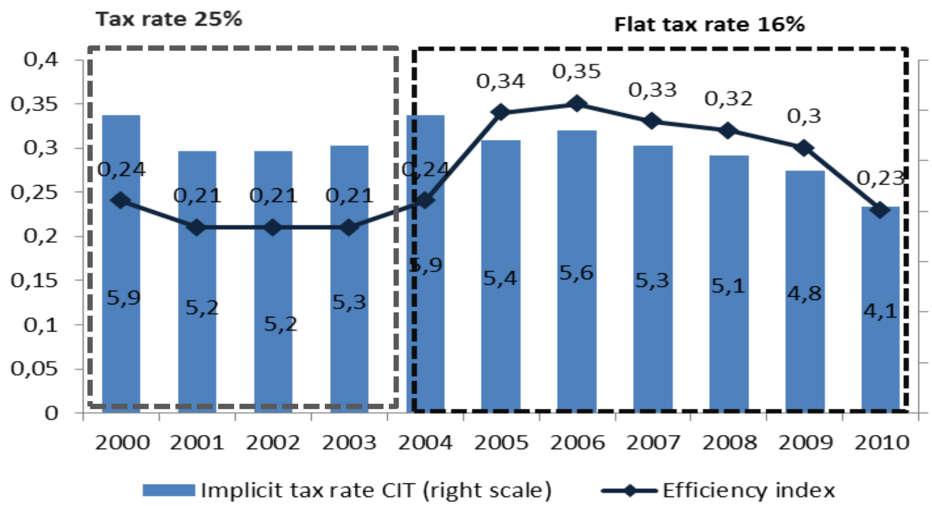


Table 9: Taxation efficiency index – Corporate income tax

Country	Legal corporate income tax rate*		Implicit tax rate**		Taxation efficiency index***		Position
	2009	2010	2009	2010	2009	2010	2009
Bulgaria	10,0	10,0	5,2		0,52		1
Czech Republic	20,0	19,0	7,8		0,39		2
Estonia	21,0	21,0	5,3		0,25		5
Latvia	15,0	15,0	3,6		0,24		8
Lithuania	20,0	15,0	4,1		0,20		10
Hungary	21,3	20,6	5,3		0,25		7
Poland	19,0	19,0	4,5		0,24		9
Romania	16,0	16,0	4,8	4,1	0,30	0,23	3
Slovenia	21,0	20,0	5,3		0,25		6
Slovakia	19,0	19,0	4,9		0,26		4

Source: European Commission, Eurostat, Ministry of Finance, Fiscal Council

** Where the standard rates were changed during the year, standard rates weighted average was reported.*

*** Computed as the ratio between budget revenues from direct taxes paid by enterprises and the corporate income tax base (approximated by the gross operating surplus from national accounts, which also includes unobserved economy).*

**** Taxation efficiency index computed as:* $\frac{Budget\ revenues\ from\ direct\ taxes\ paid\ by\ enterprises}{Legal\ corporate\ income\ tax\ rate X Gross\ operating\ surplus}$ *or as ratio between implicit tax rate and legal tax rate. For Romania, the data used are based on cash methodology.*

The implicit tax rate in the case of the value added tax (calculated as the ratio between actual VAT receipts and private consumption from national accounts - which includes the consumption of the unobserved economy) was only 11% in 2009, one of the lowest in Eastern European countries from the sample. In 2010, the implicit rate increased to 12.2% due to the increase in VAT rate by 5 percentage points.

The VAT efficiency collection index is 58%, markedly lower than in Estonia (83%) and Slovenia (74%). Moreover, with the same tax rates, Romania collected only 6.7% of GDP from VAT in 2009, compared to 9.1% of GDP in Estonia, 7.4% of GDP in Lithuania and 7.1% of GDP in the Czech Republic. Bulgaria collected 8.9% of GDP in 2009 from VAT, while the legal VAT rate was only 1 percentage point higher than in Romania, the two countries having relative similar structure of the economy.

In 2009-2010, the VAT efficiency collection index in Romania has decreased substantially compared with the pre-crisis; in 2010, the collection efficiency index is the same as in 2009, suggesting that better collection of the second half of the year merely compensated for the loss of collection efficiency in the first half of the year.

Figure 24 : Implicit tax rate and collection efficiency index for VAT in Romania

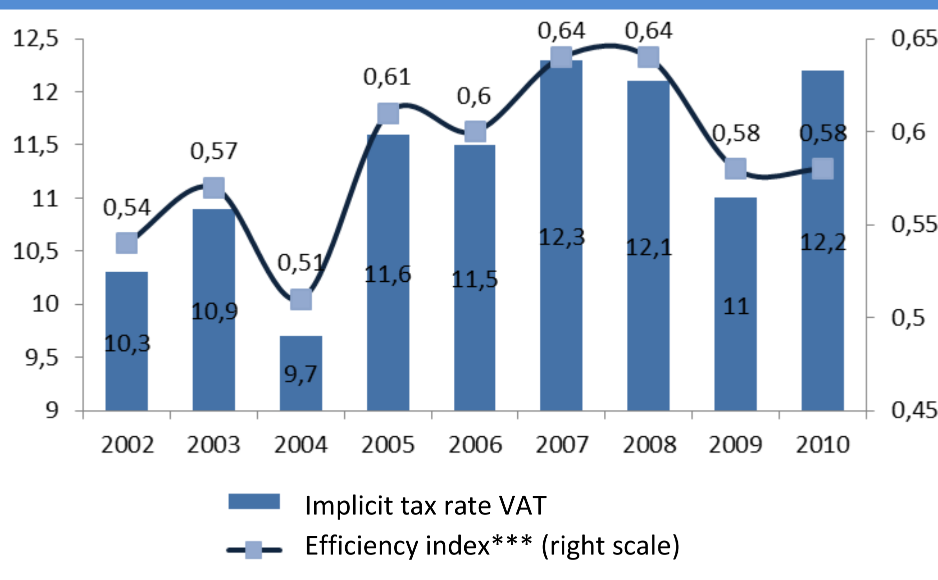


Table 10: Taxation efficiency index - VAT							
Country	Standard VAT rate*		Implicit tax rate for VAT**		Taxation efficiency index***		Position
	2009	2010	2009		2009	2010	2009
Bulgaria	20,0	20,0	14,1		0,71		4
Czech Republic	19,0	20,0	13,8		0,73		3
Estonia	19,0	20,0	17,1		0,90		1
Latvia	21,0	21,0	9,5		0,45		10
Lithuania	19,0	21,0	10,5		0,55		8
Hungary	22,5	25,0	15,5		0,69		5
Poland	22,0	22,0	11,9		0,54		9
Romania	19,0	21,1	11,0	12,2	0,58	0,58	7
Slovenia	20,0	20,0	15,0		0,75		2
Slovakia	19,0	19,0	10,8		0,57		6

Source: European Commission, Eurostat, Ministry of Finance, Fiscal Council
** Where the standard rates were changed during the year, standard rates weighted average was reported.*
*** Computed as the ratio between the "revenue from VAT" (ESA code D211R) and "households and NPISH final consumption expenditure" (ESA code P31_S14_S15).*
**** Computed as a ratio between the implicit tax rate and the legal rate. In Romania's case, the data used are based on cash methodology.*

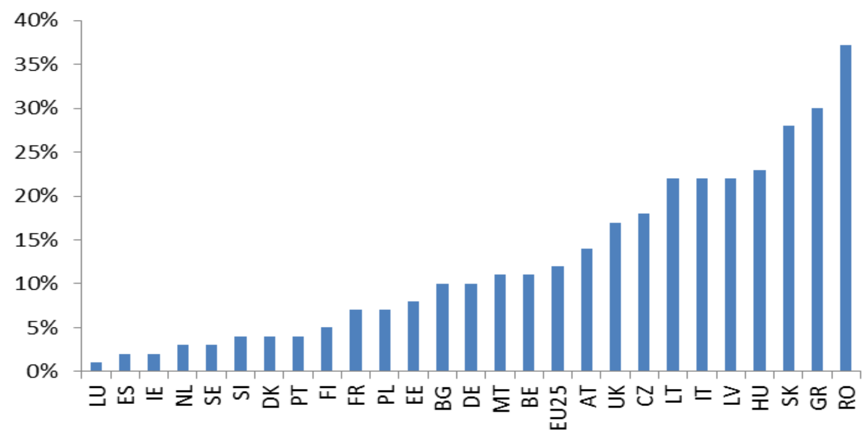
However, there are major shortcomings when assessing the VAT collection efficiency by using the standard rate of VAT and consumption by households as a proxy for the tax base. First, the total VAT base includes not only household consumption, but all components of final consumption, intermediate consumption and gross capital formation that create an obligation to pay non reimbursable VAT.

