ROMANIA

ROMANIA'S MEDIUM TERM ECONOMIC STRATEGY

BUCHAREST

March 2000
ROMANIA'S MEDIUM TERM ECONOMIC STRATEGY

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ROMANIA'S MEDIUM TERM ECONOMIC STRATEGY

Introduction

The National Strategy for Romania’s Economic Development represents the outcome of a free, in-depth and opinion-generating debate among the participants in the Commission for Designing the National Strategy consisting of Government officials, experts appointed by ruling-coalition parties, opposition parties, trade unions, employers’ federations, non-government organisations and professional associations, other panels of experts and public figures, as well as of the panel for economic appraisal of the Romanian Academy.

This strategy focuses on the creation of a smoothly functioning market economy, in consistence with EU principles, norms, mechanisms, institutions and policies. The convergence of opinions regarding this issue relies on the appraisal of resources and opportunities, of the domestic and international environment. It responds to the double imperative that Romania complete the transition to a market economy and prepare its accession to the European Union. To this end, Romania needs to take this historical opportunity given by the European Council in Helsinki in December 1999 through its decision to start accession negotiations with our country. The efforts of deepening the agreed development directions shall be continued in view of elaborating an extended version of the National Strategy for Economic Development, including a calendar of measures with firm yearly and quarterly deadlines, by May 15, 2000.

In the context where the long-, medium-, and short-term actual development of the national economy is still caught in the “vicious circle” of protracted and increasing disparities in productivity and living standards compared to those of the EU, the guidelines envisaged aim at promoting the Romanian people’s ideals and fundamental interests, its identity and tradition within a broad international perspective. It is considered feasible that, through own efforts backed by international co-operation, Romania will reduce and then rule out its lagging behind advanced economies and achieve modernisation in line with the requirements of transition to a cultural, information-based economy in which education should play the key role of economic and social development.

The strategy takes into account the rigorous assessment of the social costs of transition and reform, as well as those implied by EU accession. The philosophy behind this draft is based
on the strong belief that neither reform nor integration are the source of the difficulties the national economy is grappling with, but rather the means of overcoming them and that Romania will be able to contribute to creating a united, stable and prosperous Europe that should play a more important part in the world, as well as to promoting Euro-Atlantic values.

The major conclusion stemming from the Strategy is that by ensuring the necessary financial and legal support, through perseverance and real social solidarity, the prerequisites are created for Romania to meet the essential requirements for accession in 2007.

The options included in the strategy aim at laying the foundations for:

(a) ensuring economic growth based on a higher investment rate through an increased share of domestic capital and attracted foreign resources, particularly autonomous flows, in terms of complete transparency, so that the average annual growth rates of GDP should range between 4-6 percent after 2001;

(b) continuing macroeconomic stabilisation by ensuring sustainable budget deficits of around 3 percent of GDP, narrowing the quasi-fiscal deficit, and providing adequate management of the public debt and the current account deficit in order to ensure the gradual reduction in inflation to one-digit levels by the year 2004;

(c) the promotion of consistent policies, in line with EU mechanisms, aimed at achieving structural adjustment of the economy, the development and modernisation of material, scientific and social infrastructure, the restructuring and technological development of viable industries, the development of optimal-size farms, support to IT activities, and the creation of a favourable environment for the development of tourism, the diversification of financial services, of the tertiary sector in general;

(d) the creation of a favourable business environment based on a consistent and stable legal framework providing for a clear-cut definition of property rights, on strong and proper administrative and legal structures able to ensure enforcement of the law and observance of contractual obligations, on the development of market competition, reduction of transaction costs, and lowering of taxation burden; support to specific steps aimed at encouraging development of small- and medium-sized enterprises;

(e) the modernisation and development of utilities so as to better meet their function of suppliers of public goods and services in accordance with EU standards;

(f) the drafting of and commitment to a long-term programme to eliminate the risks of ecological accidents and to continually reduce environmental pollution;

The implementation of such options will lead to an increase in real incomes and to visible progress in fighting poverty. The unemployment rate, estimated to reach 13 percent in 2000,
will fall to about 9 percent in 2004. Gross domestic product per capita, in terms of purchasing power parity, is expected to amount to about EUR 7,250 in 2004. The close co-operation with experts of the European Commission, EU member states, International Monetary Fund and World Bank has proven to be extremely fruitful.

One of the essential conclusions of the Commission refers to the necessity of establishing a permanent body to ensure a commonly agreed updating of the strategy and monitor the enforcement of its provisions.

Leaving aside different political and doctrinaire orientations, all members of the Commission consider that the drafting and implementation of the National Strategy for Economic Development offers all political and social forces a possible common base to promote the national interest, the welfare of all Romanians in a broader international perspective.
I. THE CURRENT STATE OF THE ROMANIAN ECONOMY

A. The starting point of transition

The start of transition was much more difficult in Romania than in other ex-socialist Central European countries. The economy was almost fully state-owned; the private sector contribution to gross domestic product formation represented barely 12.8 percent in 1989. The hyper-centralised management system conflicting with rational criteria had stopped reacting to any real stimulus. The existence of oversized productive capacities had rendered the economy highly rigid. Its inefficiency increased during the 80s due both to further investment in largely energy-intensive industries and the discontinuing inflows of Western technology caused by the policy of forced, early repayments of foreign debt. The competitiveness of national production was stifled by the weak motivation to work combined with an unrealistic “full employment” policy. The cumulative effect of these factors brought on ever-declining standards of living in Romania, economic underdevelopment, as well as the menace of losing the chance to get connected to the new evolutions of civilisation.

After December 1989, the abrupt dismantling of the command economy resulted at first in deepening dysfunctions arising from structural imbalances. These were exacerbated by lack of preparedness to deal with democratic practices and market mechanisms on behalf of the political class, managers and citizens at large. The unfavourable circumstances in which transition started in Romania are accountable, to a considerable extent, for the large disruptions it yielded. However, these disruptions are also attributable to the way reform was managed.

B. Economic developments during the 90s

An analysis of macroeconomic indicators between 1990-1999 highlights the existence of significant economic and social changes, but also that of delays in promoting market mechanisms and in paving the way for ensuring a long-lasting development of the Romanian society.
## Table 1

Main indicators in 1990 - 1999

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<tbody>
<tr>
<td>GDP growth rate (%)</td>
<td>-5.6</td>
<td>-12.9</td>
<td>-8.8</td>
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<td>3.9</td>
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<td>Annual inflation rate (%)</td>
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<td>210.4</td>
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<td>Annual depreciation rate of average ROL/USD exchange rate (%)</td>
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<td>240.6</td>
<td>303.1</td>
<td>146.8</td>
<td>117.8</td>
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<td>ROL/USD exchange rate index / Consumer price index (1990=100)</td>
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<td>163.7</td>
<td>113.4</td>
<td>104.3</td>
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<td>Wage earnings index / Consumer price index (October 1990 =100)</td>
<td>81.7</td>
<td>71.3</td>
<td>59.4</td>
<td>59.4</td>
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<td>Employment – total (thou. pers.)</td>
<td>10,839.5</td>
<td>10,785.8</td>
<td>10,458.0</td>
<td>10,062.0</td>
<td>10,011.6</td>
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<td>- Agriculture</td>
<td>3,153.5</td>
<td>3,112.3</td>
<td>3,448.8</td>
<td>3,621.1</td>
<td>3,653.0</td>
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<td>- Industry</td>
<td>4,004.7</td>
<td>3,802.9</td>
<td>3,300.9</td>
<td>3,030.6</td>
<td>2,881.7</td>
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<td>- Construction</td>
<td>705.9</td>
<td>500.9</td>
<td>579.2</td>
<td>574.0</td>
<td>562.7</td>
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<td>- Services</td>
<td>2,975.4</td>
<td>3,269.7</td>
<td>3,129.1</td>
<td>2,836.3</td>
<td>2,914.2</td>
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<tr>
<td>Unemployment rate - %</td>
<td>3.0</td>
<td>8.2</td>
<td>10.4</td>
<td>10.9</td>
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<tr>
<td>Broad money (annual average)</td>
<td>478.0</td>
<td>603.5</td>
<td>1,209.6</td>
<td>2,764.4</td>
<td>6,652.2</td>
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<td>- bill. lei -</td>
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<td></td>
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<td></td>
<td></td>
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<tr>
<td>Broad money (annual average )</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- growth against previous year - %</td>
<td>17.0</td>
<td>26.2</td>
<td>100.4</td>
<td>128.5</td>
<td>140.6</td>
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<tr>
<td>Broad money (M2) / GDP - %</td>
<td>55.7</td>
<td>27.4</td>
<td>20.1</td>
<td>13.8</td>
<td>13.4</td>
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<tr>
<td>Total gross foreign debt (mill. USD)</td>
<td>2,131.0</td>
<td>3,240.0</td>
<td>4,249.0</td>
<td>5,563.0</td>
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<td>Total gross foreign debt per capita (USD)</td>
<td></td>
<td>91.9</td>
<td>142.2</td>
<td>186.7</td>
<td>244.7</td>
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<tr>
<td>Consolidated general government budget deficit in GDP - %</td>
<td>1.0</td>
<td>3.2</td>
<td>-4.6</td>
<td>-0.4</td>
<td>-2.4</td>
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<tr>
<td>Exports fob (mill. USD)</td>
<td>5,775</td>
<td>4,266</td>
<td>4363</td>
<td>4892</td>
<td>6151</td>
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<tr>
<td>Imports fob (mill. USD)</td>
<td>9,202</td>
<td>5,372</td>
<td>5,784</td>
<td>6,020</td>
<td>6,562</td>
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<td>Net exports fob/fob (mill. USD)</td>
<td>-3,427</td>
<td>-1,106</td>
<td>-1421</td>
<td>-1128</td>
<td>-411</td>
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<tr>
<td>Net direct investment (of non-residents) - mill. USD</td>
<td>37.0</td>
<td>73.0</td>
<td>87.0</td>
<td>341.0</td>
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Table 1 (continued)

