"Policy options for the post-crisis economy in Central, East and Southeast Europe“ - ROMANIA

- Varujan VOSGANIAN -

The economic crisis has been stronger in Romania than in other EU countries

- Between 2003 - 2008 the GDP has increased from 52 billion Euros to 137 billion Euros.
- The Romanian economy is largely dependent on external factors.
- The economic growth was due to external resources. The current account deficit got in 2008 to 16 billion Euros (11.7% of GDP), the NGO sector external debt also increased.
- Most private equity is foreign(over 90% in banking, insurance, telecommunication, in major manufacturing industries: cars, siderurgy, etc)
- Banks have reduced credits to private sector.
- Foreign investments have fallen dramatically (from 9.3 billion Euros in 2008 to 4.4 billion Euros in 2009).
- 2009 was an election year, the Government avoided taking strong measures against the economic crisis

The IMF Agreement 2009-2010 (I)

- GDP decrease by about 10% in real terms
- A budgetary deficit of more than 70 billion lei (about 17 billion Euros)
- A spectacular growth of the public debt – from 110 billion lei to 200 billion lei (estimate), therefore more than 20 billion Euros. As percentages, from 22% to 39% of GDP.
- Deterioration of living standards. (GDP/capita) from 6400 €/capita in 2008 to 5400 €/capita in 2009.
- Wages in the public sector are in real terms decreased by 50% if you compare October 2010 to December 2008.

The IMF Agreement 2009-2010 (II)

- The collapse of foreign direct investment from 9.3 billion Euros in 2008 to 4.4 billion Euros in 2009 and 3.5 billion Euros (estimate) in 2010. The collapse of capital expenditures from 24 billion lei in 2008 to 14 billion lei (estimate) in 2010, which represents a 50% in real terms.
- Three times more insolvency proceedings opened by comparison with 2008.
- The collapse of domestic demand.
- The loss of half a million jobs in the private sector.
- Raising taxes (social security tax increasing by 3.8 percentage-points, increase in VAT from 19% to 24%, the introduction in May 2009 - September 2010 of the minimum tax, etc)
- Exceeding the inflation target by about 4 percentage-points

IMF agreements with Romania

Type of agreement	Approval date	Expiration date	Approved amount (mil SDR)	Executed amount (mil SDR)	Situation
Stand-by	11/04/1991	10/04/1992	380.5	318.1	incomplete
Stand-by	29/05/1992	28/03/1993	314.04	261.7	Incomplete
Stand-by	11/05/1994	22/04/1997	320.5	94.27	Incomplete
Stand-by	22/04/1997	21/05/1998	301.5	120.6	Incomplete
Stand-by	05/08/1999	28/02/2001	400	139.75	Incomplete
Stand-by	31/10/2001	15/10/2003	300	300	Completed
Stand-by turned into precautionary	07/07/2004	06/07/2006 suspended 01/01/2005	250	0	incomplete

Measures to reduce or avoid imbalance

1. The relative exchange rate stability.
2. The strengthening of the international reserves of the Central Bank.
3. Commencement of adjustment measures in budgetary expenditures (personnel downsizing in the public sector, the reduction of the share of wage's costs and goods and services in total expenditures, no increase in pensions in 2010).
4. The introduction of laws in terms of fiscal consolidation (Fiscal Responsibility Law, Payroll's Law, Pension System's Law).
5. Avoid, especially in 2010, taking some populist measures.

The IMF Agreement was constantly reviewed, each time in a negative way

In 2010 the deficit target for Romania was readjusted from 5.9% to 6.8% of GDP due to:

- Downward revision of GDP.
- Collecting revenues lower than expected.
- Increasing tax evasion
- Exceeding the arrears target.
- Hesitations in the process of readjustment.

Share of revenues in GDP – RO and EU

(percentage)

Country/Year	2003	2004	2005	2006	2007	2008	2009	2010 (estimate)
Czech	41,1	41,7	41,5	40,7	39,6	40,2	40,3	41,0
Poland	39,9	38,6	40,8	40,0	40,0	39,0	37,6	38,6
Romania	**29,4**	**30,0**	**29,8**	**31,0**	**31,3**	**32,8**	31,6	31,6
Hungary	43,4	44,1	44,5	42,6	43,9	44,7	45,9	45,1
Greece	43,2	42,0	41,8	39,5	39,4	39,9	37,3	37,2
Spain	38,3	38,7	39,3	40,4	40,2	40,0	34,0	35,6
Portugal	42,9	43,2	41,8	42,5	42,5	42,8	43,7	43,5
Italy	44,8	44,3	44,0	45,6	46,3	46,3	46,3	45,5
EU15 / EU25	44,7	44,5	45,0	44,9	44,9	44,6	43,4	44,5

Source: European Commision, EUROSTAT database, central banks, INSSE, 2009

Share of expenditures in GDP– RO and EU

(percentage)

Country/Year	2003	2004	2005	2006	2007	2008	2009	2010 (estimate)
Czech	47,3	45,2	44,9	43,6	43,0	43,0	46,9	46,5
Poland	44,6	42,6	43,3	43,8	42,7	42,3	44,0	46,1
Romania	**30,9**	**31,5**	**31,2**	**32,9**	**33,6**	**37,7**	38	37,3
Hungary	49,1	48,9	49,9	51,8	50,3	48,9	50	49,4
Greece	44,9	45,5	43,0	42,0	42,3	41,8	50	49,4
Spain	38,4	38,9	38,5	38,6	38,4	38,7	45,2	45,6
Portugal	45,5	46,5	47,8	46,4	45,4	45,4	49,5	50,2
Italy	48,3	47,7	47,2	50,1	48,6	48,6	51,6	50,8
UE 15 / UE 27	47,3	46,7	46,9	46,5	45,9	45,8	50,4	50,6

Sursa: European Commision, EUROSTAT database, INSSE, 2009

Evolution of real GDP

FORECAST OF THE MAIN MACROECONOMIC INDICATORS							
As compared to the previous year (%)							
	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
GDP, current prices - million RON -	514,654	491,274	511,582	544,426	599,060	659,429	722,918
GDP, current prices - real growth (%) -	7.3	-7.1	-1.9	1.5	3.9	4.5	4.7
Industry	1.9	-4.3	3.6	2.7	3.8	4.3	4.1
Agriculture, forestry, fishing industry,	21.9	-0.4	1.0	1.0	1.7	3.1	2.9
Constructions	26.1	-13.6	-15.9	1.6	4.5	7.1	6.1
Services	5.4	-6.8	-3.1	0.9	4.1	4.4	4.9
Final consumption	9.1	-8.2	-3.5	1.2	3.4	3.5	3.6
Household actual consumption	9.4	-9.2	-3.4	1.5	3.6	3.7	3.8
Public administration consumption	5.4	1.2	-4.6	-1.0	1.5	1.8	2.0
Gross fixed capital formation	16.2	-25.3	-1.5	3.0	5.8	7.6	8.4
Goods and services export	8.7	-5.5	7.0	7.7	7.8	8.3	9.5
Goods and services import	7.8	-20.6	4.1	7.3	7.7	8.0	9.6