A full assessment of VAT liabilities is done within the Reckon report[9], commissioned by the European Commission, where the total obligations related to VAT were calculated for 25 European Union countries, except Romania and Bulgaria, using the input-output tables from the national accounts at product level (thus taking into account the reduced rates of VAT) until 2006. *Figure 25* shows the VAT gap (the ratio between the VAT due and unpaid to the budget and the total VAT liability to the budget) for the 27 European Union countries. For Bulgaria, the data regarding VAT not collected to the budget and VAT liability for the period 2002-2009 are

[9] *European Commission, Directorate General for Taxation and Customs Union, Reckon report, 2009*

estimated by the World Bank[10]. For Romania, the data on VAT not collected by the budget are based on National Institute of Statistics and Fiscal Council estimates.

Figure 25 – VAT gap* in EU



Data for 2006

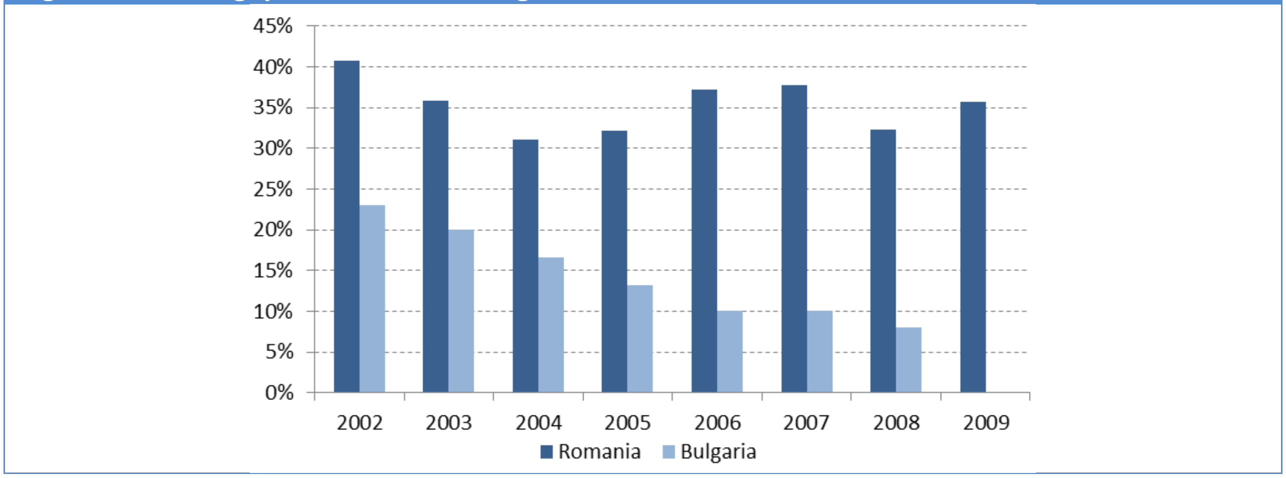
Source: European Commission, Directorate-General for Taxation and Customs Union, Reckon report, 2009, World Bank, NIS, Fiscal Council

** VAT gap is defined as the ratio between VAT not collected by the budget and total VAT liability.*

Figure 25 shows that the highest uncollected VAT, relative to the total VAT liability, is found in Romania, followed by Greece. About 37% of VAT liability was not collected in Romania in 2006. By contrast, in Bulgaria only about 10% of total VAT payment obligations was not collected. Bulgaria has made remarkable progress in terms of tax collection following a project implemented with the World Bank on the tax administration reform. Consequently, in 2008, Bulgaria managed to collect about 92% of the total VAT owed to the budget, while Romania was collecting only 67%. In 2009, according to the Fiscal Council estimates based on the National Institute of Statistics' data, Romania collected just under 65% of the VAT owed.

[10] *World Bank Report No: ICR00001345, December 2009, IMPLEMENTATION COMPLETION AND RESULTS REPORT ON A LOAN IN THE AMOUNT OF EURO 31.90 MILLION (US$ 34.15 MILLION EQUIVALENT) TO THE REPUBLIC OF BULGARIA FOR A REVENUE ADMINISTRATION REFORM PROJECT*

Figure 26 – VAT gap* Romania vs. Bulgaria



Source: NIS, Fiscal Council, World Bank

** VAT gap is defined as the ratio between VAT not collected by the budget and total VAT liability.*

Regarding the social contributions, the budget revenues collected in 2009 were 9.6% of GDP, much lower than in the Czech Republic (15.4% of GDP), although the legal contribution rates were relatively similar, Estonia (13.1% of GDP) and Poland (11.3% of GDP), where the legal social contribution rates were significantly lower than in Romania. Additionally, starting with 2008, there was a downward in the collection efficiency index of SSC. Moreover, among the countries of Central and Eastern Europe, Romania ranks last in 2009 in terms of collection efficiency of social contributions, although it has one of the largest legal rates (the forth position after Slovakia, Hungary and Czech Republic. However, as regards the employer SSC, Romania ranks sixth among the countries surveyed).

Figure 27: Evolution of implicit tax rate and the efficiency of SSC collection index in Romania