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<tbody>
<tr>
<td>GDP growth rate (%)</td>
<td>7.1</td>
<td>3.9</td>
<td>-6.1</td>
<td>-5.4</td>
<td>-3.2</td>
</tr>
<tr>
<td>Annual inflation rate (%)</td>
<td>32.3</td>
<td>38.8</td>
<td>154.8</td>
<td>59.1</td>
<td>45.8</td>
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<tr>
<td>Annual depreciation rate of average ROL/USD exchange rate (%)</td>
<td>22.9</td>
<td>51.6</td>
<td>132.5</td>
<td>23.8</td>
<td>72.8</td>
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<tr>
<td>ROL/USD exchange rate index / Consumer price index (1990=100) - %</td>
<td>96.9</td>
<td>105.9</td>
<td>96.6</td>
<td>75.2</td>
<td>89.1</td>
</tr>
<tr>
<td>Wage earnings index / Consumer price index (October 1990 =100) - %</td>
<td>66.5</td>
<td>72.7</td>
<td>56.3</td>
<td>58.2</td>
<td>58.4</td>
</tr>
<tr>
<td>Employment – total (thou. pers.)</td>
<td>9,493.0</td>
<td>9,379.0</td>
<td>9,022.7</td>
<td>8,812.6</td>
<td>na</td>
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<tr>
<td>- Agriculture</td>
<td>3,270.2</td>
<td>3,326.4</td>
<td>3,389.6</td>
<td>3,354.3</td>
<td>na</td>
</tr>
<tr>
<td>- Industry</td>
<td>2,714.2</td>
<td>2,740.8</td>
<td>2,449.6</td>
<td>2,316.9</td>
<td>na</td>
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<tr>
<td>- Construction</td>
<td>479.1</td>
<td>474.4</td>
<td>439.2</td>
<td>391.0</td>
<td>na</td>
</tr>
<tr>
<td>- Services</td>
<td>3,029.5</td>
<td>2,837.4</td>
<td>2,744.3</td>
<td>2,750.4</td>
<td>na</td>
</tr>
<tr>
<td>Unemployment rate - %</td>
<td>9.5</td>
<td>6.6</td>
<td>8.9</td>
<td>10.3</td>
<td>11.5</td>
</tr>
<tr>
<td>Broad money (annual average)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- bill. lei -</td>
<td>13,107.7</td>
<td>22,219.5</td>
<td>45,116.4</td>
<td>70,212.5</td>
<td>106,348.3</td>
</tr>
<tr>
<td>Broad money (annual average )</td>
<td>97.0</td>
<td>69.5</td>
<td>103.0</td>
<td>55.6</td>
<td>51.5</td>
</tr>
<tr>
<td>Broad money against previous year - %</td>
<td>18.2</td>
<td>20.4</td>
<td>18.0</td>
<td>19.1</td>
<td>20.4</td>
</tr>
<tr>
<td>Total gross foreign debt (mill. USD)</td>
<td>6,482.1</td>
<td>8,344.9</td>
<td>9,502.7</td>
<td>9,807.0</td>
<td>8,589.0</td>
</tr>
<tr>
<td>Total gross foreign debt per capita (USD)</td>
<td>285.8</td>
<td>369.1</td>
<td>421.5</td>
<td>435.8</td>
<td>382.5</td>
</tr>
<tr>
<td>Consolidated general government budget deficit in GDP - %</td>
<td>-2.9</td>
<td>-4.1</td>
<td>-3.9</td>
<td>-4.1</td>
<td>-4.0</td>
</tr>
<tr>
<td>Exports fob (mill. USD)</td>
<td>7,910</td>
<td>8,084</td>
<td>8,431</td>
<td>8,302</td>
<td>8,505</td>
</tr>
<tr>
<td>Imports fob (mill. USD)</td>
<td>9,487</td>
<td>10,555</td>
<td>10,411</td>
<td>10,926</td>
<td>9,592</td>
</tr>
<tr>
<td>Net exports fob/fob (mill. USD)</td>
<td>-1,577</td>
<td>-2,471</td>
<td>-1,980</td>
<td>-2,624</td>
<td>-1,087</td>
</tr>
<tr>
<td>Net direct investment (of non-residents) - mill. USD</td>
<td>417.0</td>
<td>263.0</td>
<td>1,224.0</td>
<td>2,040.0</td>
<td>961.0</td>
</tr>
</tbody>
</table>

*Provisional data
1. The essential change that the Romanian economy underwent over the past decade, offering real opportunities for durable future development, resides in the opening-up of the former autarchic social and economic system towards the rest of the world and in Romania’s starting to align with the recent trends in Europe and across the world. The European Union became Romania’s main trade partner in terms of both exports and imports of goods and services and inflows of foreign investment. For instance, the share of exports to EU member states in Romania’s total exports increased, from 24.8 percent in 1989 to 65.5 percent in 1999, while the share of imports coming from EU countries accounted for 60.4 percent of Romania’s total imports in 1999, compared with 13.1 percent in 1989. The components of foreign trade underwent several noticeable changes, with exports increasing from 20.9 percent of GDP in 1989 to 30.1 percent of GDP in 1999, whereas imports increased from 18.2 percent of GDP in 1989 to 34.3 percent in 1999. EU countries made up for 56.6 percent of total cumulative foreign direct investment in Romania.

2. The persistence of high inflation rate was one of the main reasons behind the fall in investment rate, due to the higher risk attached to the Romanian business environment (plagued by difficulties arising from legislative and institutional inconsistency, widespread bureaucracy, and the expansion of the informal sector). The decline in domestic saving rates caused by the sharp drop in household real income and high lending interest rates added to the negative effects. The low infusions of new technologies entailed by the falling investment rate contributed to the sluggish pace of restructuring. This development was also due to the relatively low amount of foreign direct investment flows, since Romania has joined the group of poorest-performing transition countries in this area (at end-1999, the stock of foreign direct investment amounted to around EUR 240 per capita, compared with EUR 1,900 per capita in Hungary and EUR 1,518 in the Czech Republic).

3. Another characteristic of the Romanian economy during the years of transition, was the emergence of the twin deficits (fiscal and current account) following the liberalisation policies pursued against the backdrop of a weakly structured economic system. The current account deficit was mostly the result of the trade gap. The policy of regular intervention in the managed floating of the exchange rate was driven by the need to improve the competitiveness terms with a view to narrowing the trade deficit in the short run.

4. With industrial restructuring well under way, the competitiveness of the Romanian exports entered an upward drift due both to the structural changes and the real depreciation of the domestic currency. For instance, although the manufacturing sector contracted by 8 percent in 1999 versus 1998, the share of exports of manufactured goods in total exports increased from 30.7 percent to 35.1 percent, while the annual growth rate of exports equalled 5.9 percent. The drop in the income elasticity of imports acted to narrow the current account deficit. The sustained uptrend in competitiveness and the prospective favourable effects on the Romanian
economy brought about by the larger inflows of foreign direct investment are consistent with Romania’s fulfilment of the Copenhagen criteria.

5. The budget deficit was generated by the growth of budgetary expenditures in a context of economic decline, by poor revenue collection and by the insufficient transparency of budget execution, which enabled the inefficient funnelling of financial resources. The authorities pursued tight fiscal policies, aiming at control of the budget deficit. The process of bringing these policies in line with the requirements set by EU and international bodies was initiated, thus paving the way for the declining GDP share of the consolidated general government deficit.