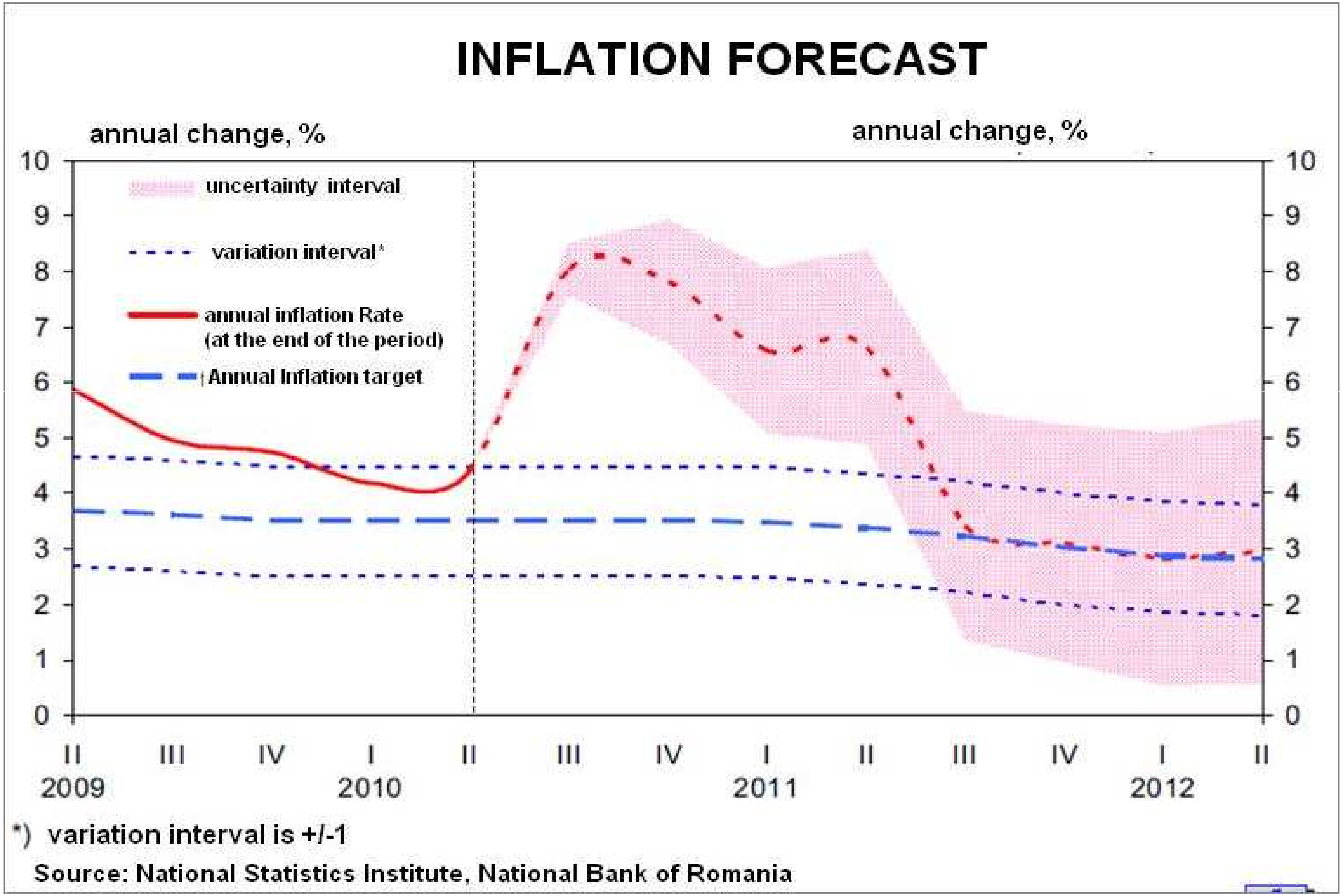
Sursa: www.cnp.ro

Inflation - Forecast

	2008	2009	2010	2011	2012	2013	2014
Consumer price growth							
-end of the year	6.30	4.74	8.2	3.2	3.0	2.8	2.5
-annual average	7.85	5.59	5.9	5.3	3.5	3.2	2.8
GDP deflator	15.2	2.8	6.2	4.8	5.9	5.3	4.8

Source: www.cnp.ro

Inflation



INFLATION FORECAST
annual change, %
annual change, %
uncertainty interval
variation interval*
annual inflation Rate
(at the end of the period)
Annual Inflation target
10
9
8
7
6
5
4
3
2
1
0
II
III
IV
I
II
III
IV
I
II
III
IV
I
II
2009
2010
2011
2012
*) variation interval is +/-1
Source: National Statistics Institute, National Bank of Romania

Budgetary revenues and expenditures

	2008 achieved	**2009 achieved**	**2010 estimate**	**2011 estimate**	**2012 estimate**	**2013 estimate**
Total budgetary revenues	32.8	32.0	31.6	32.4	32.5	32.4
Total budgetary expenditures	37.7	39.4	38.4	36.8	35.5	34.9
Balance	-4.9	-7.4	-6.8	-4.4	-3.0	-2.5

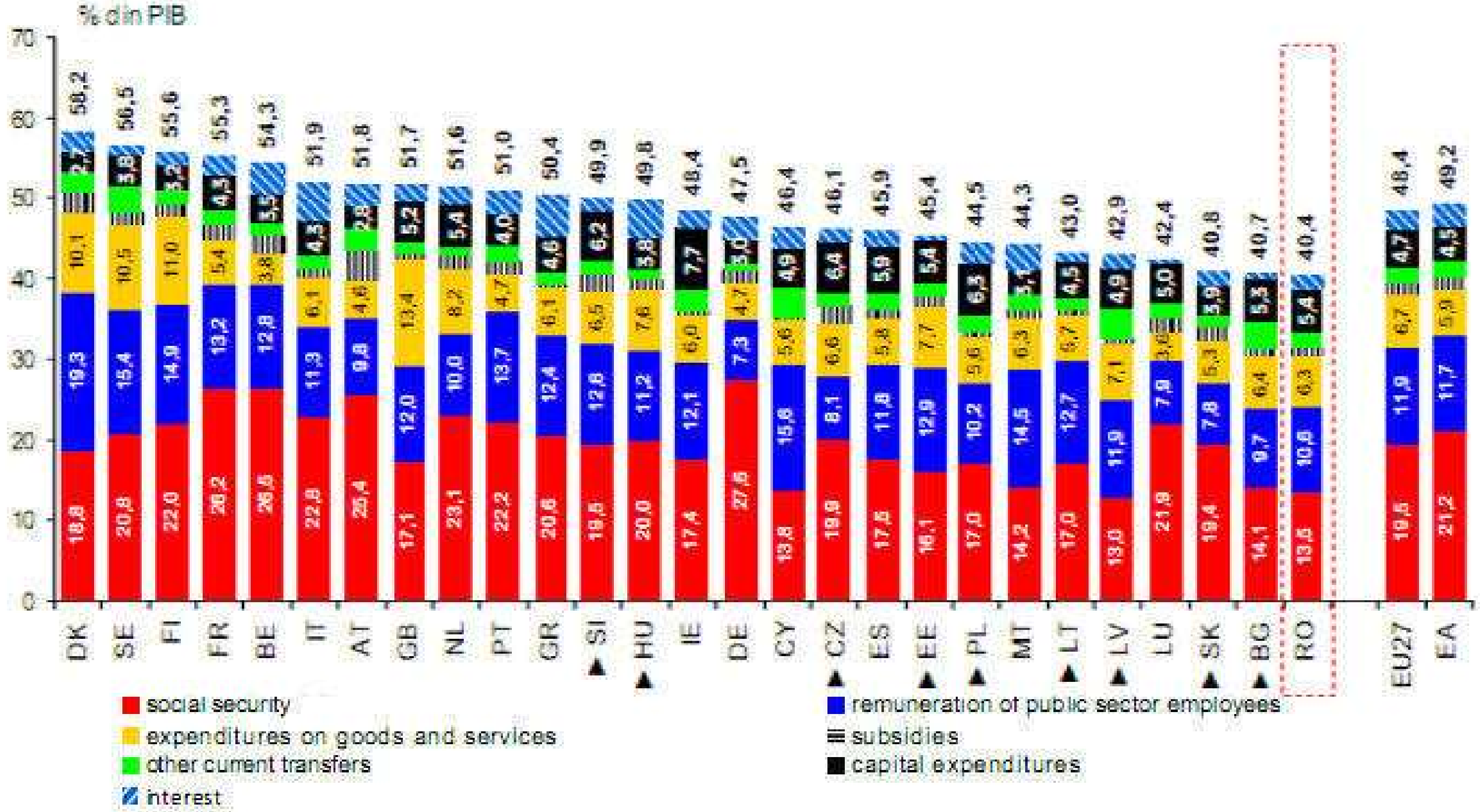
Source: Fiscal budgetary strategy 2011-2013, www.mfinante.ro

BALANCE SHEET - FINANCIAL AND CAPITAL ACCOUNT							
							Million Euro
	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
1.Needed to be covered	17,830	6,149	6,880	7,160	6,975	6,540	7,050
1.1 Current account deficit	-16 ,157	-5 ,168	-6 ,880	-7 ,160	-6 ,975	-6 ,540	-7,050
1.2 Other	-1 673	-981	0	0	0	0	0
2.Capital and financial account	17 ,830	6 ,150	7,570	7,495	8,125	8,260	9,440
2.1Capital account	622	537	340	930	1,120	1,520	2,170
2.1.1Capital transfers	616	510	340	930	1,120	1,520	2,170
- public administration	479	415	180	750	910	1,250	1,820
- other sectors	136	94	160	180	210	270	350
2.2Financial account	17,208	5,612	7,230	6,565	7,005	6,740	7,270
2.2.1Direct investments	9,308	4,400	3,680	4,200	5,300	5,900	6,750
2.2.2Portfolio investments	-563	512	2,450	1,620	1,810	1,935	2,050
2.2.3Other investments	8,718	1,827	2,950	2,750	2,625	2,430	2 ,350
- Assets	-655	-2 514	-1 800	-1 495	-1 875	-2 660	-3 640
- Liabilities	9,371	4,342	4,750	4,245	4,500	5,090	5,990
2.2.4provisions	38	-1,124	-1,850	-2 ,005	-2 ,730	-3,525	-3, 880
Balance	0	0	690	335	1,150	1,720	2,390