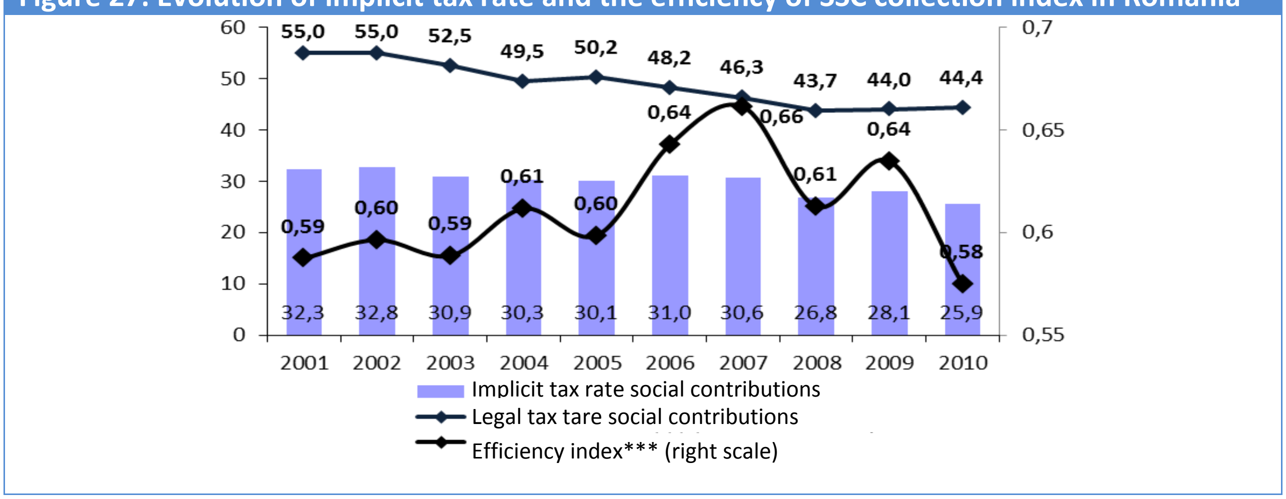


Table 11: Taxation efficiency index – Social Contributions							
Country	Legal tax rate for social contributions* (%)		Implicit tax rate**		Tax efficiency index		Rank
	2009	2010	2009	2010	2009	2010	2009
Bulgaria	30.9	28.9	24.3		0.79		7
Czech Republic	46.3	45.3	44.9		0.97		1
Estonia	35.6	37.2	34.1		0.96		2
Latvia	33.1	33.1	21.3		0.65		9
Lithuania	40.0	40.1	33.7		0.84		6
Hungary	49.0	48.5	36.4		0.74		8
Poland	37.4	37.4	35.4		0.95		3
Romania	44.0	44.4	28.1	25.9	0.64	0.58	10
Slovenia	38.2	38.2	32.8		0.86		5
Slovakia	48.6	48.6	41.9		0.86		4

Source: European Commission, Eurostat, Ministry of Finance, Fiscal Council

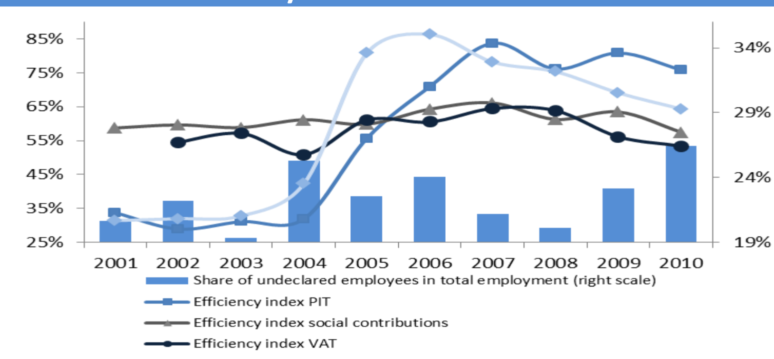
** Aggregate data for employer and employee. Where rates were changed during the year, weighted average was used.*

*** Computed as the ratio between "actual social contributions" (ESA code D.611) and "gross wages and salaries" (ESA code D11). Revenues based on cash methodology were used for Romania.*

With an efficiency collection index of 64% and an implicit tax rate of 28.1% in 2009, Romania ranks last in the group of Eastern European countries. In 2010, the collection efficiency worsened, and the implicit tax rate fell to 25.9%.

The collection efficiency index by types of taxes followed a relatively similar pattern in the last two years (*Figure 28*). Amid the economic and financial crisis, the unobserved economy has risen, the undeclared work increased, which consequently was reflected in a lower collection of taxes.

Figure 28: Index of collection efficiency and the share of undeclared work



Source: Eurostat, Fiscal Council

Tax evasion has a large share in the Romanian economy, as SSC, VAT and personal income (PIT) tax evasion alone accounts for over 9% of GDP (*Table 12*). If Romania collected taxes at their maximum potential, the budget revenues as a percentage of GDP would be close to the European average. Consequently, a profound reform of the tax administration, targeted towards increasing tax collection, is imperative.

Table 12: VAT, SSC and PIT tax evasion

RON mn	2004	2005	2006	2007	2008	2009
Tax evasion from undeclared work:	9.032	11.298	14.951	19.044	22.055	21.247
personal income tax(PIT)	1.885	2.358	3.259	4.277	5.238	4.919
social contributions(SSC)	7.147	8.940	11.692	14.767	16.817	16.328
VAT fraud	7.441	10.684	16.437	18.901	19.548	19.107
Tax evasion from informal economy (households)	1.511	2.158	2.819	3.626	5.062	4.956
Total tax evasion PIT, SSC and VAT	17.984	24.140	34.207	41.572	46.666	45.310
Non-observed economy (GVA)	35.814	47.849	66.117	83.063	100.741	97.155

% of GDP	2004	2005	2006	2007	2008	2009
Tax evasion from undeclared work:	3.7%	3.9%	4.3%	4.6%	4.3%	4.3%
personal income tax(PIT)	0.8%	0.8%	0.9%	1.0%	1.0%	1.0%
social contributions(SSC)	2.9%	3.1%	3.4%	3.5%	3.3%	3.3%
VAT fraud	3.0%	3.7%	4.8%	4.5%	3.8%	3.8%
Tax evasion from informal economy (households)	0.6%	0.7%	0.8%	0.9%	1.0%	1.0%
Total tax evasion PIT, SSC and VAT	7.3%	8.4%	9.9%	10.0%	9.1%	9.1%
Non-observed economy (GVA)	14.5%	16.6%	19.2%	20.0%	19.6%	19.8%

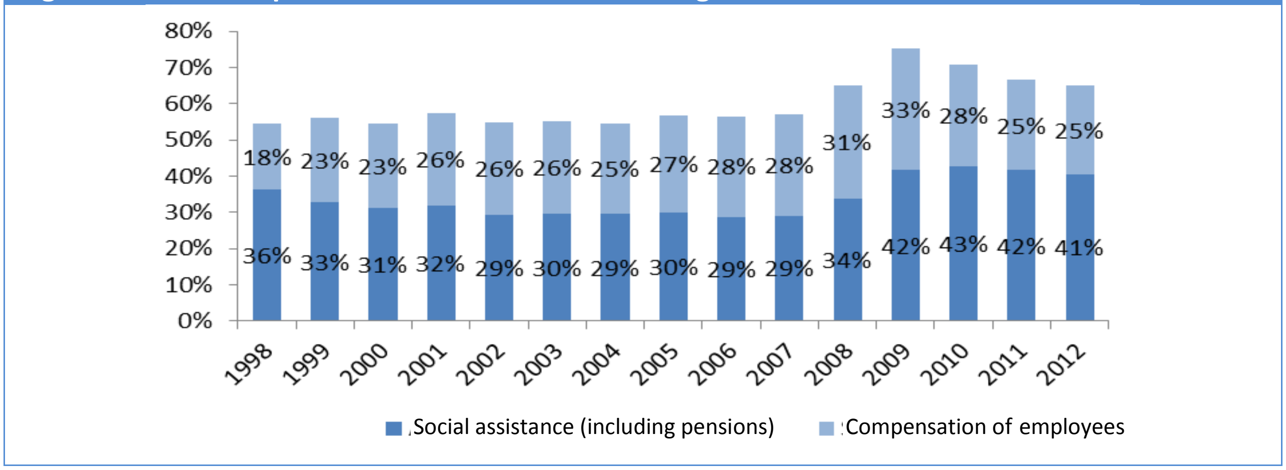
Source: Fiscal Council, NIS

V.4 Public expenditure- structure and sustainability

On the expenditure side, the priorities for the coming years should focus on improving the efficiency of public spending and restructuring the budget expenditure.

In Romania, the structure of budget expenditures is characterized by the dominance of social outlays (salaries, pensions, social assistance). The social outlays increased substantially in the years preceding the crisis and are projected to decline slightly over 2010-2012.