6. The labour market was affected by imbalances in terms of the ratio between the working population and the jobless, as well as in terms of the employment rate. The decline in the number of people employed in the economy occurred, particularly in the industrial sector; the population engaged in agriculture still holds a large share in the total of working population (38 percent). The poverty coverage rate (the poverty line is equivalent to 60 percent of the average monthly spending requirements for an adult) hit 33.8 percent of the total population (28.2 percent in the urban area, 40.5 percent in the rural area, respectively). Despite imbalances between supply and demand on certain labour market segments, as well as the still low level of labour force migration, human resources enjoy a high degree of adaptability to the standards of the European labour market.

7. Romania’s foreign debt accumulated during the transition period is still low compared with other applicants, which helps the promotion of more active policies meant to attract foreign capital to the real sector, based on a higher indebtedness ratio.

8. The evolution of the Romanian economy in the period under consideration is synthetically illustrated by the growth and composition of GDP.
### Table 2

**Gross domestic product development (1989=100)**

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<tbody>
<tr>
<td><strong>GDP growth rate</strong> (previous year=100)</td>
<td>-5.6</td>
<td>-12.9</td>
<td>-8.8</td>
<td>1.5</td>
<td>3.9</td>
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<tr>
<td><strong>GDP index</strong></td>
<td>94.4</td>
<td>82.2</td>
<td>75.0</td>
<td>76.1</td>
<td>79.1</td>
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<tr>
<td><strong>Household consumption</strong></td>
<td>108.1</td>
<td>90.6</td>
<td>83.7</td>
<td>84.5</td>
<td>86.7</td>
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<tr>
<td><strong>Public administration consumption</strong></td>
<td>114.1</td>
<td>126.1</td>
<td>128.9</td>
<td>132.3</td>
<td>146.8</td>
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<tr>
<td><strong>Gross fixed capital formation</strong></td>
<td>64.4</td>
<td>44.1</td>
<td>48.9</td>
<td>53.0</td>
<td>64.0</td>
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<tr>
<td><strong>Exports of goods and services</strong></td>
<td>60.6</td>
<td>49.7</td>
<td>51.2</td>
<td>56.9</td>
<td>67.7</td>
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<tr>
<td><strong>Imports of goods and services</strong></td>
<td>118.5</td>
<td>83.4</td>
<td>89.7</td>
<td>93.6</td>
<td>96.2</td>
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<tr>
<td><em><em>VA</em> agriculture</em>*</td>
<td>137.3</td>
<td>120.3</td>
<td>104.8</td>
<td>119.1</td>
<td>122.5</td>
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<tr>
<td><strong>VA industry</strong></td>
<td>83.3</td>
<td>72.6</td>
<td>62.6</td>
<td>63.3</td>
<td>65.4</td>
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<td><strong>VA construction</strong></td>
<td>101.1</td>
<td>81.5</td>
<td>76.9</td>
<td>95.9</td>
<td>122.1</td>
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<tr>
<td><strong>VA services</strong></td>
<td>102.1</td>
<td>94.3</td>
<td>95.8</td>
<td>93.6</td>
<td>95.7</td>
</tr>
<tr>
<td><strong>GDP per capita in PPP terms (USD)</strong></td>
<td>5,706.0</td>
<td>5,087.0</td>
<td>5,068.0</td>
<td>5,259.0</td>
<td>5,628.0</td>
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<tbody>
<tr>
<td><strong>GDP growth rate</strong> (previous year=100)</td>
<td>7.1</td>
<td>3.9</td>
<td>-6.1</td>
<td>-5.4</td>
<td>-3.2</td>
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<tr>
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<td>150.5</td>
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<tr>
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<td>72.3</td>
<td>73.5</td>
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<td>130.8</td>
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* VA – value added
Table 3

Gross Domestic Product composition

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<td>36.2</td>
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<td>39.4</td>
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Weight of the private sector in GDP and in the VA of the sectors

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<td>26.4</td>
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<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
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</tr>
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<td>18.5</td>
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<tr>
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<td>30.1</td>
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<td>36.2</td>
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<tr>
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<td>95.5</td>
<td>92.5</td>
<td>90.4</td>
<td>90.0</td>
</tr>
<tr>
<td>Share of agriculture in total VA</td>
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<td>20.1</td>
<td>19.5</td>
<td>16.2</td>
<td>15.4</td>
</tr>
<tr>
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<td>33.4</td>
<td>30.4</td>
<td>31.0</td>
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<td>5.6</td>
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<tr>
<td>Share of services in total VA</td>
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<td>38.3</td>
<td>41.5</td>
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Weight of the private sector in GDP and in the VA of the sectors

<table>
<thead>
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</thead>
<tbody>
<tr>
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<td>54.9</td>
<td>60.6</td>
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<td>61.5</td>
</tr>
<tr>
<td>VA agriculture</td>
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<td>96.8</td>
<td>95.9</td>
<td>97.2</td>
</tr>
<tr>
<td>VA industry</td>
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<td>38.5</td>
<td>42.1</td>
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</tr>
<tr>
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<td>78.0</td>
</tr>
<tr>
<td>VA services</td>
<td>58.1</td>
<td>66.7</td>
<td>71.5</td>
<td>72.7</td>
<td>73.0</td>
</tr>
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</table>
A basic outcome of the transition period is the private sector development whose contribution to GDP formation reached 61.5 percent in 1999 versus 16.4 percent in 1990. GDP composition differs from that of the GDP of the EU, but a certain convergence trend is detected: the share of the agricultural sector in the creation of gross value added dropped from 20 percent in the early 1990s to 15.4 percent in 1999; the share of the industrial sector dropped below 31 percent, while the services and construction sector accounted for 53.6 percent of the gross value added (compared to about 70 percent in the EU), 20 percentage points more than at the beginning of the decade. The importance of this process needs not be exaggerated as it occurred amid the delay in restructuring and rapid economic decline in Romania, while EU countries posted a significant economic growth.

C. Synopsis of current economic conditions

In the light of the restoration of norms and institutions of the rule of law, of a reactivation and organisation of civil society, of creation of the regulatory framework (for price liberalisation, banking and stock markets, financial, monetary, insurance markets, etc.), Romania has made great strides towards a functioning market economy. The indisputable proof of this advance is the emergence of a sector of market players that are competitive in both the domestic and international business environment. Complex econometric analyses have also revealed, at the macroeconomic level, the existence of economic behaviour typical for a market economy.

1. Nevertheless, an objective assessment, free from prejudice or partisan motivation, indicates that the Romanian economy is still weakly structured from the institutional standpoint.

(a) For most of national assets, ownership rights are not clearly defined. This category includes the following:

- real estate (which is still state-owned) destined to be privatised (by means of sale or restitution);
- state-owned companies for which the distribution of ownership prerogatives is not specified or is not clear;
- assets subject to trade disputes and whose volume has risen considerably.

(b) Market economy mechanisms are not fully institutionalised, and their efficiency is low due to the inconsistencies in legal framework, the persistence of statist practices and the emerging system’s limited capacity in ensuring the enforcement of the law. On the other hand, economic activity is extensively carried out – in what rules, entities and motivations are concerned – in the informal sector.

(c) The authorities’ discretionary intervention is still widespread, often contradictory and subject to circums tantial political interests.
2. The poor institutional structure of the Romanian economy is a fact. It mirrors the influence of many factors that have affected the functioning of the economy, with the behavioural ones being the most important.

(a) The objective function of companies with majority state-owned capital or that have recently been privatised is mainly the preservation of jobs and the limitation, as much as possible, of the erosion of wages under the impact of inflation. The lack of financial resources, their shaky positions on the market and the ongoing adverse economic environment in which they operate have made small-sized firms operate at subsistence levels. Even private firms largely oriented towards profit maximisation display a strong tendency to fulfil their target, either by price increases or by means of redistributive operations borne by the public sector rather than by (quantitative and qualitative) growth in real output and the efficient use of production factors. Undoubtedly, there are also highly profitable companies, but these are not dominant in terms of behaviour.

(b) The poorly structured economy is characterised by low expected stability, which entails overly high transaction costs. The reverse of this phenomenon is the sharp depreciation of fixed and human capital, and the persistence of high interest rates. The predominance of short-time horizon in allocation decisions limits investment even further, thus impeding on economic growth in the medium and long run.

(c) The economy is undermonetised. The ratio of broad money (M2) to GDP (20 - 22 percent) is well below that required by the normal functioning of the economy.