Source: www.cnp.ro

The structure and level of total expenditures in the Budget in the EU

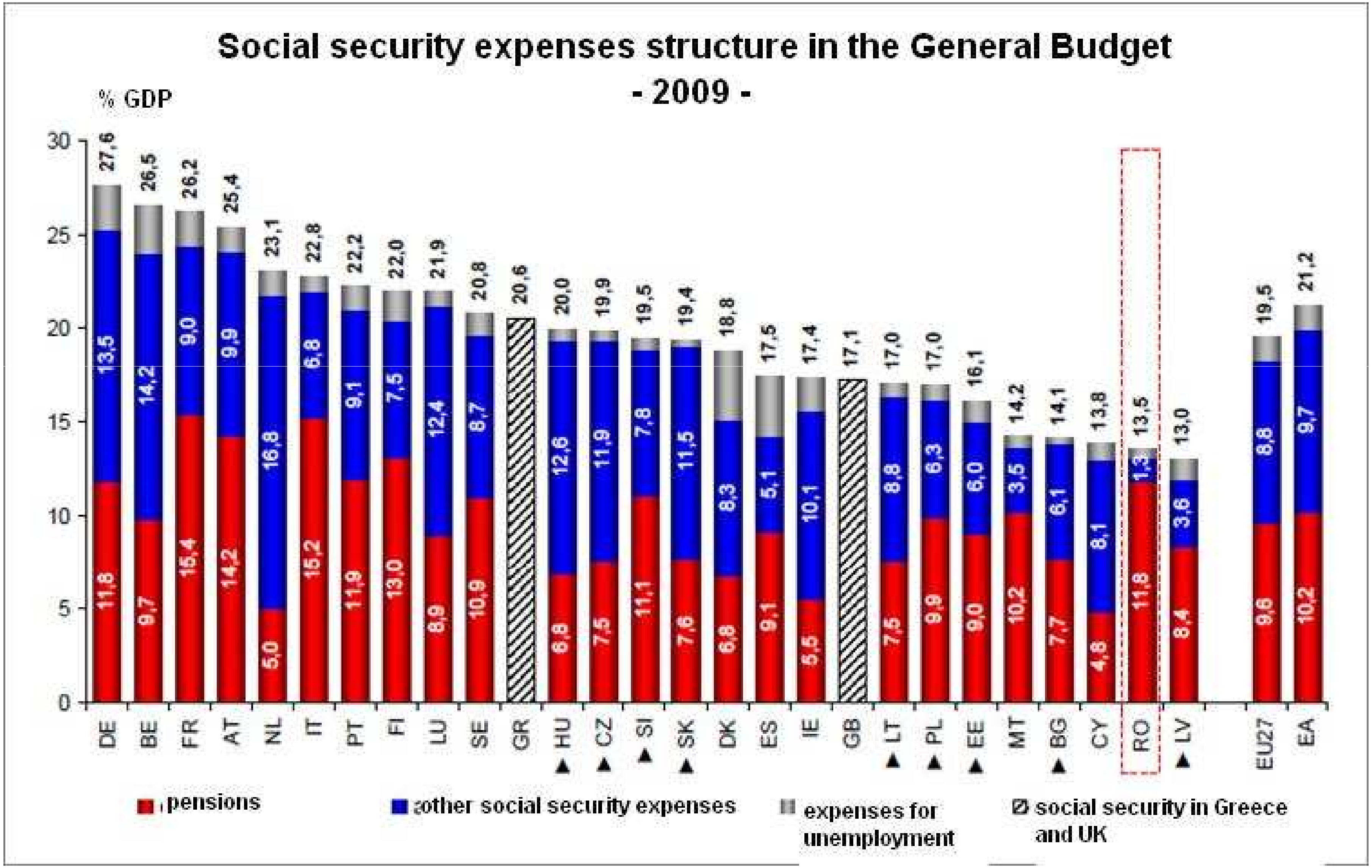
- 2009 -



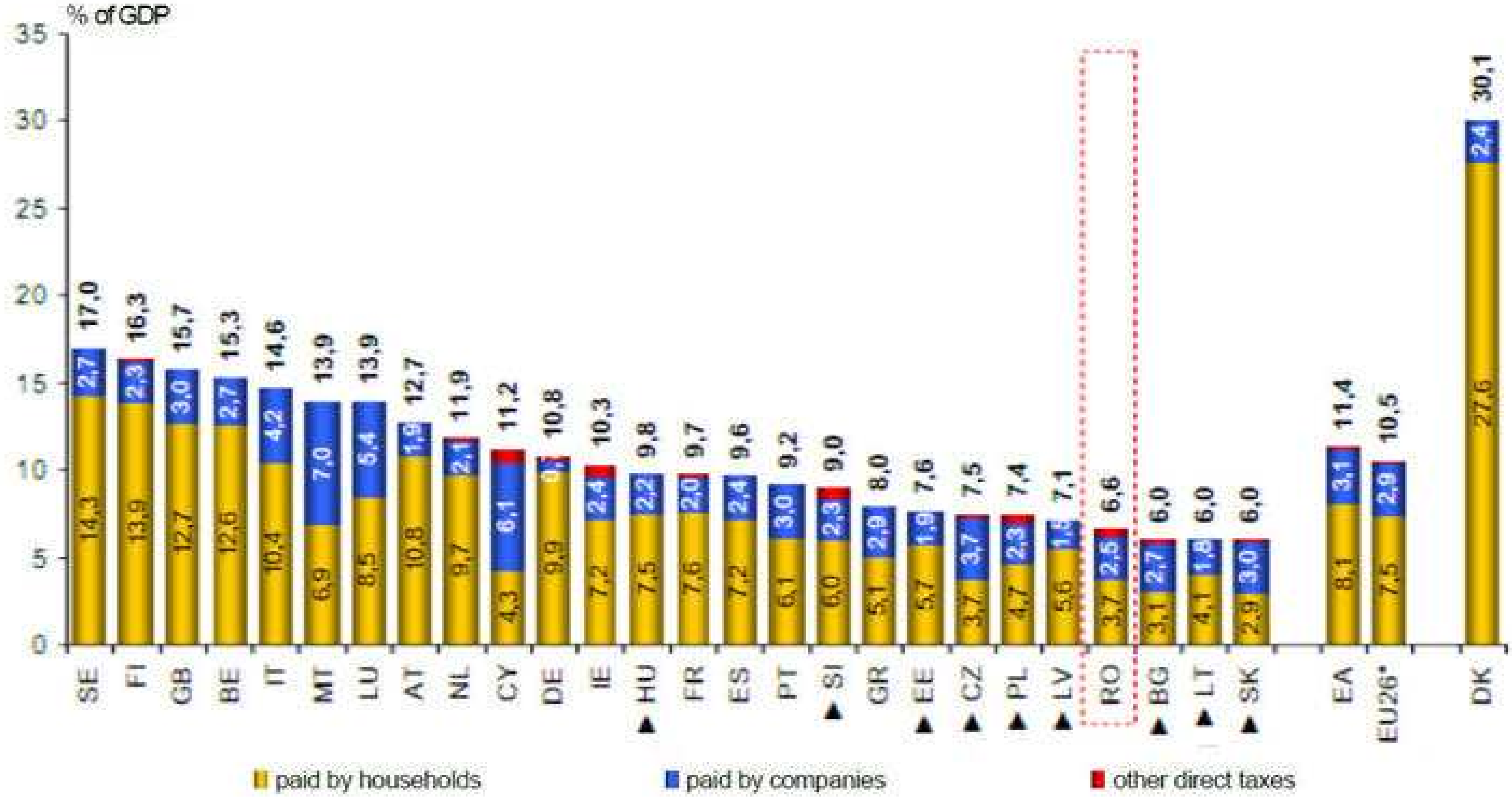
*) metodologie ESA 95

- **Romania is ranked last by one considering tax revenue**
- **Romania is ranked last considering total budgetary revenue**
- **Romania is ranked last considering public expenditures (40.4% of GDP)**

Romania after the crisis. Social Risk



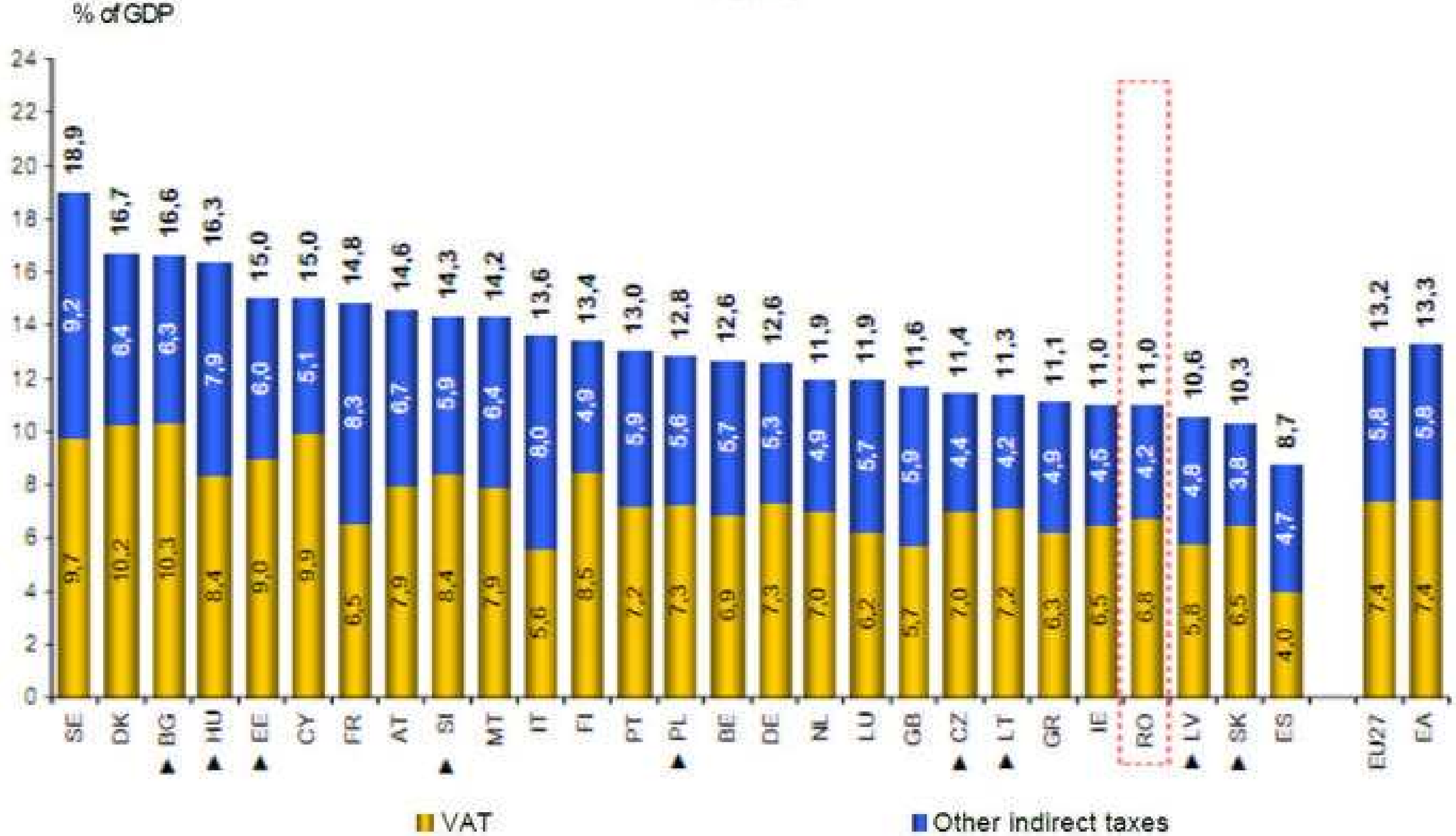
DIRECT TAXES IN THE UE
– 2009 –



*)ESA

- Rank **23 all considered, rank 7** in the NSM10
- Rank **23 considering taxes paid by households and rank 13 considering direct taxes paid by companies**