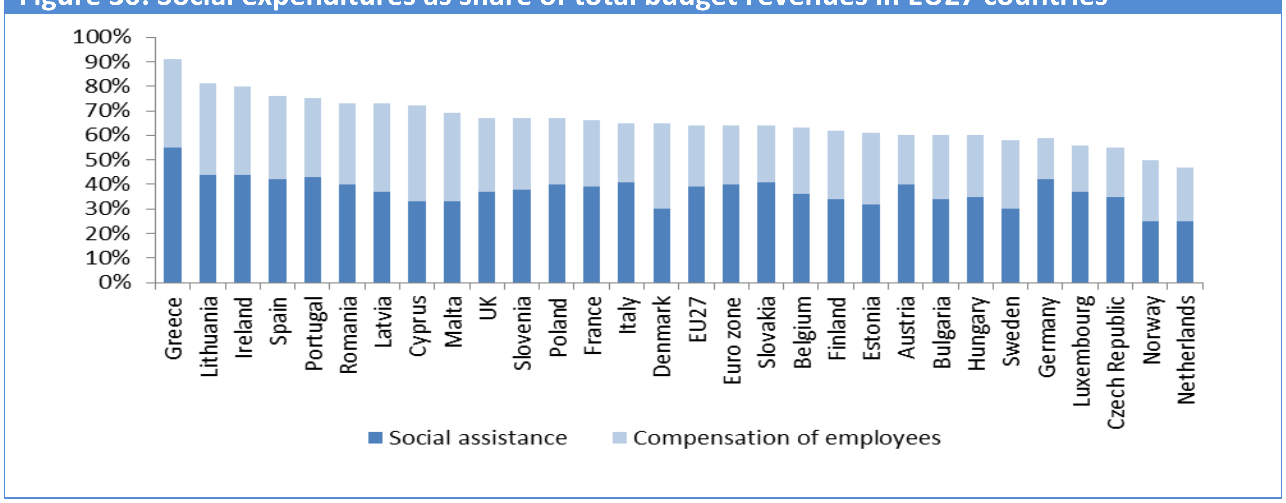
Figure 29: Social expenditures as share of total budget revenues



Source: Eurostat, European Commission forecasts

Compared with other European countries, Romania has one of the highest social outlays as a share of the total budget revenues; exceeded only by Greece, Lithuania, Ireland, Spain and Portugal.

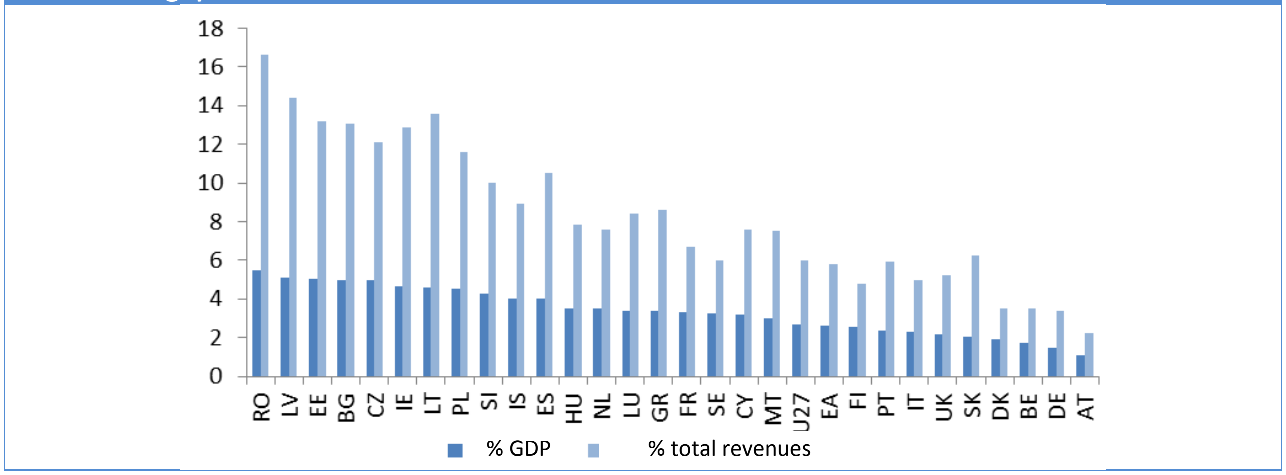
Figure 30: Social expenditures as share of total budget revenues in EU27 countries



Source: Eurostat, 2009 data

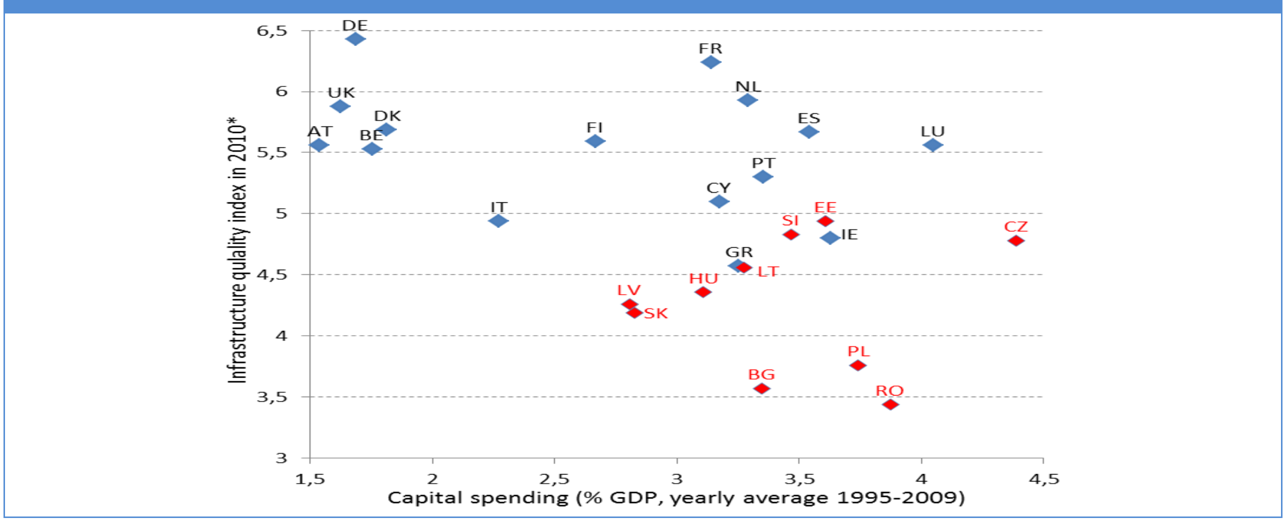
During 2006-2009, Romania had the highest allocation for capital spending (both as percentage of GDP and share of budget revenues, ESA95 standards) as compared with the EU27 countries (*Figure 31*). Even so, the results in terms of improved infrastructure quality have been modest. Despite the fact that during 1995-2009 Romania had one of the largest capital expenditure among European countries, countries like Poland, Hungary and Bulgaria have a better quality of infrastructure with lower allocations for investment spending. (*Figure 32*).

Figure 31: Capital expenditures as share of GDP and budget revenues in EU27 countries (2006-2009 average)



Source: Eurostat

Figure 32: Capital expenditures and infrastructure quality

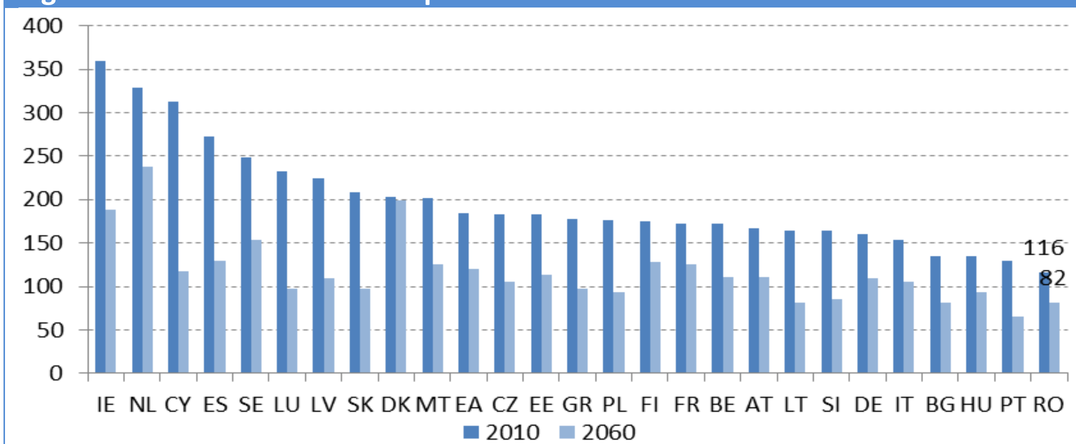


Source: World Competitiveness Report, 2010

Additionally, the financial position of the pension system is very weak, the pensions expenditures being unsustainable with respect to the revenues raised from contributions. Also, the contributors/beneficiaries ratio is the worse in the EU and the demographical projections show a further deterioration. Therefore, increasing the number of contributors and raising the retirement age are absolutely necessary in order to ensure the sustainability of the pension system.