An obvious monetary asymmetry has also evolved. A large part of the ROL and foreign currency deposits fail to be invested in the real economy, while the latter stays sharply undercapitalised. The paradoxical combination of hyper- and hypo-liquidity against the said overall undermonetisation is the reason behind the blatant real-nominal dichotomy in the Romanian economy.

(d) From the behavioural standpoint, the poorly structured economy is characterised by a very steep deterioration of the frontier between the official economy and the informal sector. This relative demarcation renders macroeconomic management more difficult. The frequent forecast errors of the bodies responsible for this field – concerning both the evolution of the main indicators and effects of some pieces of legislation or economic policy measures – are illustrative of this state of affairs.

D. The key issue of the strategy

The key issue of the strategy is to identify the ways to overcome this state of affairs, i.e. to turn the Romanian economy into a well structured, functioning market system.
1. The linchpin of this structure is the clarification of ownership rights. In this respect, the following steps should be taken:

(a) settling the disputed claims on ownership;
(b) completing the privatisation process;
(c) delimiting the optimal size of the public and private sectors of Romania – under the current circumstances – and the long-term settlement of its functioning;
(d) speeding up the settlement of ownership disputes, so as to bring the volume of disputes to normal levels as soon as possible;
(e) adopting regulations with a view to enhancing the confidence of people and companies (domestic and foreign) in the strength of the ownership system in Romania.

2. The adoption of a package of corrective regulations to ensure the consistency of economic legislation appears more and more necessary. It should refer to:

(a) the removal of discrepancies and redundancies leading to inaccurate interpretation of rules and even to the inapplicability of some important provisions;
(b) filling up of the “legal gaps”, including the harmonisation of rules and regulations with European Union standards.

In this specific case, it is important to make use of an in-depth preliminary analysis to identify the major problems in order to work them out on an integrated basis. One goal is to downsize public administration structures along with the creation of a legal framework in order to rule out the main sources of bureaucracy.

It would be worthwhile to identify an appropriate legal way to provide for, in the future, – at least for a determined period – the change in the core elements of economic legislation only upon the approval of Parliament and only in exceptional cases, therefore as a result of a larger than usual number of votes. Such an embargo would have to include the main regulations concerning ownership, taxation, the functioning of firms, currency regime, customs system, labour contracts, and essential provisions for social protection.

3. The settlement of the institutional framework would prove to be worthless unless it is accompanied by significant improvement in financial discipline throughout the economy.

4. Another essential issue is the reversal of the trend in the informal sector. A stable taxation system, the alleviation of bureaucratic constraints (which currently distort the activity of firms) are expected to stop the shift of firms to the informal sector, and even stimulate part of it to reintegrate. Institution building and the systematic and sustained fight against corruption, without political discriminations, will contribute to the enhancement of such an evolution.
In the process of drafting the medium-term economic strategy, several development scenarios have been considered – including the use of econometric models – that differ in terms of the pace and the depth of structural changes involved by transition, as well as in terms of the applicable macroeconomic policies. If economic performance follows the trends recorded so far (inertial scenario), every estimate pinpoints an inherent quasi-chronic stagflation. Starting from the objective of EU membership – which received broad political and social support – priority has been given to those development patterns that would allow the rapid overcoming of the present crisis and sound recovery of the national economy (restructuring scenario); the assumptions of this scenario and the forecasts it entails are presented henceforth.

A. Key assumptions of the restructuring scenario

1. Its essential underpinning is the completion and consolidation of the institutional framework of market economy by means of: a long-lasting clarification of ownership rights and continuing privatisation; ensuring the functional consistency and stability of the legal framework; completion of banking sector reform; clear-cut regulation of the natural monopoly regime and the effective fight against economic monopolies; boosting competition by simplifying the procedures governing market access and the speeding up of bankruptcy proceedings; the significant improvement of the business environment. The restructuring scenario takes account of the following potential effects:

   (a) the improvement, most notably in the latter part of this period, in production factor returns; the econometric functions for measuring real output have been adjusted accordingly;

   (b) the increase in saving rates and domestic accumulation; the allocation, starting 2001, of privatisation revenues for development particularly for co-financing of projects agreed on with the European Union, the World Bank and other international organisations;

   (c) the substantial rise in foreign capital inflows (direct and portfolio investment), which is quite possible in a stable, undistorted business environment;

   (d) non-redeemable fund transfers from the EU are expected to reach 2 percent of annual GDP starting the year 2001.

The estimates are also based on the assumption that the share of the informal sector in total output is to be gradually reduced.
2. The macroeconomic policy mix lying at the heart of the restructuring scenario focuses on
the removal of restrictions on the supply side and its stimulation to the detriment of increase
in aggregate demand, which – in an economy marked by a weak institutional structure –
cannot but foster the vicious circle of inflation-decapitalisation accompanied by stagnation
and even by output declines. Specifically, it refers to:

(a) the effects of fiscal reform in early 2000, particularly those on the ratio between direct
and indirect taxes against the backdrop of lower taxation on employment and profit; assessment of customs duties revenues in terms of the agreements concluded by Romania with international institutions;

(b) a more rational distribution of public spending, focusing on research and education, healthcare, and defence;

(c) maintenance of the budget deficit around 3 percent of GDP throughout the entire period;

(d) gradual monetisation of the economy in the context of a strictly non-inflationary growth
of reserve money, the development of other monetary aggregates through the expansion
and diversification of banking instruments, and reductions – to reasonable levels – both
in minimum reserve requirements and real interest rates;

(e) further maintenance of the managed float regime of exchange rate of domestic currency
aimed at ensuring its relative stability in real terms, the avoidance of distorting
disruptions in the forex market;

(f) an increase in NBR foreign reserves to 4-5 months of import cover.

3. The restructuring scenario envisages a reduction of pressure for increased nominal wages
that is not correlated with economic performance, based on an appropriate social agreement
with trade unions and employers’ federations.

4. In what concerns the labour market, a certain growth of the employment rate was taken into
account, as a natural response of the labour force to the consequences of pauperisation; the
assumption of early retirement was excluded. No ample disruptions are foreseen in the trends
already outlined in the demographic field (number and structure of population by age, labour
resources, internal migration and emigration).

The investment effort during this period – from domestic resources, non-debt-generating
financing, and larger inflows of foreign private capital – will lead to an increased number of
jobs. Stimulating the expansion of SMEs will also make a substantial contribution in this
respect. Massive layoffs are expected to come to a halt in 2000-2001.
5. Sectoral projections take into account the rescaling of the most troubled industrial sectors (mining, metallurgy, some thermal power stations, petrochemicals), a recovery of the viable but inhibited sector (due to undercapitalisation), and speeding up of the economic restructuring process.

The strengthening of financial discipline is epitomised in the projection by a sharp contraction of the monetary distortion chiefly induced by arrears and various barter-type-clearing schemes (either bilateral or multilateral).

6. The orientation of trade policy towards export promotion is outlined by the systematically higher growth rate of exports compared to the growth rate of GDP. Foreign demand for Romanian products is calibrated based on the forecast growth of both Romania’s main trading partner – the EU – and other areas of interest, mainly neighbouring ones; the world inflation considered – 1.3 - 1.4 percent per annum – stems from the most recent Western estimates in the field.

B. Estimates of the restructuring scenario for 2001 - 2004

1. In the said assumptions, a more sustainable economic growth becomes feasible starting as early as 2001; an annual growth rate of 4.75 percent is within reach during 2001-2004. The economic structure will experience a drastic change on the supply side, with the services sector (including construction) rising to about 55 percent to the detriment of the primary sector’s share. The contribution of industry to gross value added creation enjoys an almost steady weight (about 31 percent), while the weight of the agricultural sector goes down to 14 percent.

Table 4

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<tr>
<th>Indicator</th>
<th>2000</th>
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<th>2004</th>
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<td>110.8</td>
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<td>108.6</td>
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<td>109.2</td>
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</table>

Therefore, the restructuring scenario envisages a reversal in the trend of domestic consumption. In this framework, government policies shall focus on improving the efficiency of measures (by selective distribution) aimed at protecting the underprivileged categories of population so as to make considerable progress in the fight against poverty as early as the next few years. The most significant indication that Romania has overcome the protracted crisis it had been in is the higher level of gross capital formation. Even part of the trade deficit would
be expected to result from increasing purchases of advanced equipment and technology. These trends contribute to the change in the use of gross domestic product:

Table 5

<table>
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<tr>
<th>Indicator</th>
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<th>2003</th>
<th>2004</th>
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<tr>
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</tr>
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<td>23.7</td>
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<tr>
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<td>30.5</td>
<td>30.7</td>
<td>30.9</td>
<td>30.9</td>
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<tr>
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<td>34.5</td>
<td>35.4</td>
<td>35.6</td>
<td>35.7</td>
<td>35.8</td>
</tr>
</tbody>
</table>

2. Gross domestic product per capita, estimated in terms of purchasing power, is expected to reach about USD 7,250 in 2004, compared with almost USD 6,000 in 1999.