Indirect taxes in the EU
– 2009 –

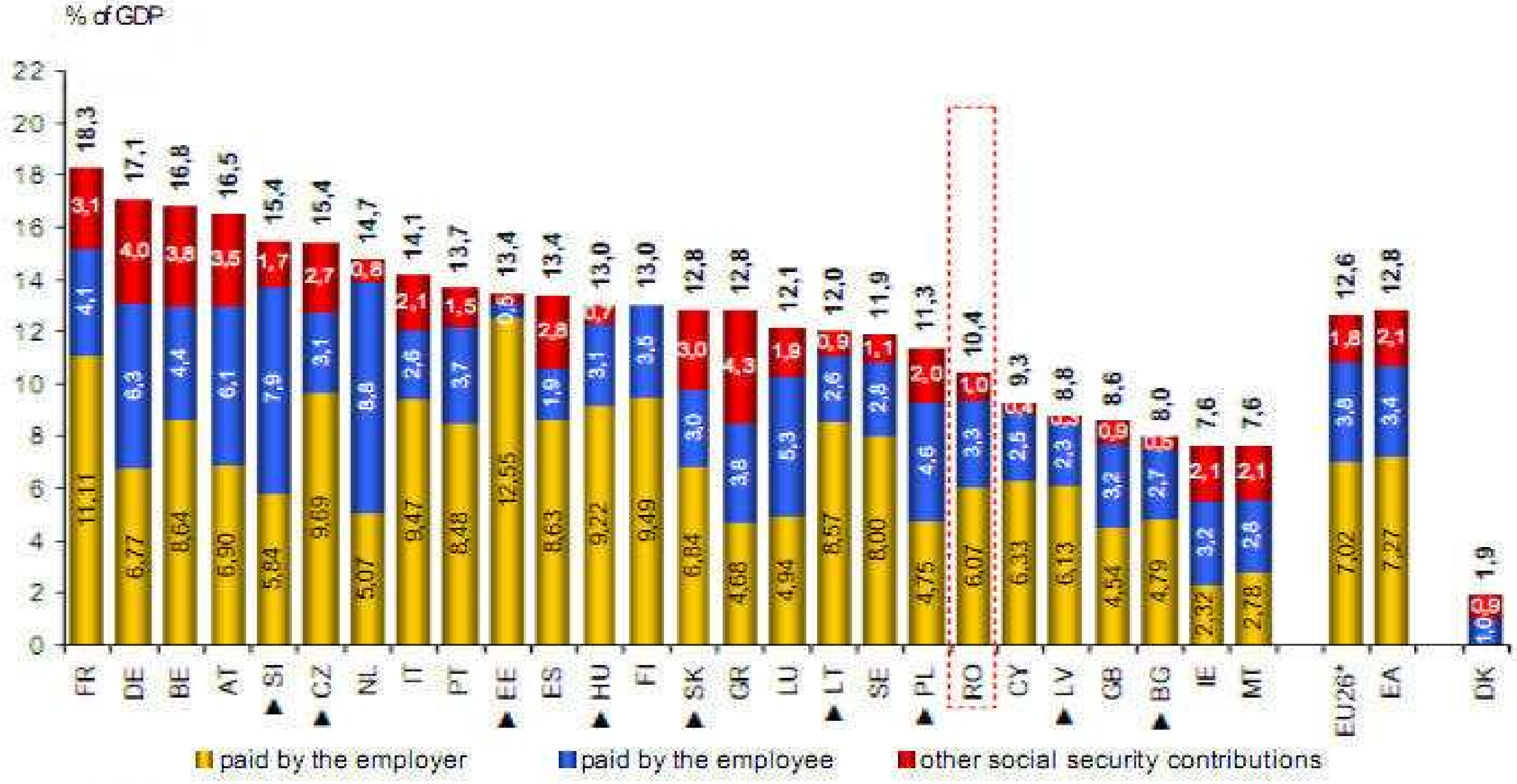


Rank 24 considering all indirect taxes

Rank 18 considering VAT collection

Rank 25 considering other indirect taxes collection

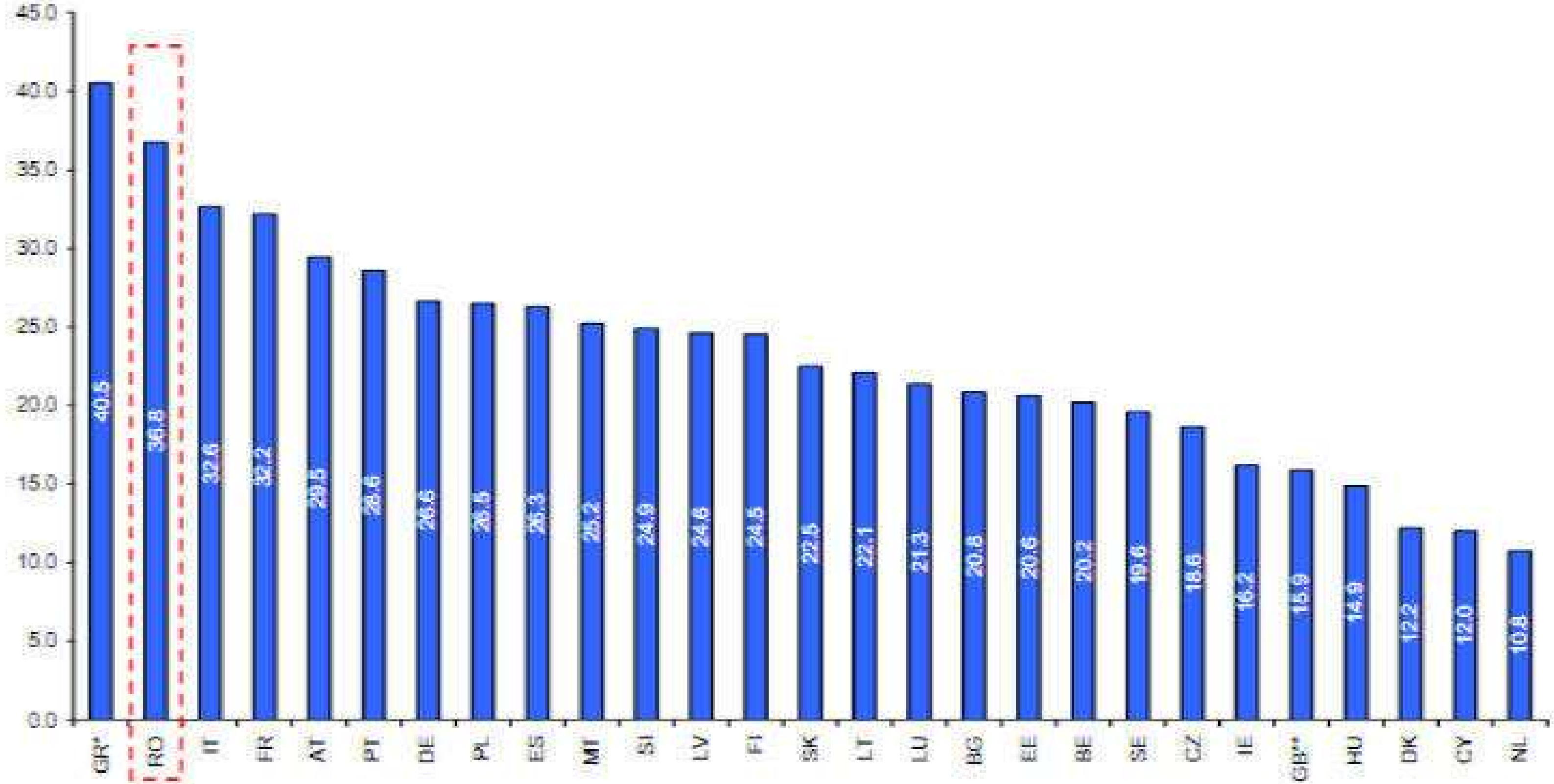
Social security contributions in the EU
- 2009 -



*) ESA 95

- Rank 20 considering all contributions
- Rank 16 considering contributions paid by the
- Rank 12 considering contributions paid by the employee

The share of pension expenditure in the budget revenue (2009)