It should be noted that the estimates of the European Commission below are prior the approval of the new pension law, which will improve the long-term fiscal sustainability.

Figure 33: Contributors to 100 pensioners



Source: Eurostat, European Commission

V.5 State owned companies- arrears, efficiency and fiscal impact

A potential risk for the fiscal sustainability on the medium run is the accumulation of losses and arrears in the companies where the state is the major shareholder (SOEs). If these companies fail to streamline their activity, sooner or later the Government will be forced to intervene, which may deteriorate the fiscal balance. Hence, under the European methodology, several SOEs have been re-classified within the public sector at the October 2010fiscal notification to Eurostat. As a result, their losses were the main cause for the upward revision of ESA 95-based budget deficit to 8.6% of GDP for 2009, as compared with 8.3% of GDP initially reported.

At the end of 2009, there were 722 SOEs that reported financial statements to the Ministry of Finance, with an aggregate turnover of nearly RON 50 billion. The table below shows the disproportion between the SOE’s contribution to the overall economy turnover and the share of these companies in total arrears. Although the contribution of SOEs to the overall economy turnover was only 6%, the accumulated outstanding payments represented 27.1% of the arrears registered in the economy.

Table 13: SOEs share in overall economy		
Indicator (2009)	**State Owned Companies(SOE)**	
	Value	**% of overall economy**
Number of companies	722	0.1
Value added(RON bn)	40	10.4
Turnover (RON bn)	49.9	6.0
Arrears (RON bn)	23	27.1
Employees	363 011	8.9

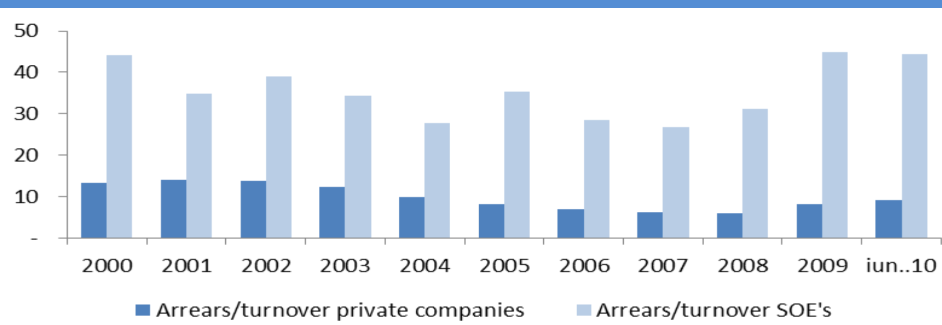
Source: Fiscal Council's calculations on financial statements from MoF

The persistence of arrears in the public companies sector indicates a culture of non or late payment to the budget and private sector, thus undermining an efficient allocation of resources and creating an uneven playing field among enterprises.

There are several factors accounting for the continued prevalence of arrears. First, the budgets of public enterprises are often approved with little attempt to ensure that the enterprise concerned will be able to pay its budgetary obligations. Second, certain legal provisions favor the lack of financial discipline, particularly in relation with the utility suppliers. Third, offsetting schemes and frequent debt cancelations create low incentives for state companies to pay their outstanding obligations. Between 2006 and 2010, arrears reduction through administrative measures amounted RON 6 billion for the largest 150 companies. The main beneficiaries were CFR SA (RON 1.5 billion in 2007), Termoelectrica (RON 2.2 billion in 2007) and the National Hard Coal Company (RON 1.3 billion in 2006).

In terms of arrears to turnover, the public enterprises stand out with a much higher share than the private companies. The bulk of their arrears are towards the general consolidated budget, particularly to the social security budget. In contrast, most of the outstanding payments of private companies are to suppliers. SOEs are the largest debtor towards the social security budget, as their total outstanding debt amounted over 2% of GDP as of June 2010.

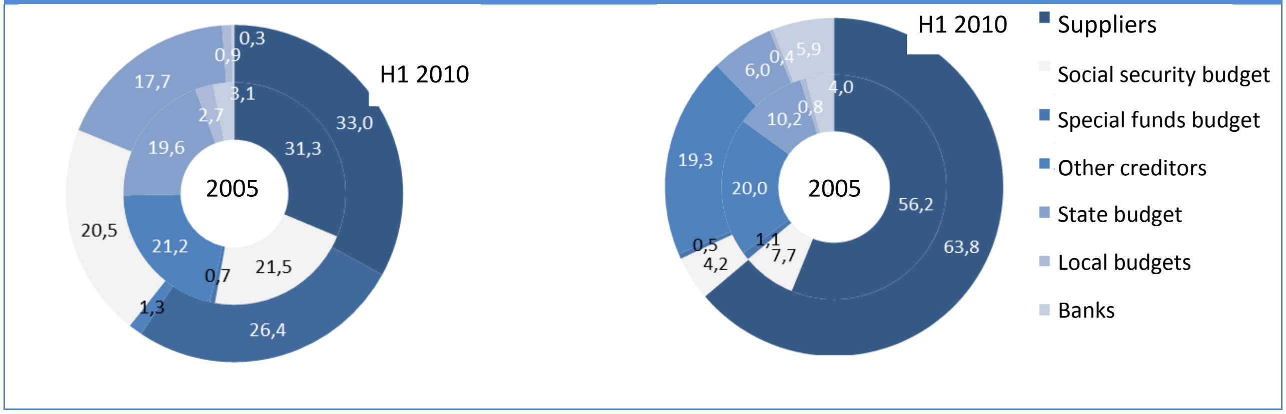
Figure 34: Arrears to turnover ratio for public and private companies



Source: Fiscal Council's calculations on financial statements from MoF

Figure 35: Structure of arrears (%)

SOEs **Private companies**



Source: *Fiscal Council's calculations on financial statements from MoF*

The data for 2006-2010 show a constant increase in the stock of arrears of the largest 150 SOEs, up to 4.2% of GDP in 2010. Arrears of all SOEs reached about 4.8% of GDP as of June 2010.

Besides direct fiscal consequences generated by such arrears - revenue shortfalls to general budget – the accumulation of arrears towards private sector is likely to create liquidity problems and to hamper the economic recovery.

The top 10 companies in terms of outstanding payments account for about 73% of the total arrears of SOEs, while the arrears are particularly high in railway and mining sectors.