3. Structural adjustment and macroeconomic policies shall underpin the resumption of economic growth under the circumstances of fast disinflation. The scenario is predicated on gradually bringing the annual inflation rate to less than 10 percent by the end of the forecast period.

Table 6

<table>
<thead>
<tr>
<th>CPI increases (% p.a.)</th>
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<th>2003</th>
<th>2004</th>
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</tbody>
</table>

4. The restructuring scenario in terms of unemployment also envisages a reversal of the current trend starting with 2001, when unemployment will initiate a downward creep. Further economic growth after 2004 will make this indicator come closer to its normal level in a functioning market economy, thereby significantly alleviating emigration pressures.

The increase in labour productivity – as a result of an improved business environment, better firm management, and the technical streamlining of some sectors – is associated with a relative increase in the real wage.
Table 7

Unemployment and real wage

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment rate (end of year, %)</td>
<td>13.3</td>
<td>11.7</td>
<td>10.5</td>
<td>10.2</td>
<td>9.1</td>
</tr>
<tr>
<td>Unemployed (thou persons)</td>
<td>1,290</td>
<td>1,124</td>
<td>995</td>
<td>943</td>
<td>822</td>
</tr>
<tr>
<td>Net real wage (percent)</td>
<td>2.9</td>
<td>4.9</td>
<td>5.0</td>
<td>4.9</td>
<td>5.2</td>
</tr>
</tbody>
</table>

5. The increase in the trade deficit requires, even in the case of intensified foreign direct investment flows, an additional foreign financing through other capital inflows.

Table 8

Components of the balance of payments

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports of goods and services (USD bill.)</td>
<td>9.9</td>
<td>10.6</td>
<td>11.5</td>
<td>12.5</td>
<td>13.6</td>
</tr>
<tr>
<td>Imports of goods and services (USD bill.)</td>
<td>11.4</td>
<td>12.3</td>
<td>13.4</td>
<td>14.5</td>
<td>15.7</td>
</tr>
<tr>
<td>Current account deficit (USD bill.)</td>
<td>-1.4</td>
<td>-1.6</td>
<td>-1.7</td>
<td>-1.8</td>
<td>-2.0</td>
</tr>
<tr>
<td>Net foreign direct investment flows (USD bill.)</td>
<td>1.3</td>
<td>1.7</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
</tr>
<tr>
<td>Foreign debt (% of GDP)</td>
<td>30.7</td>
<td>30.7</td>
<td>29.8</td>
<td>29.2</td>
<td>28.6</td>
</tr>
<tr>
<td>Total foreign debt (USD bill.)</td>
<td>10.0</td>
<td>10.9</td>
<td>11.5</td>
<td>12.3</td>
<td>13.3</td>
</tr>
<tr>
<td>Gross foreign exchange reserves (USD bill.)</td>
<td>3.5</td>
<td>4.2</td>
<td>5.0</td>
<td>5.8</td>
<td>6.6</td>
</tr>
</tbody>
</table>

The table synthesises the irreversible opening of the Romanian economy towards international flows and its involvement in the processes of European integration and globalisation.

The weight of foreign debt service in the exports of goods and services will represent 21.5 percent in 2000 and around 16 percent in 2004, mostly due to falling interest rates and a broadening of maturities (the ratio between the volume of foreign debt and exports – of 90 - 95 percent – is also within acceptable margins).

6. According to this scenario, the weight of total public debt in the gross domestic product will fluctuate around 30 percent and the weight of its annual service will decrease from 5.65 percent in 2000 to 4.55 percent at the end of the forecast period.
These trends are likely to strengthen the confidence of financial markets and foreign operators in the soundness of Romanian economic development.

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public debt interest rates (% of GDP)</td>
<td>5.65</td>
<td>5.5</td>
<td>5.3</td>
<td>4.85</td>
<td>4.55</td>
</tr>
<tr>
<td>Total public debt (% of GDP)</td>
<td>31.0</td>
<td>30.6</td>
<td>30.1</td>
<td>30.1</td>
<td>29.9</td>
</tr>
</tbody>
</table>
III. MACROECONOMIC POLICIES

The medium-term macroeconomic policies envisage a deepening of efforts aimed at resuming long-term economic growth.

A. Financial policy

Viewed from the perspective of the development of a competitive economy, financial policy will harmonise the constraints imposed by macroeconomic stability with the goal of durable growth. Financial policy will contribute to the increase in saving and investment. Its medium-term priorities are the following:

1. controlling the consolidated general government budget deficit;
2. completion of fiscal reform;
3. rational budget appropriations in terms of expenditure priorities;
4. ensuring transparency in public funds allocation.

1. Controlling budget deficits

1.1. Controlling budget deficits will be accomplished by taking the following steps:

(a) the sizing of budgetary expenditures in terms of revenue sources and the constraint of non-inflationary financing of the public sector;

(b) proceeds from privatisation should be used for modernisation and development, especially for co-financing of projects achieved with the support of the European Union, the World Bank, and other international institutions;

(c) the consolidation of financial management capabilities of both the Ministry of Finance and local financial authorities;

(d) the improvement of tax collection.

1.2. With respect to local budgets, the upward trend of their share in the consolidated general budget will continue, on the background of ongoing decentralisation process, while the ability of local authorities to manage local budgets will increase.

1.3. As regards the social security budget, the institutions responsible for managing this budget will diversify (National House of Pensions, Agency for Management of Risk and
Accident Fund, Private Pension Funds, National House for Health Insurance, National Agency for Employment and Vocational Training).

1.4. The improvement of tax collection will materialise through measures focusing on the following:

(a) the state will take on the position of hard lender, while public institutions will meet financial commitments to their own suppliers;
(b) companies incurring fiscal arrears will be equally treated, and fiscal discipline of firms will be strengthened;
(c) the generalisation of fiscal files for all tax-payers;
(d) the enlargement of the tax base through a reduction in the size of the informal sector;
(e) the modernisation of the tax collection system by using information and communication technologies.

2. Consolidation of tax system reform

The general principles of medium-term financial reform in 2000 will be identified in the establishment of a modern tax system meant to give impetus to labour, saving, and investment and to ensure that an equal taxation treatment will be applied. Distortions in resource allocation will be reduced by ensuring the prevalence of the equal tax treatment principle. Personal income tax, wealth tax, value added tax and excise duties will represent the pillars of the Romanian tax system, while customs duties will lose ground. The reform of the tax system will be consolidated starting from requirements concerning the broadening of the tax base and the setting of reasonable marginal tax rates.

2.1. With respect to personal income tax, proper means will be identified to include income from agriculture, while pensions exceeding a certain level will also be taken into account. Taxing pensions will allow for the necessity to reassess these incomes in order to levy the tax on gross amounts. In addition, the possibility to include dividends in the personal income tax base has been considered; the decision will be taken during 2000.

2.2. The acknowledgement of expenses associated with business operations as regular costs will be gradually achieved during 2001-2004. Accordingly, in the case of interest expense deductibility, a maximum tax-deductible protective interest will be established.

2.3. Indirect taxation rates, particularly in regard to value added tax and excise duties, will be lowered proportional to the collections in order to bring them to levels compatible with EU requirements. The harmonisation of value added tax with EU requirements also includes the clarification of regulations addressing VAT refunds to non-resident natural persons. As
concerns excise duties and customs duties, it is necessary to bring fiscal deposits under normal development. According to this measure, customs duties and excise duties shall be paid only for products taken out of tax warehouses. Moreover, this measure facilitates the establishment of a tax suspension arrangement for the circulation of excise products between tax warehouses. This system would eliminate abrupt changes of business liquidity flows as well as discrepancies between the excise duty legislation in Romania and that of the European Union.

2.4. In order to ensure the effective and efficient implementation of the fiscal system, the code of fiscal procedure and the fiscal code (including the integration of all fiscal regulations dissipated in the Romanian legislation) will be introduced.

3. Strengthening the operational and allocative efficiency of budgetary expenditures

Discretionary budget appropriations have encouraged rent seeking and have distorted the signals conveyed by a liberalised price system. Resources that could have been allocated on a competitive basis were directed towards supporting non-viable activities. Under the circumstances, the increase in operational and allocative efficiency of budgetary expenditures requires steps aiming at:

3.1. Carrying out a public expenditure review. This action will start in the second half of 2000 and will be completed at the latest by end-2001, with international assistance. Public expenditure review must give prominence to budgetary expenditures, involving investment in human capital (health and education), social security and social assistance.