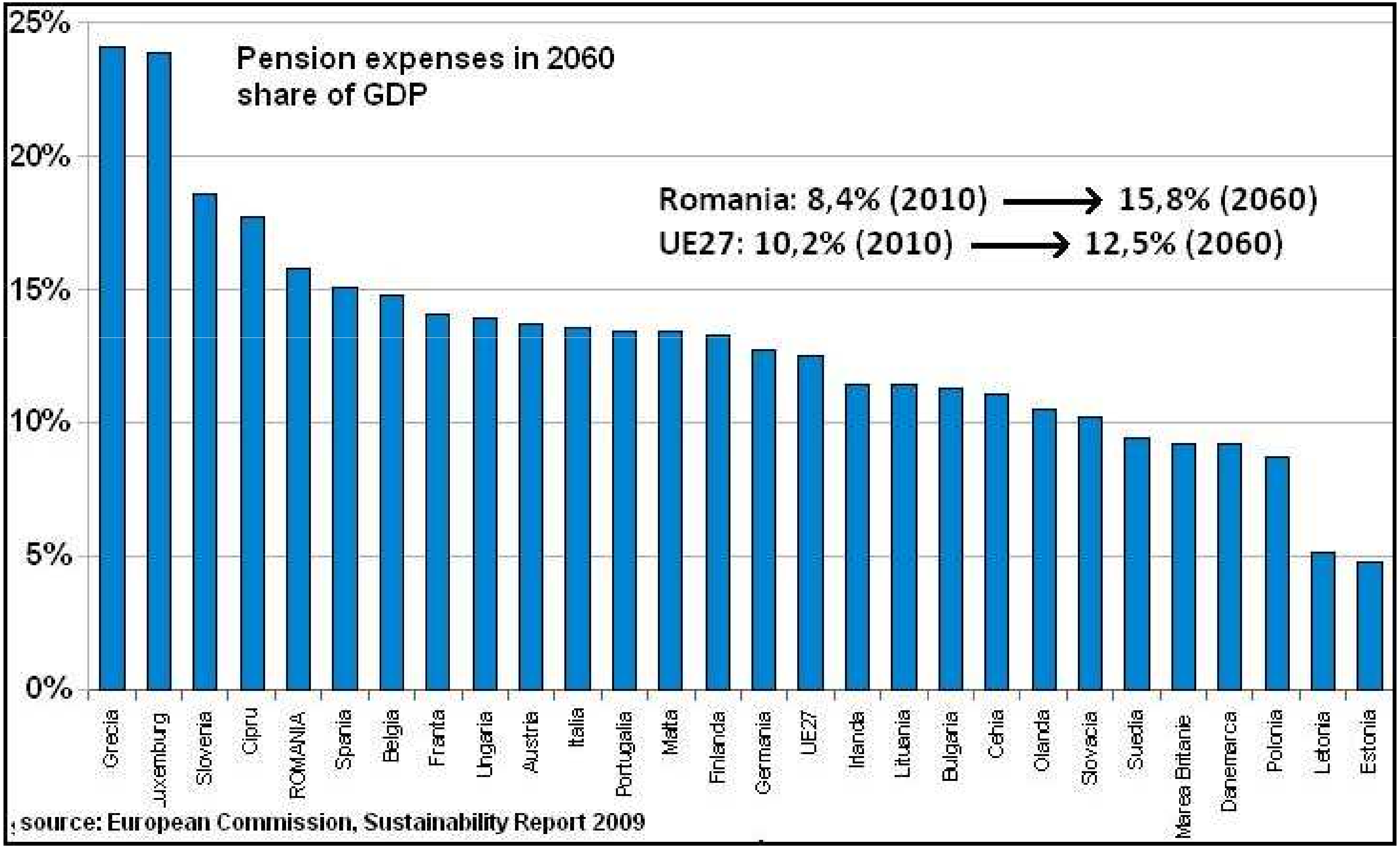


– **Romania is ranked second in EU27**

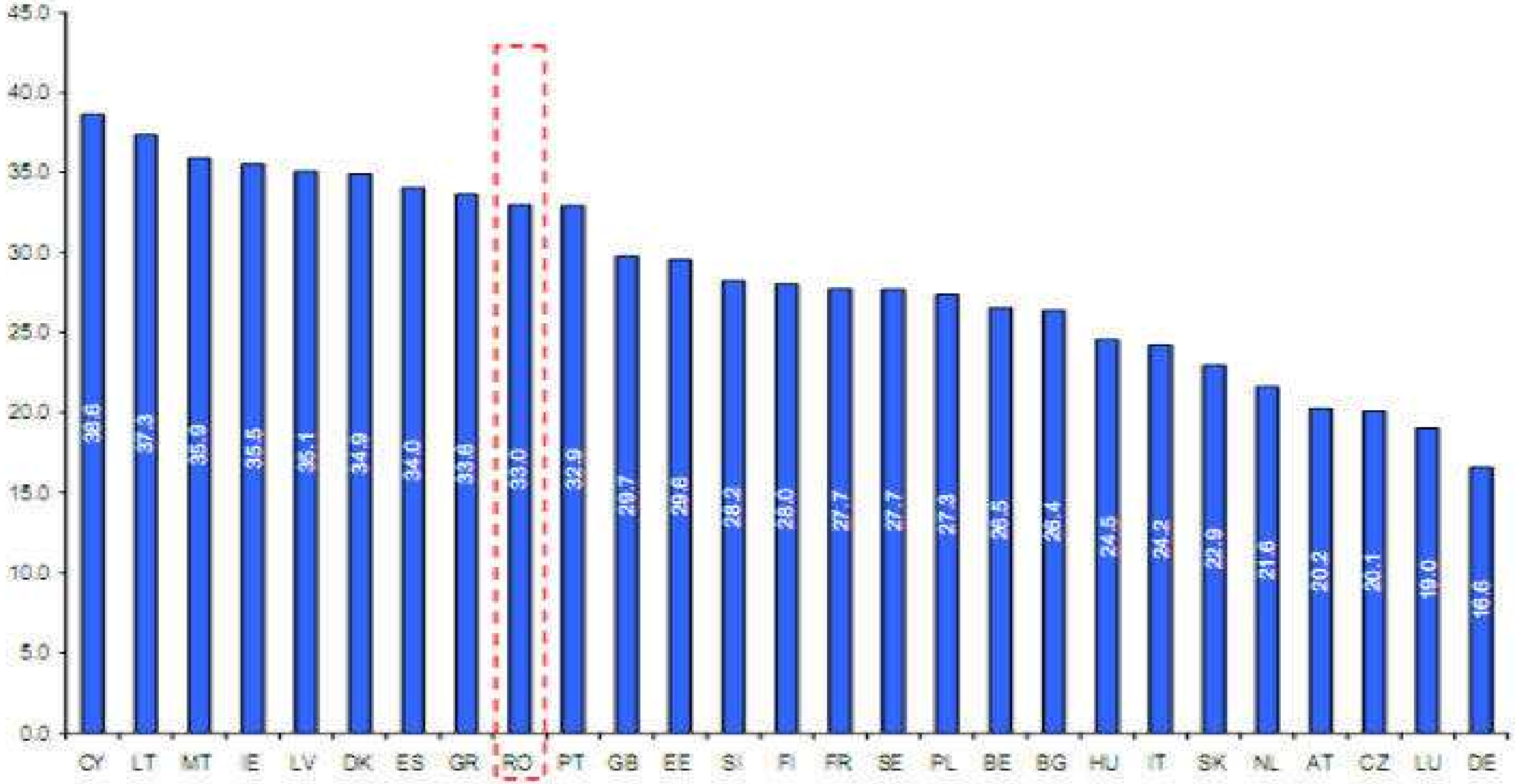
* for Greece the calculation is for 2008

** for the UK the calculation is for 2007

Romania after the crisis
Risk. Pension system crisis

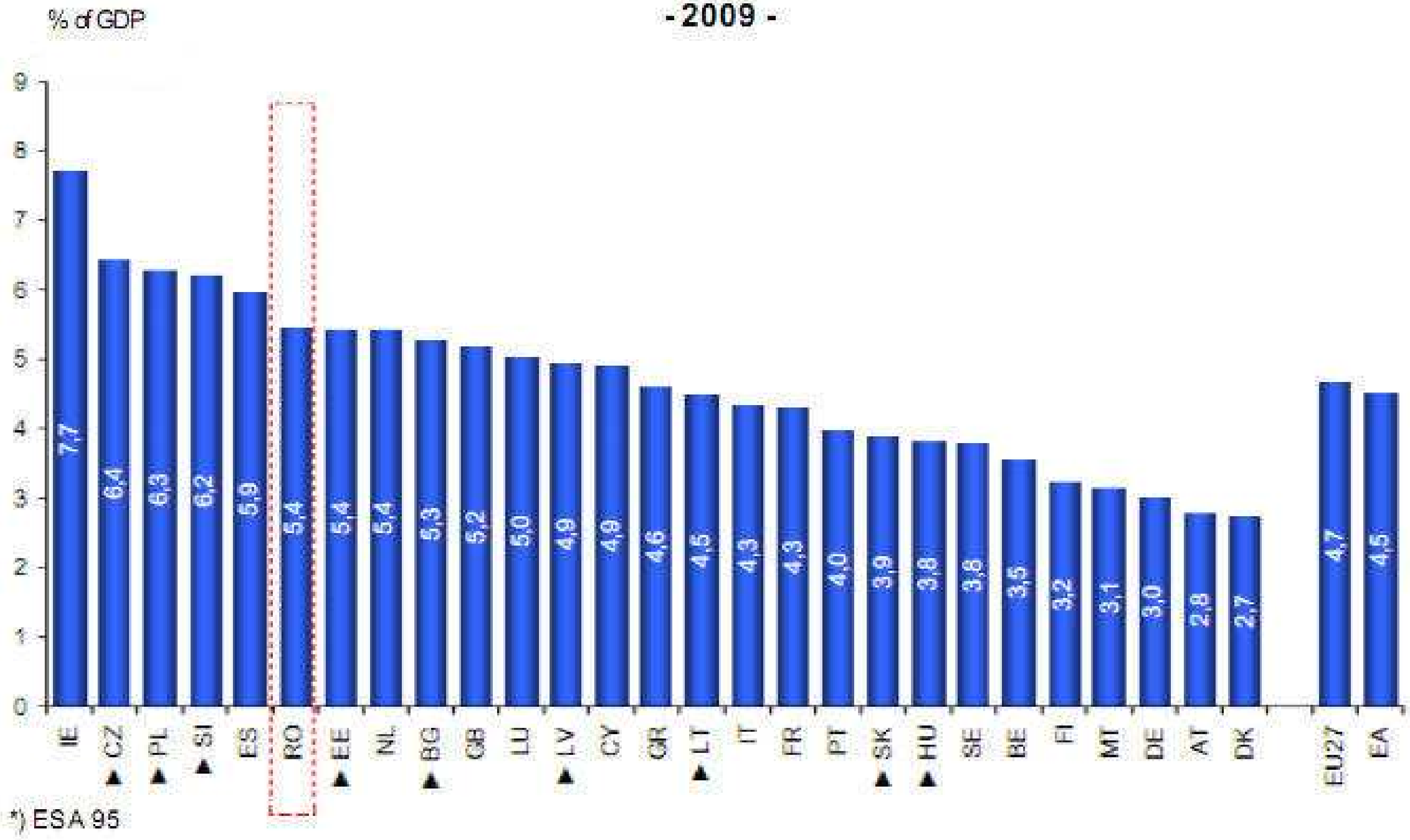


EMPLOYEE COMPENSATION SHARE IN BUDGET REVENUES (2009)