Table 14: SOE's arrears (RON bn)	2006	2007	2008	2009	2010
Total SOE	**15.8**	**14.0**	**16.9**	**23.1**	**24.9**
TOP 150 SOE's arrears	**8.7**	**10.1**	**12.1**	**18.0**	**21.5**
The National Railway Company "CFR" S.A.	1.8	1.1	1.6	3.2	5.2
Compania Nationala a Huilei SA	1.3	3.2	3.5	4.1	4.8
Termoelectrica SA	3.0	2.1	2.4	3.2	3.0
Oltchim SA		0.5	0.7	0.8	1.1
The National Road Company CNADR SA			0.5	1.1	1.0
The National Freight Company "CFR Marfa"	1.8	1.1	1.6	0.7	0.9
The National Railway Company "CFR Passengers"	0.2	0.3	0.2	0.5	0.6
SC Electrocentrale Bucuresti	0.1	0.0	0.4	0.6	0.5
Electrificare CFR				0.4	0.5
Societatea Nationala a Carbunelui SA	0.3	0.4	0.1	0.5	0.5

Source: Ministry of Finance

Table 15 shows the distribution of the 722 SOEs based on solvency, computed as the ratio between equity and total assets at the end of the first half of 2010 and their ability to generate positive cash-flows, determined as ratio of profit before tax, depreciation and amortization, and turnover, both on a cumulative basis for 2005-H12010.

The data shows that about 28% of the number of employees and 18% of turnover generated by SOEs are related to insolvent companies (have negative equity). Furthermore, these companies account for 67% of total arrears of the state companies, receive 37% of the total subsidies and are responsible for over 66% of losses. Even public enterprises with positive solvency receive large subsidies (about 63% of total subsidies), therefore artificially improving their financial position, while many of them have negative cash-flows eroding their solvency.

Table 15: The distribution of the 722 SOEs depending on solvency and their capacity to generate positive cash-flows

Companies with negative solvability but generating positive cash-flows

Company	Turover (mill RON)	Employees	EBTDA/Turnover (avg 2005-2010H1)	Solvability (net assets/total assests)
Total	**2.607**	**23.881**	**4%**	**-11%**
- o/w the 10 largest companies by turnover				
CFR Călători SA	2.003	16.589	4%	-11%
RA Distribuție Energie Termică C-ța	157	631	2%	-22%
RA Termoficare Craiova	96	755	0%	-4%
RA Transport Timișoara	82	1.503	6%	-5%
RA Transport Brașov	60	1.025	14%	-29%
RA Romavia	47	227	0%	-5%
RA Drumuri și Poduri Vâlcea	29	284	1%	-1%
Urbis-Serv SRL	22	446	1%	-11%
Braicar SA	22	532	1%	-16%
Cuprumin SA	20	203	23%	-21%

Companies with positive solvability and generating positive cash-flows

Company	Turover (mill RON)	Employees	EBTDA/Turnover (avg 2005-2010H1)	Solvability (net assets/total assests)
Total	**36.427**	**202.617**	**17%**	**60%**
- o/w the 10 largest companies by turnover				
Romgaz SA	3.194	5.725	37%	87%
Transelectrica SA	2.485	2.184	13%	55%
Hidroelectrica SA	2.421	5.233	35%	72%
Electrocentrale București SA	1.859	3.670	4%	69%
Nuclearelectrica SA	1.527	2.165	28%	71%
"Loteria Română " SA	1.424	2.899	22%	60%
Transgaz SA	1.187	4.984	38%	66%
Complex energetic Craiova SA	1.132	2.412	9%	72%
Complex Energetic Turceni SA	1.126	4.146	15%	70%
RA Romsilva	1.076	19.605	10%	42%

Companies with negative solvability and generating negative cash-flows

Company	Turover (mill RON)	Employees	EBTDA/Turnover (avg 2005-2010H1)	Solvability (net assets/total assests)
Total	**7.535**	**92.457**	**-20%**	**-49%**
- o/w the 10 largest companies by turnover				
RADET	1.101	4.442	-13%	-44%
CFR SA	1.082	26.830	-54%	-9%
Oltchim SA	1.078	3.468	-2%	-34%
CFR Marfă SA	1.064	17.089	-5%	-5%
Termoelectrica SA	723	2.393	-5%	-21%
Compania Națională a Huilei SA	694	10.742	-45%	-546%
CET Iași SA	238	1.363	-19%	-32%
Electrocelntrale Oradea SA	197	1.109	-4%	-99%
CET Brașov SA	104	689	-43%	-51%
Apaterm SA	91	1.090	-22%	-245%

Companies with positive solvability but worsening solvability

Company	Turover (mill RON)	Employees	EBTDA/Turnover (avg 2005-2010H1)	Solvability (net assets/total assests)
Total	**1.137**	**13.358**	**-16%**	**7%**
- o/w the 10 largest companies by turnover				
CNADNR	752	6.416	-11%	3%
FORTUS SA	72	1.516	-63%	5%
R.A. Municipală Buzău	60	223	0%	5%
GOSCOM S.A.	28	252	-1%	15%
HIDRO PRAHOVA SA	25	579	-1%	47%
ROMARM SA - Uzina Mecanică Buc.	23	322	-8%	69%
"Îmbunătățiri Funciare" SA	23	615	-26%	58%
Ecoterm S.A.	22	176	-26%	10%
Confort Urban SRL	18	287	-75%	14%
RA a Domeniului Public Cluj-Napoca	14	236	-3%	18%

**Operating Cash-flow = EBTDA/Turnover (Earnings before taxes, depreciation and amortization accumulated during 2005-2010S1/Turnover accumulated during 2005-2010S1)*

*** Solvency = Equity/Total assets (2010S1)*

V.6 Arrears of the general budget

One of the recurrent problems in 2010 was the general budget payment arrears towards private sector. Despite the significant payments made throughout the year (for example RON 1.9 billion at the end of September for the public health sector, RON 900 million allocated from the reserve budget fund), all the quarterly targets for the reduction of the stock of outstanding payments agreed with the IMF have been missed.

Although the arrears of the state budget are significantly lower as a result of authorities' efforts, pressures still arise from local governments where arrears continued to increased constantly until Q3 2010, amounting 81 % of total arrears.

Table 16: The quarterly evolution of General Consolidated Budget arrears in 2010

	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4
State budget	**638.9**	**664.9**	**733.1**	**267.2**	**57.4**
Over 90 days	152.2	116.9	130.7	81.0	21.6
Over 120 days	335.9	337.1	354.7	145.4	24.1
Over 360 days	150.7	210.9	247.7	40.9	11.7
Local governments	**925.7**	**1,035.2**	**1,003.2**	**1,123.6**	**910.0**
Over 90 days	304.9	399.0	336.4	336.4	247.4
Over 120 days	326.0	357.7	390.1	485.0	342.2
Over 360 days	294.8	278.6	276.7	302.2	320.4
Social Security budgets	**14.1**	**61.8**	**110.7**	**125.0**	**159.3**
Over 90 days	9.5	45.3	87.1	64.5	109.9
Over 120 days	4.1	15.9	23.1	59.2	39.9
Over 360 days	0.5	0.7	0.5	1.3	9.6
Total	**1,578.6**	**1,762.0**	**1,847.0**	**1,515.9**	**1,126.7**
Over 90 days	466.6	561.1	554.2	481.8	378.8
Over 120 days	666.0	710.7	768.0	689.6	406.1
Over 360 days	446.0	490.1	524.9	344.4	341.7
IMF target	**910**	**1,270.0**	**1,090.0**	**810**	**480**
Overrun	**668.6**	**492.0**	**757.0**	**705.9**	**646.7**

Source: Ministry of Finance

VI. 2011- Outlook and risks

VI.1 Macroeconomic framework

The recovery of the global economy is currently underway and the level of business confidence indicators suggests economic recovery will continue in the following quarters. However, the developments diverge significantly between different geographical regions and different countries.

In the interim forecast of spring 2011, the European Commission has revised upwards the projected growth rate of the global economy, yet the risks regarding economic growth remain still substantial.

For the EU economy, the European Commission forecasts a 1.8% economic growth, 0.1 percentage point higher than the autumn forecast, but the developments of the member states economies are uneven. Germany - with a forecasted growth for 2011 of 2.4%, is expected to be the main driver for growth in the Eurozone and EU, followed by France, projected to increase by 1.7%. On the other hand, the European Commission anticipates a modest growth for Spain and Ireland, while for Greece and Portugal negative growth rates are expected.