3.2. The institutional framework of medium-term fiscal and budgetary policies assumes the capability and willingness to establish priorities and observe them. The analysis of budget expenditures will create the prerequisite for launching project-based budgets in 2002, for specific areas under which budgetary priorities will be rigorously established on the basis of cost/benefit analysis. The introduction of the two-year indicative budget could be considered; this would be forwarded to Parliament along with the current year budget. A longer time horizon for such projections will be achieved under consistent medium-term fiscal and budgetary policies. In this context, the Ministry of Finance will attach particular importance to the strengthening of macroeconomic analysis and the laying out of budget priorities.

3.3. Fiscal transparency is an essential prerequisite for enhancing government performance, thus contributing to the consolidation of public finance and ensuring the soundness of government accounts. The declaration of September 1996 titled “Partnership for Sustainable Global Economic Growth” acknowledges the importance of increased transparency of fiscal policy by reducing off-budget transactions and quasi-fiscal deficits. In order to enhance fiscal transparency, the following measures will address:
(a) the unification of definitions referring to the government sector and the reduction of special funds;

(b) improved budgetary accounting;

(c) ensuring that “hidden” fiscal liabilities are transparently recorded;

(d) introduction in the legal and institutional framework of the “Code of fair practices in the field of fiscal transparency” adopted in 1998.

3.4. As regards social protection expenditures, the strategy of social protection envisages the provision of assistance to genuinely underprivileged groups, simultaneously with the possibility of reconsidering the granting of such aid in the case of groups that have unduly benefited from assistance.

B. Exchange rate and monetary policies

From the standpoint of the objectives, the time frame taken into consideration in drafting the strategy includes two stages. The first stage (2000 - 2002) focuses on restoring the credibility of public institutions based on accelerating reforms, particularly in the field of structural adjustment, which will lead to a sharp decline in inflation rates and to the elimination of important sources of quasi-fiscal deficits. The second stage (2003 - 2004) will be dominated by the initiation of real and nominal convergence, the maintenance of relatively high growth rates being the key feature of this stage.

1. Monetary policy

1.1. In order to attain significant disinflation, reserve money will be controlled and broad money (M2), as an intermediary variable, will be monitored. The monetary policy stance will remain austere. The analytical framework will be heavily reliant upon aggregate indicators, with the key role incumbent upon the monetary conditions index, which includes the developments of monetary aggregates, interest rates, exchange rate, reserves, etc. A key monetary policy objective for the period ahead is the remonetisation of the Romanian economy through non-inflationary means:

1.2. Monetary policy instruments will be developed and diversified in order to increase the effectiveness of monetary policy as their degree of market compatibility increases. To this end, the following steps will be taken:

(a) consolidation of the infrastructure required to use market-compatible instruments;

(b) diversification of instruments (instruments concerning the permanent sterilisation of potential surplus liquidity will be increasingly resorted to);
(c) open-market operations will become dominant in liquidity management and in monetary policy implementation to the detriment of more administrative instruments (the case of minimum reserves);

(d) the central bank will seek to regain a net creditor position vis-à-vis the banking system in order to exert an effective influence on the evolution of short-run nominal interest rates.

The increase in monetary policy effectiveness also depends on reduction of fiscal dominance, which will enable broader investment time spans as well as a gradual and sustainable drop in interest rates.

2. Exchange rate policy

During 2000 - 2002, the exchange rate regime will continue to be predicated on managed floating. This policy will focus on maintaining competitiveness, given tight external constraints and the still low level of expected foreign exchange reserves. Starting with 2002 - 2003, if higher and more stable capital inflows are confirmed, more predictable alternatives to the exchange rate regime will be considered, in the absence of inflation targeting; the advantage of these alternative regimes resides in the consolidation and acceleration of nominal convergence which will facilitate participation in ERM2. This would also enable the readjustment of the real exchange rate, were its long-run equilibrium level to be modified due to steady external financing and structural adjustment.

3. Balance of payments issues

3.1. During 2000 - 2002, the resumption of economic growth together with the envisaged structural adjustment will generate persistent current account deficits (under the conditions of maintaining the real exchange rate broadly at its equilibrium level). Changes in the real sector will engender, on one side, the rescaling of demand for imports coupled with a reduction of the inelastic segment involving poorly restructured industries (accompanied by a rise in demand for imports of intermediary products correlated with the growth of real output); on the other side, changes in the real sector will increase the economy’s export capacity, especially due to productivity and effectiveness gains recorded by outward-oriented sectors.

In the medium term, it is envisaged that the current account deficit will be financed by means of non-debt generating inflows. The deepening of structural reforms will serve as a means to attract foreign direct investment flows.

3.2. Romania’s external public and publicly guaranteed debt service (based on outstanding arrangements) will increase slightly by 2002, followed by a certain decline between 2003 - 2005. At the same time, the switch to a long-run (over 10 years) financing strategy, in which indebtedness and repayment will be complementary and will take place within the same cycle,
implies a controlled increase in outstanding debt up to about USD 12 - 13 billion at the end of the time frame of the present strategy.

3.3. The prospects of larger and longer-term capital inflows, albeit favourable from the standpoint of foreign financing and that of the credibility of domestic reform, raises the issue of their potential impact on monetary policy. Their complete sterilisation would involve high costs and the protraction of the central bank’s net debit position vis-à-vis the banking system, as well as a slowdown in decelerating real interest rates, which would conflict with the objective of durable economic growth. The alternative consists in partial sterilisation, with commercial banks being assigned the role to build up forex reserves complementary to official reserves.

3.4. Capital account liberalisation will be achieved in compliance with EU legislation and practices. While in 2000 capital inflows were extensively liberalised, the reduction of restrictions concerning capital outflows will be gradual, starting from longer to shorter maturities, while the cumulative ceiling on private sector foreign indebtedness will also be lowered successively, so that starting 2003 only large value transfers will be subject to NBR approval.

C. Trade policy

The establishment of trade policy targets will take into account the need to adjust to the trends in the world economy under the impact of globalisation. Trade policies should focus on the following issues:

1. the observance of commitments to international institutions, of which the provisions under the Europe Agreement are of the utmost importance;

2. the consistent promotion of the equity principle;

3. drafting of trade policy in the agricultural sector will be complementary to, and not a substitute for, domestic agricultural policy;

4. supporting of the Romanian-made products’ access to foreign markets by spurring their increased competitiveness.

1. Both the obligations taken on under the Europe Agreement, those in terms of WTO membership, as well as those arising from the CEFTA Agreement underscore the complete openness of the Romanian economy. With this end in view, steps will be taken to enhance the ability of the national economy to withstand competitive pressures on foreign markets by stimulating the transition to a new structure of foreign trade based on innovation, research, and development, as well as on sustainable comparative advantages. This represents one of the economic criteria of EU accession.
Protectionist measures will be gradually and progressively harmonised with the structure and the levels applied in the European Union in order to avert a negative impact leading up to and including the moment of accession.

2. Another steering element for trade policy will be the steadfast promotion of the equity principle. Equal rights will be enjoyed by consumers and producers. In this respect, Romanian legislation must be strengthened in terms of consumer and environmental protection, whereas the laws on competition should be enforced to allow higher competition on the domestic market. Some higher standards governing environmental protection and consumer protection will be gradually harmonised with EU standards.

3. The drafting of trade policy in agriculture needs to be complementary, and not a substitute for domestic agricultural policy. The tendency of promoting a certain trade policy in agriculture based on merely imitating the policies pursued by some developed economies will be abandoned.

4. Trade policy measures will have to shift focus to improving competitiveness and facilitating the access of Romanian-made products to foreign markets, even though they require (in virtue of the mutuality principle on which most of the international trade negotiations are based) an even more drastic reduction in protection at the border. To this end:

(a) the stability and predictability of the exports and imports regime should be ensured;

(b) the abandonment of granting exemptions and rebates in import customs duties with a derogation from the basic level should be monitored;

(c) the practice of opening quotas with zero or reduced customs duties should be relinquished if they facilitate rent-seeking;

(d) customs duties levied on manufactured products will be negotiated gradually in keeping with the MFN regime (applicable to imports from other sources) to minimise the shock of the once-over adoption of the EU customs tariff;

(e) the present level of protective customs duties on imports of farm produce in terms of MFN will be preserved, thus withstanding the temptation to reinstate prohibitive customs duties after the ASAL agreement runs out;

(f) trade negotiations with the EU should be initiated in order to improve mutual market access for farm products under really comparable conditions;

(g) measures entailing effects equivalent to non-tariff restrictions on imports will be eliminated gradually and finally ruled out;
(h) the re-entrance and consolidation of the presence of Romanian products on traditional markets other than European ones.