- Romania is ranked 9 in EU27

CAPITAL EXPENDITURES IN THE BUDGET IN THE EU
- 2009 -



– **Considering capital expenditures Romania is ranked 6 in the EU**

EMPLOYMENT

SITUATION ON THE 2nd QUARTER 2010

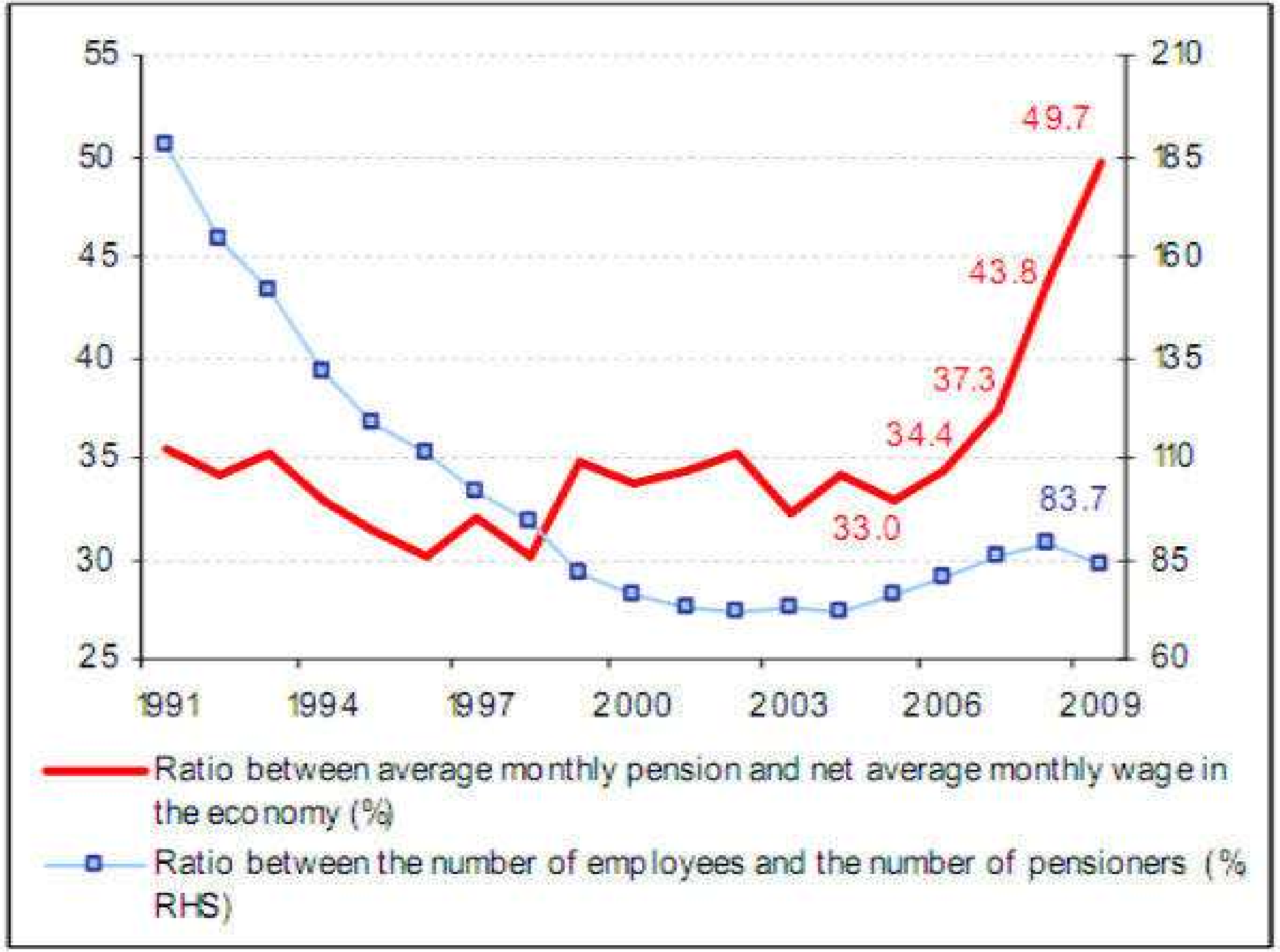
AMIGO

THOUSAND PERSONS

<table>
<tr><td colspan="11">TOTAL POPULATION: 21,462</td></tr>
<tr><td colspan="10">POPULATION 15 YEARS OLD AND OVER:18,210</td><td>UNDER 15 YEARS OLD: 3,252</td></tr>
<tr><td colspan="6">ACTIVE POPULATION:10,185</td><td colspan="4">INACTIVE POPULATION 15 YEARS OLD AND OVER:8,025</td><td rowspan="2"></td></tr>
<tr><td colspan="5">Employment:9,488</td><td>Unempl oyed: 697</td><td colspan="3">Pensionars: 5,675</td><td>Other inactive persons: 2,350</td></tr>
<tr><td colspan="2">On a salary basis: 6,088</td><td colspan="3">Other categories: 3,400</td><td></td><td>Social Security 4,759</td><td>Farmers: 744</td><td>Police, lawyers others: 176</td><td colspan="2"></td></tr>
<tr><td>On contract 4.550</td><td>Black market: 1.538</td><td>Farmers : 2.000</td><td>Workers abroad: 1.000</td><td>Freelancer 400</td><td colspan="6"></td></tr>
</table>

Sursa: www.insse.ro

Wages vs. Pensions and Employees vs. Pensioners



Unemployment.Salary earnings

	2008	2009	2010	2011	2012	2013	2014
Average employees - thousand persons	5,046.3	4,774.3	4,665	4,690	4,735	4,775	4,830
%	3.3	-5.4	-2.3	0.5	1.0	0.8	1.2
Unemployed registered (at the end of the year) – thousand persons	403.4	709.4	760	720	690	650	600
%	4.4	7.8	8.5	8.0	7.6	7.1	6.5
Average gross earnings – RON	1,761	1,845	1,910	2,022	2,125	2,232	2,338
%	26.1	4.8	3.5	5.9	5.1	5.0	4.7
Average net earnings – RON	1,309	1,361	1,393	1 472	1,546	1,622	1,697
%	25.6	4.0	2.4	5.7	5.0	4.9	4.6
Real earnings	16.5	-1.5	-3.3	0.4	1.5	1.7	1.8