Inflationary pressures have started to arise in both developed and emerging economies, caused by increases in oil and commodity prices. This increase in global commodity prices (especially food) has significantly contributed to the rise in inflation, particularly in emerging economies, where commodities hold an important share in the consumer basket. In developed countries, however, core inflation (excluding energy and unprocessed food prices) is still under control, but it is anticipated that it will begin to rise. This will probably determine central banks to start a new cycle of monetary policy tightening in the coming quarters.

In Central and Eastern Europe the economic activity has recovered, though at a different pace from country to country. In this region, the economic recovery was driven by external demand, since domestic demand is still weak, as a consequence of labor market conditions, higher commodity prices, the effects of fiscal consolidation and the ongoing process of reducing indebtedness of households, companies and banks.

There is a consensus among analysts - that matches the EC and IMF expectations, that economic activity has reached the bottom in 2010 and Romania will begin a gradual economic recovery in 2011. According to this forecasts, external demand is likely to continue to be consistent in the coming quarters, while domestic demand will remain weak and will recover relatively slow.

VI.2 Fiscal framework

As agreed with the IMF and European Commission, the Government plans to reduce the budget deficit to 4.4% of GDP this year and to 3% of GDP in 2012. Most of the measures required to achieve the fiscal budget consolidation have been enforced.

By the end of 2010, the Parliament approved the Fiscal strategy for 2011-2013, the new Pension Law (which imposes a pension freeze this year and changes the future indexation method) and the unitary pay law in the budgetary sector.

In this context, reducing the budget deficit to 4.4% in 2011 and 3% in 2012 is achievable but it rests solely to maintaining strict control of budget expenditures and refraining from discretionary fiscal policy measures that might significantly impact budget revenues.

To this end, eliminating the stock of general government arrears as well as the structural causes behind them, together with reducing the losses and arrears of state-owned companies are key issues for achieving the assumed consolidation path. Additionally, this issue is particularly important since 2012 is the deadline for eliminating the excessive deficit (on ESA 95 basis).

The budget data for the first months of 2011 indicates a path consistent with the annual deficit target, based on the 8.3% increase of budget revenues (compared with the same period of the last year) and the 4.4% reduction of budget expenditures, mainly due to a reduction by 22.5% in the public wage bill.

After the first two months of 2011, the budget deficit reached RON 2.34 billion (0.43% of GDP), well below the ceiling agreed with the international financial institutions for the first quarter of 2011 (37% of RON 6.3 billion ceiling for the first quarter).

VI.3 Risks

In the Fiscal Council's opinion, the risks to macroeconomic outlook are broadly balanced, while the risks to the conduct of fiscal policy are tilted on the upside (a higher effective deficit).

The higher domestic risks could materialize if the authorities' commitment for the fiscal consolidation process weakens due to potential political turmoil anticipating the 2012 elections. The potential slippages from a restrictive fiscal policy (e.g. reversing some of the already implemented austerity measures) could lead to a higher than targeted fiscal deficit in 2011 and 2012 and consequently, an increased risk aversion for the Romanian economy.

Regarding inflation rate, risks are inclined on the negative side, with supply shocks generated by food prices, international oil price and administrated prices. In the end, these could lead to a inflation substantially higher than the official projections.

The external risks include a potential re-emergence of the sovereign debt crisis in countries peripheral to the euro area, facing fiscal sustainability challenges. If such a scenario occurs, the level of risk aversion in the international financial markets could increase, with negative effects on capital inflows in Romania. Furthermore, a weaker economic performance of western economies can be translated in a weaker performance of the national exports, the main driver of economic recovery in Romania.

On the positive side, a better absorption of EU funds and improved confidence may lead to higher than expected economic performance, supported also by higher foreign direct investments driven by a more rapid pace of structural reforms.

In the Fiscal Council's opinion, the current fiscal policy is adequate to put the budget deficit target for 2011 within reach, based on the full year effects of the consolidation policies already enacted in 2010. However, the 3% of GDP deficit target for 2012, (both cash and accrual based), seems ambitious and may require additional measures to restrain public expenditure and improve tax collection, even though economic activity is projected to accelerate in 2012.

Moreover, the expected pattern of future economic growth, based on the recovery of investment and a better performance of exports, is not necessarily a 'tax rich' one, capable of generating proportional increases of budget revenues, therefore an even more cautious approach of fiscal policy is required. In this context, the election year 2012 involves a significant risk for the ongoing fiscal consolidation process.

Adjustment program - a detailed economic program, usually supported by use of IMF resources, that is based on an analysis of the economic problems of the member country and specifies the policies implemented or that will be implemented by the country in the monetary, fiscal, external, and structural areas, as necessary to achieve economic stabilization and set the basis for self-sustained economic growth.

Aggregate demand - total expenditures of internal and external users for acquiring final goods and services produced in an economy. It is computed as the sum between internal demand and exports of goods and services.

Aggregate supply - represents all goods and services offered on the domestic market by all domestic and foreign operators. In other words, the aggregate supply is total domestic production of economic goods plus foreign countries offer (imports).

Arrears - delayed payments as result of contractual terms' violations

Automatic stabilizers - features of the tax and transfer systems that tend to offset fluctuations in economic activity without direct intervention by policymakers. Examples are unemployment compensation and progressive taxation rates.

Balance of payments - accounting record describing the transactions concluded between a country and its external partners in a specified period of time

Budget balance - indicator computed as the difference between overall budget revenues and budget expenditures.

Capital account- account which reflects the evolution of capital transfers and acquisitions/ sale of non-financial assets

Cash methodology - involves recording revenues when they are actually received and recording expenses at the time of payment.

Conditionality - Economic policies that members intend to follow as a condition for the use of IMF resources. These are often expressed as performance criteria (for example, monetary and budgetary targets) or benchmarks, and are intended to ensure that the use of IMF credit is temporary and consistent with the adjustment program designed to correct a member's external payments imbalance.

Contagion - the transmission of shocks to several economic sectors, internally and abroad

Contribution - compulsory imputation of a share from the revenues of employees or firms, with or without the possibility of obtaining a public service in exchange

Countercyclical fiscal policy - is a fiscal policy behavior which has the role of stabilizing the economic cycle and helps to reduce cyclical fluctuations and inflationary pressures from excess demand.

Current account deficit - occurs when total imports of goods, services and transfers of a country are greater than exports of goods, services and transfers of that country; in this case, that country becomes a net debtor to the rest of the world.

Cyclical adjustment of budgetary revenues - elimination of the budgetary revenues component dependent to the demand excess/deficit (economic expansion/contraction), eliminating trend deviations; the level of budgetary revenues cyclically adjusted is the level that would have been collected if the GDP reached its potential growth.

Direct Public Debt - total public debt, except guaranteed public debt.

Disinflation - process of reducing inflation.

Economic classification - expenditure structuring based on their economic nature and effect

Economic growth - annual growth rate of the real GDP

ESA 95 methodology (European System of Accounts) - The European System of National Accounts is an accounting reporting framework used internationally for an systematic and detailed description of an economy (of a region, a country or group of countries), or its components and its relations with other economies; The main differences between ESA95 methodology and cash methodology are revenues and expenditures recording in "accrual" system (based on commitments, not actual payments like in cash system) and treatment of EU funding (EU is considered in ESA95 system a separate sector).

Euro Plus Pact - it is also known as the Competitiveness Pact and its objective is the stability of euro area, member states committed themselves to take measures to encourage competitiveness, employment and consolidation of public finances.