The maintenance of potential restrictions should rely on reasonable prerequisites in accordance with usual practices, flexible enough to accommodate the particular constraints that need to be faced by Romanian exporters. The development of Romanian trade policy along these lines should be facilitated by putting in place an institutional device by means of which the drafting of trade policy would be separated from that of eventual sectoral policies. In this respect, the foreign trade department within the Ministry of Industry and Trade should be reinforced and the influence exerted by the Ministry of Food and Agriculture on trade policy decisions regarding farm produce should be abated.
IV. STRUCTURAL ADJUSTMENT AND ECONOMIC DEVELOPMENT POLICIES

The policies in these areas are aimed at stopping the decline of the economy, creating the prerequisites for economic recovery and preparing Romania for EU accession.

A. Structural adjustment

1. The restructuring process of the Romanian economy envisages carrying through the implementation of a package of policies, based on the following principles:

(a) the use of a coherent set of corrective, functional and stimulating measures in line with both current EU regulations and intra-EU as well as global trends;

(b) making intra-sectoral structures compatible with the present and future structures in the EU member states;

(c) adjusting and strengthening economic structures in view of gradually bringing competitiveness to the level of member states’ economies and of gaining advantages from entry requirements for Romanian products in the EU market.

2. The following objectives are set for promoting a favourable business environment:

(a) development of market competition in Romania in accordance with EU regulations, for a gradual harmonisation with the requirements of ensuring the free movement of goods and services;

(b) ensuring the conditions for effective corporate governance;

(c) achieving flexibility of the central administration and of the staff involved in Romania’s official international relations so as to stimulate international trade and to harmonise the domestic and global business environments.

B. Sectoral policies

1. Industrial sector adjustment will be consistent with the objective of increasing external competitiveness and domestic productivity in terms of all production factors. In this respect, the following directions will be pursued:

(a) extending the process of redesigning industrial capacity and structure, including by developing and encouraging co-operation with EU partners, backed by the market economy consolidation and the establishment of a competitive environment; stimulating potentially competitive small- and medium-sized enterprises;
(b) sequencing the process of selection and rescaling of the economic agents involved in restructuring in view of ensuring a proper business environment capable of fulfilling the increasing internal demand and that can also significantly spur the volume and efficiency of exports of goods and services;

c) completing the privatisation of industrial companies; exposing the remaining state-owned industrial units to market forces, on the background of strengthening the legal discipline concerning competition issues (including the Bankruptcy Act);

d) restructuring of the energy- and material-intensive sectors, as well as of those with under-utilised capacities by diminishing losses and recording substantial productivity gains; promoting technologies which enable the cut in energy consumption;

e) the revival and efficient deployment of the national research and technological development potential, including the microeconomic R&D;

f) increasing competitiveness by promoting strategic alliances, holdings, and group companies in view of including the Romanian industry in the globalisation process, including by developing complex exports;

(g) the rapid development, outsourcing and specialising of production-related services;

(h) accelerated growth in the volume and efficiency of exports by encouraging exports of high value-added manufactured products; setting as a priority, within the limits traced by international legislation, the support for globally expanding industries or high-tech industries insufficiently developed in Romania;

(i) taking advantage of Romania’s geographic position by directing exports also to neighbouring areas that may become strategic markets for EU.

2. The results of reform measures implemented in the agricultural sector need to be consolidated in the coming years, taking into account the issue of food security and the necessity of rural development.

(a) The development of optimal sized, efficient farms shall be stimulated. The policy in this field will be aimed at increasing plot size, by association, exchange and acquisition, discouraging property division below a certain limit. Simultaneously, family associations and partnerships for integration and management will be promoted, based on farmers' interests and competitiveness, and long-term leasing will be encouraged in order to spur technical progress in agriculture.

(b) Structural reforms will be deepened, the emphasis lying on farm development and privatisation of rural companies where the state is the major shareholder. The Government will improve the legal and institutional framework for the functioning of
essential agrarian and rural markets: the farm produce markets, raw material market, agriculture-related services market, credit market, and the land market. The Government will also support the improvement of the infrastructure necessary for the functioning of these markets.

(c) Product-based policies to spur the increase in economic effectiveness over the entire agricultural activity chain, starting with production and ending with trading on the domestic and foreign markets, will be promoted.

(d) The rural development policy, based mainly on the financial support under the EU SAPARD Programme is aimed primarily at:

- the modernisation and co-ordination of production and trade sectors in line with EU norms and quality standards;
- the consolidation of optimal sized farms and diversification of complementary non-agrarian activities;
- the development of social infrastructure;
- providing advisory and training services to farmers, to land and forest owners.

3. The development of infrastructure, by taking into account both the National Programme for Territorial Planning and the connections with the European infrastructure system, will play a major part in economic recovery and the creation of new work opportunities.

In the context of increased EU financial support (through the pre-accession instrument ISPA) and by attracting private resources, the modernisation, rehabilitation, and development of transport infrastructures are envisaged. In this field, the priorities are the following:

(a) the start of highway building, in accordance with the provisions of the TINA Final Report, in order to integrate the Romanian transport infrastructure into the Pan-European Transport Network;

(b) the modernisation of railway and road infrastructure, the building of bridges and beltways around cities along the pan-European transport corridors No. IV and IX, in order to ensure an increase in the mobility of population, goods and services;

(c) changing the current tax and tariff systems regarding railway and road transport, in order to increase service accessibility, and achieve harmonisation with European Union standards;

4. A more effective exploitation of the tourism potential represents a primary objective for medium-term development.
5. The strategy envisages the rebound of housing, the rehabilitation, consolidation, and modernisation of the existing buildings, including earthquake protection.

6. Development of a country-wide IT network by promoting actions aimed at developing information technology and communications, linking Romania to information flows, especially to those of the EU member states.

C. Policies for small- and medium-sized enterprise sector consolidation and development

In view of exploiting the substantial economic growth and job-creation potential of the SME sector, the Government will focus on:

1. providing incentive facilities (credit guarantees, interest subsidies, grants, etc.);

2. organising government-assisted advisory and training centres, entrepreneurial training, technological parks and business incubation centres, which should provide free or low-priced services to SMEs;

3. supporting SMEs’ participation in projects based on public investment or on foreign borrowing.

D. Policies for science and technology

The medium-term priority objectives aim at:

1. The development of skills and capabilities for scientific and technological know-how generation through: support to the formation and expansion of excellence centres and networks in fields considered a priority; increase in research resources through R&D programmes as well as the research grant programmes of ANSTI, the Ministry of National Education and the Romanian Academy; improvement in access to information sources; improving research and development project management; integration of Romanian specialised organisations in the relevant international programmes and networks.

2. The main requirements for the increase in the quality and efficiency of research and development units are:

   (a) the reduction in technological gaps concerning the material base;

   (b) the development of informational infrastructure;

   (c) implementing standard procedures for the appraisal of research and development organisations, activities and personnel, in line with international standards;

   (d) the improvement in selection procedures, managerial practices and market orientation
of research and development units;

(e) implementing a remuneration system consistent with the scientifically or technologically recognised value of the activities and results;

(f) developing the ability to disseminate scientific and technological know-how by expanding marketing services, the network of industry contact offices, etc; the development of public promotion activities;

(g) enhancing the ability to absorb innovation in the economic environment; supporting the migration of researchers, experts and students from institutes and universities towards companies; the improvement in firms’ access to informational facilities and scientific and technological assistance services.

3. The microeconomic potential for research development and innovation shall be developed through projects with specialised institutes and centres, and implementation of attractive co-financing schemes.

4. Starting 2001, the share of resources earmarked for scientific research and technological development in GDP will gradually increase so as to bring them in line with those existing in the EU member states.
V. HUMAN RESOURCES AND SOCIAL POLICIES

The policies on human resources and social policies will rely on the provisions of the revised European Social Chart and the European Social Code, mirroring the practices used by the European Union and developed in the European Social Model.

In this area, the main objectives are the following:

1. The implementation of reform at the level of both secondary schools and tertiary education. The modernisation of the education system will be achieved in compliance with the trends emerging in the most developed countries, focusing on:

   (a) decentralisation of the national education system;
   (b) promotion of contract-based relationships between education units and local communities;
   (c) organisation of the national training system for education managers;
   (d) endowment of education units with information technology and communication means;
   (e) expansion of the national system of distance learning;
   (f) implementation of the National Programme for Adults’ Education and the “Second Chance through Education” Programme;
   (g) continuous professional training, according with similar policies in the European Union;
   (h) restructuring of education financing.