Sursa: www.cnp.ro

Romania after the crisis

The risk of maintaining an unpredictable business environment

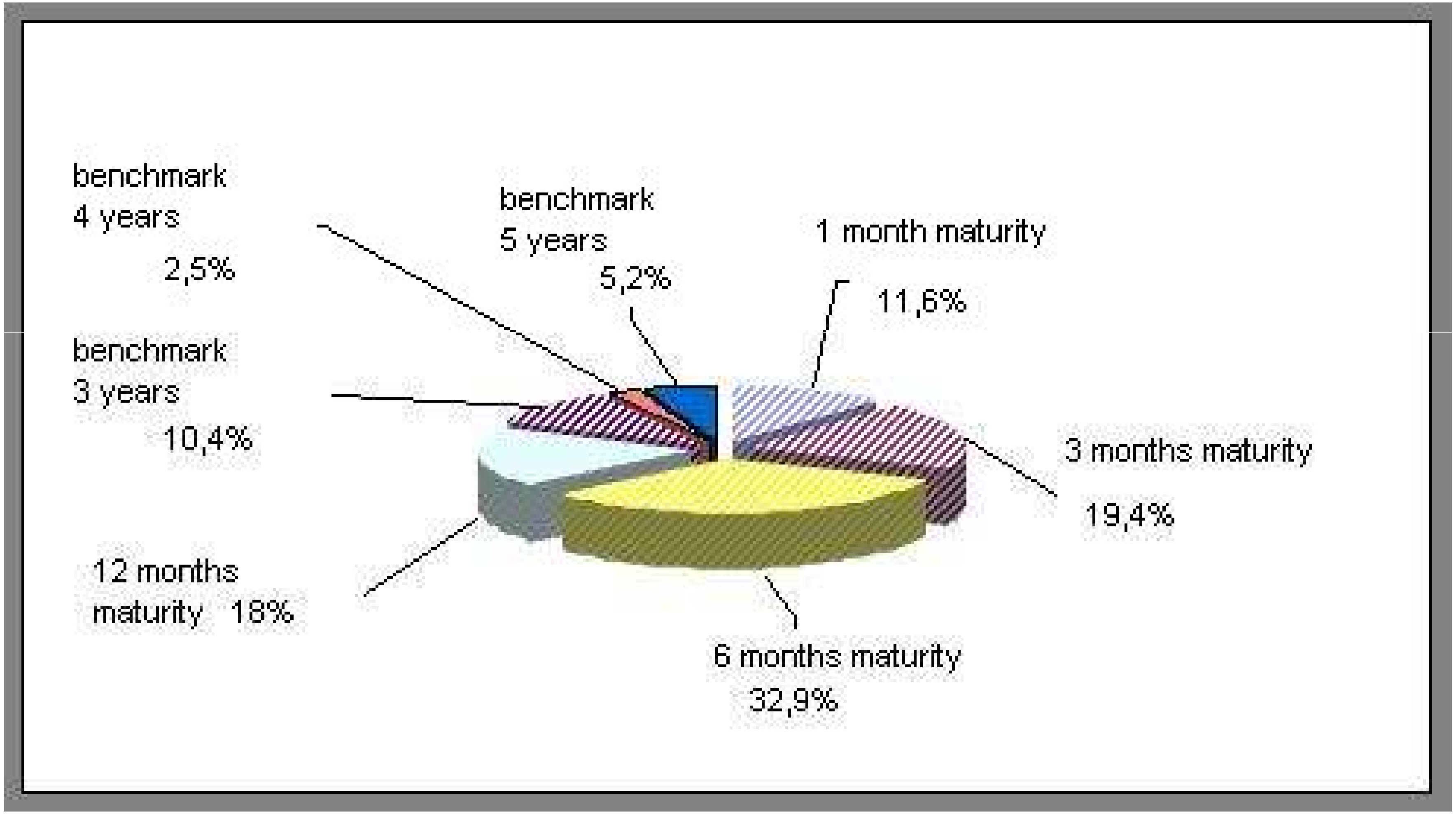
Country	Rank (out of 183 countries)				Data on taxes in over countries					
	Ease of paying taxes	Number of tax payments per year	Time reqiured to pay taxes	Total taxation rate	Number of tax payments per year	Time reqiured to pay taxes (hours)	Total tax rate	Tax on profit	Taxes on labor	Other taxes
Bulgaria	95	55	172	45	17	616	31.4%	4.6%	22.9%	3.9%
Latvia	45	9	121	54	7	279	33.0%	2.2%	27.2%	3.6%
Slovenia	84	76	104	75	22	260	37.5%	15.2%	19.9%	2.4%
Poland	151	129	155	98	40	395	42.5%	17.3%	21.9%	3.3%
Lithuania	51	37	63	99	12	166	42.7%	4.1%	35.1%	3.5%
Romania	149	182	79	108	113	202	44.6%	8.2%	34.2%	2.2%
Czech	121	37	171	122	12	613	47.2%	4.7%	39.5%	3.0%
Slovakia	119	96	103	130	31	257	48.6%	7.1%	39.6%	1.9%
Estonia	38	30	16	131	10	81	49.1%	8.1%	37.5%	3.5%
Hungary	122	43	137	150	14	330	57.5%	9.1%	39.5%	8.9%

Why is a new IMF Agreement necessary?

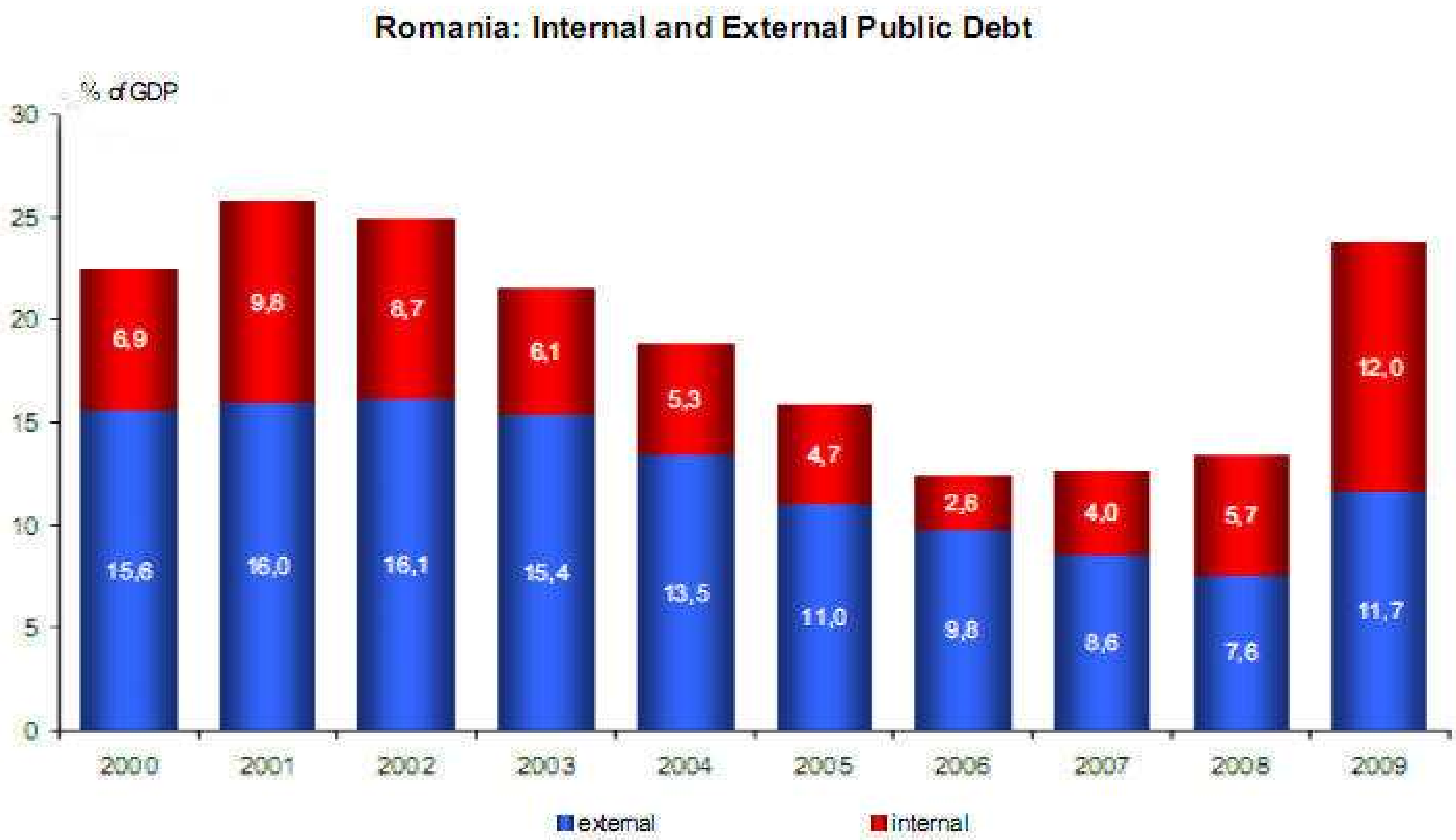
- Fiscal consolidation process is just beginning.
- The sustainability of the budget is not convincing.
- The political pressures risk jeopardizing the fiscal consolidation process.
- Huge financing requirements for covering the public debt and the budget deficit for 2011 (about 16 billion lei) can not be found on local market. Romania needs more credibility in international financial markets.