European semester - additional tool for preventive surveillance of economic and fiscal policies of the Member States; the European Semester is a six-months period every year during which the Governments of the member states have the opportunity to collaborate and discover the experiences and opinion of their EU homologues in order to detect any inconsistencies and emerging imbalances of economic and fiscal policies that could violate the rules of the Stability and Growth Pact.

Eurosystem - the central banking system of the euro area. It comprises the ECB and the national central banks of those EU Member States whose currency is the euro.

Exchange rate mechanism II (ERM II) - the exchange rate arrangement established on 1 January 1999 that provides a framework for exchange rate policy cooperation between the Eurosystem and EU Member States whose currency is not the euro. Although membership in ERM II is voluntary, Member States with a derogation are expected to join. This involves establishing both a central rate for their respective currency's exchange rate against the euro and a band for its fluctuation around that central rate. The standard fluctuation band is ±15%, but a narrower band may be agreed on request.

Expansionary fiscal policy - is a fiscal policy behavior that has an accelerating effect in aggregate demand growth and possible amplification of inflationary pressures.

Expansionary monetary policy - the monetary policy behavior has effect in stimulating aggregate demand and a possible amplification of inflationary pressures.

Fee - the price one pays as remuneration for services provided by an economic agent or a public institution.

Final consumption - component of the aggregate demand which includes private consumption and government expenditures for public good and services

Financial account - account which presents the transactions associated with ownership change on assets or liabilities of a country and includes foreign direct investments, portfolio investments, financial derivatives, other capital investments and reserve assets.

Fiscal consolidation - the policy aimed to reduce budgetary deficits and the accumulation of public debt

Fiscal impulse - the impact of fiscal policy on aggregate demand; a positive value corresponds to an expansionary fiscal policy and a negative value - to a restrictive fiscal policy.

Fiscal revenues - budget revenues collected through taxation. Fiscal revenues include: personal income taxes, profit taxes, capital gain taxes, property taxes and fees, good and services taxes and fees, use taxes, taxes on foreign trade and international transactions, other taxes and fiscal fees, social contributions.

Fiscal strategy - public policy document designed to set out fiscal objectives and priorities, revenue and expenditure targets of the Consolidated General Budget and its components and the evolution of the budget balance for a three-year period.

Fiscal sustainability - a set of policies is said to be sustainable if the state is able to meet its debt payments without any major additional correction in the budget balance.

Functional classification - expenditure structuring based on their destination in order to assess public funds allocations

GDP deflator - an indicator that reflects the change in prices of the goods and services composing GDP; it is computed as a ratio of GDP in current prices and GDP in prices of the base year.

Guaranteed public debt - loans guaranteed by the Ministry of Finance and local government authorities.

Harmonized Index of Consumer Prices - Consumer price index whose methodology has been harmonized between European Union countries; the inflation objective of the European Central Bank and the euro area inflation rate are expressed based on this index.

Implicit tax rate - the ratio between revenue collected for a particular type of tax and its associated tax basis.

Inflation - reflects the widespread and persistent increase in prices and it is typically measured by the consumer price index. Inflation erodes the purchasing power of money: the same amount is used to buy fewer goods.

Inflation target - inflation target set by central banks that have adopted inflation targeting strategy. The target can be set as a fix-level of inflation and/or as a range. The National Bank of Romania sets the target as a midpoint within a target band of +/- 1 percentage point.

Informal Economy - legal economic activity, but hidden from public authorities in order to avoid paying taxes, social contributions or to avoid compliance with legal standards on labor and with other administrative procedures.

Medium Term Objective (MTO) - is the medium-term objective for the budgetary position and differs for each EU member state. For states that have adopted the euro or are in the Exchange Rate Mechanism II, it is -1% of GDP or a budget surplus. Reassessment of medium-term objectives is done every four years or when major structural reform is adopted.

Monetary policy interest rate - represent the interest rate used by NBR in order to achieve its monetary policy objectives. At present this is defined as the interest rate used for deposit within a week, developed by auction at fixed interest rate.

Nominal convergence criteria (Maastricht) - the four criteria set out in Article 140(1) TFEU that must be fulfilled by each EU Member State before it can adopt the euro, namely: 1) the inflation rate must not exceed by more than 1.5 percentage points the average of the three best performing EU countries in this respect; 2) the long-term nominal interest rate must not exceed by more than 2 percentage points the average interest rate in the first three member states with the best performance in terms of price stability; 3) the public budget deficit must be less than 3% of GDP, public debt to GDP ratio must be less than 60%; 4) exchange rate fluctuations must not exceed + / - 15 percent in the last two years preceding the examination.

Non-fiscal revenues - other budget revenues that do not include taxation, such as royalties, payments from SOE' profit, fines, charges.

Output gap - an indicator that measures the difference between actual GDP of an economy and potential GDP; the term "excess demand" is also used.

Potential GDP - real GDP that can be produced by the economy without generating inflationary pressures; Potential GDP is determined by long-term fundamental factors as organization of the economy and the productive capacity of economy determined by technology and demographic factors that affect the labor, etc.

Primary balance of the Consolidated General Budget - the difference between budget revenues and budget expenditure, excluding the interest payments with regard to public debt.

Pro-cyclical fiscal policy - the fiscal policy behavior does not fulfill its stabilizing role of economic cycle but rather contribute to amplify cyclical fluctuations and inflationary pressures from excess demand.

Quasi-fiscal deficit - takes into account public sector expenditure not recorded into the budget; particularly, it refers to the losses of state owned enterprises which translate in the defaults of their financial obligations to the public budgets and public utilities.

Real convergence - in the process of adhesion to a single currency area, it is necessary to achieve also a real convergence, respectively a high degree of similarity and cohesion of economic structures of the candidate countries; although the Maastricht treaty does not mention real convergence criteria, these can be summarized by a series of economic indicators like GDP per capita, the degree of openness, the share of the commerce with member states, economic structure.

Real GDP - represent the value of final goods and services produced in an economy in a given period, adjusted with price increases. Real GDP dynamics is used to measure the economic growth of a country.

Reference interest rate - represent the average interest rate at which the central bank takes deposits on the interbank market during a month.

Restrictive monetary policy - the monetary policy behavior constrain the aggregate demand in order to reduce inflation.

Royalty - payment to the holder of a patent or copyright or resource for the right to use their property.

S1 - indicator of the sustainability gap that shows increasing taxes or reducing expenditure (as a percentage of GDP) required subject to a debt level of 60% of GDP at the end of the period.

S2 - indicator of the sustainability gap that indicates the fiscal effort (as a percentage of GDP) required subject to the inter-temporal budget constraint on an infinite time horizon.

Seasonality - periodic pattern in the evolution of an economic variable that systematically appear at certain times of the year.

Stability and Growth Pact - The Stability and Growth Pact consists of two EU Council Regulations, on "the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies" and on "speeding up and clarifying the implementation of the excessive deficit procedure", and of a European Council Resolution on the Stability and Growth Pact adopted at the Amsterdam summit on 17 June 1997. More specifically, budgetary positions close to balance or in surplus are required as the medium-term objective for Member States since this would allow them to deal with normal cyclical fluctuations while keeping their government deficit below the reference value of 3% of GDP. In accordance with the Stability and Growth Pact, countries participating in EMU will submit annual stability programs, while non-participating countries will provide annual convergence programs.

Stand-by Arrangement - A decision of the IMF by which a member is assured that it will be able to make purchases (drawings) from the General Resources Account (GRA) up to a specified amount and during a specified period of time, usually one to two years, provided that the member observes the terms set out in the supporting arrangement.

Structural budget deficit - the budget deficit that would be recorded if GDP was at its potential level; it’s the size of the deficit recorded in the absence of business cycle influences.

Taxes - compulsory and non-refundable levy charged by a government with the purpose of financing public goods and services.

Trade balance - section of the balance of trade which presents the difference between exports and imports of goods and services recorded in a specified period of time