2. Health reform, whose main objective is to improve the population’s health conditions by reducing the number of avoidable deaths, of the frequency and gravity of diseases, and ensuring:

   (a) equal access to health services and across-the-board contributions to healthcare financing and free choice of both patients and physicians;
   (b) efficient health services;
   (c) a correlation between financing capacity and the level of economic development;
(d) improvement of Health Ministry capacity in the field of health policy development and sector settlement by reducing its intervention in the direct administration of some activities and institutions;

3. Social reform, which will ensure:

(a) social assistance reform by moving from programmes stressing universal eligibility to those targeted to specific categories of the population;

(b) pension system reform, considering:
   – the restoration of the inter-generation equity;
   – the restoration of the financial balance of the public pension system; and
   – complementing the current pay-as-you-go system with capitalised pension funds so that the integrated system should be financially sustainable. The system should preserve the real value of contributions and of the level of the contracted incomes, and pension funds should contribute to improvement of capital flows, in order to uphold economic growth;

(c) the policy in the area of employment and the protection of the unemployed will switch from passive measures to active ones;

(d) harmonisation of labour legislation with European Union norms concerning both labour relationship and labour protection;

(e) fighting poverty by having increased recourse to social security benefits. In order to identify the eligibility to social security, the Government will calculate the level of minimum guaranteed income, according to the social-demographic features of every family. For a better implementation of the programme, financing will be provided from the state budget, while local authorities and the competent tripartite institutions will apply and monitor the programme;

(f) the reform of childcare institutions system will continue, through ensuring adequate financial and human resources required by the smooth functioning of dedicated public institutions and supporting partnerships with the related NGOs. Particular attention will be given to family-type assistance by strengthening family reintegration activities, the placement of children in family-type care centres, adoptions or the placement of children in care with foster parents.
VI. ENVIRONMENTAL PROTECTION, TERRITORIAL PLANNING AND REGIONAL DEVELOPMENT

A. Environmental protection

The National Programme for Environmental Protection has been designed as an integral part of the restructuring and development programme. In terms of the assessment of the European Commission, Romania’s annual spending requirements for environmental protection would amount to USD 60-70 per capita.

1. The medium-term programmes envisage the following:

(a) the protection and preservation of nature, of biological diversity and the durable use of its elements, the development and good management of the national network of protected areas in line with the strategies, the policies and practices applicable at the European and international levels; implementation of the national technical programme for evaluation and financing of costs incurred by the reduction of greenhouse gas emissions in conformity with the provisions under the Framework Agreement for Climate Changes (1992) and the Kyoto Protocol (1997);

(b) the enforcement of environmental legislation (Law No.137/1995); adoption of a system of norms, standards and regulations in line with EU requirements;

(c) stimulation of environmentally-friendly products and durable consumption;

(d) decentralisation of the institutional system;

(e) introduction and use of economic instruments for environmental protection purposes.

2. In 2000 - 2004, Romania will pursue the harmonisation of its environmental policy and practice with EU directives. To this end, the following issues need to be tackled:

(a) the assessment of Romania’s natural capital according to its current diversity and weak spots, development of the Protected Area National Network;

(b) initiation of measures to restore natural capital in the damaged areas;

(c) development of a long-lasting management of water resources in conformity with the provisions of the Dublin Conference (1992) and the Summit in Rio de Janeiro (1992);
(d) ensuring the integrity of national forested regions while taking into account the shift in ownership and management by enforcing tough legal regulations to stop the reduction of present, forest-covered areas and engender an increase up to 27.3 percent of the country’s total area by 2004 - 2005;

(e) implementation of the national programme for soil planning and durable use and the fight against soil erosion;

(f) implementation of the national programme for the management of industrial and urban refuse and recycling of materials and products;

(g) the design of necessary financial instruments related to environment for the gradual absorption of the acquis communautaire, particularly in the field of water exploitation, environmental protection in industry and agriculture, the protection of soil and damaged land, organic protection and certification of organic products;

(h) consolidation of institutional capacities and acquiring the necessary skills in order to establish a partnership between the environmental institutions in Romania and those in the European Union, thus ensuring administrative support for turning to account the opportunities provided by the European Union by means of strategies and instruments to support our country in the accession process;

(i) the establishment of the Environment Fund is instrumental in attaining the main targets under the National Plan for Environment Protection and the National Plan for Accession to the European Union;

(j) creation of the legal and institutional framework to stimulate the dialogue between the authorities and the civil society on the strategy, the policies, the programmes and the decisions on the environment and the social and economic development of Romania.

3. Environmental policy is to shift focus from recovery actions towards prevention ones. From this angle, the following issues need to be tackled:

(a) the development of an integrated system of monitoring the environment, an environment information system, a state-of-environment reporting system, in an attempt to implement environmental protection decisions and assess the achievement of the targets of environmental policy and informing the population on environment-related issues;

(b) environmentally-friendly products and durable consumption will stand out as the centrepiece of integrated prevention strategy for environment protection in the long run. In addition, stress will be laid on the promotion of ISO 14,000 and EMAS standards to achieve some environmentally-friendly processes, products, and services with
minimum risk to the population and the natural capital. Promotion of ISO 14,000 standards notably in SMEs is a top priority;

(c) the decentralisation of the institutional system is to be achieved by applying the principle of administrative autonomy and that of “the polluter is held liable”. Action must be taken with a view to establishing environmental protection competences of local communities, represented by local authorities, and stimulating prevention policies for environmental protection by companies, thus entailing a cut in public spending;

(d) long-term environmental policy will resort more frequently to economic instruments instead of command and control instruments. In this respect, budget subsidies will be restructured by both reducing those subsidies granted to the activities having a negative impact on the environment and boosting those activities that reduce polluting gas emissions or contribute to ecological restoration and preservation, by levying duties on polluting gas emissions, and by spurring incentive-compatible regulations;

(e) Romania is to grant support to the international enforcement of economic instruments (foreign taxes or harmonised national taxes, negotiable quotas on greenhouse gas emissions, the joint implementation in terms of the Framework Agreement for Climate Changes and the “clean” development mechanism in terms of the Kyoto Protocol).

**B. Territorial planning and regional development**

1. The medium-term strategy attaches a major importance to the National Programme for Territorial Planning observing the principles of sustainable development, as well as EU standards. This will be implemented by means of government programmes, including foreign borrowings, in the perspective of a balanced development of the locality network, infrastructure, urban and rural housing, the rational management of land and the national and real-estate patrimony.

2. Regional policy development objectives are the following: the reduction of existing regional imbalances, stimulating balanced development, boosting underprivileged areas; preventing the emergence of new imbalances; the correlation of regional development policies with sectoral development ones; encouraging inter-regional domestic and international co-operation in order to contribute to economic and social development; further development of special, preferential relationships between Romania and the Republic of Moldova, the consolidation of their common spiritual and cultural heritage in line with the norms and the values of integration within a united Europe.

3. The strategic principles of regional development are the following:
3.1. At national level:

(a) promoting market economy mechanisms in all regions in order to improve competitiveness and to achieve economic growth;
(b) promoting a harmonious development of territorial and localities network;
(c) increasing the regions’ capacity to support their own development (in terms of financing institution building and decision-making);
(d) promoting the principles of sustainable development;
(e) equal opportunities in terms of access to information, technological research and development, continuous education and training.

3.2. At regional level:

(a) the reduction of disparities between regions, counties, urban and rural areas, central and suburban areas, etc;
(b) preventing the emergence of problem areas;
(c) the harmonisation of regional development initiatives with national priorities and EU orientations;
(d) promotion of policies adjusted to regional features (mono-functional areas which preponderantly refer to agriculture and mining, large urban centres, protected natural and housing areas, border areas, areas with environmental problems).

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The Commission for Strategy Designing has reached the conclusion that its objectives are not only desirable, but realistic as well. Romania enjoys important natural resources and highly skilled human capital, potentially competitive productive capacities, as well as a strategic position at the crossroads of international trade flows. All these comparative advantages offer a series of attractive opportunities for Western capital. The willingness of the European Union and other international institutions to support our country to take this historic step towards integration was unequivocally stated as well. It is now decisive for Romania to overcome its
institutionally poorly structured economy, to put into operation new mechanisms, to promote
clear-cut and coherent policies that should redirect social resources away from false goals,
which have been using them uselessly, towards the authentic objectives of individual and
overall welfare.

The Government of Romania

has adopted

The national medium-term development strategy of the
Romanian economy

in its session held on 16 March 2000

Prime Minister

Mugur Constantin Isărescu