Romania after crisis

Risk. Debt crisis

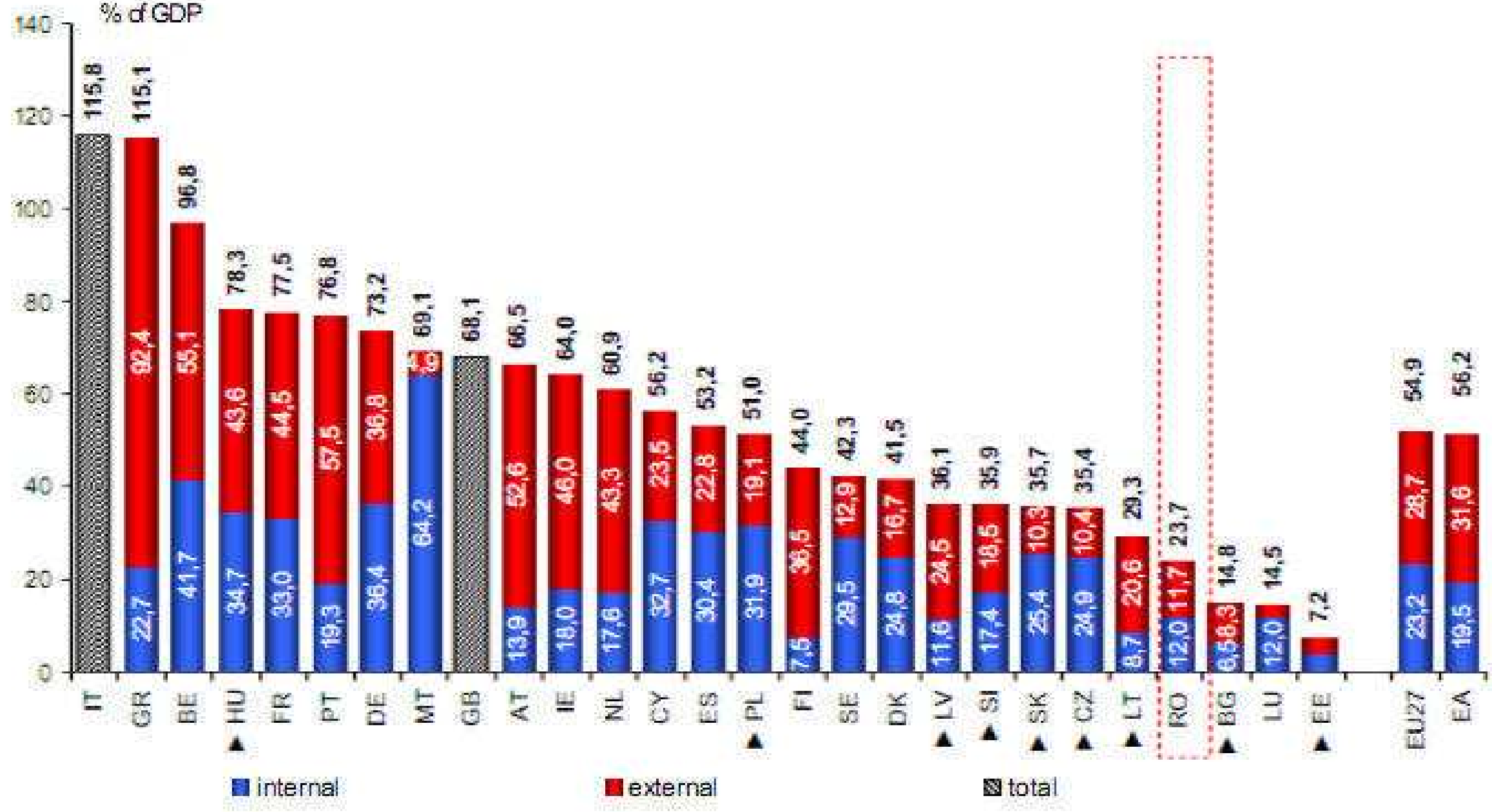


Source: Romanian Ministry of Finance


Romania: Internal and External Public Debt
% of GDP
30
25
20
15
10
5
0
6,9
9,8
8,7
6,1
5,3
4,7
2,6
4,0
5,7
12,0
15,6
16,0
16,1
15,4
13,5
11,0
9,8
8,6
7,6
11,7
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
external
internal

*) ESA 95

Internal and external debt in the EU



*) ESA

– Considering the public debt Romania is ranked 24 among the EU27 countries (43% of the EU27 average)

Necessary funding 2011

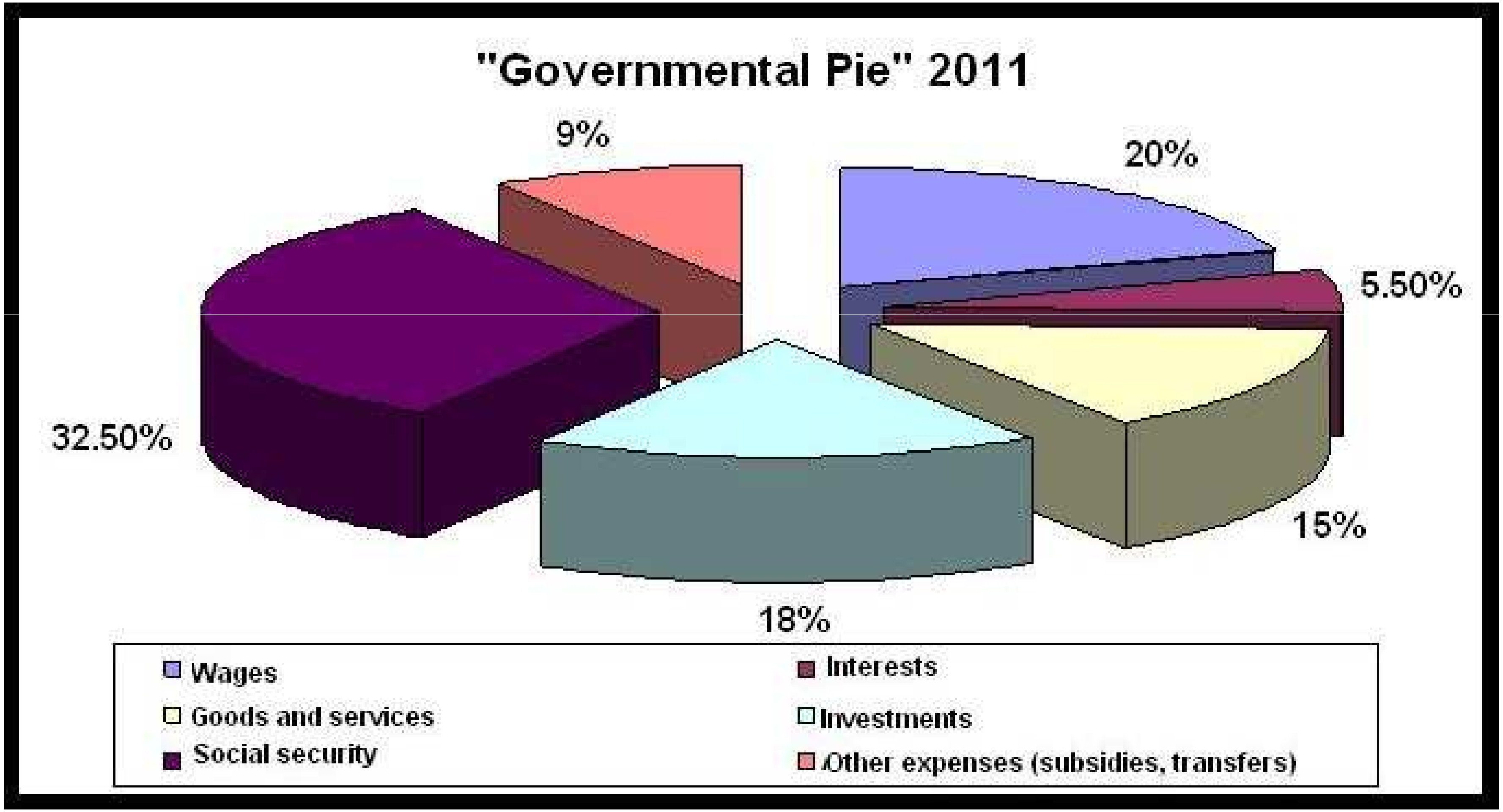
In 2011, Romania will have a public debt of 55.7 billion RON, ie 10.5% of GDP;

85% of public debt (47.3 billion RON) represents principal repayments, and 15% interest and fees;
87% of the public debt is internal, the rest is external;

All in all the Government needs about 16 billion Euro in 2011(13% of GDP):

- 5 billion Euro for the budgetary deficit (including interest);
- 11 billion Euro for capital ratios of maturity.

Necessary funding 2011



The best type of a new IMF Agreement for Romania is *precautionary*

- The international reserves of the Central Bank do not require additional funding.
- The International Monetary Fund has decided not to finance the budget deficit of Romania from now on.

The targets of a new IMF Agreement

- Further fiscal consolidation and structural adjustment.
- The reform of the major public systems (Pension System, Healthcare System).
- Reducing arrears.
- Restructuring and privatization of large state companies.
- The resumption of economic growth.

FINANCIAL RELATION WITH EU

mil. EUR

1. **EU funds allocated to Romania between 2007-2013 in february 2010, according to The Covergence Program**	**34 805**		
	2007	2008	2009
2. Revenues for Romania from the EU's post-accesion funds	663,1	1 432,0	1 129,9
3. Absorbtion rate (2/1)	1,9	4,2	3,2
Absorbtion rate of aggregated	**-**	**-**	**9,3**

mil. EUR

	2007	2008	2009	**TOTAL 2007-2009**
Romania's payments to the European Commission	**1 144,6**	**1 222,3**	**1 314,0**	**3 680,8**
Revenues for Romania from the EU's post-accesion funds, of which:	**663,1**	**1 432,0**	**1 129,9**	**3 225,0**
- Subsidies from the EU budget	7,4	122,3	573,7	703,4
- Current transfers paid by the EU budget to Romania	473,4	478,5	556,1	1 508,1
- Current transfers paid by the EU budget to the NGO sector	22,0	37,0	na	na
- Capital transfers paid by the Eu budget to Romania	32,1	158,8	na	na
- Capital transfers paid by the Eu budget to the NGO sector	128,2	635,4	na	na
Balance	**-481,5**	**209,8**	**-184,1**	**-455,9**
NOTE: Net receipts from the EU's pre-accession funds	978,2	817,3	587,0	2 382,5

The evolution of the exchange rate and euro zone membership (I)

- The IMF Agreement reduced the pressure on the depreciation of the RON
- The quasi-stabilization of the RON was also supported by the unexpected correction of the current account deficit
- Unfortunately, the disinflation process was halted temporarily in October 2009 - December 2010. Among the reasons: Advancing increase excise duty on cigarettes and fuel, increased VAT, tense internal political environment.

The evolution of the exchange rate and Euro zone membership (II)

- Coming out of the excessive deficit procedure
- Exhaustion of adverse effects of global economic crisis
- The recovery of the national economy fundamentals.
- Continuing the convergence
- Gradually aligning the reserve requirements in domestic and foreign currency to the ECB's standards.
- Resumption of RON appreciation trend against the EURO

Romania has set 2015 as a target for the integration in the Euro zone.

PERSPECTIVES

- In Romania, it will take five years to remove the effects of the economic crisis.
- In 2013 Romania will reach its economic potential from 2008, but on a more sustainable basis.
- The objective of joining the euro zone has been postponed for 2015.
- The year 2011 could be the year to stop the economic decline.
- Also in 2011 Romania will sign a new agreement with the IMF and the EC with the objectives of fiscal consolidation and resumed growth
- Several economic measures (fiscal stability, reducing taxation, reducing corruption) could play attractive business environment.
- In 2013, Romania could regain rank A in terms of investment risk, which it acquired in 2006.

THE END